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SPANISH SOCIEDADES LABORALES: ACTIVATING THE UNEMPLOYED

A Potential New EU Active Labour Market Policy Instrument

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by Jens Lowitzsch, Sophie Dunsch and Iraj Hashi (Palgrave/McMillan 2017)

Executive Summary

Employee financial participation in Spain mainly takes the form of Sociedades Laborales (SL=Worker-Owned Companies). **A SL is a qualified form of conventional corporations, majority-owned by its permanent employees**. Unlike a cooperative, an SL having a minimum of three owners, two of which must be working partners, is based on shared ownership and is permitted to utilise non-employee capital. In general no partner may own more than 33% of the company's stock.

SLs are usually **small and micro-sized limited liability companies employing an average of 4.8 workers**. Joint stock SLs are less common. A major reason for the steady growth in the number of SLs is that since 1985 in lieu of receiving monthly payments, **job seekers may choose to capitalise their unemployment benefits** into a lump sum in order **to found a new SL or to recapitalize an existing SL** by becoming a member.

Scope of Investigation

The capitalization of unemployment benefits in setting up an SL is **similar to start-up subsidies for the unemployed**, a practice already well established in active labour market policy (ALMP) in many countries. There is, however, a significant difference in that SLs are set up not only by unemployed persons but also by ordinary entrepreneurs and typically involve external investors. It is estimated that **about one-third of SLs utilise the capitalisation of unemployment benefits at the time of their founding**.

Unlike the start-up subsidies used in the context of ALMP, **SLs offer not only access to capital but practical assistance and entrepreneurial advice** to an unemployed person joining or setting up an SL. Most importantly these enterprises have a sound potential for creating additional jobs as they grow.

This book will investigate the **potential of Sociedades Laborales to supplement ALMP as an additional means for both reactivating the unemployed and encouraging the entrepreneurship** on which national economies depend for innovation and growth. It also explores the question of how a scheme unique to Spain could be extended to other EU Member States.

Review of the Literature on Employee-Owned Firms

The large majority of the academic literature on employee ownership finds that when properly implemented employee share schemes and employee (co-)ownership have **a positive influence both on the performance of companies as well as the company culture and employee satisfaction**. However, empirical studies, showing these positive effects also suggest that employee ownership may be associated with problems for both firms and workers above all with regard to interference with management, underinvestment, and the risk for employees.

Many of the **benefits of employee share ownership are complementary to the policy aims of ALMPs**. With regard to SLs this is in particular the case for employment, retention of key staff, access to finance and resilience. The feature that SLs are set up as corporations by a minimum of three partners makes them genuinely different from other ALMP start-up schemes in particular with regard to access to capital. However, over time SLs sometimes face difficulties to comply with the 50 per cent threshold of employee ownership, a problem that is known as deliberate 'disqualification'. While a change of employee owned firms to private firms is sometimes connected to possible tensions between owner workers and non-owner workers in the case of SLs disqualification is related rather to the inability not the unwillingness of new employees joining an SL to acquire its shares.

Legal Framework; Fiscal and Other Incentives; Government Subsidies

SLs are subject to the 2015 Law on Worker-Owned and Participatory Companies (replacing the 1997 Law on Sociedades Laborales) and to regular company law. In general, non-owner workers may not work more than 49 per cent of the hours worked by worker-owners. When a worker-owner leaves the company, his or her shares must be offered for sale internally, with non-shareholding employees having priority. An SL must also allocate **ten per cent of its annual net profit to a Special Reserve Fund**.

An SL may apply for a modest exemption from taxes and notarial deeds on asset transfers to the SL incurred in the start-up phase; it may also depreciate the cost of assets acquired during the first five years. Independently general fiscal incentives for SMEs and newly founded businesses introduced in 2013 also apply to the SL. **Government grants facilitate the integration of unemployed persons as worker-owners as well as technical assistance and training**; furthermore, investment in fixed assets and the reimbursement of loan interests are supported by aids and subsidies.

