

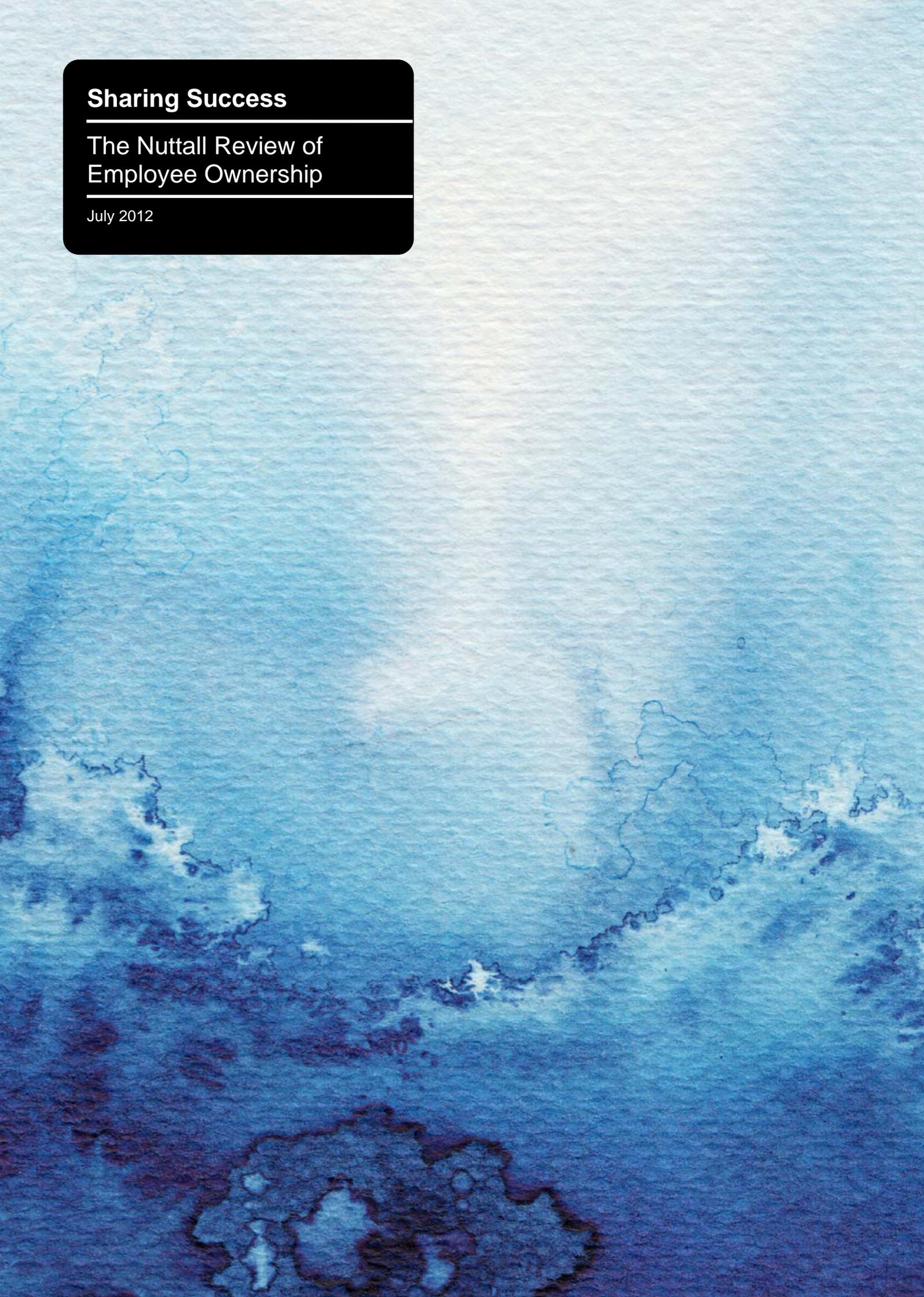
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## The Nuttall Review of Employee Ownership

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July 2012



## Foreword by Norman Lamb, Minister for Employment Relations, Consumer and Postal Affairs



Growing the economy is the Coalition's most pressing priority. Lessons from the financial crisis have exposed our economy as too narrowly focused on certain sectors and regions, with the majority of our companies structured around one type of business model. We need to fundamentally change our economy to ensure long term growth is strong and more evenly balanced in the future. One of the centrepieces to creating this sustainable growth is to encourage more responsible and more diverse ways of running a business in Britain today. I want this to be the decade of wider employee ownership.

The relationship between a business and its employees is key to this. As Minister for Employment Relations, I see at first hand how crucial this relationship can be and the benefits for business when it works to its full potential.

That is why I strongly support the expansion of employee ownership in the UK economy. Giving all workers a greater stake in the company they work for is a powerful way of aligning the interests of employees with that of the business. A worker who has a financial and personal stake in a company will take more responsibility for its success. The evidence shows that this is reflected in the economic strength of such companies: lower absenteeism, a happier workforce and therefore less staff turnover, higher profitability. These companies also tend to be more resilient in tough economic times.

But this is not a new concept. Employee ownership already has a strong foothold amongst some of our most iconic British companies. However, more can and should be done to raise awareness of this business model amongst professionals and employees. My goal is to shift employee ownership into the mainstream of corporate Britain. That is why I asked Graeme Nuttall, one of the foremost experts on employee ownership, to undertake an independent review into employee ownership.

His report is illuminating; his recommendations are persuasive. The arguments for spreading employee ownership, to create a more diversified and balanced economy, are compelling. This report provides a forensic examination of the barriers to expanding employee ownership. It raises the level of debate and lays down a challenge to

Government and the private sector. Government will respond fully in the autumn, but we can all begin right now, to take the steps that have been identified.

I would like to thank Graeme Nuttall, the team supporting him and all the individuals and organisations that have committed time to develop this report and deliver its findings.

A handwritten signature in black ink, appearing to read 'Norman Lamb', with a horizontal line underneath.

**Norman Lamb**

**Minister for Employment Relations, Consumer and Postal Affairs**

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# Foreword by Graeme Nuttall



Employee ownership is a great idea.

It means a significant and meaningful stake in a business for all employees. It creates successful businesses in which employees enjoy working and which deliver wider benefits. The longevity of companies with employee ownership is impressive. Employee ownership is an adaptable concept and whatever the business or the stage a business has reached employee ownership can work well.

I discovered employee ownership because a former managing partner of my firm asked me to co-write the first UK book on the legal and tax aspects of employee ownership, and introduced me to the persuasive founder of the Employee Ownership Association, Robert Oakeshott. Many in the employee ownership sector have said their awareness of the concept is because of serendipity. This must change. A great idea should not depend on a happy accident to spread awareness. The concept needs to be as familiar as franchising or a management buy out.

