The role of employee share ownership for corporate governance

in the aftermath of the financial crisis – a closer look at the

Central Eastern European EU Member States

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*Abstract*

Following a 2010 initiative opinion by the European Economic and Social

Committee and a 2012 study on employee financial participation (EFP)

commissioned by the European Parliament, in December 2012 the European

Commission included the promotion of employee share ownership

(ESO) in its Action Plan to reform European company law and corporate

governance (European Commission, COM/2012/0740). This marks an extension

in the perception of the issue of EFP in general and ESO in particular

as a policy area that in the 1990ies had been seen predominantly as

related to social policy.

As the link between better corporate governance and ESO is complex it

is worthwhile to review the main arguments and findings. As will be

shown, ESO is directly relevant to all three areas for action identified in

the Action Plan, i.e., transparency, responsibility and competitiveness.

These related issues, i.e., information sharing, long-term shareholding

and participation in decision-making are interlinked and elevate the status

of employees; they are workers but also shareholders and stakeholders

who can play an active role in corporate governance. Such employee

shareholding is a kind of long-term investment that may help to stabilise

capital markets, a welcome contrast to the destabilising effect of speculative

short-term investment.

Against this background we investigate the dynamics of ESO in the

Central Eastern European (CEE) countries over the last decade. Particular

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attention is given to the difference in evolution of ESO in the CEE countries

– as opposed to that in the old EU Member States. Finally, lessons for

the support of sustainable employee ownership are drawn from the cases

of Poland, Hungary and Lithuania.

*Introduction*

In 2005 in the EU-152, between 17 per cent (employee share ownership -

ESO) and 36 per cent (profit sharing) of employees in the private sector

currently participate financially in the enterprise for which they work.

These existing schemes constitute a pillar of the European Social Model.

A generally favourable attitude within a given country has usually led to

some supportive legislation for EFP schemes, which in turn has spread

their practice. This suggests a clear link between national attitudes, legislation

and diffusion.

A quite different situation exists in the emerging economies of the

EU-13 and candidate countries (Lowitzsch, 2006).3 Few laws specifically

address employee financial participation (EFP), and these refer almost exclusively

to ESO; legislation on profit sharing is rare. Although employees

were frequently offered privileged conditions for buying shares of their

employer companies, the purpose was not to motivate employees to become

more efficient and productive; nor was there more than mild concern

for social justice. Rather, this method was simply an expedient for privatising

state-owned enterprises for which at the time there were no buyers.

Essentially it was a decision made by default.

In the aftermath of the financial crisis, employee shareholding as a type

of long-term investment that may help to stabilise capital markets has received

attention as a welcome contrast to the destabilising effect of speculative

short-term investment. Contrary to expectations4 across the EU-27

both take-up and offer continued to rise (see Figure 1).

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2 Member States, which had joined the European Union before 1 May 2004: Belgium,

Denmark, Germany, Ireland, Spain, France, Greece, Italy, Luxembourg,

Netherlands, Austria, Portugal, Finland, Sweden, United Kingdom

3 Member States, which joined the European Union after 1 May 2004: Bulgaria,

Croatia, Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta,

Poland, Romania, Slovenia, Slovakia

4 With the risk discussion in mind, one might expect employees under the current

economic uncertainty to seek conventional pay systems and flee EFP schemes. Of

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It is against the background of the recent discussion of ESO and its role

for corporate governance that the question arises of what impact, if any,

the different origins of ESO in the emerging economies of the new EU

Member States had on the development of employee shareholding.

*Figure 1. Dynamics employee shareholding 2000-2013 in EU.*

*Source: Lowitzsch & Hashi (2014).*

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*Figure 1.* Dynamics of employee shareholding 2000-2013 in the EU. Source:

Lowitzsch & Hashi (2014).

Digesting three EU-wide cross country data sets, i.e., European

Working Condition Survey (EWCS) and the Cranfield Network on

International Human Resource Management (CRANET) from 2000, 2005

and 2010 and European Company Survey (ECS) from 2009 and 2013, we

discuss the dynamics of ESO in the ten new EU CEE Member States

focusing on possible implications these may have had for the role of ESO

in the aftermath of the financial crisis. Narrowing the angle to the cases of

Poland, Hungary and Lithuania, and describing the circumstances for the

development of ESO in these countries more in detail, lessons for the

support of sustainable employee ownership are drawn.

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17,7

19,9

4,7 5,2

1,44 2,34 3,28

0

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15

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Year 1999 Year 2000 Year 2005 Year 2009 Year 2010 Year 2013

Proportion of employees covered by ESO scheme - CRANET (firms employing > 200 employees)

Proportion of companies offering ESO scheme - ECS (firms employing > 10 employees)

Proportion of employees participating in ESO schemes - EWCS

Digesting three EU-wide cross country data sets, i.e., European Working

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and Lithuania, and describing the circumstances for the development

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course, this argument would be more relevant to share ownership schemes since

market volatility affects share prices directly.

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*Background: EFP and Corporate Governance5*

Good corporate governance improves company performance and thus

benefits all of its shareholders. As the link between better corporate governance

and ESO is complex it is worthwhile to review the related arguments.

ESO broadens the role of employees thus elevating their status

contributes to:

1. A desired change from short to long-term incentives: Companies with

a significant employee shareholder base gain a bloc of demanding but

loyal shareholders made up of their own employees who understand

the firm more intimately than outsiders ever could. In this way employees

support management in resisting the prevailing short-term policies

of the financial markets and may impose some constraint on opportunistic

management and short term oriented management.