Population and Development Over Time

We observe a **shift in legal form from joint stock SLs to limited liability SLs (SLLs) over time** with the overall number of SLs rising by 18 per cent from 9,620 firms in 1999 to 11,322 in 2013. During the same period, though, the number of workers employed in SLs declined by 16% — from 75,606 workers to 63,472. Reflecting the shift to the smaller form of corporation, nevertheless, both population (from 5,060 to 9,984) and employment (from 20,808 to 47,727) of SLLs doubled in the same interval. However, these official employment figures do not capture independent workers which are estimated to account for between 15 and 25 per cent of overall employment. This decrease was mainly due to the financial crisis; the largest loss occurred in the construction sector.

Capitalized Unemployment Benefits and Survival Rates

Between 2006 and 2013 on average 2,240 persons capitalized unemployment benefits to set up or join a SL in Spain (164 in the Basque Country), with an average annual total of around EUR 13,233 (EUR 16,775 in the Basque Country) per person. Survey data from Andalusia (FEANSAL, 2012) and anecdotal information from ASLE in the Basque Country indicates that around **a third of SLs receive monies from the capitalisation of unemployment benefits** as a lump sum to start the firm. This stresses the impact of the capitalisation of unemployment benefits as a tool for the creation of new SLs – as opposed to capitalisation used to join an existing SL.

In both Spain and the Basque Country the crisis years had a negative impact on the use of the capitalisation mechanism and women are largely underrepresented which indicates that they are less active in SL start-ups and; in general **the youngest age groups are significantly underrepresented**, a result that is not surprising as the vast majority of them will not have been previously in employment – a prerequisite to make use of the capitalisation mechanism of unemployment benefits.

SLs survive long enough to amortise capitalised unemployment benefits: The average paid-out lump sum in Spain represents roughly the cost of 1.3 years (1.2 years in the Basque Country) worth of unemployment benefits; on average, 88 per cent of all SLs survive this long (99 per cent in the Basque Country). More general, between 1999 and 2013, the **median survival rates of SLLs stabilized at around 88 per cent after one year**, 63 per cent after three years, and 49 per cent after five years indicating a low risk for the unemployed involved. **SLLs generally have higher survival rates than their conventional competitors** but there are regional differences. For example, although the median survival rate in the fourth year for Spain is around 63 per cent, in the Basque Country the figure is as much as 95 per cent. This gap, however, could be caused by use of different statistical methods.

The Disqualification Problem: Evidence from the Basque Country and Anadalusia

Data from the Basque Country shows that some SLs convert to a conventional firm because they have grown too fast to comply with the legal restrictions of the program. Thus a **successful SL may loose its status when employee ownership drops below the 50% threshold** as it grows and employees cannot keep up buying newly issued shares. Such firms become **victims of their own Success**. They are expanding and have substantial employee ownership, but the rules force them to become conventional companies. In previous statistics SLs that transformed to conventional firms were erroneously accounted for as exiting the market in the course of bankruptcy or being wound up. When adjusting survival rates for the SLLs founded in 2003 in the Basque country including those firms that remained after disqualification with substantial employee ownership on the market these were increasingly higher over the time span reaching a difference of 7 percentage points in some years.

A 2012 survey from Andalusia indicates that **insufficient government support and restrictions on hiring permanent workers** are the main reasons why SLs have converted abandoning the SL formula. Although only 3.9 per cent of firms gave absence of tax incentives as a reason for seeking disqualification, 73.25 per cent of disqualified firms reported that they would have striven to remain an SL had financial incentives been in place.

Capitalisation of SLLs in the Basque Country

SLs can also receive capital from investing partners that are not working in the SL. The dataset from the Basque Country shows that from 2003 to 2013, on average, 16 per cent of all SLs partners were investors (while in Spain the average is much higher with 27 per cent over the same period); the vast majority of SLLs has three or four partners and independently of size investing partners are present throughout the population though to a somewhat varying degree. With regard to the amount of investment by working and investing partners in the Basque Country it is remarkable that the median capital in SLLs without investing partners is significantly higher than that in SLLs with investing partners; this indicates that **investors step in where working partners themselves cannot contribute sufficient capital for the start-up** but also that **investing partners are by no means the dominant partners in SLs**.