A listed company wishing to establish an executive share plan will find all the assistance it needs. The Employee Ownership Association and a number of other organisations provide valuable information and guidance on employee ownership. But their resources are not enough if employee ownership is to enter the mainstream of the British economy. Much wider resources, including finance, are needed.

A good number see employee ownership as complex. It need not be. The company can be much like any other company. What is different is how it is owned. It is really easy to create a new company with employee ownership. There are examples in the Government's public sector mutualisation programme of hundreds becoming employee owners overnight through buying a share for £1 in their company. Many new employee owned companies are wholly owned by an employee benefit trust. Establishing an employee benefit trust is not difficult. Most professional advisers can arrange this; they just need to appreciate that an employee benefit trust can be a genuine part of a business ownership model.

There will be, of course, legal and tax complexities in some situations. If employee ownership is to become widespread work is needed to reduce these situations.

Everyone in the employee ownership sector applauds the Government's announcement that it wishes to see employee ownership in the mainstream of the British economy. There has been all party support for decades, and successive governments have

encouraged employees to acquire shares through tax advantaged share plans but this Government is the first to promote the wider concept of employee ownership.

There is a valuable wider debate about ensuring any venture has the right ownership model. It is sensible for government to facilitate a plurality of ownership models, including employee ownership.

This review explains the obstacles to promoting employee ownership and sets out a framework for knocking them down. This task of knocking down the barriers falls to all in the employee ownership sector, as much as it does to government, and also to new audiences, who need to consider what employee ownership means and join the growing number that believe employee ownership is a great idea.



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**4 July 2012**

# List of recommendations

## Chapter 3: Raising awareness of employee ownership

### Promoting and raising awareness of employee ownership

#### Recommendation A (page 32)

The Government should continue to promote employee ownership, building upon the Deputy Prime Minister's vision set out at Mansion House and on the framework established by this review.

#### Recommendation B (page 35)

Through the Minister for Employment Relations, the Department for Business, Innovation and Skills should design and lead an awareness raising programme aimed at promoting the concept and benefits of employee ownership and, in particular, of employee owned companies. The design and delivery of the programme should involve other Government departments and external stakeholders wherever possible, and be coordinated with wider Government messages on, for example, mutuals and co-operatives policy, plurality of ownership models and employee engagement.

### Raising awareness of employee ownership within the Government, and ensuring continuity

#### Recommendation C (page 35)

The Government should maintain the appointment of a Minister responsible for promoting employee ownership across Government.

#### Recommendation D (page 35)

The Department for Business, Innovation and Skills, Cabinet Office, HM Treasury and HM Revenue & Customs should report on steps taken to ensure continuity of knowledge in central Government on employee ownership, including though:

- official visits to employee owned companies;
- lead points of contact on employee ownership at each department;
- the content of HM Revenue and Custom's website and manuals;
- regular updates on Business Link; and
- policy on archiving employee ownership information.

**Recommendation E** (page 36)

The Government should improve the data collected on the extent of employee ownership, for example, by adding new questions on employee ownership into Office for National Statistics surveys and the Workplace Employment Relations Study; and business surveys coordinated by the Department for Business, Innovation and Skills.

**Raising awareness of employee ownership at key points in the business lifecycle****Recommendation F** (page 37)

The Department of Work and Pensions should disseminate information to New Enterprise Allowance partnerships, aimed at promoting employee ownership solutions to groups of claimants eligible for the New Enterprise Allowance.

**Recommendation G** (page 37)

The Employee Engagement Taskforce should consider opportunities to build employee ownership into their work with practitioner panels and their forthcoming employee engagement website.

**Recommendation H** (page 38)

The Department for Business, Innovation and Skills, with external stakeholders, should promote employee ownership as a business succession solution.

**Recommendation I** (page 38)

The Department for Business, Innovation and Skills should promote the Business Finance Partnership to funds that support employee ownership and target employee owned companies.

**Recommendation J** (page 39)

Co-operatives UK, the Department for Business, Innovation and Skills and the Insolvency Service, should assess the scope for a pilot scheme, running from 2013, to test the potential for employee buy outs as a solution in relevant business rescue situations.

**Raising awareness and demand through a Right to Request employee ownership****Recommendation K** (page 44)

The Department for Business, Innovation and Skills, working with ACAS, should encourage employer and employee groups (including trades unions) to develop a voluntary Code of Practice setting out best practice on requesting and agreeing employee ownership in a company. In parallel the Department for Business, Innovation and Skills should consider what further role Government has in providing statutory support, through Recommendations L and M.

**Recommendation L** (page 44)

The Department for Business, Innovation and Skills should issue a call for evidence on the introduction of a statutory Right to Request consideration of an employee ownership proposal, covering the issues and challenges covered in Table 5.

**Recommendation M** (page 45)

The Department for Business, Innovation and Skills should issue a call for evidence on the best means to encourage owners and employers to make information available to employees, if a change of control of a company or sale of the business in which employees work is envisaged, in order to allow employees to consider an employee buy out.

## Chapter 4: Increasing the resources available to support employee ownership

**Recommendation N** (page 49)

Key organisations from the employee ownership and co-operatives sectors should develop and deliver an independent Institute to:

- provide guidance to businesses making the transition to employee ownership, including on standard models (see recommendation T);
- provide a membership organisation for individuals interested in employee ownership;
- consider providing accreditation associated with employee ownership;
- advance generally the education of the public on employee ownership; and
- promote research in all aspects of employee ownership.

**Recommendation O** (page 50)

The Department for Business, Innovation and Skills should collaborate with the employee owned and co-operative sectors to set up and publicise a single point of contact providing information and guidance on employee ownership to the private sector. This website and telephone service would be similar in scope to the Mutuels Information Service, which is available to public service providers.

**Recommendation P** (page 50)

The Department for Business, Innovation and Skills should collaborate with the employee owned and co-operative sectors and relevant professional bodies to support the development of the Institute and, in particular, the creation of information resources on employee ownership to be transferred to the Institute in due course.

## Ensuring employee ownership and employee buy outs are well known business concepts

### Recommendation Q (page 51)

The Department for Business, Innovation and Skills should convene a time-limited taskforce of legal, tax, accountancy and other professional bodies and representatives of employee owned companies to identify how employee ownership can be a more integral part of advice provided by intermediaries, including through supporting intermediaries with training resources on employee ownership.

## Improving employee owned companies' access to finance

### Recommendation R (page 53)

The Employee Ownership Association should consider what measures there are to communicate financing opportunities directly to employee owned companies, building on company case studies where appropriate.

### Recommendation S (page 53)

The Government should consider to what degree there is a lack of funding for employee buy outs and employee owned companies, for example through the advice of the Small Business Economic Forum, and make recommendations.

## Chapter 5: Reducing the complexity of employee ownership

### Providing simplified 'off the shelf' models for employee ownership

#### Recommendation T (page 60)

The Department for Business, Innovation and Skills, working with HM Treasury and ACAS as necessary, should develop simple employee ownership toolkits including 'off-the-shelf' templates, to cover legal, tax and other regulatory considerations set out in Table 10.