2. Improving EU firms’ competitiveness by productivity gains arising

from increasing employees’ loyalty and identification with the company:

Employee share ownership can increase employee participation

and reward the assumption of new responsibilities at both the shop

floor and shareholder levels including issues of transparency and exchange

of information.

3. Higher transparency of remuneration: Employee shareholders having a

‘say on pay’ contributes to making executive compensation transparent,

a step toward more sustainable remuneration policies. As knowledgeable

insiders they can exercise effective ‘oversight’.

The related issues, i.e., information sharing, long-term shareholding and

participation in decision-making are interlinked and result in employees

not being regarded as just another factor of production, but as shareholders

and stakeholders who can make an active contribution to good corporate

governance.

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5 This section is an extended version of the discussion of the relationship of ESO and

corporate governance in the Final Report of the Commission’s DG MARKT pilot

project ‘The Promotion of Employee Ownership and Participation’ prepared by the

Inter-University Centre (Lowitzsch & Hashi , 2014, p. 17 et seq.).

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*With regard to information sharing*

Anyone with an important stake in a company such as his/her own job naturally

wants full transparency on company accounts and company decisions.

In this way participation based on share ownership complements

participation based on information and consultation. To facilitate the development

of positive attitudes and behaviours, management also needs to

adopt practices such as information sharing, clarifying and strengthening

the link between both individual and organisational performance, and employee

participation in decision-making, as adjuncts to the incentive plan -

measures which complement EFP (Pendleton & Robinson, 2010). Well-informed

employees can also make a significant contribution to the operation

of company boards and their important function of monitoring and

overseeing management.

Financial participation and in particular ESO is also believed to enhance

information sharing because of the alignment between individual

employees and corporate interests, which is also likely to improve the decisions

made within the company. The company should supply the employees

with extensive, independent and regular information about firm

performance and its determinants in order to help employees understand

the financial risks and benefits associated with joining a scheme (Pérotin

& Robinson, 2002). Moreover, information sharing can attract a large

number of employees that might otherwise not involve themselves in company

affairs.

For non-employee shareholders, it is advantageous to know that they

have the company’s employees as fellow shareholders pursuing the same

objectives. ESO appears to benefit the firm by also increasing disclosure

from the firm to *all* of its stakeholders by mitigating the firm’s need to

keep information opaque (Bova et al., 2013). Employee shareholders can

monitor and exercise oversight on management better than any other entity.

They also have an incentive to monitor their fellow employees. This

can potentially lead to improved corporate governance arrangements within

the company. The presence of employee shareholders should assure other

long-term investors, such as institutional shareholders, that long-term

interests of the company would prevail.

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*Related to participation in decision-making*

Employee participation in the decision-making process and employee financial

participation are regarded as complementary, with the potential to

mutually increase each other’s beneficial effects on productivity and the

quality of management. While financial participation gives employees an

additional incentive for involvement, participation in decision-making

processes gives them a means to realise it. In this way financial participation

rewards results - i.e. profits - while participation in decision-making

offers employees the ways and means to actually make the firm more

profitable - not necessarily by working harder but smarter, and by eliminating

the organisational and other bottlenecks that impede production and

increase costs.

As a concept, participation in decision-making has been so heavily

weighted with ideological connotations that it is necessary to state that the

term as used in this context encompasses various levels of involvement –

having a say on work organisation is quite different from participating in

board decisions. The extent of participation in decision-making will be influenced

by the home country’s history of labour relations6, by the amount

of company stock employees own, and many other factors. These are corporate

governance issues relating to the future development of the firm,

especially in respect to employee ownership. Concerning financial participation,

however, three areas of participation have proved to be crucial: information

sharing; involvement at the shop floor level, and executing voting

rights as a shareholder.

• Because company performance depends on many factors, both internal

and external, employees may be generally unwilling to exert more effort

unless they are informed about major decisions, e.g., those investment

or strategic decisions having an impact on profit and share prices.

The positive impact of financial participation may depend on providing

employees with all information needed to understand how firm profitability

can be increased. This in turn will influence employees’ in-

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6 E.g., the consensual continental contrasts with the Anglo-American confrontational

model; likewise the strong position of the state in France contrasts with the powerful

role of the German collective bargaining parties, such as trade unions and employer

associations (Pendleton & Poutsma, 2004).

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vestment decisions, i.e., the decision whether or not to acquire shares

in the employer company.

• As to active involvement at the shop floor level, it is important that

employees’ ideas and concerns are listened to and that employee suggestions

for improving work procedures and operations are put into effect.

Otherwise inability to positively influence the company’s financial

results could lead to demoralizing frustration, undermining the

positive motivational effects that financial participation was adopted to

provide.

• Regarding participation via shareholder voting rights, employee shareholders

represent a type of investor who is concerned with the longterm

performance of the business, not short-term fluctuations, which

may occur from year to year. In this respect ESO may lead to participation

in decision-making processes through voting rights, which - depending

on its structure - are executed individually or collectively, via

an intermediary entity. Employee shareholders as the natural stewards

of their companies will support them in their efforts for sustainable development.

