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FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

FINAL REPORT

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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

FINAL PROJECT REPORT

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1 Introduction

Financial participation, in the form of share ownership by employees, either individually or through share ownership plans, such as ESOPs (Employee Share Ownership Plans), has been a feature of employee participation in EU Member States for many years. While financial participation has been supported in some countries through tax incentives and other forms of legislation, there is a wide divergence in approaches to be found between the Member States. The costs, administrative and other complexities in Member States have also hampered the introduction of financial participation schemes across the EU, in particular in transnational enterprises.

Consequently, financial participation has been the focus of attention by the European Commission since the publication of the two PEPPER reports in 1992 and 1996.¹ In an effort to move the issue forward, the Commission published a Communication in 2002² on a framework for the promotion of employee financial participation, which set out key principles for financial participation schemes. Opinions drafted by the European Economic and Social Committee and a European Parliament resolution further underline the importance of financial participation, particularly in relation to small and medium sized enterprises (SMEs).

Following the publication of this Communication, a High-level Expert Group, chaired by Jean-Baptiste de Foucauld, French Ministry of Economics, was set up by the European Commission and this body published its report in 2004. It identified a range of transnational barriers that obstruct the introduction of financial participation schemes in companies with subsidiaries and operations across the EU.

One of the key recommendations of the High-level Expert Group was that a *Model Plan for Financial Participation* be drawn up, and that this *plan* would

*... serve to remove barriers and also promote cross-border financial participation. it might streamline a blueprint for the main types of financial participation. It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprises having to adapt their plans if they expand across the EU.*³

¹ European Commission *Proposal for a Council Recommendation concerning the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(91)259, Brussels, 1991; and *Report from the Commission: PEPPER II: the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(96)697, Brussels, 1996.

² European Commission *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a Framework for the Promotion of Employee Financial Participation* COM(2002)364, Brussels

³ European Commission *Report of the High Level Group of Independent Experts on cross-*



With financial support from the European Commission, the International Association for Financial Participation (AIFP/IAFP) undertook to draft this Model Plan for European enterprises that are interested in introducing financial participation arrangements for their employees. This Model Plan was launched at a conference in Brussels in September, 2005.⁴

2 New Project, 2009-2010

The AIPF/IAFP received further funding from the European Commission to undertake a study into aspects of financial participation during 2009 and 2010. This new project reviewed key issues related to financial participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the AIPF/IAFP and from the Model Plan.

The project focused, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The role of financial participation in corporate restructuring
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs.

The project also took stock of what progress had been made since 2005 in tackling the obstacles identified by the High-level Expert Group and makes a number of recommendations to the European Commission for the further diffusion of employee financial participation in enterprises operating within the EU.

3 Methodology

The project was organised around four drafting seminars and a final conference. Each drafting seminar focused on one of the key issues and a discussion paper, setting out the main points of the issue and a number of questions for the seminar to address, was circulated to invited participants in advance of the seminar. Following presentations and a discussion of the questions posed, a report was drawn up following each seminar.

border obstacles to financial participation of employees for companies having a trans-national dimension Brussels, 2004: Recommendation 4.3.2.4

⁴ COMMON ELEMENTS OF AN ADAPTABLE MODEL PLAN FOR FINANCIAL PARTICIPATION IN THE EUROPEAN

UNION SEE [HTTP://WWW.IAFP.EU.COM/ABOUTUSA.HTML](http://www.iafp.eu.com/aboutusa.html)



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The four seminar reports were the basis for the final project conference, drawing together the findings and addressing important challenges for the further promotion of financial participation in Member States.

Overall, 195 participants from eighteen EU Member States, from the USA and the Russian Federation participated in these five events. Interpretation was provided for all events in the relevant languages to each particular event.

4 Workplace Philosophies ⁵

Depending on the form of corporate ownership and the form of financial participation in place, these can have an impact on the attitudes and behaviour of employees and management to the employment relationship. These attitudes can also be influenced by national differences, as can the application of similar policy objectives within national contexts that can give rise to different practices. For example, the UK and France might have the same public policy approach to forms of financial participation, but adopt different implementation strategies to reach the same objective.

The importance of differing workforce philosophies, for example, treating:

- employees as outsiders
- employees as insiders
- employees as equals,

together with the importance of trust, fairness and transparency in the employment relationship have all been identified as of key importance in the dissemination of financial participation.

The various forms of financial participation may have different impacts in relation to these different philosophies. Key questions are:

- i) what happens if the workplace philosophy changes?
- ii) how can a co-operative workplace philosophy be developed in both employers and employees?

In the context of these philosophies, education of employers, managers and employees is central to workplace partnerships, including their involvement in financial participation. The role of financial knowledge and economic literacy is important and there needs to be more courses in third-level institutions across the EU on financial participation. Already some tentative steps have been made in some UK universities to address this educational gap, while in Germany

⁵ Based on a presentation made by Prof Erik Poutsma, Institute for Management Research, Radboud University, Nijmegen, The Netherlands, to the seminar held in Leiden



universities have stopped teaching these areas which are vital to the effective workings of financial participation plans.

5 Communications and Transparency

The European Commission consider the general principles, set out in the PEPPER reports (1992 and 1996) and in the Council Recommendation (1992), still apply in the present environment and should continue to be a guide to Member States in the framing of policies and/or legislation. These general principles were reiterated in the Commission's Communication (2002), two of which are related to communications and transparency:

- *Schemes must be transparent, with clear and comprehensive plans*
- *In the interests of transparency, employees should be made aware of the risks resulting from investment decisions and, consequently, possible fluctuations in income from the schemes.*

The High-level Expert Group, in addressing the issue of communications and transparency, looked at the problems from a labour law perspective, such as employee data protection, the availability of information in the national language of employees and the requirement in some Member States to inform and consult with the works councils, trade unions or other employee representative bodies.

All these publications and reports, therefore, focus on the need to ensure the highest level of communications to employees and their representatives in the setting up and operations of financial participation schemes. Communications strategies should be in place at each step in the setting up of and operation of the scheme:

- When proposing the introduction of a scheme
- When inviting employees to participate in a scheme
- When the scheme is in place
- When key decisions need to be made by employee participants (e.g. whether to exercise previously granted stock options).

The extent to which information about financial participation schemes and the sponsoring company's performance and prospects is made available, and the quality of this information, appears to vary between Member States. However, there is little definitive research on information disclosure of this sort and the extent to which company practices vary between Member States.



5.1 Regulatory context

Disclosure of information to participants in share-based financial participation plans is likely to be governed by laws and regulation relating to capital markets and to employment, social dialogue and industrial relations. It will also be affected by industrial relations custom and practices in each Member State.

In general, capital market regulation is likely to have a more powerful impact on information disclosure in this area, as employees are primarily treated as investors in share-based financial participation.

i) Capital markets

Employee share ownership plans are governed by various EU Directives relating to transparency and provision of information, deriving from the Financial Services Action Plan designed to create a single European capital market. Recent Directives have been transposed into national regulatory regimes in various ways, reflecting the principles of subsidiarity.

In understanding the potential impact of these Directives on the provision of information and transparency of information to participants in employee share schemes, employees should be seen as minority investors (except where employees take majority ownership and control of a company). In general, it is important that, as minority investors, employees are protected from the actions of the majority owners and/or controllers that may not be to the benefit of all shareholders. This is especially so where employees are required to subscribe to shares. Recent European initiatives have been concerned with enhancing minority investor protection.

Historically, there have been widely differing standards of minority investor protection in EU Member States but these differences have narrowed considerably with the implementation of recent Directives and their transposition into national legislation. The model for much of this legislation has been the UK where transparency and minority investor protection has been relatively high (at least for listed companies) and where employee share plans have been widely used for many years.



a) *Transparency Directive*⁶

The key elements of the Transparency Directive, as they might affect provision of information to employees, are as follows:

- Companies are required to produce annual and half-yearly reports, supplemented by 'interim management statements' for the first and third quarters
- The annual and half-yearly reports are required to include a statement of the main risks and uncertainties that may affect the company in the next six months
- Companies are required to disclose regulated information on a pan-European basis whether or not they have investors in other EU Member States
- Investors are required to notify companies when they have built up (or reduced) voting stakes beyond certain levels: up to 75% (some countries, such as the UK, already exceed this level of detail).

The Directive applies to companies listed on the main stock exchange in each Member State.

Clearly, an issue is how far these formal regulatory requirements give rise to information that is passed specifically to employees and, if so, what form is made available to employees.

b) *Prospectus Directive*⁷

This Directive requires that any public offer of securities or admission to a regulated market within the EU must have a prospectus approved by the regulator in the country where the company is registered. Once approved by the authorities in one Member State, the prospectus is valid throughout the EU.

In general the Prospectus Directive requires companies that offer shares to their employees (or former employees) in the European Economic Area (EEA) to provide a share prospectus unless an exemption applies. There are two exemptions that impact on employee share plans – a general and a share plan-specific exemption:

- There is a general exemption for offers that are made to less than 150 employees in each Member State, that do not exceed €5 million in a twelve month period and for offers of free shares and non-tradable securities, such as restricted stock and stock options
- There is a partial exemption for employee share schemes offered by companies listed on an EU-regulated stock market as long as these companies provide an 'Information Memorandum' to participants.

⁶ Directive 2004/109/EC

⁷ Directive 2003/71/EC amended by Directive 2010/73/EU



An issue with the 2003 Directive was the operation of share plans within Europe by firms that are listed in countries outside the European Economic Area (EEA), such as in the USA. These plans were not exempted from issuing a prospectus. However, the intention of the 2010 Directive is that the exemption will be extended in the case of companies listed in countries where the regulated market is 'equivalent' to EU markets

The transposition of the Prospectus Directive, and subsequent amendments, into national law may affect formal requirements and company practices concerning the disclosure of relevant information at the point of offer. In what form is required information disclosure made available to employees? Does company practice exceed regulatory requirements? To what extent is relevant information made available to employees at other key points within the share plan, such as when options vest?

ii) *Employment, Social Dialogue and Industrial Relations*

In general, EU workplace legislation does not specifically regulate employee financial participation. However, a number of acquired rights Directives, such as the safeguarding of employees' rights in the event of the transfer of undertakings or businesses,⁸ the 'recast' European Works Council Directive,⁹ the European Company (SE) Directive¹⁰ and the framework Information and Consultation Directive (ICD)¹¹ all set out circumstances in which employees and/or their representatives have rights to information and to be consulted.

However, it is feasible that representative processes and institutions established under the ICD, for instance, seek information relevant to financial participation. Under this Directive, 'information' is defined as the:

*... transmission by the employer to the employees' representatives of data in order to enable them to acquaint themselves with the subject matter and to examine it*¹²

and 'consultation means:

*the exchange of views and establishment of dialogue between the employees' representatives and the employer*¹³

⁸ 2001/23/EC, which replaces Directives 77/187/EC and 98/50/EC

⁹ 2009/38/EC

¹⁰ 2001/86/EC

¹¹ 2002/14/EC

¹² *ibid* Article 2 (f)

¹³ *ibid* Article 2 (g)



This Directive includes 'economic, financial and strategic developments' as one of three areas which employers are obliged to provide information and to consult employees' representatives on. The 'recast' EWC Directive also includes 'the economic and financial situation' of the undertaking as one of the items for information and consultation, as set out in Annex 1, which outlines the 'fall-back' arrangements in the event of no agreement been reached on the establishment of an EWC.

There is considerable diversity across Member States to which employment and industrial relations regulation, directly or indirectly, influences information disclosure in financial participation. Well-developed works council systems may include financial participation within their remit and this will clearly affect information disclosure and transparency. In some countries financial participation legislation may require extensive information disclosure and consultation – for example, in Belgium financial participation legislation requires that schemes are subject to collective agreement.

5.2 Communications and Transparency – Project Outcomes

Four main themes emerged from the study of this issue by the project – Communications; Information; Training; and Employee Involvement. The following are the key points raised as a result of this project:

Communications

1. Communications can be through a range of media – print, drop-in sessions, team-briefings, telephone, texting and electronic formats. With regard to the latter, it is more environmentally friendly and cost-effective and can include the use of social networking sites and intranet. In fact, increasingly for plan-statements to be accessed by members on-line.
2. It is important to understand the workforce structure and to use different communication methods for different groups of workers.
3. The type of communication will depend on where the scheme is in its 'lifecycle'. It is necessary for members of schemes to be informed as often as possible and to ensure their informed participation in decisions.
4. On the issue of who should communicate information, depending on the stage that the plan is at, it was generally agreed that the trade unions could play a role in explaining a financial participation scheme, in particular at the introduction stage, (although in France it would not be possible for the trade unions to fulfil this role and in the UK it would be very rare) and management have a primary role in the dissemination of information during the implementation and operation stage of a plan. It is important, however, that whoever communicates with employee members, have credibility with the perspective members at the introductory stage and with members during the lifecycle of the plan.
5. In the UK, there are annual awards for best practice communications and winning



schemes are invited to a special event hosted by **ifs ProShare** where they tell others what they have done. This helps to spread best practice in communications and the dissemination of information.

Information

- 1 The information, which should be made available to participants in a financial participation scheme, was addressed by the seminar in two phases – a) the setting up of schemes and b) its on-going operations. It is essential to provide information on the risks as well as the benefits. Information should be trustworthy and it should not be too detailed or complex, which would make it difficult to understand but should be detailed enough to provide an understanding of the most important issues.
2. All the main financial indicators should be made available to members and there is a need for clear rules, including what happens when an employee leaves the company and the plan. Members need to be in a position to understand what the financial risks and benefits are associated with joining a plan, so it is important that they have all relevant information to make investment decisions.
3. It should be clear from the outset whether participation in a plan is voluntary or compulsory, having in mind that the General Principles advocate voluntary participation.
4. Any remuneration derived from participation in a financial participation plan should not be considered as part of wages or salaries.
5. Information should be based on the performance of the whole group, in the case of a MNC, but also local performance information should also be available.
6. With regard to the role of legislation in the dissemination of adequate information, there are differing views. One approach would be that legislation or formal guidelines could ensure that information is comprehensive, but even if there is legislation to ensure the provision of adequate information, it does not help if management at the company level is obstructive or 'secretive'.
7. There is a wider right to information covered by a number of EU Directives and the requirement for information provision through other regulations, for example, on issue of securities and prospectus requirements, which can be relevant to information disclosure in relation to financial participation plans.
8. It should be emphasised that it is essential to distinguish between information and advice. In the UK some companies will provide advice at key points in the scheme but most are unwilling to do so because of liability risks.



Training

1. Training in the introductory phase is very important for employee participants but when a scheme is introduced financial literacy should be provided by external experts, paid for by the company.
2. In France, there is a right to training for those involved in the supervision of funds.
3. There could be a useful role of trade unions in providing training, especially in the planning and introductory stages.

Employee Involvement

1. The integration of financial participation with other employee involvement arrangements within companies was briefly discussed. In a number of companies European Works Councils already play a key role in the introduction of financial participation schemes.
2. In France, the comité d'entreprise has a role in the introduction of schemes, except for stock options. Other schemes have to be negotiated with the comité d'entreprise.
3. To avoid a conflict between shareholders, employees and management, clear communications between all the interested groups, monitored by people in whom all groups have confidence. This can take time to balance but, if there is meaningful involvement, then time may be saved during the implementation of the plan.

6 Financial participation and the provision of pensions

The European Commission, (DG Employment, Social Affairs and Equality), as well as the European Parliament Committee for Social Affairs, have, as a priority, the finding long-term and sustainable solutions to improving the level of pensions in all Member States, as they all face the same problem of ageing populations. The project addressed the issue of how financial participation might contribute to finding such sustainable solutions.

While the European Commission's Communication (2002) did not specifically refer to the link between financial participation and the provision of pensions, it does, however, emphasise the contribution schemes can make to the

*... achievement of social policy objectives by leading to a more wide-spread participation in wealth creation and better social cohesion.*¹⁴

¹⁴ op cit, page 7



However, in the report of the *High-level Group on Cross-border Obstacles to Financial Participation* (2004) reference is made to the

... growing debate within the EU on the adequacy of future pension provision.

It goes on to draw Governments attention to this approach to pensions provision:

Governments may wish to encourage personal savings to cover any possible gaps in pension provision, as well as measures to promote greater financial participation. Tax incentives to encourage both savings and financial participation may not, however, be possible given budgetary constraints. ¹⁵

In general, concerns have been expressed in these and other documents about the risks for employees participating in financial participation schemes and for clear information and transparency in the administration of these schemes and this applies, in particular, to any link to pension schemes.

EURESAs, a group of eleven European insurance companies operating in the 'social economy', ¹⁶ published a Code of Contact for pension fund managers in 2001, which was endorsed by the European Trade Union Confederation. This Code included a number of key provisions, such as

- Financial participation is complementary to other forms of employee participation
- Financial participation should operate on an ongoing, continuous basis
- Funds should be jointly managed by workers and management
- Financial participation provides additional income and is not an alternative for wages/salaries
- The State has an important mission in assuring the success of financial participation.

Following on from the Code of Conduct and to ensure 'good practice' in the management of pension funds, the design and operation of related financial participation schemes should be integrated into and form part of an overall strategy for the greater involvement of workers at their place of work, through, for example, joint management. Second, apart from the separation of normal remuneration from additional income that may derive from involvement in a financial participation scheme, employees' investment in their pension funds must not be confused with these aspects of financial participation.

Pension funds must be kept separate and protected from any market fluctuations that might affect their long-term viability. ¹⁷

¹⁵ op cit, page 15, Section 2.3.5

¹⁶ *Towards a Sustainable Development* EURESAs, June, 2009 (Paris)

¹⁷ *Financial Participation: Seeking a European consensus* K P O'Kelly, in Transfer, *Employee Share Ownership and Profit Sharing*, ETUI (1/2002)



This view was re-enforced by the experiences with the collapse of pensions funds, linked to share plans, in high-profile corporate failures in the USA in the early years of the last decade.

Another challenge with the provision of pensions in the EU is the lack of transferability, both within Member States, as a worker moves between employers, and on a transnational basis, if a worker moves to an employer in another Member State. This militates against the free movement of workers within the single market and creates tensions between the right to job mobility and job security. If mobility is facilitated by the transferability of financial entitlements, such as pension funds and share schemes, it will contribute to the further realisation of the single market.

This challenge was addressed by the adoption of Directive 2004/38/EC on the right of citizens of the EU and their family members to move and reside freely within the territory of the Member States. This Directive updates a wide range of earlier legislation on free movement of persons. A further Directive, 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (the IORP Directive), was enacted to co-ordinate pensions activities across the Member States. It provides for minimum harmonisation, thus leaving some leeway in a number of areas to Member States in its implementation. However, in its report on the implementation of this Directive, the European Commission notes that:

*... although there has been a notable increase in the number of cross-border pension arrangements over the past few years, the level of cross-border cases still remains relatively low. A recent survey carried out by CEIOPS shows that at the end of June 2008 there were 70 cases of cross-border activity in the European Economic Area (EEA), with 21 States acting as host states.*¹⁸

There is also a noticeable shift towards dependence on supplementary pension schemes, as noted by Guardiancich and Natali, with respect to occupational pensions,

*... supplementary pension funds do in fact play an important role in protecting against old age. The changing balance between first, second and third pillars, is paralleled by European Union action in shaping pensions policy, with a particular focus on supplementary funds.*¹⁹

¹⁸ Report from the Commission on some key aspects concerning Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP Directive) COM(2009)203 final, Brussels. The survey on which these statistics are based was carried out by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), November, 2008.

¹⁹ The first pillar is the provision of a public pension; the second pillar consists of non-public schemes in which membership is collective and linked to employment; and the third pillar is where voluntary savings are set aside by the individual for his/her retirement (See *Public/Private mix in Pensions in Europe* D Natali, ETUI Working Paper 2009; 10, Brussels (2009) (footnote 1)



However,

... the EU-27 is a very fragmented and heterogeneous market. ²⁰

These differences are represented by three distinct groups of countries across the EU. First, are the 'first generation of multi-pillar systems, which include Ireland, Denmark, the Netherlands and the UK; the second group can be described as a 'second generation multi-pillar systems' and include many new Member States, such as the Baltic States, Poland and other central and eastern (CEE) countries; the third group of countries are the 'social insurance systems in transition', include many of the southern Member States, but also Belgium, France, Italy and Slovenia. ²¹

So the debate on the future direction of pensions is very much to the fore in all European countries, as well as at the EU-level, but it is a debate in which financial participation doesn't figure largely.

6.1 European Commission Green Paper

In the intervening period between the seminar on the role of financial participation in pensions' policy and the final project conference, the European Commission published a Green Paper on the future of pension in Member States. ²² This discussion paper, while recognising that pension policy is the responsibility of Member States, highlighted the importance placed by Commission President José Manuel Barroso on finding a system of adequate and sustainable pensions, which was included in the guidelines for his second Commission (2010-2014), which state that:

Millions of Europeans are wholly dependent on pensions. The [recent financial and economic] crisis has shown the importance of the European approach to pension systems.

²⁰ *The EU and Supplementary Pensions – Instruments for integration and the market for occupational pensions in Europe* I Guardiancich and D Natali, ETUI Working Paper 2009:11, Brussels (2009)

²¹ Natali, op cit.

²² *Towards adequate, sustainable and safe European pension systems* European Commission, COM(2010)365 final



The Green Paper analysed the existing pensions' situation and sets out the different policy changes introduced by Member States to protect adequacy and to respond to changes in the labour market. It identified key common trends, such as:

- Encouraging more people to work more and longer through the extension of the retirement age
- A move from largely single-tier to multi-tier pension systems, reducing the share of public funded pensions
- Measures to address adequacy gaps between incomes on retirement and pensions
- Moves to address the gender dimension and bring more women into the pensions net
- A broader coverage and easier access for vulnerable individuals and groups and increases in financial support for poorer pensioners.

It also looked at how the current economic and financial crisis has added further to the pensions challenge, such as the problems many countries are having with public finances and the attempts to regulate the financial markets, as these have a direct impact on the provision of pensions. It sets out a number of reform objectives that need to be addressed in any future policies, such as finding the right balance between time spent at work and time spent in retirement. It also raises the issue of the transportability of pensions across Member States and the need for safer, more transparent pensions, the provision of adequate information and the need for better data on pensions at the EU level.

While the Green Paper did not make any reference to the role financial participation might play in future pension policies, the discussions at the relevant seminar and at the final project conference provided the basis for the submission of the AIPF/IAFP to the Commission as part of its consultation on the issue addressed and questions posed in the Green Paper.

6.2 General points arising from the project:

1. Shares from share plans can be put into pensions (UK) or payments from profit sharing plans can be put into savings plans, including pensions, and can be invested in employer shares as one form of instrument (France).
2. There are implications for financial participation in shifting from defined benefits (DB) to defined contributions (DC) pension plans, in particular for employee share ownership arrangements.
3. If financial participation is used as a substitute for wages, this could result in a reduction of contributions to pensions funds.
4. The relationship between financial participation and savings plans in many European countries, for example, France, Germany, UK, are typically centred on medium-term savings but a trend towards facilitating long-term savings and pensions using financial participation can be identified.



5. There are complementarities between well-developed support for employee share ownership and widespread use of funded occupational pensions, i.e. funded pensions both require and develop stock markets, which in turn tend to facilitate employee share ownership schemes. These complementarities occur at 'national system' levels as compared with specific arrangements that link employee share ownership schemes and pensions.

7 Financial participation in Small and Medium-sized Enterprises (SMEs)

In most European countries financial participation tends to be found in larger companies and, consequently, it is used less in SMEs. Generally speaking, the smaller the company the less likelihood there is that a financial participation scheme will be in place.²³

This is especially true for share-based financial participation. For example, the incidence of share-based schemes is about two per cent of SMEs in the UK, excluding micro firms (with less than ten employees). Similarly, the IAB Establishment Panel in Germany also found that two per cent of establishments with 1-49 employees have share plans, while three per cent of those with 50-249 employees have a share plan.²⁴

There are many barriers to using share ownership schemes in SMEs. These include high set-up costs, a lack of share capital or high administration costs. Further problem can be found on the 'demand' side, for example, small business owner/managers may perceive that employee identification can be achieved by a greater emphasis of the 'personal touch' and, therefore, share plans are unnecessary. They may also be anxious about sharing control and providing greater information to employees than they consider necessary.

In contrast, profit sharing tends to be more widespread in SMEs, though the incidence tends not to be high in most countries. France and Germany are exceptions to this trend. In France, for example, profit sharing is compulsory in firms with over fifty employees, while in Germany there is a long tradition of profit sharing linked to asset accumulation and to 'silent partnerships'. The IAB Establishment Panel showed that in 2005 eight per cent of SMEs with 1-49 employees operated

²³ Pendleton, A., Poutsma, E., Brewster, C. and van Ommeren, J. (2001) *Employee Share Ownership and Profit Sharing in the European Union*. Dublin: European Foundation for the Improvement of Living and Working Conditions

²⁴ Oliver Stettes, 'Low incidence of financial participation schemes in companies' *Eironline* 2007



profit sharing schemes, while twenty-three per cent of those with 50-249 employees had such schemes in place.²⁵ In enterprises with a works council in place the incidence is higher.²⁶

7.1 The Rationale for Financial Participation in SMEs

Financial participation may not be as necessary in SMEs because many of the problems that financial participation may be used to tackle are less of an issue, such as work discipline, information hoarding and non-co-operation. The 'personal' or 'direct' control of work tasks that are characteristic of many small firms may deflect the need for financial participation. In an owner-managed firm the personal and informal character of management may also encourage information sharing between the owner/manager and the workforce.

The European Commission's Communication (2002) identified several specific benefits of financial participation for SMEs, over and above the general benefits available to all firms.²⁷

These include:

- Assistance in the provision of start-up finance for new enterprises through generation of risk capital
- Promotion of an 'entrepreneurial spirit' in the workforce of SMEs.
- Assistance in securing external funding by signalling high-growth potential
- Assistance in attracting and retaining key personnel
- Assistance in solving succession problems.

Although it is available to all firms, the potential for wage flexibility that financial participation may offer, especially profit sharing, may be especially attractive to SMEs.

7.2 Barriers to Financial Participation in SMEs

As the evidence on the diffusion of financial participation indicates, the barriers to share ownership plans are greater than cash-based profit sharing. 'Informal' profit sharing rather than formula-driven plans may be more attractive to SMEs. Share option plans may be more attractive, at least for high growth SMEs, than share ownership plans, as they may not vest until the company is sold or floated.

²⁵ Ibid

²⁶ 'Employee financial participation in companies' *Eironline* 2008.

²⁷ European Commission (2002) op. cit.



The specific barriers to the use of financial participation in SMEs are identified as:

- Cash flow and financing constraints that preclude payouts to employees on top of the wage scale. This argument has been advanced, amongst others, by UNICE ²⁸
- Owner/managers of small enterprises might be unwilling to disclose more information than they consider necessary to employees
- A preference for informality and *ad hoc* measures in their personnel policies. Policies on remuneration also tend to be more *ad hoc*, individual and responsive to the imperatives of short-term labour needs and product market pressures at the micro level ²⁹
- An inability to meet the set-up and administration costs of a financial participation plan.

In addition to these there are some further barriers to the operation of share-based financial participation schemes, in particular:

- Only a small percentage of SMEs have public share capital, consequently, the operation of a share scheme may well require changes to the ownership structure and legal form of the company
- To achieve broad-based share plans companies would need to provide a market for shares to provide liquidity for employee shareholders. Flotation can provide a route to liquidity but only a tiny minority of SMEs aspire to do this
- Depending on the rules of the share plan, company owners may lose control of the company if outsiders can acquire shares from employees who are free to divest shares on the open market
- Share valuation is an additional expense and hurdle for SMEs
- Share plans tend to be very bureaucratic because of the need to operate schemes within statutory parameters, to check compliance with securities legislation, to maintain formal records, to formally communicate with employees to meet statutory financial services requirements and such stringent bureaucracy is unsuitable to the employment relations in SMEs.

7.3 Policy Initiatives

There have been a number of policy initiatives to address these barriers. The European Economic and Social Committee, in responding to the European Commission's Communication (2002) dealt explicitly with SMEs, suggesting that they need to be studied in greater detail. ³⁰ There is a need for dissemination of know-how regarding both the most appropriate forms of participation for SMEs and the obstacles they face (Section 6.2.2.). It noted that a problem with SMEs is ensuring proper transparency of results and profitability/financing prospects. It argued that provision of financial participation must be flanked with a more open approach to information (6.2.3.). It also argued that developing financial participation plans can send a favourable signal about growth prospects to financial institutions and may, therefore, assist in external funding

²⁸ UNICE (2001) *Financial Participation in the EU*. Brussels: UNICE (now BusinessEurope).

²⁹ Gilman, M., Edwards, P., Ram, M., and Arrowsmith, J. (2002), 'Pay determination in small firms in the UK: the case of the response to the National Minimum Wage', *Industrial Relations Journal*, 33: 52-67

³⁰ European Economic and Social Committee (2003) *Option on the Communication from the Commission....* Brussels: European Economic and Social Committee (2003/C95/09)



(6.2.4). It also noted that the pooling of financial participation schemes between SMEs might be a good way to overcome such obstacles (6.2.5).

There have been several policy initiatives in some European countries to increase the attractiveness of financial participation to small firms. In the UK, two new share schemes were introduced in 2000 with feature designed to appeal to smaller firms. The Share Incentive Plan allows shares to be non-voting and also has the potential for forfeiture on departure from the firm. These are, in part, designed to address fears, particularly prevalent among small business owners, about control passing outside the firm. An *Enterprise Management Incentives Programme* was targeted at smaller firms and included a 'light touch' approvals regime. In France there is the potential to operate inter-firm savings plans (PEE and PERCO (Plan d'Epargne Retraite Collectif / Collective Saving Plan for Retirement)) to spread the costs of operating these plans.

7.4 Contexts for Financial Participation

There are four scenarios where financial participation might be especially relevant in SMEs - management (and employee) buy-outs; 'human capital rich and new economy' firms; business succession; and firms experiencing difficulties in recruitment and retention.³¹

i) Management Buy-Outs

Management buy-outs and buy-ins, supported by private equity and venture capitalists, typically seek to introduce high-powered incentive structures to ensure that managers and employees are motivated to deliver results. These usually apply to managers but in a substantial proportion of such firms, these incentives are extended to the workforce more widely. They may take the form of profit sharing but it is common for managers and employees to acquire shares or share options. An obstacle to this is found in the UK where regulations associated with the use of tax-approved schemes preclude their use where a company is under the control of another (i.e. private equity firm).

ii) Human capital rich and new economy firms

In SMEs where the assets of the firm are almost exclusively 'human-based' and where the human capital is specialised and costly to develop, financial participation can help to bind employees to the firm. It has been argued that employee share ownership can be the 'glue' that binds knowledge economy companies together.³² Financial participation signals that these firms

³¹ See Pendleton, A., (2003)

³² Leadbetter, C. (1998) 'Who will own the knowledge economy?', *Political Quarterly* 69: 375-



will share the returns of human capital investments with employees. Without this 'glue', employees could take their knowledge of the firm's products and plans elsewhere (perhaps even establishing their own firms, given low barriers to entry) or could use their pivotal position to 'hold-up' the firm.