#### Recommendation U (page 64)

The Ministry of Justice should exempt employee benefit trusts from the 125 year perpetuity period in the Perpetuities and Accumulations Act 2009, to enable perpetual ownership of shares in employee owned companies by employee benefit trusts. Existing employee benefit trusts should also be permitted to benefit from this exemption.

**Recommendation V** (page 66)

The Department for Business, Innovation and Skills should consult upon improving the operation of internal share markets to support companies using direct share ownership, including holding private company shares in treasury and facilitating share buy backs.

**Recommendation W** (page 69)

The Institute (see recommendation N) should provide evidence to Government on whether a new legal entity for either or both employee owned companies or collective ownership is needed, three years after the implementation of the template documents (see recommendation T).

## **Avoiding unintended regulatory burdens upon employee owned companies**

**Recommendation X** (page 71)

The Government should, when devising regulation, ensure that employee owned companies do not suffer unintended burdens due to their structure; and the Department for Business, Innovation and Skills should take into account regulatory impacts on employee owned companies as part of its consultations on future changes to employment law.

**Recommendation Y** (page 71)

As part of a 'one year on' report (see recommendation AA), and in light of the results of recommendation X, the Department for Business, Innovation and Skills should assess whether a further review of the impact of regulation upon employee owned companies is warranted, and keep an open invitation in the meantime to receive evidence on regulatory barriers faced by employee owned companies.

## **Chapter 6: Implementation**

**Recommendation Z** (page 73)

Through the Minister for Employment Relations, the Department for Business, Innovation and Skills should, within three months of this review, publish an Action Plan showing actions taken to implement its recommendations and others aimed at promoting employee ownership.

**Recommendation AA** (page 73)

The Minister responsible for employee ownership (see recommendation C) should produce a 'one-year on' report 12 months after the formal Government response to this review, reporting publicly on progress made on promoting employee ownership and the implementation of these recommendations.

**Recommendation AB** (page 73)

The Minister for employee ownership should convene a small 'sounding board' of sector representatives to advise him or her periodically on the direction of implementation and on new opportunities to promote employee ownership.

# 1. Introduction and executive summary

- 1.1. In 2012 there has been unprecedented political interest in employee ownership. There are good reasons for it.
- 1.2. This review shows how employee ownership drives economic benefits for companies that adopt it. Cass Business School found that employee owned companies create jobs faster and were more resilient through the recent economic downturn. Employee owned companies reported to this review how employee ownership increased the commitment and dedication amongst their staff. We found that employee ownership is a powerful concept for companies seeking new ways to compete and grow. It fits squarely with the Government's wider work to promote economic growth in the UK.
- 1.3. At the heart of employee ownership is employee engagement. The extra employee commitment to achieving a company's goals helps deliver business success. Employees benefit from working in companies they feel committed to and actively participate in. That can make employee owned companies great places to work.
- 1.4. The Government's stated ambition is to promote employee ownership so that it plays a bigger part in the economy. The Deputy Prime Minister has set a challenge to move employee ownership "into the bloodstream of the British economy"<sup>1</sup>. Promoting employee ownership also offers the chance to increase the diversity of ownership models in the economy. The Ownership Commission argued that a plurality of ownership models makes for better ownership, increases the resilience of the economy, and provides greater choice for investors, savers and consumers. The Ownership Commission named employee ownership as one such ownership model that should be promoted further<sup>2</sup>.
- 1.5. This review deals with employee ownership in the private sector. There are parallels with current developments in the public sector where the Government is harnessing the strength of the employee ownership model to drive improvements in public service delivery. It has embarked on a ground-breaking agenda to 'spin out' services from the public sector into public sector mutuals.
- 1.6. This review was asked to "work with Government to identify the barriers to employee ownership and help find the solutions to knock them down". This review identifies what those barriers are, and through a set of recommendations provides a framework for how the Government and others can address them. It sets an agenda for promoting employee ownership by better communicating its significant benefits, and making it as simple as possible to set up and run an employee owned company.

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<sup>1</sup> Deputy Prime Minister's speech at Mansion House, January 2012.

<http://www.dpm.cabinetoffice.gov.uk/news/deputy-prime-minister-s-speech-mansion-house>

<sup>2</sup> The Ownership Commission (2012). *Plurality, Stewardship & Engagement*.

## Executive summary

### The evidence

- 1.7. There is substantial body of evidence demonstrating the benefits of employee ownership.
- 1.8. Many companies already have employee share plan arrangements in place, allowing employees a financial stake in their company. This review examined the evidence for the additional benefits of employee ownership – that is when all employees own a significant and meaningful stake in their company.
- 1.9. The benefits are seen in terms of business performance and employee well-being. A conclusion that underpins the majority of the findings is that that these benefits are best achieved when employee share ownership is integrated with ensuring employee engagement.
- 1.10. The concepts of employee ownership and employee engagement are interlinked and mutually reinforcing: employee owners are more likely to be engaged with their company, whilst employee ownership can enshrine employee engagement into a company for example by providing management structures allowing the employee voice to be heard.
- 1.11. The economic benefit of employee ownership is significant. For example, chapter 2 summarises findings from a survey conducted by Cass Business School showing that employee owned companies were more profitable, added more staff and were more resilient during the 2008 - 2009 economic downturn.
- 1.12. The work of the MacLeod Review and others demonstrates the benefits of workplaces with a high standard of employee engagement: greater staff commitment, well-being and reduced staff turnover.

### The barriers to employee ownership

- 1.13. The benefits of employee ownership go beyond academic studies – the employee owned companies we spoke to during this review emphasised how their day by day success was underpinned by their employee ownership models.
- 1.14. If such compelling benefits exist, why aren't more companies in the economy employee owned? This review sought to understand what factors may hold back companies and employees from adopting employee ownership, and what other measures might promote employee ownership further in the economy.
- 1.15. This review took evidence from a wide range of sources, covering, in particular, employee owned companies, sector representatives, professional advisers and employer and employee groups. The broad categories of obstacles to employee ownership were soon identified, and were continually reinforced as this review proceeded. They fall into the following three categories.
- 1.16. Firstly, **a lack of awareness of the concept of employee ownership**. In many respects this underpins all other barriers to employee ownership and many of the

recommendations this review makes. The concept of employee ownership is not widely known, and is undermined by misperceptions. Too often we came across a notion that employee owned companies must necessarily be social enterprises, not for profit, or that they were impossible to manage. A fundamental objective of this review is to challenge those perceptions and help build a new identity for employee ownership: based on it being a business model in its own right, with proven benefits to businesses and to individuals. The aim is to increase the interest in and demand for employee ownership.