However, with the annual average capitalisation by formerly unemployed in the Basque Country as high as Euro 16,775 and the average of capitalisation in firms with investing partners being comparably low, we can conclude that **insufficient capital contribution of formerly unemployed would not be a determining factor for the involvement of investing partners**. As far as the initial capital of SLs is concerned, there are large variations within companies with different number of partners; in firms with three founding partners for example the capitalisation ranges from the minimum of Euro 3,000 gradually to Euro 300,000 – an indication that not all founders are formerly unemployed capitalising their unemployment benefit.

Generally **the proportion of capital contributions between investing and working partners is roughly stable at 33 per cent for investing partners and 66 per cent for working partners**; information provided by ASLE from their practical experience in coaching SLs suggests that SLL partners generally contribute an equal share. The average representation of male and female partners shows a similar pattern over the whole population: While women are strongly underrepresented as working partners they are more active than men as investing partners.

Government Cost of the Program in the Basque Country

In the Basque Country **from 2006 to 2013, an average of 49 SLs were created annually, providing jobs for 164 owner-workers**. It is estimated that the secondary employment effect equates to creation of approximately 1.3 non-owner jobs after incorporation, or an annual average of 213. With annually on average subsidies of EUR 355,917 for 377 jobs this breaks down into **a subsidy of EUR 944 per job created.** Non-profit organisations representing SLs, e.g., ASLE in the Basque Country, provide major on-going support for entrepreneurs — **training, coaching and similar services are provided by ASLE at an average annual subsidy cost of EUR 817 per SL**. In the Basque Country somewhat more than one-third of SLs, i.e., 309 out of 883, are clients of ASLE and thus beneficiaries of this type of subsidy.

Although the crisis clearly had a negative impact on unemployed joining or setting up SLs as in rest of Spain the dynamic is different in the Basque Country; it stabilises by 2010 and from 2011 shows a positive trend which is much more pronounced for women, an indication that they have become more active in the aftermath of the crisis.

ACCESS TO FINANCING

Two factors in particular positively affect the ability of an SL to attract external financing. First, as a corporation **SLs may sell shares to outside investors without the risk of personal liability** for either the working partner or the investor. Second, SLs originate in a conventional start-up concept; from the outside they appear as conventional firms **not bearing the stigma of being set up by unemployed persons** — an important factor in applying for bank loans. Indeed, unlike most ALMP start-ups, SLs as a rule attract outside capital. **Investing partners represent 27 per cent of partners in all SLs founded in Spain between 2003 and 2013**.

SECONDARY EMPLOYMENT EFFECTS

With respect to secondary employment, SLs have two structural features that differentiate them from ALMP start-ups: Firstly, **they involve outside investments, a condition for growth**. Secondly, they require a minimum of three partners as a condition of incorporation (generally two working partners and one investor partner) and **are designed to integrate additional employees**.

According to employment data for 2008 – 2013, 1.3 additional jobs were created per founding worker partner; this suggests that other years will show a similar secondary employment effect. This assumption, however, is based on aggregate data and thus must be considered tentative. Corresponding data on individual SLs for the years of this analysis are currently unavailable.

POTENTIAL LINKS OF THE SL CONCEPT WITH CURRENT ALMPS

SLs have one conceptual shortcoming when it comes to returning young unemployed workers to the labour market. As young people who have no work experience or job history have never paid into the unemployment insurance program they are not entitled to capitalizing their unemployment benefit to found a new or join an existing SL. Consequently, **the group most in need of this successful program is excluded from it**.

Microfinance or similar programs might be adopted to extend the existing SL concept to unemployed young people. This could be a way to alleviate the urgent problem of youth unemployment in the European Union. An extended SL program designed for unemployed young people could be transformational not only for them but for society and the European Union of the future.

TRANSFERRING THE SL CONCEPT TO OTHER MEMBER STATES

The SL program, so successful in its home country, Spain, could be a fruitful addition to the labour market policies at the national as well as at the EU level. Since the concept is essentially based on the legal form of a conventional low-threshold limited liability company, there are **no legal obstacles in national company law to prevent its adoption.**

The model has important benefits that make it particularly **suitable for combination with existing national start-up incentives for the unemployed**. However, although all Member States operate a variety of different start-up incentives for unemployed, only four countries foresee the possibility to convert unemployment benefits to capitalise start-ups, a mechanism that has been a key factor in the success of the Spanish SLs.