There is considerable evidence that share ownership schemes (especially share options) are widespread in 'new economy' firms. Share options, in particular, can be attractive in firms with high growth potential and where flotation is planned. Share-based rewards can provide a form of deferred compensation or informal pay substitution and may be especially helpful at early stages of the growth cycle when revenues may be limited. The problem of meeting the wage bill out of the profit and loss account is met by transferring it to the balance sheet. Until options had to be accounted for on the profit and loss account, managers tended to see options or shares as zero cost to the firm. From an employee point of view options can be highly attractive, at least in rising markets, but there is a considerable degree of risk.

iii) Business succession

Employee share ownership may provide a solution to business succession, especially when employees take on a large proportion of the ownership. The owner's family may be unwilling to take on ownership, whilst a trade sale to a competitor may be unattractive for a variety of reasons.

However, this is not a widespread solution to exit and succession problems. The most obvious barriers are those of liquidity, risk and coordination. Employees may not have the money to acquire the firm and may be unwilling or unable to take the risk of borrowing to fund the acquisition. Transaction costs still remain a problem, especially for the vendor in selling potentially small parcels of the firm to each employee.

One solution is to establish an employee benefits trust with the power to purchase and sell equity to employees. In effect, the trust acts as a 'market-maker' and also possibly as a 'warehouse' for shares. However, the establishment and operation of employee benefits trusts is perceived to be costly and the set-up costs are a barrier for many enterprises. Furthermore, a trust clearly has to have a source of finance to acquire shares in the first place (where shares are initially located in trust) and to re-acquire them from divesting employees. In most cases either the company will gift or loan the money required or underwrite a loan to the trust. In some circumstances this can be a major drain on a company's cash flow.



iv) Recruitment and retention

Financial participation can help to recruit and retain employees by providing additional benefits to wages and salaries. SMEs typically face problems in attracting and retaining high quality personnel. By virtue of their size, SMEs don't have an 'internal labour market' from which to develop and promote staff and promotional opportunities are usually very limited. Also, by the nature of their size, the challenge for SMEs, therefore, is to attract and retain experienced managers.

Profit sharing is used as a way of providing additional benefits for managers in some countries, such as in Germany. In some cases these may be extended to employees more generally, especially where it is difficult to attract and retain highly skilled staff.

However, an advantage of offering share-based rewards is that SMEs can provide similar reward packages to large publicly quoted companies and, also, provide the potential for capital gains should the enterprise do well. They may also help to close the gap in average pay levels between SMEs and larger firms. Once employees have been attracted to the SME the deferral provisions of share ownership schemes or the gap between grant and exercise in stock options schemes provide a degree of 'lock-in'.

The nature of employee risk preferences might influence the type of financial participation scheme introduced into a SME. Where employees are concerned about any risks to their incomes, profit sharing might be the most appropriate form, while, on the other hand, where employees are prepared to take risks, employee share ownership might be appropriate. In examining these various forms of financial participation, a SME might adopt a 'financial participation building-block' approach, by starting with the introduction of a profit-sharing plan and then gradually developing an employee share-ownership plan.

The particular business sector a SME operates in will also be a determinate of the form of financial participation. The growing importance of SMEs in new information technology and professional service enterprises could be an opportunity to promote financial participation.

Finally, financial participation in SMEs is potentially important. Cash-based profit sharing is probably best suited to most SMEs. However, the SME sector is highly diverse and different forms of financial participation might suit different types of SMEs. Employers, employees and trade unions share similar views on the barriers to financial participation in SMEs. However, the support of public authorities is essential, in the short term, for long-term benefits. Overall, it is important that financial participation is further extended in the SME sector and further research and work on this topic would result in a greater understanding of the best way to ensure such an extension.



8 Financial participation and corporate restructuring

Financial participation may assist in the process of restructuring enterprises and help to secure results that are beneficial to all stakeholders, especially employees. In general, consideration of the features of the various forms of financial participation suggests that employee share ownership may be more effective in these respects than cash profit sharing or stock options.

In general, financial participation may assist the process of restructuring in several ways:

- It can avert the need for 'crisis' restructuring by facilitating continual adaptation to market conditions and high levels of performance
- It can lay the conditions for successful restructuring through the encouragement of employee commitment, motivation and engagement
- It can facilitate the process of corporate restructuring itself.

Indeed, it could be argued that firms with financial participation arrangements in place may have less need to engage in restructuring because financial participation contributes to a higher level of performance. There is now a substantial body of evidence that suggests that firms with financial participation have higher productivity. Although there have been few direct comparisons between the different types of financial participation, the balance of evidence suggests that profit sharing may be most effective,³³ possibly because employees value cash more highly than shares and because profit sharing schemes usually benefit all or nearly all employees, whereas not all employees may choose to participate in a share scheme.

There is also evidence to suggest that firms with high performance work practices, which include financial participation, have a higher capacity to implement both process and product innovations.³⁴ Unfortunately, most of the research in this area does not explicitly examine the role of financial participation.

³³ C. Doucouliagos (1995) 'Worker participation and productivity in labor-managed and participatory capitalist firms: a meta analysis' *Industrial and Labor Relations Review* 49: 58-77.

³⁴ J.Michie and M.Sheehan (2003) 'Labour market deregulation, flexibility and innovation' *Cambridge Journal of Economics* 27: 123-143



It seems likely, however, that financial participation may encourage and facilitate innovation in a number of ways. For example, it may encourage supportive employee attitudes and behaviour, high levels of trust, employee commitment, engagement and a willingness to be flexible. It may also encourage 'peer pressure' and 'mutual monitoring', where employees encourage each other to behave in positive ways. There is a growing body of evidence that points to the positive effects of financial participation in these respects.³⁵ However, nearly all of the research assesses the role of employee share ownership plans, with very little focus on the effects of profit sharing. A limitation of the share ownership literature is that it often does not clearly differentiate between 'free' shares and subscription-based schemes: in the case of the latter, favourable employee attitudes may determine participation in the scheme rather than vice versa.

Financial participation can also boost remuneration above market levels thereby enabling firms to attract better quality employees ('efficiency wages'), while not adding to fixed wage costs. In such cases, profit sharing is likely to be most effective, as it is more clearly linked to wages than other forms of financial participation.

Should significant restructuring, involving changes to employment and working practices, become necessary, financial participation may have a significant role to play in achieving successful outcomes for all concerned. It can function as a guarantee to the workforce that, should they make sacrifices in the short term during a period of market difficulties, they will share in the benefits if and when the company recovers.³⁶ For example, workers may agree to working time changes, a pay freeze or pay reductions in return for future profit shares or company stock.

Employee share ownership can be more effective than other forms of financial participation in facilitating major restructuring.³⁷ Share ownership provides a 'cast iron' guarantee that employees will share in future upturns, because of the legally protected status of their shares, whereas there is always the possibility of profit sharing arrangements been discontinued. Furthermore, unlike stock options or profit sharing, share ownership provide for 'employee voice' in the governance of the firm. The effectiveness of this, however, is likely to depend on the size of the employee stake and the capacity of employees to collectively mobilise and defend their interests. A small employee stake and a lack of 'voice' are unlikely to provide the degree of protection against managerial opportunism that may be required to achieve successful restructuring.

³⁵ See, for example, D.Kruse, R.Freeman, and J.Biasi (2010) *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options*. Chicago: National Bureau of Economic Research

³⁶ M.Blair (1995) *Ownership and control*. Washington DC: Brookings Institution.

³⁷ See A.Pendleton and A.Robinson (forthcoming) 'Employee share ownership and human capital development: complementarity in theory and practice' *Economic and Industrial Democracy*



Consequently, the form of financial participation that is mostly associated with major company restructuring is a substantial or even majority employee share ownership. Examples of this include the transition to employee ownership in United Airlines in the 1990s³⁸ and the widespread transition to employee ownership in the British bus industry in the 1990s.³⁹ In both cases, the position of incumbent operators was threatened by deregulation, allowing low-cost competitors to enter the market. The incumbents needed to restructure their employment practices to reduce labour costs. Both companies were highly unionised and the workforces had the potential to oppose any proposed restructuring. The provision of substantial share ownership helped to demonstrate managerial good faith, thereby securing workforce and union acceptance of major changes to employment practices.

A more recent, but less dramatic example concerns British Airways' pilots. In 2009 they agreed to a 'shares for pay cuts' deal whereby they took a pay cut of 2.6 per cent and a 20 per cent reduction in some allowances. The General Secretary of the pilots' trade union – BALPA – commented that 'as a union we would share in the pain if our members shared in the gain'.⁴⁰

Deals, such as these, may both be more necessary, but also more likely, to be found in unionised companies. Union representation provides the degree of employee coordination to enable such deals to be developed and agreed. However, where financial participation helps to bring about pay cuts, it conflicts with trade union (and the European Commission) principles that financial participation should not be used for pay substitution. These deals also transfer significant risk to employees which also conflicts with the more general trade union views on financial participation.

³⁸ J.Gordon (1999) 'Employee stock ownership in economic transitions: the case of United and the airline industry' in M.Blair and M.Roe (eds.) *Employees and Corporate Governance*. Washington DC: Brookings Institution.

³⁹ A.Pendleton (2001) *Employee Ownership, Participation, and Governance*. London: Routledge.

⁴⁰ Daily Mail 14 July 2009



However, some trade unions take a pragmatic position when substantial restructuring is clearly necessary, but there is no evidence on what kind of unions are more likely to sign financial participation deals in circumstances of restructuring. Even unions that are ideologically opposed to financial participation may, in practice, take a pragmatic view.⁴¹ It has been suggested that employee ownership is more likely where workforces are relatively homogenous, because the costs of coordinating employee interests are likely to be lower.⁴² On this basis, unions that represent a single group of occupations may be more likely to enter into 'financial participation for restructuring' deals.

The most dramatic instances of corporate restructuring are those where ownership itself is restructured through mergers and acquisitions. Where a company is taken over, provision of a financial participation scheme may help to generate identification with the new owner among transferred employees. In the case of private equity takeovers, there is, very often, a concern to provide employees with incentives to promote the success of the company. Share ownership schemes are often substantial in such cases, though regulatory issues may prevent the use of tax-approved schemes (as in the UK). Finally, in the case of share ownership schemes in companies that are the subject of a take-over, financial participation provides a degree of protection and insurance for employees. They may also have access to information concerning the terms of the takeover, which may be better than the information that would be provided to them as employees. They may also have a vote on the take-over proposals and may benefit from the premium that normally accrues to shareholders of acquired firms.

⁴¹ A.Pendleton and E.Poutsma (2004) *Financial Participation: The Role of Governments and Social Partners*, Dublin: European Foundation for the Improvement of Living and Working Conditions

⁴² H.Hansmann (1996) *The Ownership of Enterprise*. Cambridge MA: Belknap Harvard



9 Conclusion

Key Findings of the Project

- The role financial participation can have in the re-organisation of enterprise-based, supplementary pension schemes needs to be explored further, while having cognisance of the European Commission's 'Principals' (i.e. 'Avoiding unreasonable risk for employees').
- Financial participation has an important role to play in the development of SMEs within EU Member States and this should be the focus of further studies.
- Financial participation can assist companies to restructure through the direct involvement of employees in reducing overall costs in a competitive environment and in a way that benefits all stakeholders.
- Each form of financial participation has its own advantages in the involvement of the workforce in restructuring. Profit sharing can have an immediate impact in sharing the gains of re-structuring, while share-ownership plans would have a longer-term sharing of the losses and gains.
- All stakeholders have to buy into and support the role of financial participation so that it can contribute to the successful restructuring of the enterprise.
- Financial participation should be central to any re-structuring, resulting from the current economic and financial crisis, undertaken by enterprises operating within the EU.
- The Model Plan, drawn up by the AIPF/IAFP in 2005, needs to be revised to take into consideration the findings from this project, including:
 - a. how financial participation plans can be made more transparent
 - b. how vital information might be made available to participating employees
 - c. to include profit-sharing as a format of financial participation.
- Action is needed to promote financial participation and to disseminate an understanding and information on all the issues involved in the new Member States of Central and Eastern Europe. Already, as a result of this project, the Polish Ministry of Economy hosted a seminar to promote financial participation in Polish enterprises, on 7 February, 2010.
- Financial participation has the support of the European Parliament and the European Economic and Social Committee.



Recommendations to European Commission

- The role played by the European Commission in the past twenty years in promoting financial participation within Member States has been crucial to putting this topic on the EU agenda. In the light of the current economic and financial crisis and the consequent re-structuring of enterprises across the EU, the European Commission might consider revising the 2002 Communication (COM(2002)364 final) and re-issuing it to promote the further dissemination of financial participation arrangements.
- It is essential that the European Commission continue to support further studies into specific aspects of financial participation. For example:
 - a) What forms of financial participation are most suited to SMEs and to different business sectors?
 - b) How can financial participation plans contribute to the provision of supplementary pension schemes?
 - c) How can enterprises be motivated to incorporate employee shareholding, ESOPs or other forms of financial participation, into their re-structuring plans?
 - d) What links are there between financial participation and other forms of employee involvement, for example, as set out in Directive 2002/14/EC on a general framework for informing and consulting employees? Is financial participation more effective in enterprises where there is a deeper level of employee involvement through works councils or direct participation arrangements?
 - e) What communications strategies are in place in Member States to inform participating employees of developments in their financial participation plans?
 - f) How can financial participation schemes be designed for workers employed in the non-profit and Public Sectors?
 - g) How can financial participation be promoted and extended into the new Member States of Central and Eastern Europe? What forms of financial participation are most suitable to enterprises operating in these Member States?
 - h) As there is a lack of EU data on various aspects of financial participation, a project which would focus on data collection, such as the share of company profits allocated to financial participation and the real effect of financial participation on the results of companies which have financial participation arrangements in place, would be important in strengthening the arguments in favour of financial participation.
- For Member State governments, there is the policy issue of providing legislative and taxation incentives to enterprises to provide financial participation plans for their workforces, in particular in SMEs.



- Formal Guidelines or Codes of Practice, drawn up by governments and social partner organisations, would be useful for enterprises and employee representatives in designing and implementing financial participation schemes. Such Policy Guidelines and/or Codes of Practice should take into consideration both the European Commission 'Principals', as set out in the Communication of July, 2002 (COM (2002) 364 final), and national practice, as guides to help enterprises introduce forms of financial participation suitable for their particular structures and sectors.
- The national employer and trade union organisations should co-operate in helping enterprises introduce financial participation schemes by developing training programmes, documentation and expert advice for management and employees during the design and implementation phases of a plan.

Project Steering Committee, AIPF/IAFP
March, 2011



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FINAL REPORT

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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

INDEPENDENT EVALUATION REPORT

Summary

This was a well-planned project based around a series of successful seminars that demonstrably met participants' needs. The seminars produced a considerable amount of new information on the extent and progress of financial participation across the EU and were particularly helpful to delegates who were new to this area.

Overall, the outcome from the seminars has been supportive of a number of existing conclusions on the promotion of financial participation, rather than producing substantial new thinking or recommendations. Wider dissemination of papers and presentations from the seminars should be undertaken. Future projects should seek to obtain greater engagement from employers and their representatives and from public officials of the Member States.

How the project was carried out

As explained in the Activity Report, this project was organised around four seminars, each seminar focussing on a specific topic, followed by a final conference in Brussels at which the findings from the first four meetings were presented and debated by a wider audience, including representatives from the European Parliament and the European Commission.



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The seminar programme

The AIPF/IAFP undertook the work required to plan the programme of seminars. This involved the choice of topics, the location and organisation of each seminar, the invitation of the participants and responsibility for the final papers and other outputs from each seminar. In advance of each seminar a paper was drafted in advance and provided to all delegates. These papers outlined the key issues and ended with a number of questions which were intended to help shape the debate at each seminar. These papers were drafted by Kevin O'Kelly with the help of an outside academic, Professor Andrew Pendleton.

The conclusions from each seminar including the final conference in Brussels are summarised in the Activity Report and are not therefore repeated here except where further comment is appropriate.

EVALUATION

What follows is my independent evaluation of this project which looks at a number of different aspects of its planning, organisation, content and outputs and provides comment and recommendations where appropriate.

Basis of my evaluation

The basis on which this evaluation is made comes from:

- A study of all the documents provided by the IAFP/AIFP
- Attendance at some of the seminars
- Discussions with participants at the seminars
- Discussions with members of the IAFP/AIFP
- My own knowledge and experience in the area of financial participation (see below).



My credentials

I have been involved in financial participation since 1997, as a civil servant in HM Revenue & Customs, as Chief Executive of ifsProShare and, more recently, as an independent consultant. As a civil servant, I was responsible for the introduction of two financial participation plans in the UK in 2000, one of which was specifically aimed at SMEs. In 2002, following a Communication from the Commission on a framework for promoting financial participation, I was appointed as a High Level Expert and helped to produce the 2004 report aimed at removing the cross-border obstacles to financial participation in the EU.

1. The structure of the project

This project was organised around four seminars, each focussing on a specific topic, followed by a final conference at which the findings from the first four meetings were debated by a wider audience. As an approach this had a number of advantages as it:

- Enabled the project's objective to be broken down into a few of the key areas which gave focus and depth and the seminars
- Gave an opportunity for a number of different cohorts to meet together, such as academics, employer representatives, trade unions and government officials in a neutral environment, which encouraged sharing of ideas and experiences
- Provided for active participation and dialogue between representatives of a large number of the Member States which considerably enhanced the European dimension to the project.

The structure of the project was well thought through and worked very well in practice. Participants could focus on those areas that were of most interest to them. Bringing together the outcomes of each of the four earlier seminars into the final conference was also a very effective way of providing a comprehensive and persuasive summary of all the findings and gave weight to the key findings and recommendations.

2. The choice of topics and preparation of the seminars

The four topics selected were:

- Transparency, information to, and consultation of, workers (Riga)
- Role of financial participation in pensions (Dublin)
- Promotion of financial participation in SMEs (Leiden)
- Role of financial participation in corporate restructuring (Rome).



These are all areas where financial participation can play a positive role. They are also subjects where difficulties which have been identified in earlier reports and studies or are areas which have been brought to prominence by the economic crisis.

While these are all individually worthwhile subjects, there is not a great deal of coherence across them and there is a tendency for them to spin off in rather different directions. This underlines one of the major issues in promoting financial participation – managing its potential scope as a tool to help promote small businesses, to increase productivity or improve corporate governance/workplace democracy, or to serve as a savings vehicle.

3. The seminars: preparation, attendance, quality and engagement, organisation

Preparation: The seminars were carefully planned and considerable efforts were made to engage a wide range of speakers who would reflect the views of a) the various stakeholders and b) a range of experience across the EU. This was often quite challenging as it was clear that some Member States did not have sufficient experience or information to contribute in depth to the specific focus of each of the seminars.

In addition, a detailed paper was prepared for each seminar. These papers provided a very helpful introduction to the project, the subject matter of the seminar and an excellent summary of the issues supported by many references to original source material such as academic research, European Commission papers, etc.

Attendance: Altogether 195 people attended the five seminars, although this will include a number of people who attended more than one seminar. Of this number nearly 50% were academics, representatives of affiliate IAFP/AIFP organisations or other experts. Of the remainder, some 23% came from employers' organisations and other enterprise management bodies (although this figure was significantly boosted by those attending the Dublin seminar). Of the remainder, 16% were from trade union groups and the other 11% were from the public administrations.

While the numbers attended were above initial expectations of 20 to 30 participants, there were very few representatives of either companies who had financial participation plans in place who could have shared their experience on the practical aspects of financial participation, or representatives of companies looking to put such plans in place or finding out more on the subject generally. Similarly, the low numbers of representatives of government administrators is of concern. This may be due to a lack of known contacts, or because such contacts do not exist or were unable or unwilling to attend. However, a number of senior European and national political figures attended the seminars in Dublin, Rome and Brussels. This may highlight an interesting difference between the level of support for financial participation from the legislative and the executive branches of government.



If financial participation is to be promoted throughout all the EU Member States, it will be critical to get better engagement with the two key stakeholders of business and government (both legislative and executive wings) as well as the trade unions, as they hold the keys to greater adoption of financial participation. In particular, national governments need to understand how financial participation can act as a lever in achieving their own policy aims and how their help is essential in removing the barriers to its greater adoption.

Representatives from 18 different Member States attended one or more of the seminars. While the location of the four seminars and the final conference will inevitably have had some influence on this, there was no representation from some of the EU's larger Member States such as Spain, Sweden, Finland, Slovakia and Austria. This may of course again be due to a lack of contacts or an unwillingness to attend. It would nonetheless be helpful to try to understand the reasons why and to ensure that extra efforts are made in any follow-up work to reach out to these States.

Quality and engagement: The data here comes from the figures in Appendix 1. Each score from the individual evaluation sheets has been included and then a weighted average has been calculated. This section covers the scores given for Groups B and C. Group B covers the quality of the seminar programme and asked delegates if they found this interesting. Group C covers the actual content of each seminar and whether delegates thought it was new and whether they would pass on the information to their work colleagues.

As far as the seminar programmes were concerned, the delegates scored this overall at 2.5 and the scores for each seminar were very consistent. This reflects the careful preparation undertaken for each seminar in terms of the selection of individual topics and the composition of the agenda for each day.

The scores for content were generally lower at an average of 2.1, reflecting a sizeable minority who felt that the material was not altogether new. This however should be seen in context. For a significant minority of delegates this could well have been one of their first introductions to these issues, whereas others will have found some of the topics very familiar. The adoption of financial participation is at very different stages across the EU and this inevitable creates challenges for a cross-EU approach.

Linking up with local organisations either formally as in Ireland and Italy or less formally as in Latvia, gave a particular focus to those seminars. While this gave the opportunity for an in-depth approach to key topics, such as the link between financial participation and pension provision, these discussions were perhaps overly-focussed on issues within one particular country and therefore distracted from the wider message and aims of the project. Moreover, while this approach might have encouraged attendance from one Member State, it may well have a less positive impact on the attendance from others. This is an aspect of the project that the IAFP/AIFP may wish to review as regards their future work programme.

In terms of the quality of presentations, this varied in the seminars I attended. Sometimes this was due to the experience of the speakers but also as a result of the amount of preparation that



had been invested in the presentations. Most of the speakers had gone to considerable lengths to prepare their material which was of a high standard.

On another positive note, the seminars afforded plenty of opportunity for debate and there was a high level of engagement and participation. Most of the audience participated during the seminar. Contributions and questions from the audience were actively encouraged and the level of challenge and debate was overwhelmingly open-minded and constructive. There was a real sense that delegates were listened to and that their views were heard.

It was not always easy to tie in the seminar presentations and ensuing discussions with the themes of the seminar and in particular with the questions set out in the preparatory paper. This happened most successfully at the Leiden seminar on promoting financial participation in SMEs, and this may reflect the fact that this is a more familiar topic and one where there is a greater spread of experience across the EU and available information. Jean-Michel Content, the Secretary General of IAFP/AIPF, was however very effective in bringing together the themes and concerns of each seminar in his closing address.

Organisation: The data here comes from the figure given for Groups A and D in Appendix 1. Group A covers the quality of the preparation and pre-seminar material and asked delegates if they found this sufficient. Group D covers the quality of the organisation of each seminar and whether delegates thought it was good.

The overall results are very high, with an overall score in Group A of 2.4 and an overall score in Group D of 2.7. The figure for Group A is understated possibly because of a poor result for the Riga preparation which may well have an understandable explanation, especially as this took place very shortly after the start of the project.

It is clear however from this data and from my own observations that the seminar programme was very well organised and all seminars were professionally run. Translation facilities were very good and as was AV support. In particular, seminars ran to time and there was plenty of time for breaks.

In addition the organisation of accommodation and the accompanying lunches and dinners was excellent. The venues were well chosen and the opportunity to continue the discussions in a less formal and relaxed setting was very helpful in breaking the ice and encouraging wider debate as well as enabling people to discuss specific issues with each other in much more depth.

General evaluation of the seminars: The data here comes from the figure given for Groups E and F in Appendix 1. Group E looks at the European context and asked delegates if they found this interesting. Group F asks delegates if the seminar was a useful contribution to the aims of this project and whether delegates thought they would recommend attendance at any future seminar to their work colleagues.



The results here are overwhelmingly positive, with a score of 2.7 for Group F and a 100% Yes vote for Group F. This gives a clear indication that, while each Member State will have its own approach to financial participation, there is genuine interest in seeing this within a broader European context and in hearing what is happening in other Member States and how this might be of wider benefit and application. This provides a strong signal that there is considerable appetite within those who participated for further debate on the issues surrounding financial participation and a role for the European Parliament and the Commission in seeking to promote this across the EU.

4. Reporting and follow-up: dissemination of the outcomes

As referred to above, a paper setting out the key issues on each area for discussion was issued before each seminar to participants attending that particular seminar. There would be considerable value in all these papers being made available to all the participants, or being available in due course to everyone through the IAFP/AIPF website.

In addition to these papers, there is a considerable amount of material that was provided in the presentations. To my knowledge this material has not yet been disseminated more widely and IAFP/AIPF should consider how they might do this.

5. Overall conclusions and recommendations

This project was well-planned from the beginning and resulted in a series of successful seminars, evidenced by the high scores received from delegates. A considerable amount of new information on the extent and progress of financial participation across the EU was obtained from the presentations and from delegates' experiences. The seminars encouraged dialogue and debate and were particularly helpful to policy-makers who were new to this area.

Overall, the outcome from the seminars has been supportive of a number of existing conclusions on the promotion of financial participation, rather than producing substantial new thinking or recommendations. This is not meant as a criticism of the project as such, but more a comment on the wide scope of the project, being the promotion of financial participation more widely across the EU. To do so requires not only the support of the European Parliament and Commission, but considerably more interest from the Member States themselves than appears to exist at present. The clear engagement and support of Member States is essential to create the necessary



framework that fosters and removes obstacles and which actively promotes financial participation as a key element of public policy.

Part of the difficulty is due to the different approaches to financial participation – it can be seen as a tool for greater consultation and dialogue in the workplace, a means of promoting the growth of SMEs, a means of providing an alternative or supplement to employee pensions, and a tool to deal with corporate or macro-economic changes. This multiplicity of roles can make it difficult for organisations like IAFP/AIFP to focus on more practical level recommendations that will promote financial participation in particular directions. Maybe part of the way forward therefore will be for them to decide on more narrowly-defined objectives and to focus their attention more in these directions. This may help them to secure greater engagement from key stakeholders such as employers and those responsible for policy-making in both the Commission and the Member States.

Diane HAY

February 2011



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Appendix 1: Overall Evaluation Scores

	SCORES				Average (max 3.0)
	3	2	1	0	
Group A – Preparation, Pre-seminar information *					
Riga	23	6	1	12	1.9
Dublin	7	1			2.9
Leiden	15	1			2.9
Rome	12	2			2.8
Brussels	13	6	1		2.6
OVERALL	70	16	2	12	2.4
Group B – Seminar Programme **					
Riga	25	22			2.5
Dublin	8	4			2.6
Leiden	20	10			2.6
Rome	23	14	3		2.5
Brussels	78	62	9	2	2.4
OVERALL	154	112	12	2	2.5
Group C – Seminar content***					
Riga	13	24	10	1	2.0
Dublin	5	4	3		2.2
Leiden	10	9	4	1	2.2
Rome	10	7	4	1	2.2
Brussels	18	28	15	2	2.0
OVERALL	56	72	34	5	2.1

* 3 = Sufficient; 2 = Some; 1 = Not enough; 0 = None

** 3 = Very interesting; 2 = Interesting; 1 = Not so interesting; 0 = Not interesting

*** 3 = Very new; 2 = New; 1 = Somewhat new; 0 = Not new. NB: All participants said without exception that they would pass on all or some of the information to their work colleagues



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	SCORES				Average (max 3.0)
	3	2	1	0	

Group D – Organisation of the seminar *****

Riga	63	26			2.7
Dublin	21	2			2.9
Leiden	38	10			2.8
Rome	34	8			2.8
Brussels	68	52	5		2.5
OVERALL	224	98	5		2.7

Group E – European dimension **

Riga	10	6			2.6
Dublin	3	1			2.8
Leiden	6	2			2.5
Rome	6	1			2.9
Brussels	13	8			2.7
OVERALL	38	18			2.7

Group F – General evaluation*****

Riga	Yes - 30	No - 0
Dublin	Yes - 8	No - 0
Leiden	Yes - 16	No - 0
Rome	Yes - 14	No - 0
Brussels	Yes - 42	No - 0

** 3 = Very interesting; 2 = Interesting; 1 = Not so interesting; 0 = Not interesting

***** 3 = Very good; 2 = Good; 1 = Poor; 0 = Very poor

***** Yes – Overall Impression of Seminar is favourable and Would you recommend to your colleagues to participate in a future seminar?



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Pre-Steering Committee Meeting, Paris 15 December 2009

MEETING MINUTES

Attendees: see the attached members list

A new “Detailed Work Programme” and a new “Timetable of Activities” are prepared (see the attached copy of these documents) to be sent as attachments to the letter addressed to the Commission asking for an amendment to the Grant Agreement recently received.

These new documents will be the basis of the newly scheduled Steering Committee Meeting which will take place in Paris the 21st of January 2010.

Because of the various constraints coming from the other Projects which are financially supported by the European Commission (TOBEQU 3 and the Dircredito Project), and also from the Commission itself, which will organize a European Conference on the same topics likely in the second half of 2010, it took a lot of time to draw this final version of our Work plan.

A draft of the Agenda for the first Steering Committee Meeting which will be held in Paris the 21st of January 2010 is prepared. *See the attached document.*



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Pre-Steering Committee Meeting, Paris 15 December, 2009

DRAFT AGENDA

Taking into account the delay in the formal answer of the Commission regarding our project, we have to adapt the Detailed Work Programme and the Timetable of activities and ask for an amendment to our Grant Agreement.

We should also take into account the Timetable of activities of the other Projects which have also been awarded a Grant Agreement from the Commission (TOBEQU 3 and Dircredito) as well as the announced International Conference to be organized by the Commission itself.

We have also to ask for the first pre-financing, with the formal guarantee of our Bank.

An information regarding Cees Vos's health, as SNPI is one of the main partners in our Project.



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FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Pre-Pre-Steering Committee Meeting, Paris 15 December, 2009

PARTICIPANTS LIST

<u>Name</u>	<u>Organisation</u>	<u>Attending</u>	<u>Signatures</u>
CONTENT Jean-Michel	IAFP France	X	
O'KELLY Kevin	IPSA, Ireland	X	
TUTHILL George	IPSA, Ireland	X	

Mise à jour au 23/03/2011



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Steering Committee Paris, on 21 January, 2010 MEETING MINUTES

Participants : see attached list

Opening:

The meeting opened with a wide ranging discussion on the objectives of this European Commission funded project and how it would fit into the work programmes of the partner organisations, what was hoped to achieve at the EU level and what would be the relationship with other projects funded by the Commission in 2010. Prof Pendleton observed that the four topics to be discussed at the drafting seminars are linked by the key word 'Risk'. The four topics are:

1. Transparency and the information and consultation provided to workers who participate in financial participation schemes;
2. The role of financial participation in corporate governance and restructuring;
3. Pension, the demographic challenge and the role financial participation can have in the maintaining the standard of living of retiring workers;
4. The promotion of financial participation in small and medium sized enterprises (SMEs)

The objective would be, on each topic, to assess what happens at present; to determine what should happen; to analyse these and make proposals.



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The seminars' participants will be composed of representatives from the social partners; public administrations and political/governmental policy-makers; academics involved in research into financial participation; enterprises (employers, employees); funds managers; and non-profit financial participation groups.