- 1.17. The consequences of the lack of awareness are broad. Put simply, opportunities to adopt employee ownership are lost when employers, employees and advisers are unaware of its relevance and benefits. This review outlines particular moments in the business lifecycle when employee ownership is an attractive solution, and where awareness raising action should be focused. This review also heard long-standing concerns about the lack of awareness of employee ownership within the Government – which can undermine the sector and lead to policy development that is blind to employee ownership. A lack of awareness amongst advisers and intermediaries used by businesses was regularly cited: would-be employee owned companies and owners too frequently could not get the advice they needed to adopt employee ownership.
- 1.18. Secondly, **a lack of resources available to support employee ownership**. All businesses need information and guidance to support them. As indicated above, there is a lack of awareness of employee ownership amongst legal, tax, accountancy and other advisers, which means advice is hard to find. Respondents to this review regularly drew a contrast between the ready availability of cost-effective information and resources on conventional business models, and that which was available for employee ownership. This review concludes that the existing information and guidance available for employee ownership is insufficient – and this deficit risks increasing still further as the employee ownership sector continues its recent growth.
- 1.19. This review also considered the financing challenge facing employee owned companies and those seeking to adopt employee ownership. There are many examples of how employee owned companies and employee buy outs have successfully found finance. However, challenges do remain. Employee ownership is normally associated with debt finance insofar as employee owners are reluctant to have their ownership interest diluted by seeking out equity capital. Closing off equity finance limits the options available to finance employee ownership, and this review received many representations advocating specialist funds or investment products sympathetic to employee ownership.
- 1.20. Thirdly, **the actual (or perceived) legal, tax and other regulatory complexities of employee ownership** were cited as barriers to its adoption, or as burdens facing existing employee owned companies. Setting up an employee owned company necessarily raises several questions of corporate governance and structure, and has tax implications. Respondents to this review claimed the complexity of these arrangements could burden and discourage those interested in employee ownership. This complexity and the uncertainty associated with it should be minimised as far as possible if employee ownership is to be promoted further.

- 1.21. This review in particular considers the argument over whether a new legal entity is required to create a clearer legal model for employee ownership, and whether and how business regulation disproportionately impacts employee owned companies.

### **An agenda to promote employee ownership**

- 1.22. This review provides a framework for promoting employee ownership and moving it into the mainstream of the economy.
- 1.23. It sets an agenda for creating the conditions in which the concept and benefits of employee ownership are much more widely understood; ultimately so that interest in and demand for employee ownership is increased. In support of those wishing to adopt employee ownership, this review sets out practical measures to ensure it is as easy as possible to do so – for example, by ensuring the right information and resources are available, and unnecessary complexity is removed.
- 1.24. The recommendations this review makes establish that agenda. They address each of the barriers identified.
- 1.25. Firstly, this review recommends that Government and others **raise awareness of employee ownership** (chapter 3). This review establishes that a clearer identity for employee ownership is required, one that moves on from the misperceptions that undermine the sector. It recommends that employee ownership is promoted as a business model in its own right, that the proven benefits of employee ownership and many case studies of successful businesses using employee ownership are promoted by the Government, and by the sector continuing to highlight its own success. This review heard that many successful employee owned companies today found the concept of employee ownership through chance. Greater information provision on the concept and benefits of employee ownership is vital to enable individuals and owners to make informed judgements about this underused business model.
- 1.26. This review recommends that the Government leads, with stakeholders in the private sector, an awareness raising programme to promote this message much more widely. It sets out particular audiences, and particular moments in the business lifecycle, to focus upon. Associated agendas, for instance the public service mutualisation programme, are embarking on similar awareness raising initiatives. This review is confident that the synergies between these agendas can be utilised to create a compelling message. This review sets Government the challenge to lead this awareness raising work, and there is more the Government can do. Creating a focus within the Government through the development of a locus of expertise on employee ownership will support the sector in the long-term. Having a means through which to be heard in Westminster, and a continuity of knowledge within Whitehall, will make a great difference to employee owned companies.
- 1.27. This review also considered ambitious ‘nudge’ policies to build upon these general awareness raising measures. It recommends that the Government considers how a Right to Request employee ownership can be introduced. The aim would be to encourage more discussion and information exchange between employees and employers about employee ownership. There would be no ‘right to have’ and regulatory burdens upon employers should be avoided. This review advocates the

idea as a ‘nudge’ that can provide a key means of making a step-change in the profile of employee ownership in the economy.

- 1.28. Secondly, this review recommends measures to **increase the resources available to promote employee ownership** (chapter 4). If employee ownership is to enter the mainstream of the economy, and an awareness raising programme is to succeed, those interested in employee ownership need better support.
- 1.29. Representative bodies in the employee ownership and co-operative sectors have signalled a willingness to consider establishing a new Institute whose primary role would be the dissemination of information and guidance on employee ownership. This review recommends that such an Institute is established. It would become a future centre of expertise on employee ownership and provide vital support to help those adopting employee ownership as well as existing employee owned companies.
- 1.30. There is also a role for the wide range of intermediaries used by business. Legal, tax, accountancy and other advisers all play an important role in supporting companies and workforces to achieve employee ownership. In response to a clear message from respondents to this review, it is recommended that the Government leads a taskforce of key professional bodies and the employee ownership sector in identifying how employee ownership can become a more integral part of the advice provided by business advisers.
- 1.31. This review outlines several underused finance options that may be particularly suitable for employee owned companies. There is more to be done to identify whether there is an ‘employee ownership finance gap’ and how the Government should respond to that – this review recommends that the question is addressed. In the short-term, this review recommends that underused finance options for employee ownership are more widely promoted.
- 1.32. Thirdly, this review recommends measures to **reduce the complexity of employee ownership** (chapter 5). This review was taken by the comparison between the ready availability of ‘off the shelf’ models for conventional companies, and the lack of similar support available on employee ownership. It makes recommendations for the establishment of a similar ‘off the shelf’ model of employee ownership.
- 1.33. The aim is that those interested in establishing an employee owned company have access to simple toolkits to guide them through the process. These will be flexible and allow individuals to tailor the company to their objectives and circumstances. The key is to provide a starting point that removes complexity and the uncertainty that can discourage some from attempting employee ownership.
- 1.34. In designing an ‘off the shelf’ model, this review also advocates the particular merits of employee ownership achieved through a trust, which provides a long term structure and one suited to achieving employee engagement.
- 1.35. This review also examined perspectives from respondents to this review on regulatory and tax complexity associated with employee ownership. This review did not find significant problems associated with business regulation disproportionately impacting employee owned companies; but recommends that the Government

remains alive to employee ownership through its policy development, and when it reviews the stock of existing regulation.