With regard to participation via shareholder rights it is important to stress

the EU trend towards using an intermediary vehicle, e.g., a trust, as custodian

of employee shares, because this allows for the pooling of voting

rights (EESC, SOC/371/2010). These indirect share ownership schemes

use a separate intermediary entity, which manages the shares held in trust

for employees (e.g., in British and Irish ESOPs) or, at the enterprise level,

uses the combination of a savings plan and a mutual investment fund (e.g.,

in French FCPEs). Pooling voting rights and voting a trustee to execute

them ensures a ‘professionalization’ of the management of employee’s

voting rights. This way employee’s share of the votes may eventually be

large enough to be represented on the board.

*Contributing to remuneration policy reforms*

Executive compensation structures are often cited as one cause of the current

financial and economic crisis. The pre-crisis executive compensation

structures are criticised for putting too much emphasis on short-term variable

compensation and thus leading to myopic management decisions (Teichmann,

2009). Furthermore, experts note that they created *moral* hazard

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as taking risks and achieving a positive outcome was rewarded with high

bonuses while failures due to high-risk management practices were not

correspondingly punished with compensation cuts. Empirical evidence

from management boards in Sweden (Oxelheim, Wihlborg, & Zhang,

2010) as well as supervisory boards in Germany (Koch & Stadtmann,

2012) support these findings. Furthermore, examples from different countries

have already shown that when employees control a significant proportion

of shares, they make effective use of their say on pay.7 The British

ESOP Centre already refers to these series of actions as the ‘shareholder

spring’ and notes that employee shareholders might be the protagonists of

‘the most capitalist of the revolutions’ (ESOP Centre, 2012).

As financial participation is promoted, it gradually facilitates a change

in the orientation of the remuneration system from short-term to longterm.

Even if initially limited in its extent, employee shareholding can be

an element supporting transparency until it eventually becomes a factor influencing

compensation systems as the employees’ equity share and thus

their voting rights increase. If employees have small minority shareholding,

as in most cases8, then they will act as a pressure group. If companies

embrace EFP, they are more likely to be transparent, share information

with employees, and therefore employees will know about executive compensation.

Although, as a rule, the extent of shareholding will be too low

for influencing compensation packages through votes, employee shareholders

can put the issue on the agenda of the general assembly. Once employees

have a significant minority of shares, they will be able to influence

the compensation package as institutional shareholders sometimes

can. Since employees are more concerned with long-term orientation than

7 In the U.S.-based firm Wal-Mart, a group of employee shareholders placed a proxy

regarding compensation (Rodgers, 2012). The employees demanded an annual analysis

with which the board should ensure that Wal-Mart’s compensation schemes

discourage managers from making capital investments, which might lower the company’s

returns. Also the firm Verizon had to deal with employee concerns about the

compensation topic. Other examples of shareholder (but not specifically employee

shareholder) actions against certain executive pay schedules are Aviva, Trinity Mirror,

Astra Zeneca as well as General Electric. In the banking sector, shareholders

voted down the proposed compensation schedules of UBS and Barclays in 2012.

8 The average shareholding of employees in large listed companies in the EU-27 is

around three per cent, although it may be slowly increasing (Lowitzsch & Hashi.,

2012, p. 30, Figure 6).

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ordinary shareholders are, they will have an interest in long-term value

maximisation.

Empirical evidence suggests that employee shareholders face significant

incentives to reduce risk while they are able to influence decisions relating

to firm risk (Bova et al., 2012). The vote of shareholders and higher

transparency of remuneration schemes will bring employees closer to the

decision about executive compensation. This should have an even more

positive effect on the desired long-term orientation of executive compensation

than the vote of the average shareholder as the following argument

illustrates:

• There are two reasons why the average shareholder might be focused

on short term profits rather than long term profitability, minimum level

of risk and survival of the firm itself: First, in economic theory the

shareholder is assumed to have a diversified position. He does not invest

in one single firm only, but in several firms. With his diversified

portfolio, he does not care about the performance of an individual firm,

but is rather interested in an attractive relationship between risk and return

(Markowitz, 1952). The second reason is that his transaction costs

are low. Thus, when stocks he holds are not performing as desired, he

might sell them and invest somewhere else.

• For an employee shareholder the situation is different: He has a rather

non-diversified position as he works for the firm and fears losing his

job. Depending on the details of the EFP scheme, employees might invest

more heavily in company shares since they are often discounted

and thus more attractive than shares of other firms. If given as a compensation

component, there might be restrictions on the time of sale,

resulting in a non-diversified portfolio. Secondly, the employee shareholder

would have transaction costs and this encourages a long-term

orientation. To change jobs is not so easy, while a sale of the shares

might not be possible if there is a holding period. These considerations

give employee shareholders a vital interest in executive compensation

oriented over the long term, which fosters a balanced attitude towards

risk.

It is sometimes argued that employee shareholders will not have the necessary

expertise to properly execute their voting rights to have a beneficial

influence as described above. However, the fact that most likely there will

be a compensation expert on the remuneration committee while the remuneration

committee will be present at the annual general meeting on com-

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pensation compensates for a possible lack of employees expertise. Thus,

EFP can contribute to ensuring that as for remuneration a long-term view

is taken. As a consequence of these issues, changes have been proposed

and/or implemented by different actors.

*EU policy initiatives embracing EFP and ESO in particular*

Both employee financial participation and corporate governance have attracted

rapidly growing interest in the European Union in the past two

decades. However, only recently have both topics been linked to each other

in a common policy approach.