Pascale Nieuwland-Jansen emphasised that the overall objectives of the project must fit with the strategy of Nederlands Participatie Instituut for 2010.

On the relationship with other EU projects, George Tuthill and Jean Michel Content reported on the two other projects in which IAFP is a participating partner – TOBEQU III (co-ordinated by the Hungarian employers' organisation) and Dircredito (co-ordinated by the Italian trade union).

Organisation of the drafting seminars:

A number of points, designed to support the partners responsible for the local organisation of the drafting seminars, were agreed:

- As the local organisers in each country will need support from the Steering Committee (in particular in Latvia and Italy) it was agreed that an organisational 'check list' to assist these local organisers would be useful;
- Agenda for the drafting seminars might broadly follow this format:
 - An outline of briefing paper
 - Outline of the position in the participating countries – on financial participation in general and on the seminar topic
 - Case study presentations from 'good practice' companies – with speakers from employees and management sides
 - Break-out groups to discuss questions in briefing paper – for analyse and to contribute to the revision of the paper.
- It was agreed that the briefing papers for the drafting sessions must be practical and, as far as possible, be non-academic, if practitioners are to be attracted to participating in these events.

George Tuthill reported on a meeting of Irish ProShare Association (IPSA) officers last week, regarding the organisation of the seminar in Dublin. IPSA proposes to incorporate the seminar into its annual conference, with a focus on pensions and financial participation at the EU-level and in Ireland.



Secretarial issues:

- Bridget Tenenbaum, secretary to FONDACT and IAFP, will provide secretarial support for two half-days per week for the duration of the project;
- The project funding can cover the cost of local secretarial support for the organisation of the drafting seminars.

Interpretation:

It was agreed that only Latvian / English interpretation would be required for the Riga seminar and that no interpretation was required for the Leiden seminar. The requirements for interpretation for the Dublin and Milan seminars would be considered by the organising partners. It was agreed that all seminar proceedings would be recorded in English to assist in a speedy preparation of the seminar reports and revision of the briefing papers.

Possible sponsorship:

The possibility of getting sponsorship for aspects of the seminars (e.g. dinners) and a project sponsor was discussed and it was agreed that David Hildebrandt, George Tuthill and Jean Michel Content would explore this further.

Timetable for the preparation of briefing papers before Riga seminar:

- Kevin P O'Kelly and Andrew Pendleton will prepare paper and circulate to Steering Committee members by 19 February
- Steering Committee members will have until 26 February to comment/suggest changes
- Final draft ready for translation into Latvian by 5 March
- Paper ready by 15 April for circulation to invited participants

Contract with Partners:

Jean Michel Content pointed out that a formal contract must be signed between IAFP and each partner organisation, setting out the contribution of each partner organisation, the financial controls, support, etc.



Seminar Invitees:

A draft list of invitees from the target Member States, for each seminar, needs to be drawn up as soon as possible to ensure that the key people/organisations in each country are targeted. One of the objectives for the project, as set out in the grant agreement, is to reach all the stakeholders (employee representatives, employer representatives, public policy-making, experts, etc.). The meeting reviewed the target countries for each seminar and agreed that any contacts members of the committee have should be sent to Jean Michel Content, who will co-ordinate the invitations to the 'outside' participants for each seminar. Kevin P O'Kelly will draft an invitation letter for circulation to the seminars.

Raita Karnite listed a number of contacts in Latvia that she proposes to invite to the Riga seminar – academics; officials from the Ministries of Labour; Social Policy; Finance; and Economy; also from Local Govt associations; the trade unions and employers' organisations and from companies.

Seminar Timetable:

Finally, the following dates were agreed for the actions during the project:

- Riga seminar on 22-23 March
- Dublin 29-30 April
- Milan 25-26 May
- Leiden 9-10 September
- Final conference Brussels – 14-15 October

Kevin P O'Kelly

January, 2010



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Steering Committee Paris, on 21 January, 2010

PARTICIPANTS LIST

Present: George Tuthill, President, IAFP/AIPF, & Irish ProShare Association
David Hildebrandt, Past President, IAFP/AIPF
Jean Michel Content, Secretary General, IAFP/AIPF
Andrew Pendleton, University of York, UK
Nelly Voyeux, Fédération des Associations d'Actionnaires Salariés et
anciens salariés (FAS), FR
Pascale Nieuwland-Jansen, Nederlands Participatie Instituut, (NPI) NL
Raita Karnite, Ekonomikas prognazu centrs (Economic Prognosis
Centre – EPC Ltd)
Kevin P O'Kelly, Executive Committee, IAFP/AIPF (Chair of meeting)

An apology was received from Chiara Magrini, Studio Magrini, IT, who was unable to participate in the meeting.



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**International Association for
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***FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL
DIALOGUE AND BETTER CORPORATE GOVERNANCE***

**First Drafting Seminar
RIGA, 22-23 March, 2010
*COMMUNICATION AND TRANSPARENCY***

AGENDA

22 March, 2010

19.30 Seminar dinner

23 March, 2010

09.00 Registration

09.30 Welcome by –

George Tuthill, President, International Association for Financial
Participation, and

Raita Karnite, Chairperson, Ekonomikas prognazu centrs
Introduction to the seminar

Kevin P O'Kelly, Executive Committee, International Association
for Financial Participation

Introduction to the European Project



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Andrew Pendleton, University of York, UK
Outline of project briefing paper

- 10.30 Coffee
- 11.00 Eduards Filippovs
Financial participation in Latvia
- Questions and discussion
- 11.30 Three breakout workshops to discuss the set of questions outlined in the briefing paper
- 13.00 Lunch
- 14.30 Three breakout workshops to discuss the set of questions outlined in the briefing paper
- 16.00 Coffee
- 16.30 Report back from workshops – responses to the questions
- 17.15 Response from panel of social partners and ministry representatives and academics
- Debate and discussions
- 17.45 Jean Michel Content, Secretary General, International Association for Financial Participation
Closing address
- 18.00 End of seminar
- Wine reception





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

First Drafting Seminar

RIGA, 22-23 March, 2010

COMMUNICATION AND TRANSPARENCY

DISCUSSION PAPER

1 Introduction

The International Association for Financial Participation (IAFP) has been funded by the European Commission to undertake a EU-wide project into various aspects of employee financial participation, during 2010.

Financial participation, in the forms of share ownership by employees, either individually or through share ownership plans such as ESOPs, has been a feature of employee participation in the EU for many years. While financial participation has been supported in some countries through tax incentives and other forms of legislation, there is a wide divergence in approaches to be found between the Member States. There is also concern within the European Commission that costs and administrative complexities in Member States have hampered the introduction of financial participation schemes across the EU.



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Financial participation has been the focus of attention by the European Commission since the publication of the two PEPPER reports in 1992 and 1996 ⁴³. In an effort to move the issue forward, the Commission published a Communication in 2002 ⁴⁴ on a framework for the promotion of employee financial participation, which set out key principles for financial participation schemes. Opinions drafted by the European Economic and Social Committee and a European Parliament resolution further underline the importance of financial participation, particularly in relation to small and medium sized enterprises (SMEs).

Following the publication of this Communication, a High-level Expert Group, chaired by Jean-Baptiste de Foucauld, French Ministry of Economics, was set up by the European Commission and this body published its report in 2004. It identified a range of transnational barriers that obstruct the introduction of financial participation schemes in companies with subsidiaries and operations across the EU.

One of the key recommendations of the High-level Expert Group was that a *Model Plan for Financial Participation* be drawn up, and that this *plan* would :

.. serve to remove barriers and also promote cross-border financial participation. it might streamline a blueprint for the main types of financial participation. It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprise having to adapt their plans if they expand across the EU. ⁴⁵

The IAFP undertook to draft this Model Plan for European enterprises that are interested in introducing financial participation arrangements for their employees. This Model Plan was launched at a conference in Brussels in September, 2005.

2 New Project

The IAFP has now received further funding from the European Commission to undertake a study into aspects of financial participation. The project will review key issues related to financial participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the IAFP and from the Model Plan.

⁴³ European Commission *Proposal for a Council Recommendation concerning the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(91)259, Brussels, 1991; and *Report from the Commission: PEPPER II: the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(96)697, Brussels, 1996.

⁴⁴ European Commission *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a Framework for the Promotion of Employee Financial Participation* COM(2002)364, Brussels

⁴⁵ European Commission *Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a trans-national dimension* Brussels, 2004: Recommendation 4.3.2.4



This project will focus, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The role of financial participation in corporate restructuring
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs.

The project will also take stock of what progress has been made since 2005 in tackling the obstacles identified by the High-level Expert Group and will make further recommendations to the European Commission for the further diffusion of employee financial participation in enterprises operating within the EU.

The focus of the Model Plan was on schemes that are more common transnationally within the EU, namely:

- Free shares or share based profit-sharing;
- Share purchase schemes;
- Stock options.

Consequently, the focus of this new project is also on these forms of financial participation.

3 Communications and Transparency

Drawing on a number of general principles from the PEPPER reports (1992 and 1997) and from the Council Recommendation (1992), which the European Commission consider still apply in the present environment and should continue to be a guide to Member States in the framing of policies and/or legislation. These general principles were reiterated in the Commission's Communication (2002), two of which are related to communications and transparency:

- *Schemes must be transparent, with clear and comprehensive plans*
- *In the interests of transparency, employees should be made aware of the risks resulting from investment decisions and, consequently, possible fluctuations in income from the schemes.*

The High-level Expert Group, in addressing the issue of communications and transparency, looked at the problems from a labour law perspective, such as employee data protection, the availability of information in the national language of employees and the requirement in some Member States to inform and consult with the works council, trade unions or other employee representative body.

All these publications and reports, therefore, focus on the need to ensure the highest level of communications to employees and their representatives in the setting up and operations of



financial participation schemes. Communications should apply at each step in the setting up of and operation of the scheme:

- When proposing the introduction of a scheme
- When inviting employees to participate in a scheme
- When the scheme is in place
- When key decisions need to be made by employee participants (eg. whether to exercise previously granted stock options).

The extent to which information about FP schemes and the sponsoring company's performance and prospects is made available, and the quality of this information, appears to vary between Member States. However, there is little definitive research on information disclosure of this sort and the extent to which company practices vary between Member States.

4. Regulatory context

Disclosure of information to participants in share-based financial participation plans is likely to be governed by laws and regulation relating to 1) capital markets, and 2) employment, social dialogue, and industrial relations. It will also be affected by industrial relations custom and practices in each Member State.

In general capital market regulation is likely to have a more powerful impact on information disclosure in this area, as employees are primarily treated as investors in share-based financial participation.

iii) Capital markets

Employee share ownership plans are governed by various EU Directives relating to transparency and provision of information, deriving from the Financial Services Action Plan designed to create a single European capital market. Recent Directives have been transposed into national regulatory regimes in various ways, reflecting the principles of subsidiarity.

In understanding the potential impact of these directives on the provision of information and transparency of information to participants in employee share schemes, employees should be seen as minority investors (except where employees take majority ownership and control of a company). In general, it is important that, as minority investors, employees are protected from actions of majority owners and/or controllers that may not be aimed at the benefit of all shareholders. This is especially so where employees are required to subscribe to shares. Recent European initiatives have been concerned with enhancing minority investor protection.

Historically, there have been widely differing standards of minority investor protection in EU membership states but these differences have narrowed considerably with the implementation of recent Directives and their transposition into national legislation. The model for much of this legislation has been the UK where transparency and minority investor protection has been



relatively high (at least for listed companies) and where employee share plans have been widely used for a long period of time.

Transparency Directive

The key elements of the Transparency Directive, as they might affect provision of information to employees, are as follows:

- Companies are required to produce annual and half-yearly reports, supplemented by 'interim management statements' for the first and third quarters.
- The annual and half-yearly reports are required to include a statement of the main risks and uncertainties that may affect the company in the next six months
- Companies are required to disclose regulated information on a fast and pan-European basis whether or not they have investors in other EU Member States
- Investors are required to notify companies when they have built up (or reduced) voting stakes beyond certain levels: 5, 10, 15, 20, 25, 30, 50 and 75% (some countries such as the UK already exceed this level of detail).

The Directive applies to companies listed on the main stock exchange in each Member State.

Clearly, an issue is how far these formal regulatory requirements give rise to information that is passed specifically to employees. In what form is it made available to employees?

Prospectus Directive

This Directive requires that any public offer of securities or admission to a regulated market within the EU requires a prospectus approved by the regulator in the home country. Once approved by the home country authorities, the prospectus is valid throughout the EU.

It is notable for making specific reference to employee share ownership plans.

In general the Prospectus Directive requires companies that offer shares to their employees (or former employees) in the European Economic Area (EEA) to provide a share prospectus unless an exemption applies. There are two exemptions that impact on employee share plans – a general and a share plan-specific exemption

- There is a general exemption for offers that are made to less than 100 employees in each Member State, that do not exceed €2.5 million and for offers of free shares and non-tradable securities, such as restricted stock and stock options
- There is a partial exemption for employee share schemes offered by companies listed on an EU-regulated stock market as long as these companies provide an 'Information Memorandum' to participants.



An issue with this Directive has been the operation of share plans within Europe by firms that are listed in countries outside the EEA, such as in the USA. Under current arrangements these plans would not be exempt from issuing a prospectus. However, the intention is that the exemption will be extended in the case of companies listed in countries where the regulated market is 'equivalent' to EU markets

The transposition of the Prospectus Directive, and subsequent amendments, into national law may affect formal requirements and company practices concerning the disclosure of relevant information at the point of offer. In what form is required information disclosure made available to employees? Does company practice exceed regulatory requirements? To what extent is relevant information made available to employees at other key points within the share plan, such as when options vest?

iv) Employment, Social Dialogue and Industrial Relations

In general, EU social regulation does not specifically regulate employee financial participation. However, a number of acquired rights Directives, such as the safeguarding of employees' rights in the event of the transfer of undertakings or businesses ⁴⁶, the 'recast' European Works Council Directive ⁴⁷, the European Company (SE) Directive ⁴⁸ and the Information and Consultation Directive (ICD) ⁴⁹ all set out circumstances in which employees and/or their representatives have rights to information and to be consulted but they do not specifically identify employee financial participation.

However, it is feasible that representative processes and institutions established under the ICD, for instance, seek information relevant to financial participation. Under this Directive, 'information' is defined as the:

... transmission by the employer to the employees' representatives of data in order to enable them to acquaint themselves with the subject matter and to examine it ⁵⁰

and 'consultation means:

the exchange of views and establishment of dialogue between the employees' representatives and the employer ⁵¹

⁴⁶ 2001/23/EC, which replaces Directives 77/187/EC and 98/50/EC

⁴⁷ 2006/109/EC

⁴⁸ 2001/86/EC

⁴⁹ 2002/14/EC

⁵⁰ *ibid* Article 2 (f)

⁵¹ *ibid* Article 2 (g)



This Directive includes 'economic, financial and strategic developments' as one of three areas which employers are obliged to provide information and consult employees' representatives on. The 'recast' EWC Directive also includes 'the economic and financial situation' of the undertaking as one of the items for information and consultation, as set out in Annex 1, which outlines the 'fall-back' arrangements in the event of no agreement been reached on the establishment of an EWC.

There is considerable diversity between Member States in the extent to which employment and industrial relations regulation, directly or indirectly, influences information disclosure in financial participation. Well-developed works council systems may include financial participation within their remit, and this will clearly affect information disclosure and transparency. In a minority of countries, financial participation legislation may require extensive information disclosure and consultation: in Belgium, for instance, financial participation legislation requires that schemes are subject to collective agreement.

4 Key questions for the seminar

- I. What form do/should communications take? –
 - a. Printed materials - leaflets, brochures, etc.
 - b. One to one meetings between supervisors and employees
 - c. Team briefings
 - d. Videos
 - e. Intranet/internet
- II. How is/should information be communicated? –
 - a. Through the trade unions, works councils or other representative body
 - b. Directly by management – local; national; and/or (in the case of an organisation/company operating transnationally) by corporate/central management
 - c. By outside consultants/service providers contracted by the organisation/company to set up the scheme
 - d. Other
- III. What information should be made available? –
 - a. Management reasons for introducing a scheme
 - b. What form will the scheme take – individual shareholding; ESOP; profit-based?
 - c. Financial position of the organisation/company, including sensitive market information
 - d. Organisation/company strategy
 - e. Financial risks to employees and to the organisation/company and how it is proposed to minimise these risks
 - f. Ratio of organisation/company to employee/workforce contributions for the purchase of employee shares
 - g. Limits on the percentage of organisation/company's total equity to be allocated as employee shares
 - h. Range of employees to be covered by the scheme – how 'broad-based' / 'narrow-based' will the scheme be?
 - i. How it is proposed to keep normal remunerations and pension funds separate from payments under the scheme?
 - j. How it is proposed to deal with the retirement/resignation of employee shareholders?



- k. Frequency for the provision of information on the operations of the scheme – monthly, quarterly, annually?
- IV. Should information be based on the financial performance of the organisation/company at the local, national or transnational level?
- V. Will the scheme be based on the performance of the local unit, a combination of national units or transnationally?
- VI. What should the role of the national/sectoral social partners (employer or trade union organisations) be in setting guidelines for communications?
- VII. What should be the role of government (through legislation, codes of practice, the tax code, etc.) in ensuring adequate information is provided to the workforce, so that employees can make 'informed' decisions?
- VIII. Should employees and/or their representatives be provided with expert advice, paid for by the organisation/company, to assist them in having a full understanding a proposed scheme?
- IX. In the context of introducing a financial participation scheme, how can economic and financial literacy be ensured? Who should provide training for participating employees?
- X. How can employees and/or their representatives be confident that management and/or the service providers are making a full disclosure of all the relevant information? How will the scheme be monitored – will a joint employee/management group be established?
- XI. How will a financial participation scheme be complementary to, and be integrated with, other employee involvement arrangements within the organisation/company?
- XII. How will the, sometimes conflicting, interests of the main body of shareholders, employees, their representatives and management be balanced to ensure mutual trust and confidence in the scheme?
- XIII. What will be the voting rights of the employee shareholders, either individually or through an ESOP?
- XIV. How far does the provision of information exceed minimum standards specified in capital market and employment legislation?
- XV. What is best practice in information disclosure and transparency? Are there clear cases of best practice?
- XVI. How can information flows be improved?





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

First Drafting Seminar

RIGA, 22-23 March, 2010

COMMUNICATION AND TRANSPARENCY

REPORT OF THE SEMINAR

The first drafting seminar of this project was held in Riga, Latvia, on 22-23 March, 2010. It was organised jointly by the IAFP and Ekonomikas prognazu centrs (EPC), Latvia. It was attended by some 30 participants from the employers, trade unions and relevant ministries in Latvia and a number of experts from other EU Member State. Annex 1 has the list of participants.

1 Opening remarks

The President of the IAFP, George Tuthill, and the Director of EPC, Raita Karnite, welcomed the participants to the working seminar, which would explore issues around communications in financial participation and the transparency of financial participation schemes.

Kevin P O'Kelly, member of the IAFP Executive Committee, outlined the background and objectives of the project and, within the context of the overall project, the specific objectives of this seminar. He said that the seminar would discuss the role of transparency, information to and consultation of workers participating in employee financial participation arrangements within the



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enterprise where they work. The discussion paper, which was circulated in advance of the seminar, outlined the issues and posed a number of key questions for the development of financial participation within the European Union. The idea is that this paper would be the basis for an exchange of views by participants in the seminar. The paper was jointly drafted by Prof Andrew Pendleton and Kevin P O'Kelly

2 Presentation by Prof Andrew Pendleton, University of York, UK

Prof Pendleton outlined the various types of financial participation plans at present in use in Member States. He went through the information process and the different stages when information should be provided to participants in financial participation schemes. He also referred to some recent research findings on communication strategies for financial participation and a range of issues around the regulatory controls with regard to the provision of information, including capital markets and industrial relations.

3 Contributions by Latvian Social Partners

Edward Filippovs, Latvian Employers Association (LDDK), made a presentation on his organisation. LDDK has ninety-seven member companies and fifty-seven affiliated local associations, covering some thirty-five per cent of all employers in Latvia. It is the single national-level employer organisation, established exclusively for social dialogue purposes. It acts as a partner in socio-economic negotiations with the Parliament (Saeima), the Cabinet of Ministers, the Latvian Free Trade Unions (LBAS) and the Latvian Association of Local and Regional Governments.

LDDK sees financial participation as very positive and has undertaken a project on this issue within its affiliate organisations. He was not sure whether there is legislative support for financial participation in Latvia but LDDK has approached the tripartite co-operation council to indicate its interest. As a result, the Ministry of Finance has established a working group on financial participation which includes representatives of the Ministry of Finance, other relevant ministries, the trade unions and accountants. The working group has discussed what legislation should be introduced and it has discussed how the taxation system might be used more efficiently to promote financial participation. LDDK has not been happy with the result on taxation incentive to date.



One of the problems faced in the promotion of financial participation is the lack of continuity in the legislative and regulatory framework – decisions are taken but these are later abandoned.

In Latvia, companies with financial participation tend to be bigger companies, where social dialogue is well developed, and financial participation is seen as part of a long-term development.

Economic situation

During the 1990s there was rapid growth and inflation, resulting in big pay increases, bonuses and other social benefits, which were used as measures to motivate employees. During this period financial participation was not considered as important.

However, in 2008-2009 everything changed. The economy was near to collapse and the country was on the verge of bankruptcy. There were serious problems with the State budget, revenues and the general national finances. Unemployment went from five per cent to twenty per cent. The Government sought urgent assistance from the International Monetary Fund (IMF) and the European Commission. As a result, the tax rate has gone from twenty-three per cent to twenty-seven per cent and this is also stimulating a greater interest in financial participation. Companies now have very little financial resources, so incomes have been cut, but, at the same time, the potential for financial participation has grown, as it was seen as a way of solving these problems in the longer-term.

LDDK is now working with other transition economy employers' organisations on the promotion of financial participation. To establish the level of interest in financial participation and the issues around introducing schemes, LDDK undertook a survey of employers and workers in February, 2010. While the data from this survey is still being analysed (by Deloitte Consulting), some initial findings show that:

- Communication is very important for success
- Government policies are also very important, especially a continuity of policies
- There is a need for instruments to invest bonuses.

Marcis Dzelme, LDDK, added to the presentation of Mr Filippovs that the employers would like to see more discussion around how financial participation can be promoted in SMEs. He would like information on this issue.



Anzelika Berke-Berga, Mortgage and Land Bank of Latvia, is doing a PhD on financial participation in equity shares. She has interviewed various people and believes that there is a need to educate both employers and employees about securities. Elsewhere in Europe they have advisors and administrators (but not in Latvia). The financial markets are not sufficiently developed in Latvia. She also concluded that there is a need for regulatory and fiscal support.

Irena Kalnina, Telecom trade union, said she would like to hear practical examples of financial participation schemes. She said that her company had tried to introduce financial participation but it didn't work because of the lack of a statutory framework. She agreed with the employer confederation view that financial participation could be implemented through collective agreements. As the regulatory framework had been used to cut wages and bonuses, there is now a challenge as to how to motivate employees, so a national collective agreement on financial participation could be developed as one way to promote financial participation arrangements.

Inga Ozola, a trade union representative in Carlsberg Brewery, spoke about the experience with financial participation in the 1990s. There is now general agreement that salaries will not be increasing. However, it is important as to how productivity is measured and the trade unions have a concern with the indicators/ benchmarks used in such measurements. Workers are not educated in financial matters, or in how financial markets work. The trade unions want to develop social dialogue but not all shareholders are in agreement with this and they don't like the idea of employee voting rights. There is a need for a strong legal framework to foster the development of financial participation.

Liene Ciguze, Ministry of Welfare, supported the trade union and employer association views that financial participation is important but it has not been given very much consideration in Latvia. (Raita Karnite added that the Ministry of Finance is 'hostile' to financial participation but that the Ministry of Welfare is supportive)

In reply to these interventions, Edward Filippovs said that the employers are in favour of supporting legislation but don't want over-regulation. The free market must be allowed to operate.



4 Contributions by Latvian Researchers

Tatjana Muravska, University of Latvia, worked on the PEPPER III Report, co-ordinated by Jens Lowitzsch, Free University of Berlin. In Latvia financial participation goes back to privatisation and the trend is to rely on American experiences rather than those of Germany or France.

The most recent PEPPER Report was based on questionnaires sent to SMEs, however, the findings were not very promising. In the economic crisis, taken together with a demographic crisis and low productivity means that financial participation is not a priority. Companies have a 'cosmetic attachment' to financial participation in the 1990s but now 'they don't want to know'!

She mentioned that SME succession is a big problem in the EU-15 but it is not an issue in Latvia as most SMEs were set up and are run by younger people, so there is little interest in financial participation among these SME entrepreneurs.

A second researcher, Inna Dovladbekova, added that knowledge of financial participation is at a low level. There is a need for more communication to the wider public. Many employers do not understand what financial participation is about.

Her research looked at financial participation in railway companies in the three Estonia, Lithuania and Latvia. It concluded that even big companies and trade unions did not understand the topic, although in Lithuania there was a better understanding than in the other two countries. In Estonia there was no support from the Government or at the company level. In Latvia there is not a long-term view on economic development and there is a need to think about productivity and human capital development strategy. Financial participation could be a useful tool in doing this and for a long-term national strategy.

5 Responses to questions posed in the briefing paper

In the final part of the seminar, participants addressed a series of questions that were focused on the theme of the seminar - *communications and transparency in financial participation schemes*. The list of questions discussed is listed in Annex 3.

Four main themes emerged from this part of the seminar – Communications; Information; Training; and Employee Involvement. The following are the key points raised during this discussion:



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Communications

1. Communications can be through a range of media – print, drop-in sessions, team-briefings, telephone, texting and electronic formats. With regard to the latter, it is more environmentally friendly and cost-effective and can include the use of social networking sites. In fact, increasingly employee members can access plan statements on-line.
2. It is important to understand the workforce structure and to use different communication methods for different groups of workers.
3. The type of communication will depend on where the scheme is in its 'lifecycle'. It is necessary for members of schemes to be informed as often as possible and to ensure their informed participation in decisions.
4. On the issue of who should communicate information, depending on the stage that the plan is at, it was generally agreed that the trade unions could play a role in explaining a financial participation scheme, in particular at the introduction stage, (although in France it would not be possible for the trade unions to fulfil this role and in the UK it would be very rare) and management have a primary role in the dissemination of information during the implementation and operation stage of a plan. It is important, however, that whoever communicates with employee members, have credibility with the perspective members at the introductory stage and with members during the lifecycle of the plan.
5. In the UK, there are annual awards for best practice and winning schemes are invited to a special event hosted by *ifs ProShare* where they tell others what they have done. This helps to spread best practice in communications and the dissemination of information.

Information

- 1 The information which should be made available to participants in a financial participation scheme was addressed by the seminar in two phases – a) the design of and setting up of schemes and b) its on-going operations. It is essential to provide information on the risks as well as the benefits. Information should be trust worthy, however, it should not be too detailed but should be detailed enough – a fine balance needs to be struck in the level of detail.



9. All the main financial indicators should be made available to members and there is a need for clear rules, including what happens when an employee leaves the company and the scheme. Members need to be in a position to understand what the financial risks and benefits are associated with joining a plan, so it is important that they have all relevant information to make investment decisions.
10. It should be clear from the outset whether participation in a plan is voluntary or compulsory.
11. Any remuneration derived from participation in a financial participation plan should not be considered as part of wages or salaries – this is a key principal set out in the European Commission Communication, 2002.
12. In the case of MNCs information should be based on the performance of the whole group, but information should also be available on national/local performance. For example, the Carlsberg Group share information across the countries it operates in.
13. With regard to the role of legislation in the dissemination of adequate information, differing views were expressed. One view was that legislation or formal guidelines could ensure that information is comprehensive, but even if there is legislation to ensure adequate information, it does not help if management at the company level are obstructive.
14. There is a wider right to information covered by a number of EU Directives and the requirement for information provision through other regulations, for example, on the issue of securities and prospectus requirements, which can be relevant to information disclosure in relation to financial participation plans.
15. It was emphasised that it is essential to distinguish between information and advice. In the UK some companies will provide advice at key points in the scheme but most are unwilling to do so because of potential liability issues.

Training

4. The question of who should provide training for participating employees on economic and financial literacy was discussed. Training in the introductory phase is very important for employee participants but when a scheme is introduced financial literacy could be provided by external experts, paid by the company.



5. In France, there is a right to training for those involved in the supervision of funds.
6. There could be a useful role of trade unions in providing training, especially in the planning and introductory stages.

Employee Involvement

4. The integration of financial participation with other employee involvement arrangements within companies was briefly discussed. It was noted that in the Carlsberg Group and in a number of other companies European Works Councils (EWCs) played a key role in the introduction of financial participation schemes.
5. In France, the Comité d'entreprise has a role in the introduction of schemes, except for stock options. Other schemes have to be negotiated with the Comité d'entreprise.
6. To avoid a conflict between shareholders, employees and management, clear communications between all the interested groups, monitored by people in whom all stakeholder groups have confidence. It can take time to find the right balance but, if there is meaningful involvement, then time may be saved during the implementation of the plan.