- 1.36. The details of tax and employee ownership are to be dealt with through HM Treasury's review of employee ownership.
- 1.37. Fourthly, this review calls upon Government to **ensure implementation** (chapter 6). The Government should maintain its focus upon employee ownership, and translate its support into concrete changes that make a real difference to employee owned companies and those considering it. This review recommends that the Government publishes updates on progress in implementation and is held to account by the sector; and that a regular forum is held to allow the employee ownership sector to engage directly with Government Ministers.
- 1.38. Further details on the background of the review are provided in Annex A.

### Table 1 – Employee ownership as a neat business succession solution

*The obstacles identified by this review may be illustrated by taking a hypothetical example of an owner who wants to consider employee ownership as a succession solution. Consider how likely this scenario is given the current lack of awareness of employee ownership and the resources available to support it.*

*This scenario does not reflect existing or currently proposed information and guidance from the Government.*

The owner of a successful private trading company is planning for his retirement in a few years' time. No-one in his family is able or willing to succeed him. He would prefer not to sell the business to a competitor and the business is too small to consider a Stock Market flotation. He would like to realise a capital gain in recognition of his success in building up the business. He has researched employee ownership and made some calculations. These show employee ownership is financially viable as a succession solution. He would therefore like to consider this as his succession solution.

What happens next?

The following illustrates how employee ownership could work as a neat succession solution with the support of professional advisers, a bank and HM Revenue & Customs.

The owner visits the company's solicitor who confirms employee ownership is a tried and tested business model and that it works well in the owner's situation. What is needed, in particular, from a legal point of view is a trust deed to create an employee benefit trust and to agree on trustees. On balance it would be worthwhile establishing a company to act as a corporate trustee. There are various detailed design points to consider but essentially the idea would be that the trading company, over a period of years, makes donations to the trustee of the employee benefit trust which are then used to buy the owner's shares. In

**Table 1 – Employee ownership as a neat business succession solution**

this way the company will become employee owned. The solicitor confirmed he would work with the company's accountant to ensure all tax issues are fully considered.

The owner meets the company's accountant who also confirms that employee ownership is a viable succession solution, checks the owner's calculations and explains the accounting and tax implications of the proposal. The tax and accounting treatment for the employee trust and the trustee company are straightforward. The trading company would not get a tax deduction for contributions it makes to the employee trust but the owner would realise a capital gain.

The owner informs his bank of the plans. The bank says it is familiar with these arrangements and if the owner is interested it would be prepared to lend money to the company to help it finance contributions to the employee benefit trust.

The owner discusses the idea of employee ownership, in confidence, with a couple of business friends who confirm they could see the advantages.

The owner explains his idea to the senior management of the business who welcome it and admit they had, in fact, been considering employee ownership as a succession solution. They want to increase employee engagement in the business. It was agreed that a recruit at a senior level is needed to replace skills that would be lost when the owner retired. The senior managers are confident staff would support the idea.

The owner has further discussions with the company's solicitor and accountant, including on how to value his shares. He encourages his advisers to investigate matters in more detail with HM Revenue and Customs and they reported back that they had received confirmations on various helpful points:

- HM Revenue and Customs had approved the draft employee benefit trust deed as eligible for various inheritance tax reliefs;
- the local tax office confirmed no tax returns would be needed in respect of either the employee benefit trust or the trustee company, on the basis neither received any income or made any gains;
- Shares and Assets Valuation had confirmed the proposed valuation was not in excess of market value; and
- the Clearance and Counteraction Team, Anti-Avoidance Group had confirmed the proposed payments by the trustee company to the owner would not be considered as disguised dividends.

The owner and senior managers explain the proposal to staff and encourage them to visit other employee owned companies to discover more about employee ownership. The staff report back that they wholeheartedly support

**Table 1 – Employee ownership as a neat business succession solution**

this new ownership model and want to know when the first trustee director elections would take place.

The owner and the senior managers and staff representatives debate whether or not they should introduce individual share ownership to operate alongside the proposed employee benefit trust. On balance it was decided there was no immediate need to do this but they would keep this idea under review.

The owner receives the detailed additional advice needed from his advisers to finalise his decision and implement it. He retires, leaving the business he had founded in employee ownership.

## What is employee ownership?

- 1.39. In this review employee ownership means a significant and meaningful stake in a business for all its employees. If this is achieved then a company has employee ownership: it has employee owners.
- 1.40. What is 'meaningful' goes beyond financial participation. The employees' stake must underpin organisational structures that promote employee engagement in the company. In this way employee ownership can be seen as a business model in its own right.
- 1.41. This review has a particular emphasis on the employees' stake being a substantial or controlling stake. There is no set rule as to what percentage of issued share capital is a substantial stake. Over 25% is substantial from a company law perspective. This review heard evidence that the full benefits of employee ownership can be achieved at lower percentages.
- 1.42. A company in which a controlling stake is held by or on behalf of all employees is an employee owned company.
- 1.43. The forms employee ownership may take can be summarised as:
- **direct employee ownership** – using one or more tax advantaged and other share plans, employees become individual owners of shares in their company;
  - **indirect employee ownership** – shares are held collectively on behalf of employees, normally through an employee benefit trust; and
  - **combined direct and indirect ownership** – a combination of individual and collective share ownership.

1.44. A glossary with a fuller definition of employee ownership and related terms is provided in Annex A.

## 2. The benefits of employee ownership

The beneficial effects of employee ownership are diverse, but several strong themes emerge in the literature. This chapter collates the principle findings around those themes. It summarises the evidence on the impact of employee ownership in relation to:

- improved business performance;
- increased economic resilience;
- greater employee engagement and commitment;
- driving innovation;
- enhanced employee well-being; and
- reduced absenteeism.

Links to further literature reviews are provided at the end of the chapter.

### The evidence base

- 2.1. The benefits of employee ownership are demonstrated by the many success stories in the sector<sup>3</sup>. There are UK companies with decades of successful employee ownership and others that have more recently introduced employee ownership, including public sector mutuals, and are benefiting from it. These companies are in diverse business sectors, spread geographically and of varying sizes. This review heard directly about the benefits of employee ownership from a wide range of companies. The benefits of employee ownership are also supported by a substantial body of academic literature.
- 2.2. What all forms of employee ownership share is the fact that some or all of the owners of a company are engaged with it on a day-to-day basis, and some or all of them will have a long-term interest in its success. These basic characteristics tend to generate the positive outcomes described.
- 2.3. The key condition under which employee ownership is recognised to succeed best is when it allows employee owners to exercise their voice internally. It is this

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<sup>3</sup> There are case studies on the website of the Employee Ownership Association (<http://www.employeeownership.co.uk/employee-ownership/about-employee-ownership/case-studies/>) and on the websites of other sector organisations mentioned in this review.

combination of share ownership and employee engagement that drives higher performance.

- 2.4. In practice, employee ownership takes many forms depending on the particular objectives and circumstances of a company. The literature reflects this diversity – each study uses its own definition of ‘employee ownership’, and some studies cover other associated concepts. In the summary below the definition and sample a particular study uses is made clear.