*With regards to ESO and corporate governance*

On 21 October 2010 the European Economic and Social Committee

(EESC) adopted an own-initiative opinion on *Employee financial participation*

*in Europe* (EESC, SOC/371/2010) referring to the 1992 Council

Recommendation (92/443/EEC)9 and the 2002 European Commission

Communication (COM/2002/364) on a *Framework for the promotion of*

*employee financial participation.* Following the EESC initiative report the

EU Parliament commissioned a study on EFP released on 3 October 2012

(Lowitzsch et al., 2014) as a prelude to an Own-Initiative Report on financial

participation of employees in companies’ proceeds that was adopted

on 14 January 2014 (European Parliament, 2013/2127(Ini)).

In a parallel move, the EU Commission included the promotion of ESO

in the action plan to reform European company law and corporate governance

(European Commission, COM/2012/740). In the action plan the

Commission commits to ‘identify and investigate potential obstacles to

trans-national employee share ownership schemes’ and to ‘take appropriate

action to encourage employee share ownership throughout Europe.’ Fi-

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9 The recommendation formulated the following principles: Regular application; calculation

in accordance with a predefined formula; application complementary to the

traditional remuneration system; variable participation depending on company results;

benefits for all employees; application to both private and public enterprises;

application to enterprises of all sizes; simple models; information and training for

employees on models; voluntary introduction and participation in models.

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nally, on the basis of a budget line previously issued DG MARKT implemented

a pilot project on employee ownership and participation with the

final report being published in October 2014 (Lowitzsch et al., 2014).

*With regards to executive remuneration*

The European Commission had already passed suggestions regarding executive

director compensation in a 2004 Recommendation (European

Commission, 2004/913/EC). In 2009, these were expanded as a consequence

of the financial crisis by two recommendations (European Commission,

C/2009/3177 and C/2009/3159), one dealing with executive director

compensation across industries and the other dealing with compensation

structures in the financial sectors on all hierarchical levels in special

consideration of those job positions dealing with risk.10

Already in 2009 new supervisory and equity provisions were issued on

the European level (European Union, 2010/76/EU) which now have been

reworked, supplemented and heavily extended. On 27 February 2013 the

European Parliament reached a compromise with the Member States

putting strict limits on the bonuses paid to bankers, hoping to discourage

the risk-taking behaviour that set off the financial crisis. On 5 March 2013

European finance ministers broadly agreed on these rules, which were approved

by a majority of the member states and the European Parliament

plenary. They comprise of equity provisions for financial service companies,

which were taken from regulation 575/2013 as well as directive

2013/36/EU of the European Union – the so called Capital Requirements

Directive (CRD) IV-package (Lowitzsch, Kocsis, & Koch, 2013) – came

into force on 17 July 2013 and have been applied since January 2014. The

extensive new regulatory package contains, among others, guidelines and

provisions on compensation policies and practices along with their supervision.

The deal is part of the ‘Basel III’ banking regulations aimed at reducing

the danger of big bank failures.

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10 Two main areas can be distinguished, i.e., structure of remuneration (esp. avoiding

‘pay without performance’) on the one hand and remuneration committees and

disclosure (‘say on pay’) on the other. Of course, there are also special regulations

related to executive compensation in banks that were granted financial state aid

during the recent crisis.

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The coveted bonuses that many bankers receive are now capped at no

more than equal to their annual salaries. Only if a bank’s shareholders approve

either with a majority of 65 per cent of the votes holding half of the

shares or with a 75 per cent majority can a bonus be higher - and even

then it would be limited to no more than double the salary. To ensure a

sustainable business strategy even with higher bonuses, in such a case

pay-out is deferred over a period of at least five years. In addition, under

these regulations banks have to submit more detailed data concerning

turnover, profits, taxes paid and subsidies received. Also additional data

on the number of employees in their respective countries of operation is

requested. In 2014 these reports were only filed to the European Commission,

in 2015 these accounts will have to be made public.

*Evolution of EFP in emerging economies of Central and Eastern*

*Europe*

As to the dynamic of EFP in emerging economies, the evolution of the attitude

of social partners, political parties and governments is a classic soft

indicator. Furthermore, the legal framework, i.e., the presence or absence

of specific regulations as well as of fiscal and other incentives is important

in distinguishing conducive and *non*-conducive legal arrangements.

*Governments and the social partners’ attitudes*

In the CEE EU-10, the general attitudes towards EFP schemes of governments

and the social partners differ markedly from those in the EU-15,

particularly in the Member States of Central and Eastern Europe. The prevailing

attitude is general indifference. This mind set has been strongly influenced

by the legacies inherited from communist times and the priorities

imposed by the post-1989 transition to multi-party democracy and a market

economy. The word ‘participation’ was frequently misinterpreted and

its promotion confused with the desire to re-introduce out-dated concepts

and practices, which these countries had long abandoned. Consequently,

EFP has rarely appeared on a trade union policy agenda; only in a few

Central and Eastern European countries have trade unions actually promoted

employee ownership within the privatisation process, nor did they

develop institutions to protect employee shareholders. As to employer

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associations in the Central and Eastern European countries, their position

on EFP has been passive; in most countries, a clear official viewpoint has

not developed.

However, during the past years EFP in its various forms is more frequently

viewed as a complementary element to social and industrial relations.

A good example is the 2009/11 initiative of the Polish Vice-Prime

Minister Pawlak, which promotes employee-owned companies and regards

ESO as a factor that enhances sustainability, one that can preserve

the national identity of Polish companies and thus benefit the economy as

a whole. (Polish Ministry of Economy, 2009) Another example is the employer

association in Slovenia, which recently successfully lobbied for tax

concessions from the government for enterprises implementing EFP

schemes (ZAVEZA, 2012).