Andrew Pendleton and

Kevin P O'Kelly

May, 2010



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First Drafting Seminar

RIGA, 22-23 March, 2010

COMMUNICATION AND TRANSPARENCY

PARTICIPANTS LIST

<i>Country</i>	<i>Name</i>	<i>March 22</i>	<i>March 23</i>
Estonia	Monika TABOR	X	X
France	Jean-Michel CONTENT	X	X
France	Paul MAILLARD	X	X
France	Nelly VOYEUX	X	X
Germany	Dirk LAMBACH	X	X
Ireland	Kevin O'KELLY	X	X
Ireland	George TUTHILL	X	X
Latvia	Agnese AVOTINA	X	X
Latvia	Egils BALDZENS	X	X
Latvia	Anzelika BERGA	X	X



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Country	Name	March 22	March 23
Latvia	Normunds BERGS	X	X
Latvia	Liene CIGUZE	X	X
Latvia	Inna DOVLADBEKOVA	X	X
Latvia	Marcis DZELME	X	X
Latvia	Eduards FILIPPOVS	X	X
Latvia	Alesandrs GAPODENKO	X	X
Latvia	Vadims JAROSSENKO	X	X
Latvia	Irena KALNINA	X	X
Latvia	Raita KARNITE	X	X
Latvia	Kriss KARNITIS	X	X
Latvia	Tatiana MURAVSKA	X	X
Latvia	Andris NATRINS	X	X
Latvia	Inga OZOLA	X	X
Latvia	Daniels PAVLUTS	X	X
Latvia	Girts RUNGAINIS	X	X
Latvia	Sterna SANTA	X	X
Latvia	Stacento SERGEI	X	X
Latvia	Rasma STABINA	X	X
Latvia	Jevgenija STALIDZÂNE	X	X
The Netherlands	Pascale NIEUWLAND	X	X
United Kingdom	Andrew PENDLETON	X	X
United Kingdom	Julie RICHARDSON	X	X





**International Association
for Financial Participation**



**Irish Proshare
Association**

**FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL
DIALOGUE AND BETTER CORPORATE GOVERNANCE**

**Second Drafting Seminar
DUBLIN, 29-30 April, 2010
THE ROLE OF FINANCIAL PARTICIPATION IN THE
PROVISION OF PENSIONS**

AGENDA

<u>29 April</u>	<i>The Challenge of Pensions in Ireland</i>
08:00 - 09:00	Registration / Welcome Coffee and Refreshments
09.00	Welcome and introduction by <u>George Tuthill</u> , President, International Association for Financial Participation
	Chairman's welcome – <u>Bernard Daly</u> , Chairman, Irish ProShare Association
	Opening of conference - <u>Éamonn Ó Cuív TD</u> Minister for Social Protection
09.30	<u>Orlaigh Quinn</u> , Assistant Secretary General, Dept of Social and Family Affairs <i>The National Pensions Framework</i>
10.00	<u>Gemma Jacobsen</u> , Director (IES Department), KPMG <i>The IPSA Response</i>



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- 10.30 Coffee/Tea
- 11.00 Social Partners' responses
- Fergus Whelan, Industrial Officer, Irish Congress of Trade Unions (ICTU)
- Brendan McGinty, Director, Industrial Relations and HR Services, Irish Business and Employers' Confederation (IBEC)
- 12.00 Discussion
- 12.30 Lunch
- 14.00 Seán Quill, Principal, Mercer Consulting
Pensions challenges in Ireland; a new role for Employee Financial Involvement
- 14.30 Gearóid Deegan, Partner, PricewaterhouseCoopers
- 15.00 Lucy Fallon-Byrne, Director, National Centre for Partnership and Performance
Financial Involvement in Ireland: Results from the new National Workplace Surveys.
- 15.30 Coffee/Tea

The Challenge of Pensions in European Unions Member States

- 16.00 Julie Richardson, Head of Employee Share Ownership, ifsProShare, UK
Employee Share Plans into Pensions
- 16.30 Heinrich Beyer, Manager, Arbeitsgemeinschaft Partnerschaft in der Wirtschaft e.V. (AGP)
Pensions Schemes and Financial Participation in Germany
- 17.30 Discussion
- 18.00 End of first day
- 19.00 Dinner and Jack Fitzpatrick Presentation



30 April

The Challenge of Pensions in European Union Member States (continued)

- 09.00 Rachael Ingle, Director, Hewitt Associates
A Comparison of Supplementary Pension Provision in EU Member States
- 09.30 Sven-Peter Nygaard, Consultant, Confederation of Danish Employers (DA)
Pensions in the Danish Private Sector
- 10.00 Paul Maillard, FONDACT
The Pensions Challenge and Financial Participation in France
- 10.30 Coffee/Tea
- 11.00 Alberto Simoes, Portugal
The Challenge of Pensions in Portugal
- 11.30 Igor Guardiancich, European University Institute, Florence, Italy
Cross-border operations of Institutions for Occupational Retirement Provisions: the route to an EU single market for occupational pensions
- 12.00 Discussion
- 12.45 Jean Michel Content, Secretary General,
International Association for Financial Participation
- 13.00 Lunch – end of conference



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Dublin, 29-30 April, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN THE PROVISION OF PENSIONS

DISCUSSION PAPER

1 Introduction

The International Association for Financial Participation (IAFP) has been funded by the European Commission to undertake a EU-wide project into various aspects of employee financial participation, during 2010.

Financial participation, in the forms of share ownership by employees, either individually or through share ownership plans such as ESOPs, has been a feature of employee participation in the EU for many years. While financial participation has been supported in some countries through tax incentives and other forms of legislation, there is a wide divergence in approaches to be found between the Member States. There is also concern within the European Commission that costs and administrative complexities in Member States have hampered the introduction of financial participation schemes across the EU.

Financial participation has been the focus of attention by the European Commission since the publication of the two PEPPER reports in 1992 and 1996⁵². In an effort to move the issue

⁵² European Commission *Proposal for a Council Recommendation concerning the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(91)259, Brussels, 1991; and *Report from the Commission: PEPPER II: the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(96)697, Brussels, 1996.



forward, the Commission published a Communication in 2002⁵³ on a framework for the promotion of employee financial participation, which set out key principles for financial participation schemes. Opinions drafted by the European Economic and Social Committee and a European Parliament resolution further underline the importance of financial participation, particularly in relation to small and medium sized enterprises (SMEs).

Following the publication of this Communication, a High-level Expert Group, chaired by Jean-Baptiste de Foucauld, French Ministry of Economics, was set up by the European Commission and this body published its report in 2004. It identified a range of transnational barriers that obstruct the introduction of financial participation schemes in companies with subsidiaries and operations across the EU.

One of the key recommendations of the High-level Expert Group was that a *Model Plan for Financial Participation* be drawn up, and that this *plan* would

*... serve to remove barriers and also promote cross-border financial participation. ... it might streamline a blueprint for the main types of financial participation. It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprise having to adapt their plans if they expand across the EU.*⁵⁴

The IAFP undertook to draft this Model Plan for European enterprises that are interested in introducing financial participation arrangements for their employees. This Model Plan was launched at a conference in Brussels in September, 2005.

2 New Project

The IAFP has now received further funding from the European Commission to undertake a study into aspects of financial participation. The project will review key issues related to financial

⁵³ European Commission *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a Framework for the Promotion of Employee Financial Participation* COM(2002)364, Brussels

⁵⁴ European Commission *Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a trans-national dimension* Brussels, 2004: Recommendation 4.3.2.4



participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the IAFP and from the Model Plan.

This project will focus, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The role of financial participation in corporate restructuring
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs.

The project will also take stock of what progress has been made since 2005 in tackling the obstacles identified by the High-level Expert Group and will make further recommendations to the European Commission for the further diffusion of employee financial participation in enterprises operating within the EU.

The focus of the Model Plan was on schemes that are more common transnationally within the EU, namely:

- Free shares or share based profit-sharing;
- Share purchase schemes;
- Stock options.

Consequently, the focus of this new project is also on these forms of financial participation.

3 Communications and Transparency

Drawing on a number of general principles from the PEPPER reports (1992 and 1997) and from the Council Recommendation (1992), which the European Commission consider still apply in the present environment and should continue to be a guide to Member States in the framing of policies and/or legislation. These general principles were reiterated in the Commission's Communication (2002), two of which are related to communications and transparency:



- *Schemes must be transparent, with clear and comprehensive plans*
- *In the interests of transparency, employees should be made aware of the risks resulting from investment decisions and, consequently, possible fluctuations in income from the schemes.*

The High-level Expert Group, in addressing the issue of communications and transparency, looked at the problems from a labour law perspective, such as employee data protection, the availability of information in the national language of employees and the requirement in some Member States to inform and consult with the works council, trade unions or other employee representative body.

All these publications and reports, therefore, focus on the need to ensure the highest level of communications to employees and their representatives in the setting up and operations of financial participation schemes. Communications should apply at each step in the setting up of and operation of the scheme:

- When proposing the introduction of a scheme
- When inviting employees to participate in a scheme
- When the scheme is in place
- When key decisions need to be made by employee participants (eg. whether to exercise previously granted stock options).

The extent to which information about FP schemes and the sponsoring company's performance and prospects is made available, and the quality of this information, appears to vary between Member States. However, there is little definitive research on information disclosure of this sort and the extent to which company practices vary between Member States.

4. Regulatory context

Disclosure of information to participants in share-based financial participation plans is likely to be governed by laws and regulation relating to 1) capital markets, and 2) employment, social dialogue, and industrial relations. It will also be affected by industrial relations custom and practices in each Member State.

In general capital market regulation is likely to have a more powerful impact on information disclosure in this area, as employees are primarily treated as investors in share-based financial participation.



v) *Capital markets*

Employee share ownership plans are governed by various EU Directives relating to transparency and provision of information, deriving from the Financial Services Action Plan designed to create a single European capital market. Recent Directives have been transposed into national regulatory regimes in various ways, reflecting the principles of subsidiarity.

In understanding the potential impact of these directives on the provision of information and transparency of information to participants in employee share schemes, employees should be seen as minority investors (except where employees take majority ownership and control of a company). In general, it is important that, as minority investors, employees are protected from actions of majority owners and/or controllers that may not be aimed at the benefit of all shareholders. This is especially so where employees are required to subscribe to shares. Recent European initiatives have been concerned with enhancing minority investor protection.

Historically, there have been widely differing standards of minority investor protection in EU membership states but these differences have narrowed considerably with the implementation of recent Directives and their transposition into national legislation. The model for much of this legislation has been the UK where transparency and minority investor protection has been relatively high (at least for listed companies) and where employee share plans have been widely used for a long period of time.

Transparency Directive

The key elements of the Transparency Directive, as they might affect provision of information to employees, are as follows:

- Companies are required to produce annual and half-yearly reports, supplemented by 'interim management statements' for the first and third quarters.
- The annual and half-yearly reports are required to include a statement of the main risks and uncertainties that may affect the company in the next six months
- Companies are required to disclose regulated information on a fast and pan-European basis whether or not they have investors in other EU Member States
- Investors are required to notify companies when they have built up (or reduced) voting stakes beyond certain levels: 5, 10, 15, 20, 25, 30, 50 and 75% (some countries such as the UK already exceed this level of detail).



The Directive applies to companies listed on the main stock exchange in each Member State.

Clearly, an issue is how far these formal regulatory requirements give rise to information that is passed specifically to employees. In what form is it made available to employees?

Prospectus Directive

This Directive requires that any public offer of securities or admission to a regulated market within the EU requires a prospectus approved by the regulator in the home country. Once approved by the home country authorities, the prospectus is valid throughout the EU.

It is notable for making specific reference to employee share ownership plans.

In general the Prospectus Directive requires companies that offer shares to their employees (or former employees) in the European Economic Area (EEA) to provide a share prospectus unless an exemption applies. There are two exemptions that impact on employee share plans – a general and a share plan-specific exemption

- There is a general exemption for offers that are made to less than 100 employees in each Member State, that do not exceed €2.5 million and for offers of free shares and non-tradable securities, such as restricted stock and stock options
- There is a partial exemption for employee share schemes offered by companies listed on an EU-regulated stock market as long as these companies provide an 'Information Memorandum' to participants.

An issue with this Directive has been the operation of share plans within Europe by firms that are listed in countries outside the EEA, such as in the USA. Under current arrangements these plans would not be exempt from issuing a prospectus. However, the intention is that the exemption will be extended in the case of companies listed in countries where the regulated market is 'equivalent' to EU markets

The transposition of the Prospectus Directive, and subsequent amendments, into national law may affect formal requirements and company practices concerning the disclosure of relevant information at the point of offer. In what form is required information disclosure made available to employees? Does company practice exceed regulatory requirements? To what extent is relevant information made available to employees at other key points within the share plan, such as when options vest?



vi) *Employment, Social Dialogue and Industrial Relations*

In general, EU social regulation does not specifically regulate employee financial participation. However, a number of acquired rights Directives, such as the safeguarding of employees' rights in the event of the transfer of undertakings or businesses⁵⁵, the 'recast' European Works Council Directive⁵⁶, the European Company (SE) Directive⁵⁷ and the Information and Consultation Directive (ICD)⁵⁸ all set out circumstances in which employees and/or their representatives have rights to information and to be consulted but they do not specifically identify employee financial participation.

However, it is feasible that representative processes and institutions established under the ICD, for instance, seek information relevant to financial participation. Under this Directive, 'information' is defined as the:

*... transmission by the employer to the employees' representatives of data in order to enable them to acquaint themselves with the subject matter and to examine it*⁵⁹

and 'consultation' means:

*the exchange of views and establishment of dialogue between the employees' representatives and the employer*⁶⁰

This Directive includes 'economic, financial and strategic developments' as one of three areas which employers are obliged to provide information and consult employees' representatives on. The 'recast' EWC Directive also includes 'the economic and financial situation' of the undertaking as one of the items for information and consultation, as set out in Annex 1, which outlines the 'fall-back' arrangements in the event of no agreement been reached on the establishment of an EWC.

⁵⁵ 2001/23/EC, which replaces Directives 77/187/EC and 98/50/EC

⁵⁶ 2009/38/EC

⁵⁷ 2001/86/EC

⁵⁸ 2002/14/EC

⁵⁹ *ibid* Article 2 (f)

⁶⁰ *ibid* Article 2 (g)



There is considerable diversity between Member States in the extent to which employment and industrial relations regulation, directly or indirectly, influences information disclosure in financial participation. Well-developed works council systems may include financial participation within their remit, and this will clearly affect information disclosure and transparency. In a minority of countries, financial participation legislation may require extensive information disclosure and consultation: in Belgium, for instance, financial participation legislation requires that schemes are subject to collective agreement.

5 Financial Participation and Pensions – The Debate in the EU

The European Commission, DG Employment, Social Affairs and Equality, as well as the European Parliament Committee for Social Affairs, have as a priority, the finding of long-term and sustainable solutions to improving the level of pensions in all the Member States, as they are all face the same problem of ageing populations. How can financial participation contribute to finding such sustainable solutions?

While the European Commission's Communication does not specifically refer to the link between financial participation and the provision of pensions, it does emphasis the contribution schemes can make to the

*... achievement of social policy objectives by leading to a more wide-spread participation in wealth creation and better social cohesion.*⁶¹

However, in the report of the *High-level Group on Cross-border Obstacles to Financial Participation* (2004) reference is made to the

... growing debate within the EU on the adequacy of future pension provision.

It goes on to draw Governments attention to this approach to pensions provision:

*Governments may wish to encourage personal savings to cover any possible gaps in pension provision, as well as measures to promote greater financial participation. Tax incentives to encourage both savings and financial participation may not, however, be possible given budgetary constraints.*⁶²

⁶¹ op cit, page 7

⁶² op cit, page 15, Section 2.3.5



In general, concerns have been expressed in these and other documents about the risks for employees participating in financial participation schemes and for clear information and transparency in the administration of these schemes and this applies, in particular, to any link to pension schemes.

EURESAs, a group of eleven European insurance companies operating in the 'social economy',⁶³ published a Code of Contact for pension fund managers in 2001, which was endorsed by the European Trade Union Confederation. This Code included a number of key provisions, such as

- Financial participation is complementary to other forms of employee participation
- Financial participation should operate on an ongoing, continuous basis
- Funds should be jointly managed by workers and management
- Financial participation provides additional income and is no alternative for wages
- The State has an important mission in assuring the success of financial participation.

Following on from the Code of Conduct and to ensure 'good practice' in the management of pension funds, the design and operation of related financial participation schemes should be integrated into and form part of an overall strategy for the greater involvement of workers at their place of work, through, for example, joint management. Second, apart from the separation of normal remuneration from additional income that may derive from involvement in a financial participation scheme, employees' investment in their pension funds must not be confused with these aspects of financial participation.

Pension funds must be kept separate and protected from any market

*fluctuations that might effect their long-term viability.*⁶⁴

This view was re-enforced by the experiences with the collapse of pensions funds, linked to share plans, in high-profile corporate failures in the USA in the early years of the last decade.

⁶³ *Towards a Sustainable Development* EURESAs, June, 2009 (Paris)

⁶⁴ *Financial Participation: Seeking a European consensus* K P O'Kelly, in *Transfer , Employee Share Ownership and Profit Sharing*, ETUI (1/2002)



Another challenge with the provision of pensions in the EU is the lack of transferability, both within Member States, as a worker moves between employers, and on a transnational basis, if a worker moves to an employer in another Member State. This militates against the free movement of workers within the single market and creates tensions between the right to job mobility and job security. If mobility is facilitated by the transferability of financial entitlements, such as pension funds and share schemes, it will contribute to the further realisation of the single market.⁶⁵

This challenge was addressed by the adoption of Directive 2004/38/EC on the right of citizens of the EU and their family members to move and reside freely within the territory of the Member States. This Directive updates a wide range of earlier legislation on free movement of persons. A further Directive, 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (the IORP Directive), was enacted to co-ordinate pensions activities across the Member States. It provides for minimum harmonisation, thus leaving some leeway in a number of areas to Member States in its implementation. However, in its report on the implementation of this Directive, the European Commission notes that:

*... although there has been a notable increase in the number of cross-border pension arrangements over the past few years, the level of cross-border cases still remains relatively low. A recent survey carried out by CEIOPS shows that at the end of June 2008 there were 70 cases of cross-border activity in the European Economic Area (EEA), with 21 states acting as host states.*⁶⁶

There is also a noticeable shift towards dependence on supplementary pension schemes, as noted by Guardiancich and Natali, with respect to occupational pensions,

*...supplementary pension funds do in fact play an important role in protecting against old age. The changing balance between first, second and third pillars, is paralleled by European Union action in shaping pensions policy, with a particular focus on supplementary funds.*⁶⁷

⁶⁵ *Financial Participation: wages, profit sharing and employee shareholding* D W Bell, Industrial Participation Association, London (1973)

⁶⁶ *REPORT FROM THE COMMISSION on some key aspects concerning Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP Directive)* COM(2009) 203 final, Brussels. The survey on which these statistics are based was carried out by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), November, 2008.

⁶⁷ The first pillar is the provision of a public pension; the second pillar consists of non-public schemes in which membership is collective and linked to employment; and the third pillar is where voluntary savings are set aside by the individual for his/her retirement (see *Public/Private mix in Pensions in Europe* D Natali, ETUI Working Paper 2009;10, Brussels (2009) (footnote 1)



However,

... the EU-27 is a very fragmented and heterogeneous market. ⁶⁸

These differences are represented by three distinct groups of countries across the EU. First, are the 'first generation of multi-pillar systems, which include Ireland, Denmark, the Netherlands and the UK; the second group can be described as a 'second generation multi-pillar systems' and include many of the New Member States, such as the Baltic States, Poland and other CEE countries; the third group of countries are the 'social insurance systems in transition', include many of the southern Member States, but also Belgium, France, Italy and Slovenia. ⁶⁹

So the debate on the future direction of pensions is very much to the fore in all European countries, as well as at the EU-level, but it is a debate in which financial participation doesn't figure largely.

In the UK, for example, pensions and financial participation have been almost entirely separate in policy discussions. Policy makers generally consider financial participation as an instrument to encourage employee commitment rather than as a long-term savings tool. It has not been considered important in the recent discussions on pensions or in related policy initiatives. ⁷⁰ However, for some time there has been a modest link in that workers can 'roll-over' their employee shares into a personal pension plan without attracting capital gains tax charges.

In France, for some 25 years, it has been possible for enterprises to offer savings plans to their employees as a means of savings, not only bonuses that they can receive from gain-sharing or profit sharing plans negotiated and agreed by the social partners within enterprises, but also voluntary payments from their proper savings. These voluntary payments may reach a quarter of the gross annual salary of an employee. Such a savings plan must last for, at least, 5 years and the money that is paid in to the fund is frozen for 5 years. The advantage of this freezing of the fund is that the sums which are paid into the plan and the profits which come from the money invested are tax-free and free of social charges, except for a general contribution of 2%.

⁶⁸ *The EU and Supplementary Pensions – Instruments for integration and the market for occupational pensions in Europe* | Guardiancich and D Natali, ETUI Working Paper 2009:11, Brussels (2009)

⁶⁹ Natali, op cit.

⁷⁰ See Pensions Commission (Chaired by Adair Turner), established in 2002, published reports on the pensions situation in the UK in 2004, 2005 and its final report in 2006.



The enterprise may decide to match the payments made by the employee, up to 300% of the employee's savings, with a legal limit which, at present, is around €1500 per year. For the enterprise, the bonuses, which are paid into the plan and any matching payments, are also free of charges and of taxes.

In 2003, a new law created a new kind of employees' savings plans that no longer had the 5 year expiration timeframe for payments into the plan, but the retirement date of the employee. This system is called PERCO (Plan d'Epargne Retraite Collectif / Collective Saving Plan for Retirement).

To date, PERCO has not been a real success and, as a consequence, a new law states that companies, which have created a PEE (a 5 years savings plan), are obliged to negotiate the creation of a PERCO and to offer it to all their employees. Furthermore, the matching payments from companies may be double compared to those for the PEE. Part of the present debate in France is around the possibility of making these matching payments part of the total amount of the legal bonuses (participation and/or intéressement) compulsory in PERCO.

With regard to the State pension, the retirement system (*Assurance Vieillesse*) provides a minimal pension to any person who has worked for 40 years. There have been numerous attempts to reform the system over the years and the latest was the recent publication of a report from the Government's Pensions Advisory Council. This report forecast that the system faces a funding shortfall of about €40 billion in 2015 and the "black hole" could rise to as much as €114 billion by 2050. Consultations are underway between the Government, the employers and the trade unions. While, the Government has ruled out reducing pensions but wants to increase the retirement age from 60 years. However, this is meeting with strong resistance from the trade unions.⁷¹

4 Irish Pension Plans

In response to the Government's Green Paper on the future of pensions in Ireland, published in October, 2007, the Irish ProShare Association (IPSA) made a submission which set out its view of how pensions might be placed in the context of employee share participation schemes. The main focus of the submission was on how the Irish taxation system could encourage long-term savings to meet the needs of retirement which could both assist in maintaining income adequacy and also increase pension coverage.

⁷¹ See Irish Times, 21 April, 2010



The key elements of the IPSA proposals were:

- Employees would agree to place their shares (or a portion of their shares) into a Revenue approved pension vehicle, e.g. PRSA or an existing Revenue approved pension scheme
- The transfer would attract no liability to capital gains tax
- The value at the date of transfer should be relieved from income tax as a qualifying personal pension contribution
- Further capital gains and dividends on shares held in the pension scheme would be allowed to roll up tax free
- The Pension Fund Manager would be able to trade the shares following a holding period on the condition the proceeds were reinvested in shares in Irish quoted or unquoted companies
- The Pension Fund Manager could dispose of the shareholding into less volatile investment, such as Government bonds or cash, anytime commencing three years prior to retirement
- Normal income tax rules would apply on retirement.

None of these proposals have been included in the recently published Government policy paper, the *National Pensions Framework*.

This policy paper proposes that the State pension will continue but on the basis of a 'total contributions' approach, so that the pension entitlement will, in future, be in line with the number of years a person has made contributions. It is also proposed to increase the retirement age in Ireland to 67 by 2021 and 68 year by 2028.

With regard to individual supplementary pension provision, for those not already in an employers' scheme, the paper envisages an automatic enrolment of all employees, aged over 22 years, into a mandatory pensions scheme from 2014. Employees will make a fixed percentage contribution that will be matched by the employer and by the State, equal to 33% tax relief. Individual pension funds will be invested in a range of funds, including low-risk options. There will be, however, an opt-out option for those who decide they do not wish to build funds for retirement. For those who make contributions for a period of five years, there will be a once-off bonus payment from the State.⁷²

⁷² *National Pensions Framework* Dept of Social and Family Affairs, Dublin (2010)



In the USA, 401(k) plans are the most popular type of defined contribution retirement plan. They are known as “401k plans” after that section of the US Internal Revenue Code that gives tax benefits to both the employer and the participating employee in such a plan. There are similar arrangements for public workers and those in the non-profit sectors covered by sections 403(b) and 457.

These savings plans allow employees to save for retirement and to have the savings invested while current income tax liabilities are deferred on funds saved and on earnings until withdrawal on retirement. The employee elects to have a portion of his or her salary or wages paid directly into his or her 401(k) account. 401(k) plans are mainly employer sponsored. The employer can, as a benefit to the employee, choose to match part or all of the employee's contribution by depositing additional payments into the employee's 401(k) account or simply offer a profit-sharing contribution to the plan.⁷³

Participating employees in 401(k) plans can select from a number of options for the investment of their funds, usually from an assortment of mutual funds, shares, bonds or money market investments, or some mix of these. Many companies' 401(k) plans also offer the option to purchase the company's shares. An employee can generally re-allocate his/her funds among these various investment choices at any time.

While there is a standard tax relief to encourage retirement plans, including deferred profit sharing pension plans, the situation with regard to profit-sharing schemes is specifically related to pensions, as outlined in an article comparing financial participation systems in the USA and a number of European countries:

*Apart from the generally decentralised wage-setting, the United States is also distinct from many European countries in that it has no special tax treatment encouraging firms and employees to adopt profit sharing plans. There is also no special tax treatment for cash profit sharing plans: employers deduct contributions and employees pay taxes in the same manner as they do with other wage, salary, and bonus pay.*⁷⁴

⁷³ See paper prepared by David Hildebrandt, IAFP Executive Committee, for the IAFP/IPSA conference.

⁷⁴ *Decentralisation of Bargaining Systems and Financial Participation: A comparative*

analysis of Italy, UK and the US by A Del Boca, University of Brescia, D Kruse, Rutgers

University and A Pendleton, University of York, (1999)



Most of the profit sharing in the USA is deferred and it appears that many firms like the flexibility of this form of pension scheme rather than the long-term obligation and administrative costs that come with defined benefit pensions. Motivational benefits are more likely to be cited as reasons for maintaining cash plans, but deferred plans are also often seen to have positive effects on employee motivation and productivity.⁷⁵

Following the corporate scandals of the early 2000s, including the collapse of the ESOP at United Airlines; the disasters for employee pension funds in Enron, Tyco, WorldCom and others, the 'bursting' of the dot-com bubble and the resulting 'wipe-out' of equity values for a lot of technology sector workers, a number of legislative changes were introduced. The first was the Sarbanes–Oxley Act of 2002 that was designed to set new or enhanced standards for all US public company boards, management and public accounting firms.

Second, the Pension Protection Act, 2006, which requires companies whose pension plans are under-funded, to pay higher premiums to the Pension Benefit Guarantee Corporation (PBGC). It also requires companies to analyse their pension plans' obligations more accurately, it closes loopholes that some companies exploited to under-fund their plans by skipping payments and it raises the cap on the amount employers are allowed to invest in their own plans. This allows employers to deduct more money using the pension tax shield in times of high profits.

The Act also:

- Provides for statutory authority for employers to enrol workers in defined contribution plans automatically
- Expands the level of disclosure about the performance of their pensions that workers are entitled to
- Gives workers greater control over how their pension accounts are invested
- It requires companies to provide quarterly notices to employees discussing investment risk issues, especially in relation to company shares
- Extends the 2001 tax act's contribution limits for individual retirement arrangements (IRA) and 401(k) companies are now required to provide diversification options in all 401(k) and ESOP 401(k) plans.

One concern with 401(k) plans is that there is no limit on the amount of employer stock that may be held within a plan, unlike other pension plans. The evidence shows that employees tend to over-invest in the stock of the company they are employed in for a variety of reasons, such as simple decision rules (i.e. there are four choices of stock so employees allocate 25% to each); extrapolation from past rather than future investment performance; mistaken beliefs concerning the risks; and trust in the employer.

⁷⁵ *ibid*



A more detailed paper on the US 401(k) system, prepared by David Hildebrandt, IAFP Executive Committee, is available for participants.

6 Key questions for the conference

- I. What role, if any, does the European Commission have in co-ordinating pension policies across the EU?
- II. Could the co-ordination of pensions policies within the EU contribute to the single market, the free movement of workers through a system of transnational transferability?
- III. How can employees' savings, through financial participation schemes that are linked to pension funds, be protected by the EU and Member States?
- IV. What can we in the EU learn from the experiences of the US and in other countries, such as Australia or Canada?





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Second Drafting Seminar

DUBLIN, 29-30 April, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN THE PROVISION OF PENSIONS

REPORT OF SEMINAR

The second drafting seminar of this project was held in Dublin, Ireland, on 29-30 April, 2010. It was organised jointly by the IAFP and the Irish ProShare Association (IPSA), in conjunction with the latter's annual conference. This event was attended by some 50 participants from employers and the business community, the trade unions and the public sector in Ireland and by experts from Denmark, France, Germany, Italy, Portugal and the UK. Annex 1 has the list of participants.

The conference was divided into two parts. First, in the light of the publication of the Irish Government's plans for pension reform, the *National Pensions Framework*, the conference focused on these proposals and the response of the social partners and IPSA to them. Second, the conference examined the approach to pensions, within the context of financial participation, in other EU Member States. A presentation was also made on the 401(k) approach to the provision of pensions through employee share ownership in the US.



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FINAL REPORT

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1 Opening remarks

Participants were welcomed by George Tuthill, President, IAFP and Bernard Daly, Chairperson, IPSA, and the conference was opened by Éamon Ó Cuív TD, Minister for Social Protection, who has political responsibility for pension reform in Ireland.

2 Proposals for Reform of the Irish Pensions' Scheme

A detailed presentation on the proposed pension reform set out in the *National Pensions Framework* ⁷⁶ was made by Orlaigh Quinn, Assistant Secretary General, Dept of Social Protection (Ministry). First, she outlined the context for pension reform, including the demographic challenge and the cost implications for the future. The changes proposed include reform of the State pension, which will continue but on the basis of a 'total contributions' approach, so that the pension entitlement will, in future, be in line with the number of years a person has made contributions. It is also proposed to increase the retirement age to 67 by 2021 and 68 year by 2028.

With regard to individual supplementary pension provision, for those not already in an employers' scheme, the paper envisages an automatic enrolment of all employees, aged over 22 years, into a mandatory pensions scheme from 2014. Employees will make a fixed percentage contribution that will be matched by the employer and by the State, equal to 33% tax relief. Individual pension funds will be invested in a range of funds, including low-risk options. There will be, however, an opt-out option for those who decide they do not wish to build funds for retirement. For those who make contributions for a period of five years, there will be a once-off bonus payment from the State.

This presentation was responded to, on behalf of IPSA, by Gemma Jacobsen, Director, KPMG. She outlined the points covered by the IPSA submission during the consultation process on pensions, including how pensions might be placed in the context of employee share participation schemes. The main focus of the submission was on how the Irish taxation system could encourage long-term savings to meet the needs of retirement which could both assist in maintaining income adequacy and also increase pension coverage.

⁷⁶ *National Pensions Framework* Dept of Social and Family Affairs, Dublin (2010) [Note that the name of the Department (Ministry) of Social and Family Affairs was changed to Department of Social Protection in 2010]



The submission included the following key elements:

- Employees who acquire shares under both approved and unapproved schemes would place their shares in an 'approved' pension vehicle
- Shares acquired under unapproved schemes would be eligible for transfer provided all tax liabilities on acquisitions are discharged
- Approved schemes, due to conditions on retention, etc., would not attract an income tax charge
- The transfer would not attract capital gains tax (CGT)
- Transfer value would attract tax relief or tie into the proposed auto- enrolment system
- A Pension Fund Manager would be able to trade the shares following a holding period on condition the proceeds were reinvested in shares in Irish quoted or unquoted companies
- A Pension Fund Manager could dispose of the shareholding into less volatile investment, such as Government bonds or cash, anytime commencing three years prior to retirement
- Normal income tax rules would apply on retirement.

In expressing disappointment that the *Pensions Framework* did not provide a distinct role for financial participation, she said that the IPSA proposals would:

- Increase pension coverage
- Make contributions towards 'sufficient income' on retirement
- Assist people to save more for longer
- Extend the employee base (particularly in approved schemes) and link into the provision of equity in the taxation system.

She compared the proposed Irish system with what is in place in the UK, where workers can transfer shares to approved schemes, and Canada, where the system is highly regulated and retirement saving plans (RRSPs) are registered with Revenue Canada.



This response was followed by comments from the social partners. Fergus Whelan, Irish Congress of Trade Unions (ICTU), said that the risks associated with occupational pension funds were been transferred to workers and the Government had no intention of saving Irish pension funds. He criticised the poor performance of fund managers in the past few years when workers pension savings were lost due to bad investment decisions. He considered the proposals in the *Pensions Framework* as ‘the most sustained attack on old age pension provision in Ireland’s history’ and ‘on the living standards of workers and older people’. He also outlined the ICTU opposition to the increase of the retirement age to 68, saying that workers have already paid into the pension fund, through the Social Insurance Funds, and they will not be deprived of three years benefits. Congress believes that the workforce will not accept this decision and it will mobilise opposition to ensure it is dropped.