## Improved business performance

- 2.5. Do companies with employee ownership outperform companies without? On balance, existing academic studies associate employee ownership with higher productivity levels (Matrix Evidence, 2010).
- 2.6. Over 2009 and 2010 Lampel, et al. (2010), on behalf of Cass Business School, conducted a survey of UK companies and found that employee owned companies (defined as companies that “are substantially or wholly owned by the people who work for them”), with fewer than 75 employees, perform better on profitability compared to non-employee owned companies.
- 2.7. Lampel, et al. (2010) also found that employment growth was substantially faster at employee owned companies in their sample, as demonstrated in table 2.

<b>Table 1 - Job creation in employee owned companies</b>		
	<b>Growth in employee numbers per annum, 2005 - 2008</b>	<b>Growth in employee numbers per annum, 2008 - 2009</b>
<b>Employee owned companies</b>	<b>7.46%</b>	<b>12.91%</b>
<b>Non-employee owned companies</b>	<b>3.87%</b>	<b>2.70%</b>

- 2.8. Bryson and Freeman (2008) studied the productivity effects of different forms of shared capitalist compensation, including profit-sharing and group pay for performance, employee share ownership and stock options. They found that share ownership, in particular, has the most discernible impact on productivity and its impact increases when combined with other forms of shared capitalist pay.
- 2.9. The Employee Ownership Index compiled by Field Fisher Waterhouse LLP tracks the share price performance of listed companies that are at least 10% owned by employees. The Employee Ownership Index has outperformed the FTSE All Share by an average of 10% annually since 1992 (FFW, 2012).

- 2.10. Studies suggest however that productivity gains may only arise under certain conditions. There is a general acceptance that employee share ownership should be combined with employee engagement for productivity benefits to occur (Lampel, et al. (2010) and Matrix Evidence (2010)). Furthermore, studies have shown that productivity benefits can depend on company size, and be higher for smaller companies. Kramer (2008), examining the productivity benefits achieved by companies with share ownership plans, demonstrated that the addition of 100 workers to a company diminished productivity based on sales per employee. Likewise, Lampel, et al. (2010), as described above, found that employee owned companies with fewer than 75 employees perform significantly better on profits compared to non-employee owned companies, but there was no significant difference between larger companies' performance on profits in their sample, whether they were employee owned or not.
- 2.11. What might drive the findings that productivity benefits of employee share ownership relate to company size? The benefits of employee ownership are most likely to be realised when ownership co-exists with wider drives for employee participation in decision-making. Studies speculate that this can prove to be a different challenge for large companies or those expanding with growing workforces that will need to adapt their managerial structures in order to ensure continued employee involvement. Smaller companies on the other hand, may find employee engagement is easier to implement and maintain.
- 2.12. The type of employee ownership may be significant. Michie and Oughton (2003) undertook a detailed analysis of the effect of employee share ownership and participation on corporate performance. They found that shares held collectively in a trust may foster "a culture of team work and a co-operative company spirit" that would not be achieved through direct share ownership, which in turn would have a positive effect on productivity since a collective effort is necessary for improving corporate performance.

## Increased economic resilience

- 2.13. Research conducted by Lampel, et al. (2010) found that employee owned companies display less variability over the economic cycle, and, in particular, were more resilient during the recent economic downturn. Their research examined sales growth amongst employee owned companies and non-employee owned companies in the UK, between 2005 and 2009.

<b>Table 3 – Economic resilience of employee owned companies</b>		
	<b>Sales growth per annum, 2005 - 2008</b>	<b>Sales growth per annum, 2008 - 2009</b>
<b>Employee owned companies</b>	<b>10.04%</b>	<b>11.08%</b>

<b>Table 3 – Economic resilience of employee owned companies</b>		
<b>Non-employee owned companies</b>	<b>12.10%</b>	<b>0.61%</b>

- 2.14. The explanation for the economic resilience offered by Lampel, et al. is that while non-employee owned companies tend to swing between excessive risk taking and excessive risk aversion, employee owned companies maintain a more consistent approach towards risk. They are not prone to taking on too much risk during economic upswings, but surprisingly are more positive about expanding ahead of demand when economic conditions are poor. In other words, they conclude that employee owned companies take a long-term view, rather than feeling that they must only move in line with current economic conditions.
- 2.15. Employee owned companies we contacted during this review claimed they kept a long-term focus which they said helped them avoid over-reaching in the short-term and instead maintain a steady growth profile over the medium and long-term.
- 2.16. Further research by Lampel et al. (2012) (using the same sample and methodology of their 2010 research) found that employee owned companies show greater preference for internal growth (where firms expand their own business base) over external growth (where firms acquire new products or lines of business from other firms). This preference may be explained by the extra difficulty employee owned businesses face in raising capital. However, during a recession, having a long-standing reliance on internal growth could be an advantage, as these companies are more adept at using internal resources to pursue growth and less dependent on external capital sources.
- 2.17. Broader empirical evidence on the resilience of employee owned companies is limited, and mixed. Kramer (2008), examining US businesses with share option plans, found that the risk that an employee owned company will not survive in a given year is about 75% of the risk for a non-employee owned company with similar characteristics. These findings are corroborated by Blair et al. (2000). On the other hand, Welbourne and Cyr (1999) find that company survival is not significantly related to ownership structures.

## **Greater employee commitment and engagement**

- 2.18. One of the clearest benefits of employee ownership is its role in providing a catalyst for greater employee commitment and engagement (for example, the studies summarised by Matrix Evidence (2010)).
- 2.19. Theoretically, it makes sense that a stake in a company drives an employee's commitment to it (Matrix Evidence, 2010). Burns (2006) surveyed a range of employee owned companies, including worker co-operatives, on their experiences. The survey found that employee owned companies perceive extra employee commitment to the company's success as the most significant outcome from

employee ownership, with 91% of companies replying to the survey stating that this was an advantage.

2.20. However, particular benefits, over and above greater employee commitment, are possible for employee owned companies. In the course of this review, employee owned companies emphasised to us how employee ownership facilitated and supported greater employee engagement in the company, as well as their commitment to it. Several studies have noted the impact employee ownership has on driving employee engagement (Matrix Evidence, 2010). As already noted, Michie and Oughton (2003), in particular, found that a collective stake in a company combined with a vehicle for a collective voice provides the optimum conditions for driving employee engagement and commitment through employee ownership.

#### Table 4 – Employee engagement

David MacLeod and Nita Clarke's (2009) independent review of employee engagement understood the term employee engagement to refer to:

- a workplace approach designed to ensure that employees are committed to their organisation's goals and values, motivated to contribute to organisational success, and are able at the same time to enhance their own sense of well-being.