*Legal framework*

There are, however, important differences between the former socialist

countries and the mature market economies of the EU-15, and, within the

former group, between those in which employees had participated in the

operations of their enterprise in varying degrees (e.g., the former Yugoslavia

and Poland) and those where employee participation was minimal

or non-existent (e.g., Czechoslovakia). The difference in legal and political

priorities between Eastern and Western Europe stems from the fact that

the first priority of post-socialist legislators was to transform their socialist

economic systems through privatisation and re‑privatisation; thus, the development

of EFP schemes does not represent any intention to develop the

remuneration system, as in the EU-15; it is rather an accidental consequence

of the transition reforms (Uvalić & Vaughan-Whitehead, 1997).

Given the absence of general support for EFP in the Central and Eastern

European countries, legislation promoting EFP schemes has been limitedaside

from privatisation laws, which favoured the acquisition of shares by

employees. Countries having privatisation laws and which sold shares to

insiders on privileged terms are also the countries that ended up with a

substantial number of firms owned by employee workers and managers

(e.g., Poland and Slovenia). Privatisation laws favouring share acquisition

by employees under privileged conditions have been a fundamental cause

for the diffusion of ESO throughout CEE.

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*Dynamics of ESO in selected Central and Eastern European countries*

Against the background of the different genesis of EFP in the EU-15 and

the CEE EU-10 described above, it is interesting that the data examined in

the PEPPER IV report (Lowitzsch, Hashi and Woodward 2009) seem to

indicate that a West-East divide (i.e., significant differences between the

old EU-15 member states on the one hand, and at least some of the 10

post-communist states that have joined the EU since 2004) is less significant

than one might have anticipated. There seems to be much more variation

within those two groups than between them. The following discussion

uses the same data sets as presented in the 2012 European Parliament

study (Lowitzsch, Hashi et al., 2012) isolating 10 CEE emerging

economies covered therein and contrasting them with the CEE EU-10 and

the EU-15 averages (weighted averages11 for all countries available in all

three data sets).

*General trends with regards to offer and take-up of ESO-schemes*

According to CRANET12 data shown in Figure 2, the percentage of companies

offering broad-based share ownership schemes, in the old EU-15,

increased from 9.52 per cent in 1999 to 16.12 per cent in 2005 while it

slightly dropped to 14.61 per cent in 2010. In the new CEE Member

States, the percentage of companies offering broad-based share ownership

schemes increased from 9.09 per cent in 2000 to 11.54 per cent in 2005

and further extended to 19.45 per cent in 2010.13

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11 In calculating weighted averages the population of each country is used as its

weight.

12 The CRANET Survey is a large-scale survey of the human resource practices of

around 10,000 companies in Europe and other countries (in 2010 it covered firms

over 100 employees, in 1999 and 2005 the threshold was 200). Some EU Member

States were not included in all of the three rounds of the survey. The questionnaire

includes a number of questions on EFP practices in thee surveyed companies. We

thank partners of the CRANET Network, coordinated by Cranfield University

School of Management, for the use of CRANET database. We are especially grateful

to Professor Erik Poutsma and Dr Paul Ligthart, Institute of Management Research,

Radboud University, who recalculated the figures of the datasets for Figure

3 and Figure 4.

13 Interestingly, we observe an opposite development for the percentage of companies

offering broad-based profit-sharing schemes in the new Member States:

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Although we observe a general trend of the offer of ESO schemes increasing

across the EU-27, it has somewhat halted in the old Member

States recently; in the new Member States it kept increasing despite of the

financial crisis (see Figure 2).

*Figure 2. Proportion of firms offering broad-based employee share ownership*

*(ESO) schemes in selected EU Member States, 1999-2010 (in per*

*cent)*

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*Figure 2.* Proportion of firms offering broad-based employee share ownership (ESO)

schemes in selected EU Member States, 1999-2010 (in per cent)

Source: CRANET 1999, 2005 and 2010. Poland, Romania and Latvia were not

included in the survey.

Using the CRANET survey, it is possible to calculate the proportion of

employees in the sample covered by broad-based ESO plans (or to whom

the schemes are offered) as shown in Figure 3. In the old EU-15, coverage

increased from 15.52 per cent in 1999 to 18.18 per cent in 2005 and

slightly increased to 19.62 per cent in 2010. In the new CEE EU-10, the

coverage increased from 10.55 per cent in 1999 to 13.24 per cent in 2005

and further extended to 23.62 per cent in 2010.

*Figure 3.* Proportion of employees covered by employee share ownership (ESO)

schemes in selected new EU Member States, 1999-2010 (in per cent)

Source: CRANET 1999, 2005 and 2010. Poland, Romania and Latvia were not

included in the survey.

With regard to the coverage of ESO schemes, the positive trend across

EU 27 is more consistent. As to the offer, however, the increase is much

Source: CRANET 1999, 2005 and 2010. Poland, Romania and Latvia were not included

in the survey.

Using the CRANET survey, it is possible to calculate the proportion of

employees in the sample covered by broad-based ESO plans (or to whom

the schemes are offered) as shown in Figure 3. In the old EU-15, coverage

increased from 15.52 per cent in 1999 to 18.18 per cent in 2005 and slightly

increased to 19.62 per cent in 2010. In the new CEE EU-10, the coverage

increased from 10.55 per cent in 1999 to 13.24 per cent in 2005 and

further extended to 23.62 per cent in 2010.