Brendan McGinty, Irish Business and Employers’ Confederation (IBEC), said that pensions were in crisis and many funds were not in a situation to meet liabilities. He was concerned about the costs of implementing the Government proposals and their effect on the competitiveness of Irish business. He outlined the employers concerns as follows:

- Employers would have to ‘foot the bill’ for auto-enrolment
- The proposed increase in the retirement age will allow an opportunity for more contributions to be made to pension funds, however, this cannot be applied across all business sectors and should be considered on a case-by-case basis – in many industrial and construction jobs there would be a health and safety issue with regard to older workers
- It is IBEC’s view that the proposed increased tax relief on pension contributions will improve pension coverage for those on lower incomes – ‘on this issue it seems that Government wants it both ways’!
- The present proposals would fuel demands for wage increases at a time of extreme economic difficulties
- Many existing schemes are not in a position to meet the limits set by the Financial Regulator.

Given the extremely difficult economic situation, employers will have to critically examine pension costs. He said that ‘most schemes have witnessed *a perfect storm* of declining asset value, stricter funding standards, higher pay, low long term interest rates, poorly performing equity markets and longer life-expectancy ... we can’t afford anymore cost hits like this [pension reform]’.



He concluded by saying that the *National Pensions Framework* raises as many questions as it answers but it fails to address the issue of income adequacy in favour of coverage and the cost of employment. 'This hardly smacks of a policy that has been born out of any consideration for competitiveness or the implications for labour intensive industries, low skilled employment and small employers'.

Two further papers, related to the pensions situation in Ireland, were presented by:

1. Seán Quill, Mercer Consulting, who outlined the pressures and changes that have been made to both defined benefit (DB) and defined contribution (DC) pensions in recent years. He also examined the implications of the proposed changes in the Government paper and looked at the advantages and disadvantages of the IPSA proposals.
2. Lucy Fallon-Byrne, Director, National Centre for Partnership and Performance (NCP), presented initial findings, with regard to reward systems and pension coverage, from the second National Workplace Surveys. Most private sector workplaces have some form of reward system in place, with individual bonuses (44%) been the most popular. Only 8% had employee share options and 9% profit sharing schemes, mainly in larger enterprises and in high-tech and financial sectors.

With regard to pensions, almost a third of workplaces had no pension schemes in place but of those that did 48% had over 90% of workers covered. The surveys showed that such reward schemes are positively linked to the level of consultation, employee involvement, innovative work

practices and are a source of productivity and competitive advantage.

3 The Challenge of Pensions in European Union Member States

United Kingdom:

Julie Richardson, Head of Employee Share Ownership at *ifsProshare* in the UK, outlined the relationship between approved share plans and pensions in the UK. For some time, it has been possible to transfer shares from the main approved all-employee share ownership plans (SAYE and SIP) into a tax-approved savings 'wrapper' (Individual Savings Account or



ISA) or a registered pension plan within 90 days of option exercise (SAYE) or withdrawal of shares from the share plan (SIP). There are tax benefits from transferring shares in this way: although there is no capital gains tax relief as such on transfers into a pension plan, in the case of SIP the base cost for CGT liability is market value of the shares on withdrawal from the plan. The share transfers attract tax relief as contributions to the pension plan. In effect, share transfers from an approved plan into a pension plan attract tax relief twice. This is, therefore, a highly advantageous arrangement for the employee.

SAYE transfers also benefit from additional tax relief on the contribution to the pension plan but there is a CGT liability on the difference between the option price and market value at transfer. However, the annual CGT allowance means that in most cases CGT will not be payable.

These arrangements relate to self-invested personal pensions. It is rarely possible to make such transfers into occupational pension schemes because this would typically violate the investment policy of the fund managers managing the investments for the pension fund.

Overall, UK policy provides a synergy between share-based financial participation and personal but not occupational pensions. In practice, these arrangements will primarily benefit managerial and higher-paid occupations, as members of these are most likely to have personal pensions.

Portugal:

Alberto Simões, provided a summary of pension arrangements in Portugal. He highlighted the dominance of a State-operated *Pay-As-You-Go* system, but noted the strains this system is facing. There is a growth of occupational pension systems, operated by larger employers including Portuguese operations of multinational companies, such as Nestle, Siemens, and Volkswagen.

France:

Paul Maillard, Honorary President of FONDACT, outlined the systems of financial participation and pensions in France. He noted that the *Pay-As-You-Go* (PAYG) element of the system in France was still operating successfully, partly due to the use of proceeds from privatisation and property sales to top-up PAYG. However, as elsewhere, the long-term



prospects for PAYG are not good. Recently civil service pensions have been reformed. Also, State pensions in France have included supplementary schemes for certain classes of employee, such as professionals and the self-employed. These funds are now in difficulties.

He then went on to outline the links between financial participation and medium-term and long-term employee savings. Around 5 million employees received average benefits of around €1000 each year from each of the main schemes - *Intéressement* and *Participation* schemes. These benefits can be invested in a company savings plan (PEE) or an inter-company plan (PEI). Company retirement savings plans – PERCO or PERCOI (Plan d'Epargne Retraite Collectif / Collective Saving Plan for Retirement) – have recently been introduced. In 2009, 230,000 companies had one or more of these plans. Overall 11.8 million employees – around three-quarters of the private sector workforce – were involved in financial participation plans in 2009.

Employee contributions to these plans can be matched by employer contributions up to three times. There is a ceiling on contributions but this ceiling can be increased if employer shares are purchased and contributed to a PERCO.

With regard to the State pension, the retirement system (*Assurance Vieillesse*) provides a minimal pension to any person who has worked for 40 years. There have been numerous attempts to reform the system over the years and the latest was the recent publication of a report from the Government's Pensions Advisory Council. This report forecast that the system faces a funding shortfall of about €40 billion in 2015 and the "black hole" could rise to as much as €114 billion by 2050. Consultations are underway between the Government, the employers and the trade unions. While, the Government has ruled out reducing pensions but wants to increase the retirement age from 60 years. However, this is meeting with strong resistance from the trade unions.

Denmark:

Sven-Peter Nygaard, DA (Confederation of Danish Employers), outlined the Danish system of pensions. This system has a basic State pension, a State supplementary pension, occupational pensions and the ATP (the Supplementary Earnings-Related Scheme). The supplementary pension is in the process of being abolished. There is a small group, maybe up to 20 per cent of the working population – mainly those on State benefits and the self-employed – who are not saving in pension schemes.



Occupational pensions are notable for being closely linked with collective bargaining and are based on industry and sectoral collective agreements. They are fully funded, in most cases by employers (8%) and employees (4%), and are defined contributions. Trade unions have the majority on pension fund trustees and trade union representatives are deeply involved in critical investment decisions. Contribution levels are negotiated in each three-year collective agreement. These have risen substantially since the early 1990s.

Occupational pensions were a response to the failure of economy democracy in Denmark in the 1970s. In the 1980s trade unions demanded these pension rights as part of collective agreements as a substitute for economic democracy.

Germany:

Dr Heinrich Beyer, Association for Employee Financial Participation (AGP), outlined the German situation. Germans contribute to a statutory retirement insurance, a statutory health and long-term care insurance and to a statutory unemployment insurance. Retirement insurance contributions are paid to insurance companies and are only held inside the company when it is as a silent partner.

Contributions to retirement insurance are split equally between the employee and the employer and are 19.5 per cent of the employee's gross salary up to a limit of €5,500. Overall, 40 per cent of an employee's gross income level is paid in insurance contributions (though not all from the employee). Based on 45 years contributions this provides a pension of 45 to 48 per cent of final net salary.

Employees can also pay into company retirement schemes as a partial substitution for the State scheme (around 50% of the German workforce do this). A recent innovation is that they can purchase 'time certificates' for sabbaticals or early retirements.

Financial participation in Germany is facilitated by the asset formation and tax laws. The asset formation law allows employees to contribute €400 and to receive a subsidy of 20 per cent. Meanwhile, tax laws enable employers (possibly in the form of a profit share) and employees to contribute €360 each per year free of taxes (and social security contributions in the case of employees). These funds can be invested in the company, into savings funds, or into employer shares. Between €10 and €15 billion are invested in employer shares or company savings schemes.



Since April 2009 there have been restrictions on the allocation of employee investments in Special Funds for Employee Participation to ensure diversification – these make it difficult for fund managers to operate these funds. A maximum of 20 per cent of the assets of these funds can be invested in own company stock.

With regard to SMEs, financial participation is very much part of the corporate culture, workplace communications and corporate leadership. Management and employees work together to try to reach objectives around competitiveness, financial stability and corporate identity. Dividend certificates are quite common in SMEs and family owned companies and some 3,500 enterprises, employing up to a million workers, have such schemes.

It is recognised that financial participation is important in the present global financial crisis by providing better liquidity, more flexible personal costs, better human resource management systems, more employee motivation and a participative corporate culture.

EU-Level

i) Rachel Ingle, Hewitt Associates, reported on the results of a major Hewitt survey of supplementary pensions in Europe, funded by the European Commission. The survey achieved 290 respondents covering 400 pension schemes (in Belgium, France, Spain, Ireland, Italy, Netherlands, Portugal and the UK). Two-thirds of companies have supplementary pensions covering 90 per cent of the workforce: in the Netherlands and Belgium this is higher. In France, the schemes tended to be more exclusive.

Forty-nine per cent were DB, 34 per cent were DC and 17 per cent were hybrids of the two. Most pensions are funded by a distinct legal entity, such as a trust, with insurance-based schemes also important. Unfunded schemes tended to be less important, except in Italy where all DB schemes take this form, and Germany and France where they are also important.

Most DC and DB schemes allow new employees to join straight away though this is somewhat more common for DB schemes. The majority of DC schemes allow transfers but this is not the case with DB.



Perhaps surprisingly, a substantial majority say that they have no plans to change their pension policies in the next three years.

ii) Igor Guardiancich, European University Institute, Florence, Italy, presented the current situation with the Directive (2003/41/EC) on the activities and supervision of institutions for occupational retirement provision (the IORP Directive), which was enacted to co-ordinate pensions activities across the Member States. It provides for minimum harmonisation, thus leaving some leeway in a number of areas to Member States in its implementation. However, in its report on the implementation of this Directive, the European Commission notes that:

*... although there has been a notable increase in the number of cross-border pension arrangements over the past few years, the level of cross-border cases still remains relatively low. A recent survey carried out by CEIOPS shows that at the end of June 2008 there were 70 cases of cross-border activity in the European Economic Area (EEA), with 21 states acting as host states.*⁷⁷

There is also a noticeable shift towards dependence on supplementary pension schemes, as noted in an ETUI working paper by Igor Guardiancich and David Natali, with respect to occupational pensions,

*... supplementary pension funds do in fact play an important role in protecting against old age. The changing balance between first, second and third pillars, is paralleled by European Union action in shaping pensions policy, with a particular focus on supplementary funds.*⁷⁸

⁷⁷ REPORT FROM THE COMMISSION on some key aspects concerning Directive 2003/41/EC on the activities and supervision of institutions for occupational retirement provision (IORP Directive) COM(2009) 203 final, Brussels. The survey on which these statistics are based was carried out by the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), November, 2008.

⁷⁸ The first pillar is the provision of a public pension; the second pillar consists of non-public schemes in which membership is collective and linked to employment; and the third pillar is where voluntary savings are set aside by the individual for his/her retirement (see *Public/Private mix in Pensions in Europe* D Natali, ETUI Working Paper 2009;10, Brussels (2009) (footnote 1)



However,

... the EU-27 is a very fragmented and heterogeneous market. ⁷⁹

These differences are represented by three distinct groups of countries across the EU. First, are the 'first generation of multi-pillar systems, which include Ireland, Denmark, the Netherlands and the UK; the second group can be described as a 'second generation multi-pillar systems' and include many of the New Member States, such as the Baltic States, Poland and other CEE countries; the third group of countries are the 'social insurance systems in transition', include many of the southern Member States, but also Belgium, France, Italy and Slovenia. ⁸⁰

So the debate on the future direction of pensions is very much to the fore in all European countries, as well as at the EU-level, but it is a debate in which financial participation doesn't figure largely.

USA:

David Hildebrandt, Chair of IAFP, focused on the defined contribution plans in the US. Although private defined contribution plans have been present for many years, they received a major boost with the introduction of 401(k) plans in 1978. This gives tax relief on their contributions to both employers and employees. Around 62 per cent of all US private sector employees had access to a DC plan in 2009. Around 62 million workers participated in DC plans in 2005, compared with 20 million in DB plans. In 2009, about \$4 trillion were held in 401(k) plans, approximately a quarter of all retirement assets.

⁷⁹ *The EU and Supplementary Pensions – Instruments for integration and the market for occupational pensions in Europe* I Guardiancich and D Natali, ETUI Working Paper 2009:11, Brussels (2009)

⁸⁰ Natali, op cit.



A major challenge has been the loss of value in individual retirement accounts as a result of the economic downturn and the suspension of contributions by around 15 per cent of participating employees. However, the system has survived, and most participants now have more assets than before in their 401(k) plans.

A couple of key lessons from the operation of 401(k) plans over the years are:

- Transparency in communications and access to information for employees is vital
- Employers must act with prudence to attract employee participation.

A big challenge is the cost of administration for SME employers.

A significant issue in the US has been the use of employer stock in 401(k) plans. One third of participants have no employer stock but 8 per cent have 50 to 74 per cent in company stock. Just under 30 per cent have 1 to 19 per cent in company stock and 22 per cent have 20 to 49 per cent.

4 A Global Survey

Gearóid Deegan, PriceWaterhouseCoopers, presented the findings of a Global Equity Incentive Survey on employee share plans undertaken in 340 multi-national enterprise. The findings of this study confirm that companies are making changes by having less service based rewards and are 'waiting to see what others are doing'. There is also an increase in Revenue audits and getting shareholders' approval for change is becoming more challenging.



5 General points arising from the seminar:

- Shares from share plans can be put into pensions (UK) or profit shares can be put into savings plans, including pensions, and can be invested in employer shares as one form of instrument (France).
- There are implications for financial participation in shifting from DB to DC pension plans, in particular for employee share ownership arrangements.
- If financial participation is used as a substitutes for wages, this could reduce contributions to pensions funds
- The relationship between financial participation and savings plans in many European countries, for example, France, Germany, UK, typically has revolved around medium-term savings but there is a trend towards facilitating long-term savings and pensions using FP.
- There are complementarities between well-developed support for employee share ownership and widespread use of funded occupational pensions, i.e. funded pensions both require and develop stock markets, which in turn tend to facilitate employee share ownership schemes. These complementarities occur at 'national system' levels as compared with specific arrangements that link employee share ownership schemes and pensions.

Andrew Pendleton, University of York
Kevin P O'Kelly, Executive Committee, IAFP/AIPF
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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Second Drafting Seminar

DUBLIN, 29-30 April, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN THE PROVISION OF PENSIONS

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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Third Drafting Seminar LEIDEN, 9-10 September, 2010 FINANCIAL PARTICIPATION IN SMALL AND MEDIUM SIZED COMPANIES

AGENDA

9 September, 2010

08.30 Registration

09.00 Welcome – George Tuthill, President, IAFP/AIPF (Chair)

09.15 Introduction to the European Union Project
Kevin P O'Kelly, Member of the IAFP/AIPF Executive Committee

09.45 Financial participation in SMEs: a review of the issues
Andrew Pendleton, University of York, UK

10.30 Coffee break

11.00 The view of employers
Paul Maillard, FONDACT, France

A trade union view
Marion Weckes, Hans-Böckler-Stiftung, Germany



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12.00 Discussion

13.00 Lunch

14.30 Chair, Cees Vos, President, Nederlands Participation Institute

Financial Participation and SMEs in the Netherlands
Eric Kaarsemaker, Consultant

15.30 Financial Participation and SMEs in Belgium
Geert Janssens, VKW Metena, Belgium

16.00 Coffee Break

16.30 Financial Participation and SMEs in Poland
Rafal Towalski, Warsaw School of Economics

17.00 End of first day

19.00 Dinner

10 September, 2010

09.30 Chair: David Hildebrandt, IAFP/AIPF Executive Committee

Financial Participation and SMEs in Romania
Petru Dandea, Vice-President, Cartel ALFA

10.00 Financial Participation Financial Participation in Germany –
From a management and a Work Council Perspective
Verena Tobsch, Helmut Schmidt University and the University of
the Federal Armed Forces, Hamburg, Germany

10.30 Coffee break

11.00 Financial participation in SMEs in EU. A critical appraisal.
Erik Poutsma, Institute for Management Research, Radboud
University Nijmegen

11.30 Open discussion

12.30 Summing up and conclusions –
Jean Michel Content, Secretary General, IAFP/AIPF

13.00 Lunch – End of Seminar





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Third Drafting Seminar

LEIDEN, 9-10 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN SMEs

DISCUSSION PAPER

1 Introduction

The International Association for Financial Participation (IAFP) has been funded by the European Commission to undertake a EU-wide project into various aspects of employee financial participation, during 2010.

Financial participation, in the form of share ownership by employees, either individually or through share ownership plans such as ESOPs, has been a feature of employee participation in the EU for many years. While financial participation has been supported in some countries through tax incentives and other forms of legislation, there is a wide divergence in approaches to be found between the Member States. There is also concern within the European Commission that costs and administrative complexities in Member States have hampered the introduction of financial participation schemes across the EU.

Financial participation has been the focus of attention by the European Commission since the publication of the two PEPPER reports in 1992 and 1996 ⁸¹. More recently, in an effort

⁸¹ European Commission *Proposal for a Council Recommendation concerning the Promotion*



to move the issue forward, the Commission published a Communication in 2002⁸² on a framework for the promotion of employee financial participation, which set out key principles for financial participation schemes. Opinions drafted by the European Economic and Social Committee and a European Parliament resolution further underline the importance of financial participation, particularly in relation to small and medium sized enterprises (SMEs).

Following the publication of this Communication, a High-level Expert Group, chaired by Jean-Baptiste de Foucauld, French Ministry of Economics, was set up by the European Commission and this body published its report in 2004. It identified a range of transnational barriers that obstruct the introduction of financial participation schemes in companies with subsidiaries and operations across the EU.

One of the key recommendations of the High-level Expert Group was that a *Model Plan for Financial Participation* be drawn up, and that this *plan* would

*... serve to remove barriers and also promote cross-border financial participation. ... it might streamline a blueprint for the main types of financial participation. It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprise having to adapt their plans if they expand across the EU.*⁸³

The IAFP undertook to draft this Model Plan for European enterprises that are interested in introducing financial participation arrangements for their employees. This Model Plan was launched at a conference in Brussels in September, 2005.

of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States COM(91)259, Brussels, 1991; and Report from the Commission: PEPPER II: the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States COM(96)697, Brussels, 1996.

⁸² European Commission *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a Framework for the Promotion of Employee Financial Participation* COM(2002)364, Brussels

⁸³ European Commission *Report of the High Level Group of Independent Experts on cross-border obstacles to financial participation of employees for companies having a trans-national dimension* Brussels, 2004: Recommendation 4.3.2.4



2 New Project

The IAFP has now received further funding from the European Commission to undertake a further study into aspects of financial participation. The project will review key issues related to financial participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the IAFP and from the Model Plan.

This project will focus, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The role of financial participation in corporate restructuring
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs.

The project will also take stock of what progress has been made since 2005 in tackling the obstacles identified by the High-level Expert Group and will make further recommendations to the European Commission for the further diffusion of employee financial participation in enterprises operating within the EU.

The focus of the Model Plan was on schemes that are more common transnationally within the EU, namely:

- Free shares or share based profit-sharing;
- Share purchase schemes;
- Stock options.

Consequently, the focus of this new project is also on these forms of financial participation.

3 Incidence of Financial Participation in SMEs

In most European countries financial participation tends to be a larger company phenomenon and it tends to be rarer among SMEs. Generally speaking, the smaller the company the less likely financial participation is to be present.⁸⁴

⁸⁴ Pendleton, A., Poutsma, E., Brewster, C. and van Ommeren, J. (2001) *Employee Share*



This is especially the case for share-based financial participation. For instance, the incidence of share-based schemes is about 2 per cent of SMEs in the UK, excluding micro firms below 5 (or 10) employees. Similarly, the IAB Establishment Panel in Germany finds that 2 per cent of establishments with 1-49 employees have share plans, whilst those with 50-249 employees have a share plan in 3 per cent of cases.⁸⁵

There are many barriers to using share ownership schemes in SMEs. These include high set-up costs, a lack of share capital, high administration costs, etc. A further problem emanates from the 'demand' side - small business owners may perceive that employee identification can be achieved by the 'personal touch' and that share plans are thus unnecessary. They may also be anxious about sharing control and providing greater information disclosure.

Cash profit sharing is easier for SMEs to use for obvious reasons. Unsurprisingly, profit sharing tends to be more widespread in SMEs though the incidence tends not to be high in most countries. Exceptions are France, where there is compulsory profit sharing in firms with over 50 employees and Germany where there is a long tradition of profit sharing linked to asset accumulation and to 'silent partnerships'. The IAB Establishment Panel shows that in 2005 8 per cent of SMEs with 1-49 employees operated profit sharing, while 23 per cent of those with 50-249 employees had such schemes in place.⁸⁶ Where there is a works council the incidence is higher.⁸⁷

4 The Rationale for Financial Participation

The incentives-based rationale for financial participation should be more compelling (at least in theory) in small rather than large businesses. The problem facing all collective forms of remuneration is the '1/n' or 'free rider' problem. The temptation to 'free-ride' on the efforts of others increases as the size of the workforce increases. Financial participation ought to be more attractive, then, to small and medium-sized firms.

Ownership and Profit Sharing in the European Union. Dublin: European Foundation for the Improvement of Living and Working Conditions

⁸⁵ Oliver Stettes, 'Low incidence of financial participation schemes in companies' *Eironline* 2007

⁸⁶ Ibid

⁸⁷ 'Employee financial participation in companies' *Eironline* 2008.



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Financial participation may be less necessary, however, in SMEs because many of the problems that financial participation may be used to tackle are less of an issue in SMEs, such as work discipline, information-hoarding and non-co-operation. The 'personal' or 'direct' control of work tasks that characterises many small firms may obviate the need for financial participation. In an owner-managed firm the personal and informal character of management may encourage information-sharing between workers and the owner.

The European Commission has identified several specific benefits of financial participation for SMEs, over and above the general benefits available to all firms.⁸⁸

These include:

- Assistance in the provision of start-up finance for new enterprises through generation of risk capital
- Promotion of an 'entrepreneurial spirit' in the workforce of SMEs.
- Assistance in securing external funding by signalling high-growth potential
- Assistance in attracting and retaining key personnel
- Assistance in solving succession problems.

Although it is available to all firms, the potential for wage flexibility that financial participation may offer, especially profit sharing, may be especially attractive to SMEs.

5 Policy Initiatives

The European Economic and Social Committee's response to the European Commission's 2002 Communication (EC 2002) dealt explicitly with SMEs (2003), suggesting that they need to be studied in detail.⁸⁹ There is a need for dissemination of know-how regarding both the most appropriate forms of participation for SMEs and the obstacles they face (Section 6.2.2.). It noted that a problem with SMEs is ensuring proper transparency of results and profitability/financing prospects. It argued that provision of financial participation must be flanked with a more open approach to information (6.2.3.). It also argued that developing financial participation plans can send a favourable signal about growth prospects to financial institutions and may, therefore, assist in external funding (6.2.4). It also noted that the pooling of financial participation schemes between SMEs may be a good way to overcome such obstacles (6.2.5).

⁸⁸ European Commission (2002) *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*. Brussels: European Commission, COM (2002) 364 Final.

⁸⁹ European Economic and Social Committee (2003) *Option on the Communication from the Commission....*. Brussels: European Economic and Social Committee (2003/C95/09)



There have been several policy initiatives in some European countries to increase the attractiveness of financial participation to small firms. In the UK, two new share schemes were introduced in 2000 with feature designed to appeal to smaller firms. The Share Incentive Plan allows shares to be non-voting and also has the potential for forfeiture on departure from the firm. These are, in part, designed to address fears, particularly prevalent among small business owners, about control passing outside the firm. Enterprise Management Incentives was targeted at smaller firms and included a 'light touch' approvals regime. In France there is the potential to operate inter-firm savings plans (PEE and PERCO (Plan d'Epargne Retraite Collectif / Collective Saving Plan for Retirement)) to spread the costs of operating these plans.

6 Barriers to Financial Participation in SMEs

As the evidence on incidence of financial participation indicates, the barriers to share ownership plans are greater than cash profit sharing. 'Informal' profit sharing rather than formula-driven plans may be more attractive to SMEs. Share option plans may be more attractive, at least for high growth SMEs, than share ownership plans as they may not vest until the company is sold or floated.

The generic barriers to the use of financial participation in SMEs are:

- Cash flow and financing constraints that preclude pay-outs to employees on top of the wage scale. This argument has been advanced, amongst others, by UNICE ⁹⁰
- An unwillingness on the part of small owners to disclose greater information to employees.
- A preference for informality and ad hoc measures in HR policies. Pay practices in SMEs tend to be ad hoc and responsive to the imperatives of short-term labour and product market pressures at the micro level ⁹¹
- Inability to meet the set-up and administration costs of a financial participation plan.

⁹⁰ UNICE (2001) *Financial Participation in the EU*. Brussels: UNICE (now BusinessEurope).

⁹¹ Gilman, M., Edwards, P., Ram, M., and Arrowsmith, J. (2002), 'Pay determination in small firms in the UK: the case of the response to the National Minimum Wage', *Industrial Relations Journal*, 33: 52-67



On top of these there are further barriers to the operation of share-based financial participation:

- Only a small proportion of SMEs have public share capital, consequently, the operation of a share scheme may well require changes to the ownership structure and legal form of the company
- To achieve broad-based share plans companies would need to provide a market for shares to provide liquidity for employee shareholders. Flotation can provide a route to liquidity but only a tiny minority of SMEs aspire to do this
- Company owners may lose control of the company if outsiders can acquire shares from divesting employees
- Share valuation is an additional expense and hurdle for SMEs
- Share plans tend to be very bureaucratic because of the need to operate schemes within statutory parameters, to check compliance with securities legislation, to maintain formal records and to formally communicate with employees to meet statutory financial services requirements.

7 Contexts for Financial Participation

There are four scenarios where financial participation might be especially relevant - management (and employee) buy-outs; 'human capital rich and new economy' firms; business succession; and firms experiencing difficulties in recruitment and retention.⁹²

Management Buy-Outs

Management buy-outs and buy-ins, supported by private equity and venture capitalists, typically seek to introduce high-powered incentive structures to ensure that managers and employees are motivated to deliver results. These usually apply to managers but in a substantial proportion of such firms, these incentives are extended to the workforce more widely. They may take the form of profit sharing but it is common for managers and employees to acquire shares or share options. An obstacle to this is found in the UK where regulations associated with the use of tax-approved schemes preclude their use where a company is under the control of another (i.e. private equity firm).

⁹² see Pendleton, A., (2003)



Human capital rich and new economy firms

In SMEs where the assets of the firm are almost exclusively human, and where this human capital is specialised and costly to develop, financial participation can help to bind employees to the firm. It has been argued that employee share ownership can be the 'glue' that binds knowledge economy companies together.⁹³ Financial participation signals that these firms will share the returns of human capital investments with employees. Without this 'glue', employees could take their knowledge of the firm's products and plans elsewhere (perhaps even establishing their own firms, given low barriers to entry) or could use their pivotal position to 'hold-up' the firm.

There is considerable evidence that share ownership schemes (especially share options) are widespread in 'new economy' firms.

Share options, in particular, can be attractive in firms with high growth potential and where flotation is planned. Share-based rewards can provide a form of deferred compensation or informal pay substitution and may be especially helpful at early stages of the growth cycle when revenues may be limited. The problem of meeting the wage bill out of the profit and loss account is met by transferring it to the balance sheet. Until options had to be accounted for on the profit and loss account, managers tended to see options or shares as zero cost to the firm. From an employee point of view options can be highly attractive, at least in rising markets, but there is a considerable degree of risk.

Business succession

Employee share ownership may provide a solution to business succession, especially when employees take on a large proportion of the ownership. The owner's family may be unwilling to take on ownership, whilst a trade sale to a competitor may be unattractive for a variety of reasons.

However, this is not a widespread solution to exit and succession problems. The most obvious barriers are those of liquidity, risk and coordination. Employees may not have the money to acquire the firm and may be unwilling or unable to take the risk of borrowing to fund the acquisition. Transaction costs still remain a problem, especially for the vendor in selling potentially small parcels of the firm to each employee.

⁹³ Leadbetter, C. (1998) 'Who will own the knowledge economy?', *Political Quarterly* 69: 375-385.



One solution is to establish an employee benefits trust with the power to purchase and sell equity to employees. In effect, the trust acts as a 'market-maker' and also possibly as a 'warehouse' for shares. However, the establishment and operation of employee benefits trusts is perceived to be costly and the set-up costs are a barrier to many companies. Furthermore, a trust clearly has to have a source of finance to acquire shares in the first place (where shares are initially located in trust) and to re-acquire them from divesting employees. In most cases either the company will gift or loan the money required or underwrite a loan to the trust. In some circumstances this can be a major drain on company cash flow.

Recruitment and retention

Financial participation can help to recruit and retain employees by providing additional benefits to wages and salaries. SMEs typically face problems in attracting and retaining high quality personnel. By virtue of their size, SMEs typically lack a well developed and extensive internal labour market found in many large firms, with the result that promotional opportunities are typically very limited. The challenge for SMEs is to attract experienced managers, and retain them once they have them.

Profit sharing is a widespread means for providing additional benefits for managers in some countries, such as Germany. In some cases they may be extended to employees more generally, especially where it is difficult to attract and retain highly skilled employees. An advantage of offering share-based rewards is that SMEs can imitate the typical reward packages of large publicly quoted companies and, also, provide the potential for major capital gains should the SME do well. They may also help to close the gap in average pay levels between SMEs and larger firms. Once employees have been attracted to the SME the deferral provisions of share ownership schemes or the gap between grant and exercise in stock options schemes provide a degree of 'lock-in'.

8 Questions for the seminar

1. How widespread is financial participation in SMEs, and what kinds of financial participation schemes are most prevalent?
2. Which types of SMEs are more likely to have financial participation, and what kinds of financial participation?
3. To what extent are there national differences in the incidence of financial participation in SMEs? What regulatory, institutional, and cultural factors appear to be important?



4. What are the specific potential benefits to SMEs of each type of financial participation scheme?
5. What are the barriers to the various types of financial participation in SMEs and how far do these vary between countries?
6. How can financial participation be promoted among SMEs by national and EU level measures?
7. How far do inter-company schemes lessen the obstacles to the use of financial participation? How widespread are they in practice? How can they be made more attractive?
8. Does the successful implementation of financial participation in SMEs inevitably compromise the European Commission's recommendations on good practice in financial participation?