The drivers behind successful engagement approaches were summarised as:

- leadership which ensures a strong, transparent and explicit organisational culture which gives employees a line of sight between their job and the vision and aims of the organisation;
- engaging managers who offer clarity, appreciation of employees' effort and contribution, who treat their people as individuals and who ensure that work is organised efficiently and effectively so that employees feel they are valued, and equipped and supported to do their job;
- employees feeling they are able to voice their ideas and be listened to, both about how they do their job and in decision-making in their own department, with joint sharing of problems and challenges and a commitment to arrive at joint solutions; and
- a belief among employees that the organisation lives its values, and that espoused behavioural norms are adhered to, resulting in trust and a sense of integrity.

2.21. The most significant analysis of employee engagement in the UK recently was the MacLeod Review of employee engagement which examined the benefits of employee engagement policies and practices for companies, organisations and individual employees. They found that: "Employee ownership was a profound and distinctive enabler of high engagement" (MacLeod and Clarke, 2009).

- 2.22. What are the benefits of employee engagement? The MacLeod Review concluded that the benefits of employee engagement extend to both the employer and employee. Their report found that employee engagement has a positive correlation with business performance, customer service, innovation, reduced sickness absence, reduced staff turnover, and fewer accidents.
- 2.23. On the other hand, whilst emphasising the correlation, studies also recognise that there has not been a definitive study which has unequivocally established causation between employee engagement and higher employee participation, performance or productivity (MacLeod and Clarke, 2009; Matrix Evidence, 2010).
- 2.24. Studies generally emphasise that employee ownership and employee engagement were mutually reinforcing. In particular, the benefits associated with employee ownership are often underpinned and made possible by employee engagement – whilst in many cases it is a company’s employee ownership structure itself that drives employees’ engagement in the company. This review’s contact with employee owned companies confirmed this.

## Driving innovation

- 2.25. There are studies that suggest employee ownership can drive innovation in a company, although the evidence is partial and requires further development.
- 2.26. Burns (2006) found that 44% of respondents to their survey strongly agreed with the proposition that employee ownership makes employees more committed to company success and that innovation happens more effectively. Correspondingly, Lampel, et al. (2010) identified that employee owned companies perceive their ability to attract and retain talented employees and harness their innovation are strong advantages of the employee ownership model.
- 2.27. Employee ownership is described as a “profound and distinctive enabler” of greater employee engagement, and MacLeod and Clarke (2009) propose that there is a strong relationship between employee engagement and innovation.
- 2.28. Research by Lampel, et al. (2012) also found that employee owned companies tended to have a longer-term focus, attaching higher importance to “pioneering innovations” and “innovative ideas from staff” than their non-employee owned company counterparts.
- 2.29. Michie and Sheehan (1999) examine the relationship between adoption of various employee participation/representation mechanisms and expenditure on research and development. They found evidence that employee involvement is positively correlated with the likelihood of firms innovating.
- 2.30. On the other hand, Burns (2006) points to a significant disadvantage identified by one company surveyed that low staff turnover (another benefit associated with employee ownership) could create circumstances in which new ideas are slow to materialise as fresh thinking and perspectives are seldom added to a company’s labour force.

## Enhanced employee well-being

2.31. Research by the Napier University Business School, cited in Davies (2011), included a survey on health and well-being outcomes at a range of employee owned companies. It found that the majority of workers were more satisfied compared to when they worked for non-employee owned companies. Why might this be the case? Davies (2011) asserts employee ownership is typically associated with enhanced engagement with management and that this sense of engagement is positively linked with well-being. Enhanced well-being is also more likely to be generated at employee owned companies which provide employees with a greater stake and involvement in long-term collaborative goals.

## Reduced absenteeism

2.32. Peel and Wilson (1991) evaluated data on manufacturing employment in the UK and found that financial participation schemes significantly reduce absenteeism. Profit sharing was found to reduce the average rate of absenteeism by about 8% while companies that implemented share option plans experienced absenteeism rates that were about 13% lower on average. They also investigated the effect of share option plans on voluntary labour turnover. They found that share options plans reduce leavers by between 2% - 2.5%, whilst the reduction due to profit sharing is slightly smaller at 1% - 2%. Brown et al. (1999), using data drawn from French companies, found that employee share ownership reduces employee absences by 14%, whilst profit sharing reduces absences by 7%.

2.33. A study by Blasi, et al. (2010) examined the relationship between shared capitalist compensation - a term which includes various measures such as profit sharing, stock holdings, stock options and profit-related bonuses - and a number of workplace outcomes, including absenteeism. This found that 'shared capitalism' reduced absenteeism, as long as it was also accompanied by supportive forms of human resource policies. This reinforces the point that employee ownership must combine a stake in the company with appropriate forms of employee engagement, if business benefits are to be realised.

## Further reading

A list of references cited can be found in Annex A. Other useful summaries and literature reviews on the benefits of employee ownership can be found at:

Briône, P. and Nicholson, C. (2012). *Employee ownership: unlocking growth in the UK economy*. Available via <http://www.centreforum.org/index.php/toppublications>

Matrix Evidence (2010). *The employee ownership effect: A review of the evidence*. Employee Ownership Association. Available via: <http://www.employeeownership.co.uk/publications/the-employee-ownership-effect-a-review-of-the-evidence/>

Michie, J. and Oughton, C. (2003). *HRM, Employee Share Ownership and Corporate Performance*. *Research and Practice in Human Resource Management*, 11(1), 15-36. Available via <http://rphrm.curtin.edu.au/2003/issue1/employee.html>

Mutuals Taskforce (2011). *Making the Case for Public Service Mutuals*. Available via <http://mutuals.cabinetoffice.gov.uk/documents/mutuals-taskforce-evidence-paper>

Postlethwaite, R; Michie, J; Burns, P. and Nuttall, G. (2005). *Shared Company: How employee ownership works*. Employee Ownership Association. Available via: <http://www.employeeownership.co.uk/publications/shared-company-how-employee-ownership-works/>

For an analysis of employee engagement, see:

MacLeod, D. and Clarke, N. (2009). *Engaging for success: enhancing performance through employee engagement*. Department for Business Innovation and Skills. Available via: <http://www.bis.gov.uk/files/file52215.pdf>

For an analysis of 'shared capitalism' arrangements in the US, see:

<http://www.nber.org/books/krus08-1/>

For analysis of employee share ownership, see:

Oxera (2007). *Tax-advantaged employee share schemes: analysis of productivity effects*. Oxera. Available via: <http://www.hmrc.gov.uk/research/tax-advantaged-report2.pdf>

# 3. Raising awareness of employee ownership

This chapter:

- **sets out the perspectives and evidence this review heard on the challenges created by a lack of awareness of employee ownership;**
- **recommends that employee ownership can be seen as a successful business model in its own right, and should be promoted as such;**
- **recommends an awareness raising programme to be led by Government to emphasise that message; and**
- **recommends that Government builds upon this programme by providing for a Right to Request employee ownership: encouraging more discussions between employees and employers about employee ownership.**