The percentage dropped continuously from 15.24 per cent in 2000 to 15.17 per

cent in 2005 which was further narrowed to 7.87 per cent in 2010.

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*Figure 3. Proportion of employees covered by employee share ownership*

*(ESO) schemes in selected new EU Member States, 1999-2010 (in per*

*cent)*

*Figure 2.* Proportion of firms offering broad-based employee share ownership (ESO)

schemes in selected EU Member States, 1999-2010 (in per cent)

Source: CRANET 1999, 2005 and 2010. Poland, Romania and Latvia were not

included in the survey.

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Member States (see Figure 3).

The availability of the new European Working Conditions Survey

(EWCS)14 2010 makes it possible to compare the take-up of ESO schemes

over the entire decade, shown in Figure 4. In the old EU-15, take-up increased

from 1.63 per cent in 1999 to 2.44 per cent in 2005 and further

increased to 3.74 per cent in 2010. In contrast, in the new CEE EU-10, the

percentage of employees participating in broad-based ESO schemes increased

from 0.78 per cent in 2000 to 1.95 per cent in 2005 dropping to

1.54 per cent in 2010.

14 The EWCS is a large-scale survey of working conditions across Europe undertaken

by the European Foundation for the Improvement of Working and Living Conditions

(Eurofound) every four or five years to investigate a variety of factors influencing

individuals working and living conditions. It covers some 30,000 people

in 30 countries. The 1999 Survey was conducted in the EU-15. The EU-12 were

surveyed in 2000. The data reported here refers to the employees of private sector

companies only as the public sector does not lend itself to ESO (as there are no

shares in these organisations).

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*Figure 4. Proportion of employees participating in employee share ownership*

*(ESO) schemes in 10 new CEE EU Member States, 2000-2010 (in per*

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*Figure 4.* Proportion of employees participating in employee share ownership (ESO)

schemes in 10 new CEE EU Member States, 2000-2010 (in per cent)

Source: EWCS 2000, 2005 and 2010.

The proportion of company employees participating in broad-based

ESO schemes – which in general has been increasing though in recent

years growth has slowed – shows a different pattern in the old Member

States, where it kept increasing and in the new CEE Member States where

it recently slightly dipped (see Figure 4).

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To summarise, in the new CEE Member States the offer of ESO

schemes in companies kept increasing despite the crisis – unlike in the

EU-15, where it remained stagnant; the increase in coverage even exceeded

that in the old Member States. However, – in spite of a generally positive

dynamic during the last decade – the percentage of employees that actually

participated in these schemes in 2010 was smaller than in the

EU-15.

*ESO in companies of different size*

The European Company Survey (ECS)15 contains information on company

size, which can be matched against the availability of an EFP scheme.

*5.2*

15 The ECS is a survey of all European companies conducted by the European Foundation

in 2009. It covers some 30,000 companies in 30 European countries (all EU

Member States and candidate countries).

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As expected, the size of the company is closely associated with the incidence

of ESO. Figure 5 shows the availability and extent of ESO schemes

in companies of different size groups (large, medium and small).

*Figure 5. Proportion of companies of different size offering employee*

*share ownership (ESO) schemes to their employees in 10 new CEE EU*

*Member States, 2009 (in per cent)*

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*Figure 5.* Proportion of companies of different size offering employee share ownership

(ESO) schemes to their employees in 10 new CEE EU Member States, 2009 (in per

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Source: based on ECS dataset, 2009, own calculations.

It indicates that large companies almost always have higher levels of

employee share ownership and profit-sharing schemes than medium and,

especially, small companies. The one exception is Poland. Similarly,

medium-sized companies exhibit higher incidence of employee share

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than small companies (only Bulgaria is an exception to this pattern).

These findings were confirmed by a study for the European Parliament

(Lowitzsch, Hashi, et al., 2012), investigating the relationship between

countries’ degree of support for EFP and the actual offer of EFP schemes

by firms.16 Consistent with the experience in many EU Member States, it

finds that profit sharing is less dependent on supportive measures than

ESO, and is often introduced without them. For ESO - especially in smaller

companies, as the incidence is strongly size-related - the opposite is

true: Only when supportive measures are in place over a long period of

time without substantial changes, is ESO likely to be sustainable.

16 For this comparison of the EU-27 (ranked according to a set of criteria – including

the legal framework, fiscal and other incentives and government support – in

countries clusters) with the offer of EFP schemes the ECS 2009 cross-country data

(EFP in firms with more than 10 employees) was used; see p. 59-63.

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*Summary of the empirical findings*

On the whole, there are some discrepancies between data sources with regard

to certain countries; however, the overall picture is quite clear. While

for most individual countries it would be rather risky to make definitive

assertions about the degree of advancement of dissemination of ESO

schemes on the basis of the data we have examined, we can identify what

seem to be some general trends.

In the new Member States the offer of ESO schemes in companies (employing

more than 200 employees) and particularly the coverage kept increasing

despite the crisis. In this respect the CEE EU-10 dynamic is more

positive than in the EU-15. However, the percentage of employees actually

participating in these schemes in 2010 was smaller than in the EU-15.

With regards to sustainability of employee share ownership – especially

in smaller companies, as incidence is strongly related to size – a key element

seems to be that supportive measures are kept in place over time

without substantial changes.