Andrew Pendleton, University of York and

Kevin P O'Kelly, IAFP Executive Committee

July, 2010



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Third Drafting Seminar

LEIDEN, 9-10 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN SMEs

REPORT OF THE SEMINAR

The third drafting seminar of this project was held in Leiden, the Netherlands, on 9-10 September, 2010. It was organised by the IAFP in conjunction with the Nederlands Participatie Instituut (SNPI). The seminar was attended by some 30 practitioners and experts from the Netherlands, Belgium, France, Ireland, Germany, Latvia, Poland, Romania, the UK and the USA.

1 Opening remarks

The President of the IAFP, George Tuthill, welcomed the participants to this working seminar, which would explore the issue of financial participation in small and medium sized enterprises (SMEs).



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Kevin P O'Kelly, member of the IAFP Executive Committee, outlined the background and objectives of the project and, within the context of the overall project, the specific objectives of this seminar. He said that the seminar would discuss the barriers and possible solutions to the introduction of financial participation plans into SMEs. The discussion paper, which was circulated in advance of the seminar, outlined the issues and posed a number of key questions for the development of financial participation within SMEs operating within EU Member States. The idea is that this paper would be the basis for an exchange of views by participants in the seminar. The paper was jointly drafted by Prof Andrew Pendleton and Kevin P O'Kelly

2 Presentation by Prof Andrew Pendleton, University of York, UK

In presenting the discussion paper, Prof Pendleton noted that financial participation tends to be more prevalent in larger firms but that there was, nevertheless, considerable policy interest, at national and EU levels, in stimulating the use of financial participation among SMEs. It was believed that the potentially favourable effects of financial participation could enhance the performance and growth of some SMEs.

Information was provided on the incidence of financial participation in SMEs in Germany and the UK. It was noted that two to three per cent of SMEs, excluding micros (less than ten employees), tend to have share-based plans, but a larger percentage use cash-based profit sharing arrangements. The incidence of financial participation tends to increase with the size of SMEs.

A key point was that only a small proportion of the approximately 20 million SMEs in the EU are likely to be attracted by the concept of financial participation and it was suggested that the promotion of financial participation should be aimed at these, which would include the larger SMEs, in the 'medium' category with over 50 employees, and high-growth potential SMEs, which may include some micro enterprises.

Various benefits of financial participation to SMEs were identified, such as:

- Contributions from share subscriptions and re-investment of profit shares in the firm could generate risk and start-up capital
- Promotion of an entrepreneurial spirit amongst workers
- Signalling of high growth potential and aspirations to financial institutions and others
- Attraction and retention of key personnel
- A solution to business succession
- Wage flexibility.



However, there are some specific barriers to the use of financial participation in SMEs:

- Cash flow and financing constraints
- The unwillingness of SME owners to disclose information to their employees
- A preference for informality and responding in an *ad hoc* way to market conditions
- A lack of knowledge of financial participation
- The high set-up costs.

For these reasons, financial participation is likely to be more widely used by larger SMEs.

In addition, some further barriers were identified, specifically in regard to the establishment of share-based schemes:

- The possible need to change the legal form and ownership structure of the enterprise
- The lack of liquidity of employee shares, given that SMEs will generally not be publicly-listed companies
- The fears of the owner/manager about the possibility of losing control
- The costs of share valuation
- The costs of establishing and setting up share plans.

For these reasons, cash-based profit sharing may well be more attractive to SMEs than share-based arrangements.

There are four possible scenarios for the use of financial participation in SMEs:

- Management buy-outs where investors and managers may want to extend incentives to employees
- Firms that are especially dependent on scarce or mobile human capital and where there are constraints on cash flow. Share and option-based schemes may be particularly attractive to these firms, which may be found in the 'new economy' and in professional services
- Business succession - the passing of shares to employees may facilitate them taking over the firm, when the owner/manager wishes to retire, in preference to a trade sale or family inheritance
- High-growth firms facing difficulties in attracting and retaining employees. The case of Enterprise Management Incentives in the UK was used as an illustration. It was noted that these options are more widely used for retention than attraction and that they are used for all employees in around a third of cases.



The following questions were posed in the discussion paper to guide the discussions and presentations at the seminar:

- How widespread is financial participation in SMEs in European countries and what kinds of financial participation are most prevalent?
- Which types of SME are most likely to use financial participation, and which kinds of financial participation?
- What are the national differences in the incidence of financial participation in SMEs. Do regulatory, institutional, and cultural factors affect differences in the use of financial participation by SMEs?
- What are the potential benefits of each form of financial participation to SMEs?
- What are the barriers to the use of each kind of financial participation and do these vary between EU Member States?
- How can financial participation be promoted amongst SMEs by national and EU-level policies and initiatives?
- How well do inter-company schemes work in practice? How widespread are they? How can they be made more attractive?
- Does the use of financial participation in SMEs conflict with the Commission's recommendations on good practice in financial participation schemes?

3 View of the Social Partners

Paul Maillard (FONDACT, France) reported on the use of financial participation in France, noting that the participation legislation provides for compulsory profit sharing for firms with more than 50 employees (i.e. medium-sized SMEs). The behaviour of SMEs is very similar to that of larger companies and regardless of the size of the company, the attitude is similar. So it is important to convince SMEs of the importance of financial participation. There is no reason for SMEs to be excluded from financial participation.

He was involved in a Parliamentary Commission in France, which investigated the use of financial participation in SMEs, in 2007. As well as interviewing SME owners who used financial participation, this Commission interviewed owners who did not use it. The typical objections of the latter group were:

- Financial participation was too complicated
- It was aimed at large firms and not at SMEs
- There was no compulsion - they did not have to do it
- They didn't like the collective dimension of financial participation, i.e. that all employees should be treated the same. They wanted to retain discretion to treat individual employees differently. Hence they preferred individual reward schemes.



In general, SME owners are indifferent to financial participation but if they do operate it they tend to like it. Some of the quotes from these latter managers were: 'participation increase loyalty'; 'participation can be helpful in paying for my house as the ownership of shares were accepted as collateral'.

In its final report, the Parliamentary Commission argued that financial participation needed to be mandatory to overcome this apathy. It, therefore, recommended that the threshold for using participation be lowered below the 50-employee limit, to a 20-employees threshold.

Marion Weckes (Hans-Bockler Foundation, Germany) drew a distinction between profit sharing and share ownership and she also emphasised the different definitions of SMEs in different Member States and also the need to differentiate between private and public companies.

She provided an overview of the various forms of financial participation, noting that the trade unions are generally more sympathetic to cash-based profit sharing. She noted the benefits of financial participation to companies and employees. In particular she noted the following benefits from a trade union perspective:

- Sustainable business decisions
- Contribution to the local community, i.e. profits are spent locally rather than by shareholders who don't live in the local area
- Reduction of the gap between income and capital.

She noted that European trade unions have the following priorities in respect to financial participation:

- Financial participation should not be a substitute for pay
- There should be no competition with other forms of co-determination
- It should be voluntary for companies and employees
- There should be transparency in the operation of financial participation plans.

She said that there is an interface of mutual interests between employers, employees and the trade unions, but she emphasised that workers' 'voice' arising from financial participation should be kept separate from that arising from legally based forms of co-determination. The collective 'voice' should have priority.



She noted that in some business sectors in Germany, for example in SME suppliers to automobile manufacturers, trade unions have agreed that employees could receive shares as part of concession bargaining when companies are in distress.

Discussion

Following these presentations, a number of important points were raised in the discussion:

- Cash-based schemes can be more attractive for SMEs. It is possible that the use of cash-based profit sharing may eventually lead to share-based financial participation
- Inter-company schemes could be attractive to SMEs, but the French experience raised the question as to how far it involved meaningful participation by employees. Information on these saving funds tended to be given to employee representatives rather than employees themselves. In 2009 Germany had introduced the idea of operating an inter-company fund, operated by a financial institution, but it had not been successful because it was too complex. It is not likely to be resurrected
- With regard to the risks to employees investing in one company, in the circumstance where that company is in financial difficulties, there are examples, for instance Opel in Germany, where it was possible for the workforce to help rescue the company by investing in, or buying part of the company. The trade unions position on such a situation is that this should only be done where there is a possibility of a successful rescue.
- It is important to take account of employees' views and risk preferences. Generally in SMEs they would prefer cash-based schemes because they are less risky and more flexible
- It was noted that trade unions were unlikely to be involved in financial participation in SMEs because their presence in SMEs was very limited. It was noted that employee consent might be obtained by employee ballots, as in France, where trade unions were not present
- It was thought that financial participation might be attractive to suppliers and customers, especially where it deals with business succession.

4 Financial participation and SMEs in Belgium

Geert Janssens (VKW Employers' Association, Belgium) summarised the reasons why Belgian trade unions tend not to be favourably disposed towards financial participation, as it is seen as undermining their power-base. This contributed to employer disinterest because they did not want the difficulties of taking on the unions on this issue.



In Belgium, 99.4 per cent of all enterprises are SMEs and many are family-owned. They provide 44 per cent of total employment. These owners of SMEs see too many barriers to financial participation. However, there is some positive news – over the past ten years there have been a number of policy initiatives to promote financial participation in Belgium, for example:

- Investment Savings Plans created by the 2001 law for firms with less than 50 employees is of interest to SMEs and ideal for family-owned businesses
- 'Non-recurring contingent benefit' is a profit-sharing based scheme, introduced in early 2008. This allows firms to pay bonuses of up to €2,200 per employee, per year, based on the achievement of a collective objective, such as an increase in profits or a reduction in absenteeism. There is no income tax on these payments, but employers' social security contributions are paid. Such a participation agreement has to be negotiated with employees. More than 10,000 of these schemes have been introduced, of which seventy per cent have been in SMEs.

Another development is the introduction by two private banks (Dexia and KBC Bank) of plans for SMEs, whereby employee bonuses can buy share options in a fund operated by the banks (a sort of co-operative fund). The fiscal treatment is beneficial but taxes have to be paid up-front and shares must be held for 5-10 years. Some 50 SMEs are participating in the scheme and it seems to be a success.

5 Financial participation and SMEs in the Netherlands

Eric Kaarsemaker (Consultant) and Cees Vos (President, the Nederlands Participatie Instituut (NPI)) presented an overview of financial participation and SMEs in the Netherlands. The role of the NPI is to develop policies, undertake research and training, to develop networking among interested enterprises and, in this context, it has developed a 'Dutch Model' for financial participation.

Noting some discrepancies between figures for incidence of financial participation in the Netherlands, an NPI-funded survey by Kaarsemaker found that share ownership was used by 3.6 per cent of companies with more than 10 employees. This amounted to 2,460 companies and 400,000 employees (of whom 150,000 were shareholders) – 50 per cent of these companies were multi-national enterprises and 54 per cent were listed on the Stock Exchange.



In 2006 of 24 listed companies studied, 15 had broad-based financial participation schemes and 5 had narrow-based plans.

A further 3.7 per cent of enterprises were considering the introduction of ESOPs or stock option schemes. It was found that the main reasons for introducing financial participation were to teach managerial skills and for recruitment and retention of employees.

Turning to SMEs in particular, a range of barriers to the use of financial participation were noted, including:

- Employer disinterest
- Too complex
- Lack of role models – there are few good examples
- Lack of expertise in financial participation, both inside and outside, and outside experts are expensive for SMEs
- The alternative savings schemes are easier to understand (save-as-you earn schemes are very popular in the Netherlands)
- There is a lack of fiscal incentives.

Financial participation plans need to be as simple as possible and it has been well proven that companies with broad-based schemes perform significantly better.

It was hoped that financial participation might be stimulated amongst SMEs by the development of a 'Dutch model' by the NPI. This model proposes that, in addition to the European Commission principals, financial participation should be integrated into HR policies. Employees should be involved at an early stage and a minimum of 75 per cent eligibility should be aimed for. Several tax incentives are also proposed. Flexibility is important and the option of giving shares when targets are met is central to the 'Dutch Model'. Maybe there is a need for such a 'core' plan for each EU Member State.

6 Financial participation and SMEs in Poland

Rafal Towalski (Warsaw School of Economics) provided information on financial participation in Polish SMEs. Employee share ownership in Poland comes about from the law on privatisation, which entitles enterprises undergoing indirect privatisation to take up 15 per cent of State Treasury's shares free of charge. Up until late-2007 this right was exercised by 1.64 million employees who took up around €1 billion worth of shares.



In 2009, 1,561 companies (with 130,700 employees) were employee-owned and 76 per cent of these were SMEs. However, managers are buying shares from workers, thus reducing the number of employee share-owners.

With regard to profit sharing, this form of financial participation is very limited in Poland.

7 Financial participation and SMEs in Romania

Petru Dandea (Vice President of the NTUC in Cartel-Alfa) outlined the trade union perspective on financial participation in Romania. He identified several forms of financial participation, such as:

- Mass privatisation. People can own 30 per cent of most industrial companies, with the exception of enterprises in the energy and banking sectors, via two routes:
 - They can acquire shares in one company. Most workers have sold these shares, but those who kept them have done well.
 - They apply to one of three asset management funds – Private Ownership Funds - and receive a dividend each year
- With the special privatisation of bigger companies, employees were entitled to 7 per cent in oil companies and banks
- Share ownership in SMEs, for example, tend to be in 'high human capital firms' with well-educated employees
- Profit sharing (the most widespread form of financial participation) is used in companies where the Government is the largest shareholder. Employees get 10 per cent of profits, with a minimum tax on these payments
- Supplementary pension and health insurance, used in multinationals.

The national Collective Labour Agreement includes a number of principles for financial participation. Plans should be:

- Voluntary for both sides
- Non-discriminatory – equal access for all employees
- Clear and transparent
- Continuity – should be set up for an undetermined period
- Supplement to salary



Furthermore, plans should not restrict mobility – an employee must retain benefits if he/she leaves the company. If there is a growth in share ownership, this principle might need to be re-examined and changed.

However, there is a lack of a specific regulatory framework and employers and employees are not very interested. Employers are not interested, because the restructuring during the 1990s meant that they could easily get skilled labour without the need of additional inducements, while employees don't know much about financial participation. The low level of financial knowledge is a key factor. However, there are signs that interest in financial participation is growing.

At present income tax is at 16 per cent on profit sharing bonuses, but there is no social security contributions charged. However, because of the economic crisis, the Government is proposing to impose social security charges on these bonuses and the trade unions are opposing this proposal.

8 Financial participation and SMEs in Germany

Verena Tobsch (Helmut Schmidt University/Armed Forces University, Hamburg) presented the results of a research project conducted jointly with her colleagues, Simon Fietze and Wendel Matiaske. This study involved a survey of firms with over 150 employees (i.e. covering larger SMEs) to assess the incidence and rationale for financial participation. A further survey of Works Councils was conducted in those firms with financial participation. Profit sharing was found in 31 per cent of firms, compared with employee share ownership in 4.9 per cent. Both percentages increased sharply from the mid-1990s and, in the case of share ownership plans, from 2000. In SMEs profit sharing was found in 27.5 per cent of cases and employee share ownership in just 3.8 per cent of SMEs. It was noted that eligibility for employee share-ownership schemes is higher than that for profit sharing.

The study investigated the determinants of profit sharing and employee share-ownership. It was found that direct participation predicted the use of profit sharing but not employee share ownership. Firms with headquarters outside Germany were more likely to use share ownership schemes. The study also found that 85 per cent of eligible employees participated in share ownership schemes and 66 per cent in profit sharing plans.

The works council element of the study investigated works councils' perceptions of problems



with financial participation. However, they stressed the potential for conflict/competition among employees and rising inequality between staff and supervisors - but 33 to 45 per cent of the work councils surveyed didn't see any problem with financial participation. The main problem in both instances was that employees had little influence on the success of the schemes.

The main conclusions of the study were:

- Financial participation is still insignificant in German enterprises: there is a low incidence and it is less likely in SME's
- Profit sharing and employee share ownership are interrelated
- Motives for businesses to introduce financial participation refer, primarily, directly or indirectly, to positive effects in productivity
- The main rationale for SME's to introduce profit sharing schemes is keeping and protecting human capital
- Obstacles are clearly assessed: it is too expensive, too difficult and too laborious (except for SME's with experience in profit sharing - they have a fear of a loss of sovereignty).

9 Financial participation and SMEs in the European Union

Erik Poutsma (Institute for Management Research, Radboud University, Nijmegen) provided a critical appraisal of financial participation for SMEs organised around five issues:

- *Incidence* He noted that the average incidence of share ownership in SMEs was around 2 per cent and identified a number of contexts in which financial participation might be encouraged in SMEs. These included those with succession problems, those needing key personnel, etc. He suggested that the notion of a financial participation cycle could be useful. SMEs might start by introducing profit-sharing and then move on to employee share-ownership plans, which are more complex and difficult to operate
- *Risk preferences* He suggested that in SMEs the nature of employee risk preferences might influence the type of scheme used. Where employees are highly risk averse, profit sharing might be the most appropriate form of financial participation. Where employees are risk positive, employee share ownership would seem to be appropriate
- *Incentives* Drawing on Klein's three models of ownership effects, he suggested that share ownership, stock options, and profit sharing may have different effects on employee attitudes and behaviour
- *National differences* He emphasised that similar policy objectives across national contexts may give rise to different practices. For example, the UK and France might have the same public policy, but different implementation strategies to reach the same objective
- *Workforce philosophy* He identified the importance of differing workforce philosophies: employees as outsiders, as insiders and as equals and, also, the importance of trust, fairness and transparency in the employment relationship. The various forms of financial participation may have different impacts in relation to these



philosophies. He posed the question as to what happens if the workplace philosophy changes? How can a co-operative workplace philosophy be developed in both employers and employees?

Finally, Dr Poutsma emphasised the importance of aligning HR management systems with the form of financial participation.

Discussion

Dirk Lambach (AGP, Germany), raised the challenge of how to educate for financial participation and partnerships. The teaching of these topics has stopped in German universities and there is an urgent need to get them back into the text books and back on the agenda. The importance of the role of financial knowledge was emphasised and it was suggested that there should be more courses at university across the EU on financial participation. It was noted that there were several courses in France but that they were primarily orientated towards fund management. FONDACT also runs training programmes but it is difficult to find participants to attend - there is very little interest. Other than in the UK (York and Aberdeen), no university courses on financial participation were identified by participants.

David Hildebrandt (IAFP Executive Committee) raised the issue of how far retirement planning should be included in the principles governing financial participation. The general feeling of the participants was that, while there may be intersections between financial participation and pension savings, the two should be kept distinct and separate. This was because the distinctive features of financial participation schemes could be diluted if such schemes were oriented primarily towards retirement planning and because the concentration of employer stock in employee share ownership schemes involved too much risk from a retirement saving perspective.

The discussion also considered how financial participation in SMEs might be further encouraged. The growing importance of the new economy and professional service companies was noted and it was thought that these could be fertile ground for financial participation. The role of financial participation models, such as the Dutch model, was seen as important in helping the development of financial participation schemes in SMEs.



Jean-Michel Content, Secretary-General, IAFP, concluded the seminar with a summing up of the main points. He said that financial participation in SMEs was marginal but potentially important. Cash-based profit sharing was probably best suited to most SMEs. However, the SME sector is highly diverse and different forms of financial participation are suited to different types of SMEs. Employers, employees and trade unions seem to share similar views on the barriers to financial participation in SMEs. However, on the role of Governments, the support of public authorities is essential, in the short term, for long term benefits. Overall, it is important that financial participation is further extended in the SME sector and the IAFP believes that further work on this topic would be well worthwhile.

Andrew Pendleton and

Kevin P O'Kelly

September, 2010



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Third Drafting Seminar

LEIDEN, 9-10 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN SMEs

PARTICIPANTS LIST

<i>Country</i>	<i>Name</i>	<i>September 9</i>	<i>September 10</i>
Belgium	Geert JANSSENS	X	
France	Jean-Michel CONTENT	X	X
France	Paul MAILLARD	X	X
France	Nelly VOYEUX	X	X
Germany	Dirk LAMBACH	X	X
Germany	Verena TOBSCH	X	X
Germany	Marion WECKES	X	X



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Country	Name	September 9	September 10
Ireland	Kevin O'KELLY	X	X
Ireland	George TUTHILL	X	X
Latvia	Raita KARNITE	X	X
Poland	Agnieszka KALISIEWICZ	X	X
Poland	Anna REDA	X	X
Poland	Rafal TOWALSKI	X	X
Romania	Petru Sorin DANDEA	X	X
The Netherlands	Denise BREEDJIK	X	
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The Netherlands	Erik POUTSMA	X	X
The Netherlands	Patrick RIETBROEK	X	
The Netherlands	Dennis VELDHUIZEN	X	X
The Netherlands	Cees VOS	X	
U.S.A.	David HILDEBRANDT	X	X
U.S.A.	Jeff MAMORSKY	X	X
U.S.A.	Patrick RIETBROEK	X	X
U.S.A.	Denis VELDHIZEN	X	X
United Kingdom	Alan CULVERHOUSE	X	X
United Kingdom	Diane HAY	X	X
United Kingdom	Andrew PENDLETON	X	X
United Kingdom	Andrew ROBINSON	X	X
United Kingdom	Ulke VEERSMA	X	X





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Fourth Drafting Seminar ROME, 20-21 September, 2010 THE ROLE OF FINANCIAL PARTICIPATION IN CORPORATE RESTRUCTURING

AGENDA

20 September, 2010

- 08.30 Registration
- 09.00 Welcome - George Tuthill, President, IAFP/AIPF (Chair)
- 09.16 Introduction to the IAFP/AIPF European Union Project
Kevin P O'Kelly, Member of the IAFP/AIPF Executive Committee
- 09.30 Financial participation and corporate re-structuring: a review of the issues
Andrew Pendleton, University of York, UK



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10.00	Overview of Corporate Re-structuring in the European Union <u>Andrea Broughton</u> , Institute for Employment Studies, UK
10.30	Coffee
11.00	Chair: <u>Joe Gerada</u> , Foundation for Human Resources Development, Malta Financial Participation in Corporate Restructuring in Europe <u>Marco Cilento</u> , CISL-SindNova, Italy
11.30	Toward a joint position of social partners: The Italian Code of Employee Participation <u>Francesco Verbaro</u> , General Secretary, Ministry of Labour and Social Policies, Italy
12.00	Round table: Building a European approach to Financial Participation Speakers: <ul style="list-style-type: none"> ➤ <u>Maurizio Petriccioli</u>, Confederal Secretary, CISL, Italy ➤ <u>Jens Lowitzsch</u>, Free University of Berlin (representing the European Economic and Social Council) ➤ <u>Eleni Dapergola</u>, European Commission, DG Employment, Social Affairs and Equal Opportunities ➤ <u>Ottheinrich von Weitershausen</u>, BusinessEurope ➤ <u>Jean Pierre Poulet</u>, Confédération française démocratique du travail, France
13.00	Lunch
14.30	Round table continues
15.45	Coffee break
16.15	Chair: <u>Károly György</u> , National Confederation of Trade Unions / MSZOSZ, Hungary ‘Good practice’ case studies on Financial Participation and Corporate Re-structuring from - <ol style="list-style-type: none"> 1 Bulgaria - <u>Nadejda Daskalova</u>, Chief Researcher and Deputy Director, ISTUR-CITUB/KNSB 2 Greece - <u>Christos A Ioannou</u>, Organisation of Mediation and Arbitration (O.ME.D)
17.30	End of day
19.30	Dinner



21 September, 2010

09.00 Chair: David A Hildebrandt, IAFP/AIPF, USA

'Good practice' case studies on Financial Participation and
Corporate Re-structuring (continued)

- 3 Hungary – Dorottya Boda, Institute for Social Policy and Labour
- 4 Malta - Jimmy Magro, Executive Secretary, Local Government
Association

10.30 Coffee break

11.00 Strengthening Financial Participation and Social Dialogue

Chair: Maurizio Petriccioli, Confederal Secretary, CISL

Speakers:

Financial participation in SMEs

Riccardo Giovanni, Industrial Relations Director, Confartigianato

Employee participation in public utilities

Anna Maria Furlan, Confederal Secretary, CISL

On. Gianni Alemanno, Mayor of Rome

Members of the Italian Parliament

On. Benedetto Adragna, Member of XI Commission Labour and Social
Protection- Senato della Repubblica

On. Tiziano Treu, Vice President XI Commission Labour and Social Protection
- Senato della Repubblica

On. Maurizio Castro, Member XI Commission Labour and Social Protection -
Senato della Repubblica

On. Pietro Ichino, Member XI Commission Labour and Social Protection -
Senato della Repubblica

12.30 Summing up and conclusions – Jean-Michel Content, Secretary
General, IAFP/AIPF

Closing of seminar by Raffaele Bonanni, General Secretary, CISL

13.00 Lunch – End of Seminar



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Fourth Drafting Seminar

ROME, 20-21 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN CORPORATE RE-STRUCTURING

DISCUSSION PAPER

1 Introduction

The International Association for Financial Participation (IAFP) has been funded by the European Commission to undertake a EU-wide project into various aspects of employee financial participation, during 2010.

Financial participation, in the form of share ownership by employees, either individually or through share ownership plans such as ESOPs, has been a feature of employee participation in the EU for many years. While financial participation has been supported in some countries through tax incentives and other forms of legislation, there is a wide divergence in approaches to be found between the Member States. There is also concern within the European Commission that costs and administrative complexities in Member States have hampered the introduction of financial participation schemes across the EU.



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Financial participation has been the focus of attention by the European Commission since the publication of the two PEPPER reports in 1992 and 1996.⁹⁴ More recently, in an effort to move the issue forward, the Commission published a Communication in 2002⁹⁵ on a framework for the promotion of employee financial participation, which set out key principles for financial participation schemes. Opinions drafted by the European Economic and Social Committee and a European Parliament resolution further underline the importance of financial participation, particularly in relation to small and medium sized enterprises (SMEs).

Following the publication of this Communication, a High-level Expert Group, chaired by Jean-Baptiste de Foucauld, French Ministry of Economics, was set up by the European Commission and this body published its report in 2004. It identified a range of transnational barriers that obstruct the introduction of financial participation schemes in companies with subsidiaries and operations across the EU.

One of the key recommendations of the High-level Expert Group was that a *Model Plan for Financial Participation* be drawn up, and that this *plan* would

*... serve to remove barriers and also promote cross-border financial participation. ... it might streamline a blueprint for the main types of financial participation. It should be available to any enterprise, even if its activity is currently restricted to only one Member State, in order to prevent enterprise having to adapt their plans if they expand across the EU.*⁹⁶

The IAFP undertook to draft this Model Plan for European enterprises that are interested in introducing financial participation arrangements for their employees. This Model Plan was launched at a conference in Brussels in September, 2005.

⁹⁴ European Commission *Proposal for a Council Recommendation concerning the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(91)259, Brussels, 1991; and *Report from the Commission: PEPPER II: the Promotion of Employee Participation in Profits and Enterprise Results (including equity participation) in Member States* COM(96)697, Brussels, 1996.

⁹⁵ European Commission *Communication from the Commission to the Council, the European Parliament, the Economic and Social Committee and the Committee of the Regions on a Framework for the Promotion of Employee Financial Participation* COM(2002)364, Brussels

⁹⁶ European Commission *Report of the High Level Group of Independent Experts on cross border obstacles to financial participation of employees for companies having a trans-national dimension* Brussels, 2004: Recommendation 4.3.2.4



2 New Project

The IAFP has now received further funding from the European Commission to undertake a further study into aspects of financial participation. The project will review key issues related to financial participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the IAFP and from the Model Plan.

This project will focus, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs
- The role of financial participation in corporate restructuring

The project will also take stock of what progress has been made since 2005 in tackling the obstacles identified by the High-level Expert Group and will make further recommendations to the European Commission for the further diffusion of employee financial participation in enterprises operating within the EU.

The focus of the Model Plan was on schemes that are more common transnationally within the EU, namely:

- Free shares or share based profit-sharing;
- Share purchase schemes;
- Stock options.

Consequently, the focus of this new project is also on these forms of financial participation.



It is a truism in business strategy that 'change' is a continuing process. Change is seen in terms of, for example, the introduction of new management techniques, of automation and the use of information/communications technologies, the employment relationship and the need to continually innovate. Competition, a continuous downward pressure on prices and the fight for business survival in an ever-increasing globalised marketplace continually challenge businesses, management and workers.

The impact of change on employment levels is an issue of concern to management, trade unions and the political establishment. In particular, in times of major economic recession, enterprises are under increased pressure to increase productivity, rationalise and cut costs, all at the same time, so as to minimise the impact of the fall-off in demand on employment levels and workers' standards of living.

Referred to as 're-structuring', enterprises have been finding ways, within the context of their market situation, to balance the costs of production with the competitive challenges and the need to stay profitable and retain market-share so as to ensure long-term viability.

Faced with the challenges of the current business environment, for a successful re-structuring of a business, a joint vision of the medium to long-term future of the enterprise is required. It is essential for all stakeholders – shareholders, management, the workforce and its representative organisations – to be part of the development of and to buy into a re-focused strategy for the future. This requires strong leadership and tough decision-making, in particular by senior management and workers' leaders.

However, both management and trade union leaders are, very often, faced with difficult choices in negotiations. In a crisis situation trade union leaders are in a weak position when faced with proposals from management for a reduction in job numbers, changes to the conditions of employment, including pay cuts or changes in working time arrangements. They will strive to preserve as many jobs as possible in a down-sizing situation and protect the incomes of remaining workers. Forced into these 'concession bargaining' dilemma, it is inevitable that negotiators have to take the long-term view on the future of the enterprise and make short-term concessions to ensure its survival and the security of jobs.



However, when job losses are part of the re-structuring mix, it can be difficult to find a consensus, but it can also open the way for greater levels of co-decision making and joint responsibility, including greater employee participation, as well as financial participation, to ensure the preservation of viable employment, in the short-term, with the prospect of expansion in the medium to long-term.

4 Re-structuring tools

In an era of substantial corporate re-structuring, a number of approaches have been put in place to counteract the worst affects of the current economic recession, some straight forward, others more innovative. Some examples of re-structuring tools are:

Reduction in employment has been the main approach to re-structuring businesses in recent years. Cutting jobs and, consequently, reducing labour costs, has been the main route to survival for many enterprises. In other cases, where it has not been easy to reduce employment numbers, or inadvisable because the loss of expertise would impact on the continued viability of the enterprise, the terms of employment have been renegotiated, including reductions in pay levels, reductions in working hours and/or changes in shift working arrangements.

The European Foundation Re-structuring Monitor (ERM) has noted that, while there has been an increase in re-structuring cases involving job losses in the six months from October, 2009, to March, 2010, in many cases a co-operative approach between management and trade unions has allowed enterprises to adapt productivity to the current economic challenges, while minimising the detrimental impact on employees.

Faced with the undesirable prospect of job losses, many labour organisations have acted to ensure that as few of their members as possible are forced to leave. ⁹⁷

Another approach taken to cut labour costs has been the use of early retirement and the non-replacement of retiring workers, or their replacement by workers on more flexible employment contracts. However, this approach also has implications for corporate pension funds, where these exist.

⁹⁷ *Industrial relations and re-structuring: some recent cases* European Foundation for the Improvement of Living and Working Conditions, Dublin, Info Sheet (EF/10/49/EN), 2010.



According to the European Company Survey (ECS), 2009, Ireland, Latvia, Estonia and Hungary have seen major reductions in employment over the past three years.⁹⁸

Pay and wage flexibility has been a crude and sharp re-structuring tool used by many companies, even in the face of opposition from workers and trade unions. Companies continually evaluate its pay and benefit structures against its competitors within its particular business sector, taking into consideration the need to motivate and retain key staff within the enterprise. However, wage levels and labour costs are a traditional early means of re-structuring.

