>> Opinion

Employee Profit-Sharing – The Silver Bullet?

Klaus F. Zimmermann

Increased profit-sharing by employees is often viewed as a socially fair means to promote growth and employment. Under Germany's ruling Grand Coalition, this idea – captured in the term *Investivlohn* ("investment wage") – has received a popularity boost of late. Virtually overnight, detailed plans to enact new legal regulations have surfaced.

Germany indeed lags somewhat behind other European nations in this respect. Only 10 percent of German companies with more than 200 employees offer stock ownership plans, while barely 18 percent provide their workforce with some form of profit-sharing. A mere cross-country comparison, however, is not entirely fair. In the United Kingdom and France, for instance, large corporations play a much stronger role, and profit-sharing or stock ownership plans are more often subsidized or legally mandated.

What can we expect from employee profit-sharing? Empirical studies find positive effects on motivation, absenteeism, job flows, innovations, profitability and productivity – particularly for small to medium-sized firms. Stronger motivation and identification with the company also improves the acceptance of necessary structural changes within the own company or the national economy as a whole. At the same time, firms with profit-sharing plans are better able to recruit and retain high-performance employees.

As an element of a flexible collective bargaining policy, employee profit-sharing plans could complement moderate wage agreements and help cushion the impact of cyclical shocks. Smaller wage increases could thus be supplemented by profit-sharing elements under favorable economic conditions while avoiding the negative impact of larger wage increases during economic downturns.

But there is also a substantial downside to profit-sharing. Particularly under stock ownership plans, employees share the entrepreneurial risk, which may involve massive losses to the extent of bankruptcy. This is why these plans are offered primarily by larger corporations listed on the stock exchange. While their stocks are easily tradable and transferable, this is much more difficult for smaller companies. In the case of partnerships, moreover, capital-sharing plans may fail due to organizational problems or resistance by the business owners. As a result, this instrument is most difficult to implement in companies where it would be most effective in terms of employee motivation.

Nonetheless, Germany should try to promote the idea of profit-sharing or stock ownership plans. After all, these are important means of employee participation. A voluntary introduction at the company level would certainly be superior to new government subsidies or legal requirements. Capital-sharing through independent, market-based equity funds would be the simplest way of protecting employees from the entrepreneurial risk and sustaining their job mobility. This scheme would not only constitute a new pillar of old-age provision, but profit-based wage agreements would also allow employees to share in the short-term success of the company.

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