*Promoting sustainable ESO – Lessons from three selected countries17*

In general, employee financial participation needs sustainable policy support

to realise its potential. Best practice from the old Member States show

that a stable legal framework for EFP induces individual firms to offer

these schemes and suggests that this is particularly true for share schemes,

as they require a more complex setting (Lowitzsch, Hashi, & Woodward,

2009). In the following we analyse three cases, i.e., Poland, Hungary and

Lithuania to investigate to which extent this finding holds true for emerging

economies. We conclude with policy recommendations drawn from

our findings.

*5.3*

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17 The authors thank in particular Gyula Kocsis, Adam Wojtkowski and Thijs

Wubbels who contributed to the case studies (for a more extensive and detailed report

on these countries see Lowitzsch & Hashi, 2012, annex 6).

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*SME employee buyouts in privatisation (Spółki Pracownicze, Poland)*

A positive example of utilisation of employee ownership plans in the

course of privatisation is the case of ‘Spółki Pracownicze’ (Employee

Companies) from Poland. The important feature of this case is that - unlike

most East European countries, which ceased to support employee

ownership after the privatisation was completed - Poland introduced further

supportive measures. As a result companies retained majority employee

ownership and also showed good performance, even during the financial

crisis.

The most significant form of EFP in Poland today is employee ownership. Poland’s

privatisation programme was characterised by significant incentives for employee

participation, especially in firms privatised by leasing and transformed into so-called

Employee Companies (spółki pracownicze). Contrary to expectations, ownership

structures in these companies have, on the whole, been relatively stable, with nonmanagerial

employees retaining, on average, a significant portion of enterprise

shares. Although all current forms of financial participation may also be used in employee

compensation schemes outside of privatisation, there are no tax incentives to

encourage this.

By 2002, the most common way to manage a privatised enterprise was to lease it to

an ‘Employee Company’. From 1990 until 2010, 62.4 per cent of enterprises undergoing

‘direct privatisation’ were transferred into private hand through a leveragelease

buyout resulting in a total of 1,563 Employee Companies that emerged from

former state enterprises. However, over time, there has been a slow but steady decline

of Employee Companies, some of them going public, others going bankrupt or

being liquidated.

Until the end of 2010, their population decreased to 852 employing a total of 131.5

thousand workers with an average size of 150 employees. It is difficult to obtain information

on the reasons for the decline of employee ownership as Employee Companies

are not a specific legal form of enterprise but registered together with all other

corporations. It was certainly not economic distress: In 2010, Employee Companies

have achieved a positive gross profit of PLN 2,322 million (as compared to PLN

2,106.7 million in 2009) with an average gross turnover profitability rate close to

five per cent.

Reacting to this decline, in the end of 2009, the Polish Government launched the current

programme to support Employee Companies entitled Supporting Privatisation

Through Granting Sureties and Guarantees to Employee Companies and Civic Activity

Companies. Beyond a system of guarantees for Employee Companies, the programme

defines the Company of Civic Activity, a joint-stock company or limited liability

company where 33 per cent shares belong to at least 30 per cent of the active

employees of a privatised enterprise.

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On the one hand, the Polish case is limited in its transferability to countries

with no significant large-scale privatisations programmes. On the

other hand, the case is useful especially for other Eastern European emerging

economies, especially for Lithuania and Hungary, which - as their cases

below will show - still have an opportunity to reactivate the support for

employee ownership and thus support employee ownership in a sustainable

way as in Poland.

*Decline of Hungary’s employee-owned firms failing long-term*

*policies*

The case from Hungary shows that the discontinuation of political support

leads to a rapid decline of employee ownership. The specific feature of the

Hungarian ESOP experience is that intermediary entities, which could be

well used after privatisation was completed, declined steeply due to lack

of political support.

In the course of transition, instruments for broad individual and collective participation

of employees have been introduced. During the first stage of privatisation, the

support of social partners and political parties, on the one hand, and the actual development

of employee ownership, on the other, seemed to be promising. However, on

the long run, the attempt of policy makers to turn a considerable proportion of Hungarians

into owners, i.e., into small capitalists, and to establish an economic balance

did not bring the desired outcome. In many ways it resulted in the opposite. Since

then only about 300 ESOPs were established in total and less than one quarter is still

functioning today.

The legal framework for the Hungarian ESOPs, which already existed in practice,

was laid down in Law XLIV of 1992 on the Employee Share Ownership Programme.

Deriving from the U.S. ESOP model, the Hungarian ESOP structure simulates the

Anglo-American trust. It served a dual purpose: It transformed employees into owners

of state-owned companies while accelerating the privatisation process. The legal

framework of the ESOP today largely retains its original form, though it has been

amended several times, most recently in 2003. The ESOP Act enabled employees to

acquire state property under preferential conditions, which were significantly limited

by Law XXXIX of 1995 on Realisation of Entrepreneurial Property in State Ownership

providing (i) credit facilities of up to 50 per cent of the value of the respective

property to be purchased, with a ceiling of HUF 50 million; (ii) a discount corresponding

to 150 per cent of an annual minimum wage. The total equity purchased by

an ESOP was not to exceed 15 per cent of the nominal value of the company. The

legal incentives are based on a governmental decree of 1991 on ‘Egzisztencia’ credit

and the amendments of the ESOP Act of 1992 still in force. The fact that no ESOP

loans have been granted since 1998, although the decree is still in force, shows that

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these conditions need revision, in particular abolishing the link of preferential credit

conditions to the nearly terminated privatisation process.

After 1996, one year after the amendment of the ESOP Act, the absolute number of

ESOP organisations declined continuously. Following 1998, no more ESOPs have

been established, and from 1996 on the number of ESOPs shrunk until 2010 to approximately

one-fourth, which is also the lowest point.