Pay cuts have been used extensively in the Public Sector across many EU Member States. Such income flexibility is often introduced in conjunction with a performance-related element included into a worker's, or the work-team's, income, or with some form of profit-sharing or share ownership arrangement.

The ECS found that 'a third of establishments with 10 or more employees use elements of pay that depend on individual performance, be it for all employees or only for some of them', while 19 per cent of establishments have pay related benefits based on the performance of the work-team.⁹⁹

The survey also noted that

*It appears that establishments that reward performance are doing better than companies opting for more traditional methods.*¹⁰⁰

Contract flexibility, such as the employment of temporary and part-time workers or of workers on fixed-term contracts, has also been used to control labour costs and to provide greater flexibility in meeting fluctuating demand for products and services. Indeed, in many enterprises part-time employment has been the first to be reduced or eliminated in attempts by management to preserve full-time jobs, while in others there has been an increase in temporary employment to replace permanent full-time jobs.

⁹⁸ *European Company Survey, 2009: Overview* (ECS) European Foundation for the Improvement of Living and Working Conditions, Dublin, (EF/10/05/EN), 2010

⁹⁹ Ibid.

¹⁰⁰ Ibid



Apart from a normal, full time employment contract, under which some 78 per cent of the EU employees work, some 18 per cent of employees work part-time and another 14 per cent have fixed term contracts across the EU.¹⁰¹

Change in the organisation of work can also reduce costs and make enterprises more competitive. It may require a re-appraisal of how the business is structured and managed. It may also require changes in the supply-chain and in the distribution of products and services to efficiently target customers, thus impacting on other organisations. It also often involves capital investment in new technologies and/or investment in re-training and up-skilling employees to implement new work organisation arrangements and improve the quality of the product/service.

Reduced working hours and a pro-rata reduction in labour costs is a re-structuring tool used frequently over the years. It preserves jobs and the expertise of the workforce, while ensuring the retention of key employees in anticipation of an up-turn in business. Indeed, there are a number of innovative variations on the reduction of working hours, such as introducing 'working time banks' or 'working time accounts', allowing for cuts in working hours at times when there is low demand and increased working hours when demand picks up.¹⁰² There have also been examples of changes to shift working, by the introduction of longer shifts during busy production periods, and a greater use of overtime to compensate for a reduced workforce, in Germany, the Netherlands and the Nordic Member States.¹⁰³

As a final and probably the most extreme form of corporate re-structuring is through *mergers, divesting, re-location and out-sourcing*:

- In a globalised economy and with the growing dominance of multi-national companies in many business sectors, mergers of companies can lead to savings in 'back-room' services, research, marketing, distribution and other key aspects of a business, and a rationalisation of formally competing products. It can also result in the merger of production sites and, consequently, job losses because of plant/office closures.
- Another approach to re-structuring is for an enterprise with financial and cash-flow problems to sell off parts of the business to raise capital and to ensure the survival of the core business. These divested parts of the business might be incorporated into another enterprise or 'asset-stripped' and closed down. Either way, this approach will result in job losses.

¹⁰¹ *Employment in Europe 2009* European Commission, DG Employment, Social Affairs and Equal Opportunities, Brussels, 2009.

¹⁰² According to the ECS, this approach is most common in the Nordic Member States and in Austria, Germany and the Czech Republic.

¹⁰³ *ibid*



- In particular in manufacturing, the closure and re-location of production and assembly plants to low-cost countries/regions, while expensive to implement, can result in major labour cost and production savings for enterprises in the medium to long term. The ERM found that 'labour costs are an important factor in determining location decisions, although it seems that other factors also play a significant role.' It also found that the main reason companies relocate from the EU-15 to any of the new Member States is almost always to improve competitiveness by moving to lower wage areas. However, in the case of component suppliers serving larger manufacturers, an important secondary factor is the need to locate their production facilities close to their main customers, many of who will already have relocated to such low cost regions.¹⁰⁴
- Another form of re-structuring is the out-sourcing to contractors of non-essential elements of the production process, or back-up services. Again, these re-structuring tools have an impact on jobs and employment levels in the country/regions where the plant closure happens, or in the sections/departments of an enterprise where the out-sourcing of particular jobs happens, with the knock-on effect on the former workers, their families, and local communities.

A European Foundation info-sheet notes that:

*While re-structuring is often analysed mainly for its immediate affects on employment numbers, another way of seeing it is a chance for companies to outline a vision for the future. Fortunately, companies of all kinds and sizes across the EU have overwhelmingly tended to realise that whatever economic challenges arose between late 2008 and early 2010, their future interests are best served by retaining as many workers as possible and ensuring that the needs of departing workers are provided for accordingly.*¹⁰⁵

5 Financial Participation and Re-structuring

Financial participation may assist in the process of restructuring and help to secure results that are beneficial to all stakeholders, especially employees. In general, consideration of the features of the various forms of financial participation, and of the extant evidence, suggests that employee share ownership may be more effective in these respects than cash profit sharing or stock options.

¹⁰⁴ See www.eurofound.europa.eu/emcc/erm/studies/tn0810026s/tn0810026s_5.htm and www.eurofound.europa.eu/emcc/erm/studies/tn0803056s/tn0803056s_3.htm

¹⁰⁵ European Foundation Info Sheet (2010), op cit.



In general, financial participation may assist the process of restructuring in several ways:

- it may obviate the need for 'crisis' restructuring by facilitating continual adaptation to product market conditions and high levels of performance
- It may lay the conditions for successful restructuring via the encouragement of employee commitment, motivation and engagement
- It may facilitate the process of restructuring itself.

Indeed, firms with financial participation arrangements in place may have less need to engage in restructuring because financial participation contributes to superior performance. There is now a substantial body of evidence from the US, UK, Europe and beyond to suggest that firms with financial participation have higher productivity. Although there have been few direct comparisons between the types of financial participation, the balance of evidence suggests that profit sharing may be most effective,¹⁰⁶ possibly because employees value cash more highly than shares and because profit sharing schemes usually benefit all or nearly all employees, whereas only a minority of employees may choose to participate in an all-employee share scheme.

However, it is difficult to empirically assess the possibility that financial participation precludes the need for restructuring because performance is generally better. We cannot tell whether firms with financial participation would have needed to restructure if financial participation had not been present and even firms that perform well may need to restructure if there is a dramatic change in product market conditions.

There is, however, evidence to suggest that firms with high performance work practices, which include financial participation, have a higher capacity to implement both process and product innovations.¹⁰⁷ Unfortunately, most of the research in this area does not explicitly test the role of financial participation.

It seems likely that financial participation may facilitate innovation in several ways. First, it may encourage supportive employee attitudes and behaviour, including high levels of trust, employee commitment, engagement and a willingness to be flexible. It may also encourage 'peer pressure' and 'mutual monitoring' whereby employees encourage each other to behave in positive ways. There is now a large body of literature that finds positive effects of financial

¹⁰⁶ C. Doucouliagos (1995) 'Worker participation and productivity in labor-managed and participatory capitalist firms: a meta analysis' *Industrial and Labor Relations Review* 49: 58-77.

¹⁰⁷ J.Michie and M.Sheehan (2003) 'Labour market deregulation, flexibility and innovation' *Cambridge Journal of Economics* 27: 123-143



participation in these respects.¹⁰⁸ Nearly all of this literature assesses the role of employee share ownership plans, with very little research conducted on the effects of profit sharing. A limitation of the share ownership literature is that it often does not clearly differentiate between ‘free’ shares and subscription-based schemes: in the case of the latter, favourable employee attitudes may determine participation in the scheme rather than vice versa.

Financial participation also has the capacity to attract high quality employees and may encourage innovation and adaptation. It can also boost remuneration above market levels thereby enabling firms to attract better quality employees (‘efficiency wages’), while not adding to fixed wage costs. Profit sharing is likely to be most effective in such cases, as it is more clearly linked to wages than other forms of financial participation.

Financial participation may also help to attract employees who have lower risk aversion and hence are more emotionally capable of responding positively to change.

Should significant restructuring, involving changes to employment and working practices, become necessary, financial participation may have a significant role to play in achieving successful outcomes for all concerned. It can function as a guarantee to the workforce that, should they make sacrifices for the good of the company, they will share in the benefits when the company recovers.¹⁰⁹ For instance, workers may agree to a pay freeze or even pay reductions in return for future profit shares or company stock.

Employee share ownership is probably more effective than other forms of financial participation in facilitating major restructuring.¹¹⁰ Share ownership provides a ‘cast iron’ guarantee that employees will share in future upturns, because of the legally-protected status of share certificates, whereas managers could renege on profit sharing. Furthermore, unlike stock options or profit sharing, share ownership should provide for ‘employee voice’ in governance. The effectiveness of this, however, is likely to depend on the scale of the employee stake and the capacity of employees to collectively mobilise their interests. Small employee stakes and a lack of ‘voice’ is unlikely to provide the degree of protection against managerial opportunism that may be required to achieve successful restructuring.

¹⁰⁸ See, for example, D.Kruse, R.Freeman, and J.Blasi (2010) *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-based Stock Options*. Chicago: National Bureau of Economic Research

¹⁰⁹ M.Blair (1995) *Ownership and control*. Washington DC: Brookings Institution.

¹¹⁰ See A.Pendleton and A.Robinson (forthcoming) ‘Employee share ownership and human capital development: complementarity in theory and practice’ *Economic and Industrial Democracy*



For this reason, the form of financial participation that is most obviously associated with major company restructuring is substantial or even majority employee share ownership. Examples include the transition to employee ownership in United Airlines in the 1990s,¹¹¹ and the widespread transition to employee ownership in the British bus industry in the 1990s.¹¹² In both cases, the position of incumbent operators was threatened by deregulation, allowing low-cost competitors to enter the market. The incumbents needed to restructure their employment practices to reduce labour costs. Both were highly unionised and able to mount opposition to restructuring. The provision of substantial share ownership helped to demonstrate managerial good faith, thereby securing workforce and union acceptance of major changes to employment practices.

A more recent, but less dramatic example, concerns British Airways' pilots. In 2009 they agreed to a 'shares for pay cuts' deal whereby they took a pay cut of 2.6 per cent and a 20 per cent reduction in some allowances. The General Secretary of the pilots' trade union – BALPA – commented that 'as a union we would share the pain if our members shared in the gain'.¹¹³

These kinds of deals may both be more necessary, but also more likely, to take place in highly unionised companies. Union representation provides the degree of employee coordination to enable such deals to be developed and agreed. However, where financial participation helps to bring about pay cuts, it conflicts with trade union (and European Commission) principles that financial participation should not be used for pay substitution. These deals also transfer significant risk to employees which also conflicts with typical trade union views on financial participation.

However, some unions clearly take a pragmatic position when substantial restructuring is clearly necessary. There is no clear evidence on what kind of unions are more likely to sign financial participation deals in these circumstances. Even unions that are ideologically opposed to financial participation may, nevertheless, take a pragmatic view in practice.¹¹⁴ It

¹¹¹ J.Gordon (1999) 'Employee stock ownership in economic transitions: the case of United and the airline industry' in M.Blair and M.Roe (eds.) *Employees and Corporate Governance*. Washington DC: Brookings Institution.

¹¹² A.Pendleton (2001) *Employee Ownership, Participation, and Governance*. London: Routledge.

¹¹³ Daily Mail 14 July 2009

¹¹⁴ A.Pendleton and E.Poutsma (2004) *Financial Participation: The Role of Governments and Social Partners*. Dublin: European Foundation for the Improvement of Living and Working Conditions



has been suggested that employee ownership is more likely where workforces are relatively homogenous, because the costs of coordinating employee interests are likely to be lower.¹¹⁵ On this basis, unions that represent a single group of occupations may be more likely to enter into 'financial participation for restructuring' deals.

The most dramatic instances of restructuring are those where ownership itself is restructured through mergers and acquisitions. Where a company is taken over, provision of a financial participation scheme may help to generate identification with the new owner by transferred employees. In the case of private equity takeovers, there is typically a concern to provide employees with incentives to promote the success of the company. Share ownership schemes are often substantial in such cases, though regulatory issues may prevent the use of tax-approved schemes (as in the UK). Finally, in the case of share ownership schemes in companies that are the subject of a take-over, financial participation provides a degree of insurance for the employees. They will have access to information concerning the takeover (which may exceed that provided to them as employees), they may have a vote on the take-over proposal and they will benefit from the premium that normally accrues to shareholders of acquired firms.

6. Questions for the seminar

1. How can financial participation assist companies to restructure in a way that benefits all stakeholders?
2. What is the relative efficacy in this respect of the various forms of financial participation?
3. What conditions need to be satisfied for financial participation to contribute to successful restructuring?
4. Does financial participation have any adverse effects in the context of restructuring?
5. How well do the European Commission principles governing financial participation function in cases of restructuring? Do they need to be modified?

Andrew Pendleton, University of York and

Kevin P O'Kelly, IAFP Executive Committee

September, 2010

¹¹⁵ H.Hansmann (1996) *The Ownership of Enterprise*. Cambridge MA: Belknap Harvard





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Fourth Drafting Seminar

ROME, 20-21 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN CORPORATE RE-STRUCTURING

REPORT OF THE SEMINAR

The fourth drafting seminar of this project was held in Rome on 20-21 September, 2010. It was organised by the IAFP in conjunction with SindNova and CISL. The seminar was attended by some 50 practitioners and experts from Italy, Bulgaria, France, Ireland, Germany, Greece, Hungary, Latvia, Malta, Poland, Romania, the UK and the USA. It was also attended by representatives of the European social partner organisations and the European Commission.

1 Opening remarks

The President of the IAFP, George Tuthill, welcomed the participants to this working seminar, which would explore the issue of financial participation in corporate restructuring.



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FINAL REPORT

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Kevin P O'Kelly, member of the IAFP Executive Committee, outlined the background and objectives of the project and, within the context of the overall project, the specific objectives of this seminar. He said that the seminar would discuss how financial participation could contribute to corporate re-structuring, in particular in the present global economic crisis. The discussion paper, which was circulated in advance of the seminar, outlined the issues and posed a number of key questions on how financial participation arrangements might contribute to the change programmes within enterprises. The idea is that this paper would be the basis for an exchange of views by participants in the seminar. The paper was jointly drafted by Prof Andrew Pendleton and Kevin P O'Kelly

- 2 Andrew Pendleton, University of York, UK outlined the main content of the discussion paper. The pressures for corporate restructuring, and the employment effects of restructuring were outlined. The latter typically include reductions in employment, pay flexibility, changes in work organisation, and changes to working hours.

It was suggested that financial participation might play a role in relation to restructuring in three ways

- By obviating the need for restructuring because firms with financial participation tend to perform better
- By laying the conditions for successful restructuring, financial participation may lead to more flexible and positive employee attitudes, may attract more motivated and better quality workers, and may attract workers with lower risk aversion. It was noted that there is some evidence that firms with financial participation have a higher capacity to innovate.
- Financial participation may be introduced during restructuring to encourage trust and cooperation and to form part of a concession bargaining package.

Focusing on the introduction of financial participation in restructuring, it was noted that share-based schemes might be especially effective as they provide a better guarantee that workers will share in the benefits of any future upturn. They might also give employees 'voice' on organisational strategies and policies. Some examples of this include United Airlines, the British bus industry in the 1990s, British Airways in 2009 and the German auto industry.

It was noted that the introduction of financial participation during restructuring may be found primarily in highly unionised industries where managers cannot restructure unilaterally and where unions help to co-ordinate employee 'voice'. These cases tend to be high-wage companies where employment conditions are threatened by the entry of low-cost competitors.



However, the use of financial participation during concession bargaining may conflict with the principle that financial participation should not substitute for core wages. There is also a danger that employees may be exposed to a high level of risk. Hence diversification and financial education are also necessary.

Five questions were posed to guide discussions during the seminar

- How can financial participation assist companies to restructure in a way that benefits all stakeholders?
- Which forms of financial participation work best in this respect?
- What conditions need to be satisfied for financial participation to contribute to successful restructuring?
- Does financial participation have any adverse effects in the context of restructuring?
- How well do the Commission principles on financial participation work in the context of restructuring? Do they need to be modified in any way?

3 Andrea Broughton, Institute for Employment Studies, UK

This presentation provided an overview of corporate restructuring in the EU. It is based on work undertaken for the European Foundation (Dublin) European Restructuring Monitor (ERM).

She outlined the current economic situation in the Member States, which indicates tentative growth returning and unemployment stabilising. However, growth in the EU remains behind the US. Employment has stabilised at around 10 per cent in the EU, three percentage points higher than in 2008. Data was provided showing unemployment rates in each Member State.

While re-structuring is an ongoing feature of business life, data from the ERM for the second quarter of 2010 (1 April to 30 June) showed that there were 214 cases of restructuring, of which 141 involved job loss. The total number of announced job losses were around 51,000 and the total number of announced jobs created was just under 25,000. Specific examples of job losses, such as those taking place in Royal Bank of Scotland, Telecom Italia, and the Polish Army, were outlined.



It was noted that the incidence of short-time working has significantly increased in some EU countries, especially Austria and Germany. It provides a good way of ensuring that companies retain skilled employees.

The presentation looked, in detail, at the impact of the economic recession on the car manufacturing and airline sectors and how a number of companies in these two sectors were re-structuring. In the case of cars, recovery seems to be occurring and many firms are now re-hiring. Priority in re-hiring tends to be given to employees made redundant as a result of the crisis.

In airlines, most major European airlines have been cutting jobs and, in some cases, pay. This is due to the impact of low cost competition as well as the economic crisis.

4 Financial Participation in Corporate Restructuring in Europe

Marco Cilento, CISL-SindNova, Italy

Corporate restructuring often spreads its effects on employment and conditions of work suddenly or in a longer term. That is why corporate restructuring draws the attention of employees and trade unions that claim to be engaged on strategic decisions made by either managers or shareholders.

The movement of capital and dialogue with investors, therefore, becomes of overwhelming interest for all employees that want to preserve their rights, to be aware of their future, be well remunerated and share in the wealth created by the production they have contributed to. This new frontier of industrial relations includes rights and opportunities that are often named under the general expression of *Economic Democracy*.

EU legislation does not start from scratch. EU Directives reforming company law, adopted in the new millennium, are exploring forms of economic democracy. Although limited to specific cases, EU law opts for a legalistic approach, while referring the economic outlook to soft-law initiatives in the field of employee financial participation.



Economic Democracy can be detected in those measures that entitle employee representatives to be involved in decisions concerning financial aspects of their companies, to submit questions to the general assembly of shareholders, to receive information in good time and with a content equal to that provided to shareholders and to address decisions that normally fall in the area of shareholders' responsibility.

The problem arises when the EU recognises the right of employees to be engaged in certain corporate decisions without a unique and wide-shared strategy, reducing or widening the extent of employee involvement in each single act. Experience shows that employees rarely exercise their rights in cases of corporate restructurings. On the contrary, there is some evidence that such rights are fully exercised in companies where employees are involved in financial participation schemes. Here, a correlation can be found.

As we have seen, Europe does not start from scratch. If European institutions would have the capacity to establish a coherent and comprehensive framework of rules and practices on employee engagement in corporate restructurings, then Social Europe would enjoy a new economic democracy dimension in which sustainable economic growth would provide a synergy with the enhancement of social cohesion.

5 Roundtable

Eleni Dapergola (European Commission, DG Employment, Social Affairs and Equal Opportunities) outlined the reasons why the Commission has supported financial participation. She noted that for financial participation to work schemes should be

- Voluntary
- Open to all
- Additional to fixed wages

Even so, there was the issue of risk bearing by employees and this could not be ignored.



Otto Heinrich von Weitershausen, BusinessEurope and BDA, Germany:

Shareholding schemes are for individual companies to decide on and this depends on national practice. Member States should provide a favourable fiscal and financial framework for the introduction of financial participation.

European employers are in favour of financial participation.

In Germany, there are different levels of co-determination and financial participation is just one level. Profit sharing schemes have found their way into collective agreements for jobs. Another issue is the constitutional right to property which is a problem for the dissemination of financial participation.

The problems of operating financial participation across borders had become a blockage to the free movement of labour between EU countries. For instance, the timing of tax liabilities for stock options differs considerably between member states. Better coordination of national taxation is needed. One solution might be to tax individuals according to the tax rules of their country of origin rather than the country they are currently working in.

He noted that from 2003 on German unions have, in some circumstances, entered into concession bargaining whereby unions give wage concessions in return for guarantees of no lay-offs. A question from the floor noted that IG Metal was proposed trade union concessions in return for 10 per cent of the equity at Opel and some influence on the supervisory board and possibly on the Board of Directors. Mr von Weitershausen noted that there were some issues relating to taxation, such as - who will be involved? What will happen to codetermination?

In answer to further questions from the floor he emphasised that works councils do not negotiate remuneration but may have a role when financial participation supplements negotiated wages.



Jean Pierre Poulet, Confédération Française Démocratique du Travail (CFDT), France:

Since 1958 profit sharing in France has been a legal requirement in all enterprise with more than 50 employees. The CFDT has re-defined financial participation to reflect the interests between capital and labour.

For the CFDT, financial participation is important across a range of workplace issues – pensions, savings, etc. It proposes to work further on financial participation but it is necessary to understand the economic principles – ‘don’t put all your eggs in the one basket’!

As trade unionists we need to go beyond the conflict between capital and labour. We need to see and influence how workers’ savings are to be invested. Workers’ savings need to be used to help develop SMEs. This is a CFDT priority.

With regard to employee share holding, it is very difficult for workers to make a point at the general assembly of shareholders. Instead workers can influence management via banks who hold funds in the company. Regular dialogue with institutions holding workers’ savings takes place – this provides indirect dialogue with corporations. These intermediaries play a major role.

The CFDT is sceptical of direct worker shareholder democracy because individual workers shareholders lack power and, instead, the CFDT affiliate unions value indirect democracy. Trade unions are a good vehicle for this, as it can force written reports from management in advance.

In answer to a question about the role of financial participation in restructuring, M Poulet suggested that financial participation does not improve the position of employees in restructuring because of the dual role of employee shareholders. However, savings funds can be used to assist SMEs in distress.

The CFDT would support the establishment of a EU-wide trade union shareholders fund.



Discussion:

It is not possible for workers to change corporate strategies through the general assembly of shareholders. Action needs to be taken by other intermediaries, for example, through employees-owned pension funds

The CFDT believes that the European Commission is a political power and, therefore, it needs to encourage financial participation. This should be done through the trade unions. There is nothing worse than sending out different messages.

An inter-sectoral committee was set up in 2002 that included all the trade union confederations, except Force Ouvrière. While the various trade union confederations have different perspectives, they have worked together and have reached common joint positions on a range of issues.

6 'Good practice' case studies on financial participation and corporate restructuring

Nadejda Daskalova, Chief Researcher and Deputy Director, ISTUR-
CITUB/KNSB (Trade union institute), Bulgaria

The economic crisis has had an adverse impact on almost all business sectors. The social partners agreed an anti-crisis package in 2009-10 but the government failed to implement it. The impact of the crisis is shown by a variety of indicators.

- 56.2 per cent of enterprises got worse-off in past 6 months
- 76.7 per cent of enterprises decreased sales
- 14 per cent increased temporary workers
- 57 per cent decreased permanent workers
- 25.5 per cent increased spending on R & D
- 61 per cent delayed payment of taxes



Company restructuring has included the following:

- Reduction of jobs (the main response)
- Early retirements
- Pay cuts
- Part-time working (supported by a State compensation scheme)
- Out-sourcing
- Projects under the Operational Programme of the EU
- Flexible working time, including paid and unpaid leave and lengthening of shifts

Financial participation in Bulgaria:

Employee share ownership was developed during privatisation from the late 1990s. A voucher scheme was used in 1996. There were about 1400 management-employee buy-outs (MEBO) in 1993-2001. The proportion of MEBO in privatisation deals fell between 1998 and 2000. These buy-outs were possible under preferential terms, i.e. a discount of 10 per cent of price, a deposit of 10 per cent and payment of the balance (90%) over 10 years. Many of the MEBO were not successful, but some are still operating well. Managers bought out the workers' shares in many cases

There is no specific legislation promoting financial participation in Bulgaria. The preferential terms of employees in privatisation initiatives were removed from 2002. There is little confidence in financial participation due to low confidence in shares and in the stock market and as a result of the privatisation process. There is also a lack of money due to wage cuts and employment insecurity. As a result, financial participation is not suitable for a period of crisis.

The European Working Conditions Survey, undertaken by the European Foundation, Dublin, found that in Bulgaria, 7.6 per cent of enterprises had profit sharing arrangements and 3 per cent had share ownership schemes.

In 2007 a Code for Corporate governance was established, along with a commission on corporate governance. There is also interest in Corporate Social Responsibility programmes (CSR).



A number of examples were provided of companies with share ownership schemes, for example, Investor BG where employees own 30 per cent of shares.

The employers are not so keen on financial participation because it may increase worker 'voice'. However, the trade unions support the introduction of financial participation but see it as a way of increasing incomes rather than 'voice'.

Christos A Ioannou, Organisation of Mediation and Arbitration (O.M.E.D), Greece

There are behavioural and structural limits to the promotion of financial participation in Greece. In southern Member States the civil law does not allow for one-tier corporate structures and there is also an adversarial approach to industrial relations. Although there has been some national level social dialogue from mid-1990s to mid-2000s, plant level IR is mainly adversarial. There is little tradition of employee involvement. Therefore, employee involvement is weak.

Another factor is that 99.9 per cent of enterprises in Greece are SMEs.

The economic crisis and the refinancing arrangements have created more barriers to social partnership. Nevertheless, during the economic crisis and the introduction of the Emergency Financial Plan, the two major trade unions confederations, the General Confederation of Greek Workers (GSEE) and the public sector confederation (ADEDY) signed a new General Collective Agreement. This agreement includes a pay freeze and an incomes policy. It also includes a clause to promote profit sharing.

However, there has been substantial corporate re-structuring in Greece, including employment reductions, pay cuts, changes in work organisation, changes to working hours etc. Job cuts are the big issue and financial participation is not on the agenda of the social partners. Nor is it on the agenda of the IMF or the ECB. Both employers and trade unions are indifferent to financial participation. In fact, the Government has increased taxes on payments resulting from profit sharing and from share schemes from 25 per cent to 40 per cent, which is now a major disincentive to financial participation.



Dorottya Boda, Institute for Social Policy and Labour, Hungary

Some of this presentation was based on the PEPPER III Report and the data on profit sharing is taken from the Industrial Wage Survey of the Hungarian Public Employment Service.

Profit sharing is often not a regular (monthly) paid bonus and hence may not be seen as profit sharing. Between 2000 and 2008 company performance-based pay decreased. In 2008 around 50 per cent of employees received a half-month's wage as an annual bonus.

The following data on financial participation comes from the Labour Force Survey, 2009:

- 0.4 per cent of enterprises have stock option plans, covering some 3 million workers
- Of those employees who purchased stocks:
 - 34 per cent work in the manufacturing sector and 44 per cent in the business services sector
 - 47 per cent work for private-owned and 19 per cent for State-owned companies
 - 22 per cent work in small or micro companies
 - 32 per cent in medium-sized companies
 - 27 per cent in large companies
 - 32 per cent are employed in the Central Hungarian Region.

ESOPs were introduced as part of the privatisation process, but since then their use has dramatically decreased. When repayments were completed, ESOP trusts ceased to operate and employees who became individual owners preferred to have the cash to retaining shares. The preference of enterprises has changed to stock options during the economic crisis.



The Employee Benefit Programme (EBP) was established in 2003, which includes the following incentives:

- A certain amount of the income from selling of the shares is not taxable, if they are sold after the vesting period
- Companies affected were, from the start, subsidiaries of five or six of the big multinational companies operating in Hungary
- Such programmes are broad-based: the managers could only take part to a limited extent
- The average acquisition is €80-€110 in the smaller firms and in manufacturing companies
- However, qualified employees consider the programme as an investment and the average acquisition is between €1100 and €1800 (The average monthly wage is €800).

Firms with Employee Benefit Programmes tend to be subsidiaries of large multinational companies, operating in financial and public services, and tend to have highly qualified young, white-collar employees. In contrast, enterprises with ESOPs tend to be SMEs, owned domestically, employing skilled blue-collar workforces.

In 2005 a study of the performance of companies with financial participation schemes in place found that:

- Measured on a number of performance indices, such as revenue, profitability and productivity, their performances have decreased since privatisation but, on average, to the same degree as in non-financial participation enterprises
- Financial indices have reduced, but companies with ESOP schemes were able to repay their credit, used for financing buy-out
- Employment decreased, but to a lesser extent than in the average in SMEs,
- Enterprises with financial participation plans paid the average wages much like other firms with similar activities and in the same locations
- Those companies that had already paid back their credit, paid dividends the employee share owners.



With regard to corporate re-structuring, a case study-based research project was undertaken by the Institute for Social Policy and Labour, in 2009, on the performance of Hungarian companies during the economic crisis. It found a number of strategies were applied by the enterprises studied:

- Numerical flexibility: A decrease in jobs through lay-offs, the termination of temporary employment, reductions in the labour reserve within the firms, etc.
- Working-time flexibility: A reduction in working hours
- Work organisations flexibility: The transformation or re-structuring of work organisation, such as stopping the product line or a reduction in the number of shifts. The organisation of work has also been made more flexible by merging jobs, the re-allocation of employees, a rotation of tasks, on-the-job training, etc.
- Income flexibility: A reduction of wages through the non-payment of performance related bonuses and the cutting of non-wage allowances, etc.

The presentation finished with two of these case studies on 1) a pharmaceutical company 2) a porcelain company, which is 50 per cent owned by employees through individual share ownership and 25 per cent of the shares are held in an ESOP.

The pharmaceutical company operates an approved EBP programme. In response to the crisis it laid-off temporary workers, reduced working time and reallocated employees. The crisis did not influence the EBP programme but equally, employee share ownership (30 per cent of employees are owners) did not influence the restructuring process.

In the porcelain company, decreased orders during the crisis led to a reduction in working time and some functional flexibility. The CEO involved worker representatives and the ESOP in all discussions concerning restructuring.

Jimmy Magro, Executive Secretary, Local Government Association, Malta

This presentation outlined the economic situation and the structure of the labour market in Malta, which is very different from other EU Member States. Some 98 per cent of employees work in micro enterprises (with less than ten employees), many are family businesses handed down from generation to generation.



There has been an increase of 6,000 new enterprises since 2005 and in 2009 some 2,612 new enterprises and 66 new partnerships were established. There were also 850 closures in 2009. There are now 46,500 businesses registered in Malta.

Only 20 Maltese companies are registered on the Stock Exchange, with a market capitalisation of just €7.5 billion – only €2.8 billion of this is in equity while the balance is in Government bonds and treasury bills.

The current global economic crisis has only had a moderate impact on Maltese business because:

- The banking sector has been conservative in its operations
- Up to now there has been a strong property market
- Government has supported industry through various grants
- The competitive labour force attracts investment.

However, there are a number of structural problems in the economy, such as high energy costs, which are becoming a major social issue. There is also the problem of an ageing population, which is a burden on the State finances and female participation in the labour market is very low.

With this backdrop, it is understandable that financial participation is not on the agenda of the social partners or the Government.