The primary cause for the failure of the ESOP model was the lack of commitment to

this idea and the lack of sufficient far-sightedness of political institutions. This is

even more regretful, as companies in majority ownership of employees did not perform

worse than other private economic entities. The Hungarian ESOP was a premature

model because policy makers did not change the provisions early enough and

thus permitted the abuse of the original concept behind it. For these reasons, ESOP

schemes were not as successful as they could have been in the long run, as they

lacked the necessary sustainable provisions in the post-privatisation era. Furthermore,

the time window of three to four years, when SMEs were privatised, was a period

too short to be able to measure the real outcomes of ESOPs and to make policy

amendments to foster employee ownership.

A lack of supportive measures and inconsistent legislation led to a steep

decrease in the number of ESOPs in Hungary. However, this tendency

could still be changed if a comprehensive supportive legislation were developed.

The European trend to implement employee financial participation

schemes through an intermediary entity could give orientation to the

Hungarian Government to introduce new rules. On the other hand, a European

framework could contain rules for intermediary entities giving positive

impulses to those still existing in Hungary.

*Failing sustainable support to employee shareholding in Lithuania*

Given the prevailing economic conditions in Central and Eastern Europe,

the CEE EU-10 could discover that financial participation is even more

important to them than to the EU-15. However, although these countries

mostly introduced share ownership as a one-time incentive to employees

during privatisation, they did not follow up with policies and measures

that would make employee share ownership a permanent component of

their new private property, free market economies. By contrast, a number

of Western governments as well as the EU itself have actively promoted

EFP precisely because of its beneficial long-range effects. In conjunction

to the best practice of Poland presented above, the case of Lithuania, like

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the case of Hungary, shows that employee ownership is likely to be sustainable

if political support is continuing.

The development of employee financial participation in Lithuania started in the early

1990s in the course of privatisation. Until 1994, Lithuania was in the vanguard of

economic reform. Not only economic, but also political considerations of achieving

complete independence from the Soviet Union led to the concept of fast privatisation.

In addition, the leading politicians favoured egalitarian forms of employee ownership

also supported by the trade unions. For that reason, the most popular privatisation

forms were mass privatisation on the basis of vouchers and management-employee

buyout, while sale to outsiders or liquidation were hardly used at all. Irrespective

of the reasons for promoting employee ownership, the policy first led to a rapid

growth of employee share ownership.

By 1994, more than 95 per cent of privatised firms in the programme implementing

the Law on the Initial Privatisation of State-Owned Property had employee ownership,

while the percentage of enterprises where employees had taken over most of the

privatised assets increased from three per cent in 1991-1992, to 65 per cent in 1993

and 92 per cent in 1994-1995 (Privatisation Department at the Ministry of Economics).

However, the situation completely changed during the late 1990s and early

2000s. Whereas in 1993 around 50 per cent of employees were shareholders of their

enterprises, in 1999 the percentage fell to one third. According to the survey conducted

in connection with the PEPPER IV Report, only four per cent of Lithuanian

firms offered broad-based ownership plans in 2007, and only 1.7 per cent of employees

actually participated in such scheme.

The case of Lithuania exemplifies the importance of sustainability of legal

and fiscal incentives. Whereas sufficient legal incentives, even if they are

not the typical tax incentives, can lead to a surprisingly rapid increase of

employee ownership from nought to almost 90 per cent in only three

years, the abolishment of the same incentives leads to an equally dramatic

decline. Not the volume of incentives, but their stability can produce a

long-term effect.

*Policy recommendations: EFP needs sustainable political support to*

*realise its potential, especially a stable legal framework*

In the new Member States the offer of ESO schemes in companies and in

particular the coverage kept increasing despite the crisis. In this respect

the CEE EU-10 show a dynamic more positive than the EU-15. However,

the percentage of employees that actually participated in these schemes in

2010 was smaller than in the EU-15. Likewise, the 2010 average of em-

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ployee shareholders’ market capitalisation in large listed firms was 0.26

percentage points below the 2007 average corresponding to a drop in takeup

rate. However, there is much variation within the CEE EU-10, especially

with regard to the different policy approaches in different countries. Actually

the sustainability of employee share ownership – especially in

smaller companies, as incidence is strongly related to size – a key element

seems to be that supportive measures stay in place for a long period of

time without substantial change.

These empirical findings from our data digest are reflected in the individual

case studies of Hungary and Lithuania. These clearly show that discontinuation

of political support leads to a rapid decline in ESO, even

when the level of ESO was previously high. By contrast, the case of

Poland shows that support measures – even small ones – can have an opposite

effect, helping to stabilise employee ownership. The important feature

of the Polish case is that – unlike most East European countries,

which ceased to support employee ownership after privatisation was completed

– the government introduced further supportive measures. As a result,

companies maintained majority employee ownership and also performed

well, even during the financial crisis.

This confirms best practice findings in the old EU Member States, especially

those from France and the UK, showing that a stable legal framework

of measures in support of EFP facilitates the implementation of ESO

schemes as a vehicle for strategic employee ownership in individual enterprises.

The experience of Lithuania, on a smaller scale, can be observed also in

other Eastern European countries where the increase in employee financial

participation was mostly a by-product of the privatisation process and often

not considered as worthy of further support. In so far, Lithuania is both

a typical case and a cautiously example.

All three cases together indicate that the stability of political support is

more important than the number of incentives and their extent.

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