- There is no specific legislative framework and it is not on the political agenda
- The few cases in Malta originate through circumstances beyond the control of Government and the social partners, such as in a couple of banks (for example, the Bank of Valetta and HSBC)
- Financial participation among Maltese enterprises is neither diffused nor broad-based.



The Ministry of Finance has the power to designate a percentage of the turnover in State-owned enterprises for profit sharing, even if the company does not make a profit! However, most State companies have now been privatised. There is also a new Co-operative Act that is designed to encourage management and workers in Government services to form co-operatives.

To summarise the situation in Malta with regard to the future of financial participation in corporate re-structuring:

- There are business size & ownership limitations
- There is no political and/or social partners commitment
- Financial participation is not included in pension reforms plans
- There is a lack of financial knowledge/literacy
- The equity market is very limited
- Legislation and EU Directives are not enough

Financial participation is not on the national agenda!

7 Roundtable: Strengthening and Social Dialogue

Chaired by Maurizio Petriccioli, Confederal Secretary, CISL, who said in opening the discussion that financial participation is just one tool to deal with the economic crisis.

Riccardo Giovanni, Industrial Relations Director, Confartigianato, spoke about the problems of financial participation in the re-structuring of SMEs. Italy has the largest number of enterprises in the EU and 98.1 per cent of them employ less than 20 workers.

He said that financial participation is not just a tool, it is a value – it is not just about information and consultation rights, it goes beyond that. Information and consultation is the first step, but we must talk about participation in the strategy of the company and in the results of the company.



With regard to social dialogue, over the past twenty years there has been a bi-lateral approach to finding solutions to workplace problems, such as training and occupational health and safety. Since 2006 there has been the development of 'bargaining federalism', as a collective bargaining model. This approach consists of a two-tier level of collective bargaining – the national level is for wage adjustments in line with inflation, while at the local/territorial level bargaining is around productivity levels, including profit-sharing.

Anna Maria Furlan, Confederal Secretary, CISL, called for attention to be paid to the value of labour. The focus has been lost over recent decades with a shift to wealth creation.

The privatisation programme of the 1990s was only about governments getting cash as fast as possible! It resulted in a reduction of services. In many cases, services just stopped being delivered all together, while overall the quality of services have suffered.

In the light of this experience, there are many questions for politicians, such as how can legislation be enacted to support employee participation? How can the remaining public services be protected?

She argued that there are many different ways to promote and implement employee participation and legislations is just one of these.

The Roundtable was concluded with contributions from three members of the Italian Senate:

- Senator Ichino spoke of the principles of financial participation. He characterised trade unions as having two roles, first as defenders of the *aquis* of workers rights and, second, as challenging and ready to guide workers. He spoke of the unified text in the legislative bill before the Senate as the result of months of difficult negotiations. It was his view that employee participation, including financial participation, should be based on voluntary agreements and the bill allows for a fall-back situation, as Article 5 stipulates that business plans should be in line with the Standard National Model – if trade unions don't agree with a company's business plan, then, by default, the Standard National Model would apply.
- Senator Castro was more pessimistic about the possibility of trade union co-operation. However, he outlined a couple of ways which he thought would improve employee participation:
 - The Mayor of Rome will re-launch the Roman Cultural Challenge, recognising it as the cultural and historical capital
 - Profit sharing should be available, even in SMEs – some corporate profits could be invested in employees.



- Senator Treu referred to the conflict of ideologies between trade union centres in Italy. He said that CISL was the prime mover in the promotion of financial participation in the 1950s. It was his view that financial participation can be positive and can be adapted to local conditions but it must and should have common values. The future challenges for business include flexible production, globalisation, etc. Financial participation can play a key role in enterprises facing up to these challenges. The legislative proposals are close to completion but what can legislation do? There is a need for State funding to support financial participation through, for example, tax relief/ allowances. Financial participation is a way of collectively managing enterprises and it gives workers a 'voice' in the management of the company. Now is the time to get down to work and complete the legislative process.

Raffaele Bonanni, General Secretary, CISL, closed the roundtable by welcoming the contributions of the three senators. He looked forward to progress on the proposed legislation to encourage and promote financial participation. He thanked the organisers for the opportunity to discuss this important initiative.



Jean-Michel Content, Secretary-General, IAFP, concluded the seminar.

He noted that employee share ownership could be riskier than other forms of financial participation in corporate restructuring. One of the drawbacks is a possible fall in share price. M Content recounted the case of a French company that collapsed and its employees were granted an indemnity that they could use to invest in a LBO. The business plan was probably not good enough, because two years later the new company was once more in difficulties and the employees lost all their investment. There is also the danger of a possible substitution of financial participation for wages: the recent example of British Airways, or a previous example in Air France, where it was proposed that employees' salaries would be reduced and in compensation they would be granted free (or discounted) shares.

In some European countries (except Malta where there is very little financial participation), there is a consensus amongst representatives of both employees and employers on the mutual advantages of financial participation to enterprises (the employees are more prudent and they constitute a factor of stability).

Financial participation is not only an additional wheel for a car, but some kind of philosophy: Rémy Schlumberger, the founder of the IAFP, used to say that in ancient times, the business relationship was between the master and the slaves; during the industrial revolution, we invented the relationship between the owner (or his representatives), who provided the capital, and the employees who provided their working energy. Today, we should invent a new kind of relationship, to bring together capital and labour.

It is interesting to learn that, in Italy, there is an attempt to launch new laws that, with appropriate incentives, should lead to the introduction of financial participation in Italian enterprises. There already exists a pilot experiment for public servants in Rome. The IAFP will follow with great interest the evolution of legislation in Italy.

He thanked SindNova for its co-operation in the organisation of the seminar, all the speakers and participants for a very worthwhile exchange of views and experiences.

Andrew Pendleton, University of York, UK, and
Kevin P O'Kelly, Executive Committee Member, IAFP
October, 2010



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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Fourth Drafting Seminar

ROME, 20-21 September, 2010

THE ROLE OF FINANCIAL PARTICIPATION IN CORPORATE RE-STRUCTURING

PARTICIPANTS LIST

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Bulgaria	Snezhanka DIMITROVA	X	X
EC	Eleni DAPERLOGA	X	
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France	Jean-Pierre POULET	X	
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Ireland	George TUTHILL	X	X
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Italy	Teresa BACAL		X
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Italy	Pietro BAROMI	X	X
Italy	Alessandro BECCASTRINI		X
Italy	Gianfranco BENIGNI		X
Italy	Mario BERTONE		X
Italy	Salvatore BIONDO	X	X
Italy	Giovani BOLOGNINI	X	X
Italy	Raphaele BONNANI		X
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Italy	Massimo CASSOLLANI	X	
Italy	On. Maurizio CASTRO		X
Italy	Ricardo CERZA		X
Italy	Marco CILENTO	X	X
Italy	Dino CONTI	X	X
Italy	Simonetta CORATO		X
Italy	Corradino DE PASCALIS	X	
Italy	Ester CREA	X	X
Italy	Carlo DEMASI		X
Italy	Ramdo DEVOLE	X	
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Italy	Francisco LAUNIA		X
Italy	Salvo LEONARDI	X	
Italy	Gianfranco LEONETTI		X
Italy	Chiara MAGRINI	X	X
Italy	Pierangelo MANCINI	X	X
Italy	Michel MARTONE	X	
Italy	Guiliati-ni MAUR		X
Italy	Fabrizio MILANI		X
Italy	Walter MOAZZ		X
Italy	Liliana OLMIN		X
Italy	Remo OSTINI	X	X
Italy	Guiseppe PASSACANTICCI	X	X
Italy	Maurizio PECATELLI		X
Italy	Roberto PEDULLA	X	X
Italy	Domineco PESSATO		X
Italy	Maurizio PETRICCIOLI	X	
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Italy	Eros PIZZI		X
Italy	Orietta RAGHETTI	X	X
Italy	Simona RICCIO	X	X



Country	Name	September 20	September 21
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Italy	Mauro RUFINI	X	
Italy	Renato SANTINI	X	X
Italy	Massimo SAOTA		X
Italy	Mario SCOTTI		X
Italy	Giorgio SERAO	X	
Italy	Sandro SILVESTRI	X	X
Italy	Volker TELLJOHANN	X	X
Italy	Mario TESI		X
Italy	Mariammonietta TOSTI		X
Italy	On. Tiziano TREU		X
Italy	Gino TURRINI		X
Italy	Pier VERDERIO		X
Italy	Antonio ZARDI		X
Latvia	Raita KARNITE	X	X
Malta	John MUSCAT DRAGO	X	X
Malta	Joe GERADA	X	X
Malta	Jimmy MAGRO	X	X
Malta	Norman MIFSUD	X	X
Poland	Agnieszka KALISIEWICZ	X	X
U.S.A.	David HILDEBRANDT	X	X
United Kingdom	Andrea BROUGHTON	X	
United Kingdom	Diane HAY	X	X
United Kingdom	Andrew PENDLETON	X	X
United Kingdom	Andrew ROBINSON	X	X





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

Concluding Conference BRUSSELS, 14-15 October, 2010

AGENDA

14 October, 2010

- 09.00 Registration
- 09.30 Welcome by George Tuthill, President IAFP, (Chair)
- 09.45 Introduction to the project – Kevin P O’Kelly
- 10.00 An overview of the key findings from the four seminars –
Andrew Pendleton
- 10.31 Coffee
- 11.00 Outcome of the first drafting seminar: “Communications and Transparency”
Raita Karnite
- 11.30 Case study on communications on a financial participation plan
- 12.00 Discussion
- 12.30 Lunch
- 14.00 Chair:
Outcome of the second drafting seminar: “The Role of Financial Participation in the
Provisions of Pensions



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- 14.30 Presentation on the European Commission Discussion (Green) Paper on Pension Reform - *Towards adequate, sustainable and safe European pension systems*
- 15.00 Discussion
- 15.30 Coffee
- 16.00 Outcome of the third drafting seminar: 'Financial Participation in Small and Medium Sized Companies'
- 16.30 The challenge of financial participation in SMEs in the Netherlands – Eric Kaasemaker
- 17.00 Discussion
- 17.30 End of day
- 19.30 Dinner

15 October, 2010

- 09.30 Chair: Jean Michel Content
- Keynote speech by Mme Pervenche Bérès MEP, President of the European Parliament Committee on Employment and Social Affairs
- 10.30 Coffee
- 11.00 Outcome of the fourth drafting seminar: 'The Role of Financial Participation in Corporate Re-structuring' Marco Cilento
- 11.30 The future of financial participation in the EU – Erik Poutsma
- 12.00 Round-table: political responses and open discussion
(facilitated by FR journalist)
ETUC
Business Europe
EESC
- 13.00 Summing up and conclusions – Jean Michel Content
- 13.15 Close of seminar – Jean François Lebrun, European Commission
- 13.30 Lunch – End of Seminar





International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

CONCLUDING CONFERENCE

BRUSSELS, 14-15 OCTOBER, 2010

REPORT OF THE CONCLUDING CONFERENCE

1 Introduction

The International Association for Financial Participation (IAFP) was funded by the European Commission to undertake a EU-wide project to investigate various aspects of employee financial participation, during 2009 and 2010.

The project reviewed key issues related to financial participation, some identified by the European Commission as essential to the further promotion of financial participation across the EU and others flowing from the work of the IAFP and from the Model Plan, drafted in 2005.



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This project focused, therefore, on issues relating to:

- Transparency in financial participation schemes and the information and consultation provided to workers who participate in these schemes
- The role of financial participation in corporate restructuring
- The demographic challenge in the labour market and the role financial participation can have in the provision of pensions and maintaining the standard of living of retiring workers
- The promotion of financial participation in SMEs.

The project was organised around four drafting seminars, each of which focused on one of these issues and the findings from the seminars formed the basis for the conference programme (see Annex 1).

There were some sixty-two participants, both practitioners and experts, from eighteen Member States and, also, from the Russian Federation and the USA. It was also attended by representatives of the European social partner organisations and the European Commission.

Annex 2 has the list of participants. Annex 3 has the PowerPoint presentations of conference speakers.

2 Opening remarks

In opening the conference and welcoming participants, George Tuthill, President, IAFP, looked forward to a productive debate and hoped that the deliberations of participants would make a significant contribution to the further promotion of financial participation within the EU.

Kevin P O'Kelly, Member of the Executive Committee, IAFP, and

Andrew Pendleton, University of York, UK, introduced the conference agenda, set out the background to the project and outlined the history of European initiatives on financial participation.

The focus of the project on the four areas set out above was explained. It was suggested that financial participation could contribute to other policy debates, such as on how to improve the performance of SMEs. It was noted that, although our knowledge of financial



participation has increased substantially over the last ten years, there are still some major gaps in our understanding. These include the focus on large companies and an inadequate understanding of how financial participation interacts with other human resource (HR) and employee involvement practices within companies.

The presentation then briefly outlined the focus of each of the earlier seminars and summarised the main questions addressed and the key findings from those seminars.

3 Financial participation and SMEs

Prof Andrew Pendleton, presented the themes that had been addressed at the SME seminar in Leiden. It was noted that financial participation tends to be more prevalent in larger firms but that there was, nevertheless, considerable policy interest, at national and EU levels, in stimulating the use of financial participation among SMEs. It was believed that the potentially favourable effects of financial participation could enhance the performance and growth of SMEs.

A key point, however, was that only a small proportion of the approximately 20 million SMEs in the EU are likely to be attracted by the concept of financial participation and it was suggested that the promotion of financial participation should be aimed at these, which would include the larger SMEs, in the 'medium' category with over 50 employees, and high-growth potential SMEs, which may include some micro enterprises (less than 10 employees).

Various benefits of financial participation to SMEs were identified, such as:

- Contributions from share subscriptions and re-investment of profit shares in the firm could generate risk and start-up capital
- Promotion of an entrepreneurial spirit among the workforce
- Signalling of high growth potential and aspirations to financial institutions and others
- The retention of key personnel and skills and increasing the attraction of the SME for potential employees
- A solution to business succession
- Wage flexibility.



However, there are some specific barriers to the use of financial participation in SMEs:

- There are cash flow and financing constraints
- The unwillingness of SME owner/managers to disclose commercial and financial information to their employees
- A preference for informality and responding in an *ad hoc* way to market conditions
- A lack of knowledge of financial participation among owners
- The high set-up costs.

For these reasons, financial participation is likely to be more widely used by larger SMEs.

In addition, there are further obstacles specifically related to the establishment of share-based schemes:

- The possible need to change the legal form and ownership structure of the enterprise
- The lack of liquidity of employee shares, given that SMEs will generally not be publicly-listed companies
- The fears of the owner/manager about the possibility of losing control of decision-making
- The costs of share valuation
- The costs of establishing and setting up share plans.

For these reasons, cash-based profit sharing may well be more attractive to SMEs than share-based arrangements.

Prof Pendleton went on to summarise the situation in a number of EU Member States presented to the Leiden seminar, on financial participation in SMEs in the UK, Germany, Belgium, France, Poland, and Romania. Finally, the mixed experience of inter-company schemes of financial participation was referred to.

In the discussion following this presentation, it was noted that one problem for SMEs can be share valuations and it was pointed out that in the UK certain brokers are now operating a share market for small SMEs – they are traded at no cost.

Eric Kaarsemaker, Consultant, the Netherlands, outlined the challenges to setting up financial participation plans in SMEs. These include decisions on what employees should participate in such plans, including part-time workers, and what happens when an employee leaves his/her employment – this usually results in the end of that employee's involvement in share-ownership schemes.



In the Netherlands the taxation treatment of financial participation doesn't make it easier for SMEs to introduce plans. There is a low level of participation of approximately 30 per cent overall. However, some enterprises have a 100 per cent participation rate. These plans are noted for good communications and are linked to other forms of employee involvement and human resources (HR) policies.

Dr Kaarsemaker gave the example of a cleaner in a particular Dutch firm who saved €32,000 from her share payments, demonstrating that even workers on low incomes and at the bottom of the workforce 'hierarchy' can benefit from financial participation.

4 Financial participation in corporate restructuring

Marco Cilento, SindNova, Italy, presented the findings from the seminar on the role of financial participation in corporate restructuring, which was held in Rome. There was a good level of interest in this topic among employers, trade unions and politicians in Italy. It was generally agreed that financial participation can improve corporate restructuring and the social partners in Italy will sign an agreement for the promotion of financial participation. However, the promotion of financial participation needs to be debated within a EU context.

Restructuring is not only a result of changes in enterprises because of the current economic situation, but also a result in changes in corporate culture. The challenge, therefore, is not only to restructure the production process but also to restructure corporate culture. For example, in the Italian subsidiary of UniCredit a new CEO re-organised the company that resulted in 6,000 job losses. One major problem in Italian enterprises is secrecy – it is very often not possible to understand why decisions are made. Is it because of the demands of the shareholders, or because of foreign investors?

Mr Cilento presented a matrix on labour involvement in corporate governance and also a table on EU Directives on company law that have an impact on employee involvement (see attached PowerPoint presentation). He pointed out that with the integration of business across the EU – 12,000 UK registered companies operate in Germany. He concluded by calling for the European Commission to publish a paper, after consultation with the social partners, on economic democracy.



Kevin P. O'Kelly presented the outcome of the seminar on financial participation and the provision of pensions, which was held in Dublin. However, as the European Commission official scheduled to present the Commission's Green Paper on pension reform, *Towards adequate, sustainable and safe European pension systems*, was, at the last minute, not able to participate in the conference, this presentation started with a short outline of the Green Paper.

Pensions policy is the responsibility of Member States but the Commission is conscious of the challenge of demographic changes which will impact on policies in the future. In 2001 the European Council included pensions reform, together with health care and long-term care, as part of its three-pronged social policy strategy. However, the economic and financial crisis and the resulting problems with public finances in many Member States, has added an urgency to pension reform.

The Green Paper set out options for pensions in the future, such as:

- Working longer and retiring later
- A shift from a single-tier to a multi-tiered system
- Pay-as-you-go pensions
- Addressing the adequacy gap
- Broader coverage
- Easy access to pensions for vulnerable groups and people living in poverty
- Addressing the gender dimension.

It posed a number of objectives and questions for the reform of pension plans:

- How can policies ensure that pensions are adequate and sustainable?
- How do we find a balance between time spent in the workforce and in retirement?
- Obstacles to the mobility of pensions across Member States need to be addressed
- For better, safer, more transparent pensions we need:
 - Better information on products
 - Better EU regulation
 - Ensure the solvency of pension funds
 - Protection against insolvency

The Green Paper proposes an improvement of EU-wide statistics and a move to a greater role for the EU in the governance of pensions policy.



With regard to the discussion and outcome of the seminar on pensions, as part of this project, a number of examples on how financial participation might contribute to addressing the growing problems in many countries were outlined. For example, UK policy provides a synergy between share-based financial participation and personal, but not occupational pensions. Also, in France there is a link between financial participation and medium-term and long-term employee savings, while in the US private defined contribution pensions are boosted by 401(k) plans.

The seminar posed a number of questions on how this problem might be addressed, many reflecting the issues subsequently raised in the Commission's Green Paper, such as:

- What role, if any, should the European Commission have in co-ordinating pension policies across the EU?
- Could the co-ordination of pensions policies within the EU contribute to the single market and the free movement of workers through a system of transnational transferability?
- How can the EU and Member States protect employees' savings, through financial participation schemes that are linked to pension funds?
- What can we learn from the experiences of the US and in other countries, such as Australia or Canada?

The resulting debate observed that it is possible to invest shares from share plans in pensions (UK) but there are implications for financial participation in shifting from defined benefit (DB) to defined contribution (DC) pension plans, in particular for employees' share ownership arrangements. Another concern is if financial participation is used as a substitute for regular income, contributions to pensions funds might then be reduced.

The relationship between financial participation and saving plans in many EU Member States, for example, France, Germany and the UK, typically has revolved around medium-term savings but there is a trend towards facilitating long-term savings and pensions using financial participation. There are complementarities between well-developed support for employee share ownership and widespread use of funded occupational pensions, i.e. funded pensions both require and, also, develop stock markets, which in turn facilitate employee share ownership schemes. These complementarities occur at 'national system' levels as compared with specific arrangements that link employee share ownership schemes and pensions.



David Hildebrandt, Chair of the IAFP Executive Committee, outlined key features of the regulatory environment in the USA, UK, and Netherlands. He emphasised the importance of appropriate governance principles in the operation of employees' pensions and recommended the adoption of global best practice guidelines. These should include specific references to financial participation given that pensions and financial participation are often connected.

6 Communications and transparency in financial participation plans

Raita Karnite, EPC Ltd, Latvia, presented the outcome of the discussion on communications and the promotion of transparency in financial participation schemes, held in Riga. This topic emerged as an important issue in the design and implementation of financial participation plans when the IAFP undertook the development of a EU Model Plan in 2005 and it was considered essential to address it as part of this current project, in advance of the examination of the other selected topics.

Four key issues emerged during this seminar. First, it is important to use all forms of communications available, including face-to-face and work team briefings; print, such as regular bulletins and notice-board posters; audio and electronic media, such as a distribution of CDs, using the intranet, e-mails, social network sites, mobile phone technology, texting, etc.

Second, it is essential to provide information on the risks as well as the benefits of participating in a financial participation scheme. Information should be from trustworthy sources and it should not be too detailed so that the participants cannot understand the information, but it should be detailed enough to provide an understanding of the benefits and risks involved.

Third, training in economic and financial literacy in the introductory phase is very important for employee participants but when a scheme is in place, external experts could be engaged to provide financial literacy, the cost of which would be borne by the company. Finally, enterprises should strive to integrate financial participation plans with its other employee involvement arrangements.



This presentation was followed by a study of how communications might be used to improve financial participation plans by Julie Richardson and Alexy Armitage, ifs Proshare, UK. This presentation defined 'communications' as an exchange of thoughts and ideas. It was stressed that education and engagement are key to its success. The message needs to be geared to the different groups, such as by age, job types and experiences.

Good communications is about building awareness and must be simple and relevant to the audience. It is important to avoid jargon. Their view of how to communicate was along the lines set out above by Raita Karnite – i.e. presentations, print, audio and electronic.

It is also important to gauge how successful communications is working. Good indicators are the take-up of shares and ongoing participation. It is also important that frequent 'feed-back' meetings are held with participating workers. ifs ProShare recognises good communications in UK financial participation plans with an annual award.

7 The view of the European Parliament (EP)

Pervenche Berès MEP, Chair of the EP Committee on Employment and Social Affairs and Rapporteur for Committee on the Financial and Economic Crisis. She outlined the origins of the current crisis, which she believed began over thirty years ago. She said that we have to focus on the present functioning of firms and asserted that there is an urgent need to reform corporate governance and was disappointed that no proposals for this were in the plans of the European Commission – there is no sign of a commitment to change.

During the current economic crisis the Member States have saved the banks but there is now a need to look at the social impact of the crisis and at corporate governance. The EP has good proposals for the reform of corporate governance, which it will table in the debate. For example, AGMs of shareholders are not taking key strategic decisions for the long-term and modern managers are constrained in their decision-making by the financial institutions.

Finally, there is a need to avoid two traps related to voting rights. First, shareholding concentrated in the hands of single funds, and second, shareholders voting at AGMs with shares they don't control (proxy votes). In this context, she also expressed concern with the number of shares been taken over by sovereign funds.



With regard to the European Commission's pensions Green Paper she found many parts of this paradoxical, for example, pension funds are long-term savings but the Green Paper seems to view them as short-term. There also needs to be a better governance of these funds so as to protect workers' savings and the EP will try to put forward proposals for the policy paper to be published in 2011. In France pensions are seen as a form of social solidarity for retirement.

Referring to the Social Market Economy, it was her view that there is an urgent need to combine market economics and social welfare and in doing this, financial participation has an important role. Financial participation is a key part of social dialogue as it relates to the circulation of capital and equity. While the Commission is focused on financial participation at present, it is important to take into consideration the diversity of conditions in the Member States.

The economy has become too 'financial' and it is difficult for workers to be involved in the management of enterprises, as there is often a lack of expertise in financial transactions. Workers want to participate but their first objective is to keep their jobs, not necessarily to own shares.

In the questions/answer session following Mme Berès presentation, the following points were made:

- 1 The EU needs to be wary of the practicalities of implementing Directives that might have an impact on financial participation, such as the Prospectus Directive. It is important to be careful that we do not damage non-EU companies and their workers operating in Europe.
- 2 It was also suggested that the rules governing financial participation can be inflexible, but should always be voluntary (unlike the French experience).
- 3 Employee involvement in corporate governance, arising out of financial participation, needs to go beyond establishing rights to vote by mail.



In reply Mme Berès emphasised the need for full social dialogue to make things go smoothly in, for example, restructuring. She also suggested that employee share-ownership could be a useful tool to control short-termism because employees would be committed shareholders. She also noted that a 'financial watch' observatory had been created to scrutinise financial papers submitted to the European Parliament.

8 The PEPPER IV Report

Jens Lowitzsch, Free University, Berlin, Germany, noted that, although diverse data sources can give differing pictures of the incidence of financial participation, all data sources indicate an increase in the use of financial participation in Europe. Employee share-ownership is up by 5 percentage points, whilst profit sharing is up by 6 percentage points. The findings from the work done on the PEPPER IV Report show that there is a substantial upwards trend.

It should be noted that this is in the context of a number of factors, including a reduction in labour's share of national income, making instruments like financial participation more vital. He also noted an increase in the number of 'precarious' jobs.

In the context of the current economic crisis, financial participation could aid economies by boosting purchasing power. It could also help to deal with the succession problem in SMEs, which affects 690,000 SMEs (2.8 million jobs) each year. A further benefit of financial participation in SMEs is that the rewards to workers are likely to be spent locally.

Noting a series of European publications on financial participation, including *Financial Participation for a New Social Europe* 2008, Prof Lowitzsch pointed out that the European Economic and Social Committee (EESC) was likely to adopt a report on financial participation later in October.¹¹⁶ This report calls for:

- A framework for financial participation
- Highlighting the role of financial participation in the competitiveness of SMEs
- A new Council Recommendation on financial participation
- A reaffirming of the common principles
- A dedicated budget heading to support research and communication on financial participation
- Highlighting the role of employee buy-outs in the succession problem in SMEs
- A greater provision of information on financial participation.

¹¹⁶ This report has now been adopted by the EESC, with minor amendments



9 The future of financial participation

Erik Poutsma, Institute for Management Research, Radboud University, Nijmegen, the Netherlands, outlined some possible future scenarios for financial participation within the EU. The key points in his presentation included:

- On the whole, the level of financial participation in the EU had been sustained during the current economic recession
- Financial participation is still only found in a minority of enterprises
- In terms of adoption, a 'S-curve' is a useful way of looking at it. Financial participation can be initially adopted with little change to other workplace practices, but in a second phase of growth firms might need to change some other workplace features to achieve the full benefits of financial participation
- It is important to target managers, and potential managers, to encourage a take-up of financial participation.

10 Roundtable

The seminar concluded with a roundtable discussion, facilitated by Frank Pauly, a financial journalist from France. The contributors to the roundtable were:

- Prof Andrew Pendleton
- Prof Jens Lowitzsch
- Prof Erik Poutsma
- Marco Cilento

Question 1: Is this harsh economic environment favourable to the introduction of financial participation?

In response a number of points were made. First, the diffusion of financial participation has held up during this current economic environment. However, future growth will be slower, as governments are focused on getting out of the crisis and improving revenue, so they will not be inclined to provide any more tax incentives. Second, we need to learn how to avoid a repeat of the present financial crisis. There needs to be greater control of financial products and financial markets in the future and financial participation can be central to the reform of these markets. At present, there is an emphasis on 'green' products but no focus on how to control the financial markets.



Question 2: What are the main conclusions from this conference?

While financial participation is not an easy subject to promote, progress has been made over the past twenty years, since the publication of PEPPER I. However, the effects of the economic crisis, in the medium-term, will be an impact on social security costs and financial participation might be one of the victims because of a loss of tax relief. The EU is still the model – other economic blocks are looking at the European Social Model. The EU needs a more focused approach to further promote financial participation.

Question 3: What of the future? What works for SMEs?

The SME sector is worth looking at further. Financial participation has many positives for these enterprises. In the UK, for example, financial participation in SMEs seem to be on the increase and recent legislation has tried to deal with any barriers to the further diffusion of financial participation in SMEs – for example, the issuing of shares that don't necessarily carry voting rights. However, the issue of non-voting shares may be construed as diverging from the *Principles* set out in the European Commission's 2002 Communication.

Question 4: What do trade unions think of better corporate governance?

The trade unions want better corporate governance in the long-term. We need to work towards an integration of the total economy and employees need to be more engaged in the management of enterprises – there is still too many managers and owners who take a conflictual view of the employment relationship. There are examples of banks in Italy and Sweden that have financial participation with substantial employee share-ownership and these banks survived the economic crisis of the 1990s and again have performed well during the current crisis.



With regard to financial participation, the situation with trade unions is complex with some union confederations in favour and others against. However, there is a growing interest among trade unions in financial participation because of the economic crisis and the limitation on increase in incomes. For example, the Hans-Böckler-Stiftung¹¹⁷ has agreed to finance a project on financial participation in Germany. It was pointed out that the trade union group in the EESC are supportive of financial participation.

Question 5: What are the taxation barriers?

There is very little possibility of further tax incentives for financial participation in the medium-term. An example of how governments are tightening up tax concessions, because they need the revenue, was a presentation made by the Nederlands Participatie Instituut to Dutch MPs last September – when they were asked about using the taxation system to encourage more financial participation, the MPs made it clear that there was no possibility of that.

Question 6: How can a system of mutual recognition be put in place – i.e. so that financial participation plans in one Member State are recognised in the other Member States?

The IAFP Model Plan is already available to the European Commission and the Member States and it clarifies the key principles for a EU-wide approach to financial participation. However, mutual recognition is essential. A good example of this is the recognition by the German Ministry of Finance of mutual saving plans in operation in France.

With the growth of the Chinese economy and with Chinese sovereign wealth funds taking larger stakes in European companies, China is becoming an important player in the EU economy and, as Chinese business takes a positive view of financial participation, it will become more important as there is an increase of Chinese investment in Europe.

¹¹⁷ The research institute of the Confederation of German Trade Unions (DGB)



Jean-François Lebrun, Chef de Unit, DG Employment, Social Affairs and Equal Opportunities, European Commission, in closing the conference said that he was pleased that at least one-third of the conference participants were from the new Member States of Central and Eastern Europe. He thought that the focus on SMEs, pensions, and governance is timely, as these are central issues for the European Commission and for the *Europe 2020* strategy. Social dialogue is also very important to the Commission, as it is central to the European Social Model, so the appreciation of its role in financial participation is important. He would like to see a single framework agreement for multi-national enterprises operating within the EU.

He concluded by emphasising the gap in knowledge identified by the work of the project in promoting financial participation in SMEs. He thought this was an issue that needed to be investigated further, as this was a sector where the Commission would like to see a greater diffusion of financial participation.

Kevin P O'Kelly, IAFP Executive Committee and

Andrew Pendleton, University of York, UK





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International Association for Financial Participation

FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

CONCLUDING CONFERENCE

BRUSSELS, 14-15 OCTOBER, 2010

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Portugal	SANTOS Herculano	X	X
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Portugal	SIMOEES Alberto	X	X
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FINANCIAL PARTICIPATION: A TOOL FOR BETTER SOCIAL DIALOGUE AND BETTER CORPORATE GOVERNANCE

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