## The need for change

- 3.1. An overwhelming message received during this review is that awareness of employee ownership is extremely low among all involved in business. Lack of awareness was cited repeatedly as a fundamental obstacle.
- 3.2. Employee ownership is insufficiently understood. There are some businesses, such as John Lewis Partnership, which are well known for their employee ownership model. But employee ownership does not have instant recognition in contrast to, say, franchising or operating as a charity. Too few owners or employees know about the proven benefits of employee ownership to even be able to consider whether it is something they want to adopt.
- 3.3. When employee ownership is understood a little better, it is undermined by misperceptions and confused terminology. It can be confused with related, but different, concepts such as social enterprise, not for profit organisations and worker co-operatives. Whilst employee owned companies can take on these characteristics, this review considers that employee ownership is best understood as a business model in its own right, and can be just as effective in achieving growth and profit maximisation as other models.
- 3.4. There is a wider understanding of financial participation – for example, employees owning a small stake in their company through an employee share plan. There have been a lot of drivers in the UK to promote employee share ownership through, for example, the tax reliefs in tax advantaged share plans. But this can cause confusion too. Employee share ownership is often associated with executive remuneration rather than being available to all employees. Even when the connection is made to

share ownership by all employees this is very much from the point of view of financial participation rather than employee ownership involving employee engagement.

3.5. Because of this lack of awareness, this review noted that certain myths repeatedly need dispelling. It is important to realise that employee ownership:

- does not detract from profit-making: companies could have employee ownership and operate on a not for profit basis, but most are typical commercial businesses;
- does not mean less effective decision making; most companies with employee ownership have professional managers that any business would recognise;
- does not prevent decision making on difficult topics, such as redundancies;
- does not mean a company has to be a worker co-operative; there are other forms of employee ownership; and
- is compatible with trades unions; trades unions operate in many companies with employee ownership.

3.6. There is a second impact of the lack of awareness. Respondents gave examples of how they were held back by a lack of awareness amongst the wide range of groups businesses need to support them. Many could not find advisers who were sufficiently knowledgeable about employee ownership to advise on it. This review heard of owners who were never told about employee ownership as a succession solution.

3.7. Others had problems in accessing bank lending due to the lack of familiarity with this business model. Also, general understanding of employee ownership in business schools or higher education is low. Leadership and management development programmes even if designed specifically for owner managers of private companies do not cover employee ownership. There can be resistance from professional advisers and others to considering employee ownership due to fixed ideas about ownership models and, in particular, what The Ownership Commission referred to as the PLC monoculture<sup>4</sup>.

3.8. Government support for employee ownership has, historically, been lacking which has impacted on what the Government knows and does about employee ownership.

3.9. These factors limit the resources and support available to employee ownership. The next chapter makes particular recommendations to address these problems and enhance the resources available to support employee ownership.

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<sup>4</sup> The Ownership Commission (2012). *Plurality, Stewardship and Engagement*.

- 3.10. All this prevents wider adoption of employee ownership. An enquiry by the All-Party Parliamentary Group on Employee Ownership, undertaken in 2008, found awareness of employee ownership was “at best patchy, and at worst non-existent”<sup>5</sup> and during the course of this review we have found no reason to update that assessment.
- 3.11. This review concluded that a lack of awareness of the concept and benefits of employee ownerships limits interest in and demand for this model.
- 3.12. Without action to raise awareness, business owners will continue to be – as this review heard – limited in their options and drawn towards more conventional ownership models; and employee ownership will remain as one respondent described: “unorthodox, unproven, unprecedented”. Our discussions with existing employee owned companies frequently found that they adopted their employee ownership model through their own innovation or serendipity. Without greater awareness there will be missed opportunities when chance does not intervene.
- 3.13. There is a sufficient body of research, business success stories and worked examples to show beyond doubt that employee ownership works and brings the benefits described in the previous chapter. This review therefore sets a challenge to the Government to promote this message much more clearly.

## Promoting and raising awareness of employee ownership

- 3.14. The political focus on employee ownership in 2012 has made a genuine impact. Employee owned companies refer readily to the keynote speech on employee ownership made by the Deputy Prime Minister at Mansion House in January 2012. Hits to the Department for Business, Innovation and Skills webpage on employee ownership peak around the times when Ministerial speeches are made on employee ownership.
- 3.15. Support from the Government matters: it establishes the broader vision necessary to raise awareness of employee ownership amongst new audiences and increase interest in the concept, and sends a signal to existing employee owned companies which increases the sector’s self-confidence.

### Recommendation A

The Government should continue to promote employee ownership, building upon the Deputy Prime Minister’s vision set out at Mansion House and on the framework established by this review.

- 3.16. There are commendable examples of individual initiatives to raise awareness of employee ownership in the private sector. Co-operative Education Trust Scotland has published an open access, introductory-level analysis of democratic models of enterprise for undergraduate students. The Employee Ownership Association website is a very helpful source of news and developments for anyone considering

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<sup>5</sup> All-Party Parliamentary Group on Employee Ownership (2008). *Share Value*.

employee ownership. Co-operative Development Scotland supports employee ownership in Scotland. The Wales Co-operative Centre does the same in Wales. Mutuo promotes mutuals owned by employees as well as by customers. Co-operatives UK works to promote co-operative enterprises. Ifs ProShare promotes employee share ownership and the Employee Share Ownership Centre promotes all forms of broad based employee share ownership plans in the UK and Europe.

- 3.17. There is a limit however to what separate initiatives can achieve given the fundamental lack of awareness of the concept of employee ownership. Government has a role in leading a wider promotional and awareness raising programme in aid of employee ownership.
- 3.18. What should an awareness raising programme seek to achieve? An over-arching aim of this review is to create a clearer identity for employee ownership. A frequent problem is that employee ownership is confused with related but different concepts (such as employee share ownership, profit related pay or mutuals). The introductory paragraphs of this chapter set out common misconceptions of employee ownership.
- 3.19. It was helpful in the course of this review for the Minister for Employment Relations to confirm in interviews and speeches what the Government means by employee ownership, and, in particular, that this includes the collective ownership of shares on behalf of employees in employee benefit trusts. The Deputy Prime Minister also reinforced this message in a speech to the British Chambers of Commerce annual conference on 15 March 2012<sup>6</sup>.
- 3.20. The connection with social enterprise also causes confusion. Whilst many employee owned companies consider themselves socially responsible, and some employee owned companies are social enterprises, this review's contention is that employee ownership must be seen as a business model in its own right with its own benefits. It is a business model characterised by who owns a company not what the company does.
- 3.21. Awareness raising work should therefore be underpinned by simple messages that employee ownership:
- is a business model in its own right. It leads to proven research-based economic benefits as well as broader benefits of employee well-being and to the community; and
  - there are many existing case studies, across all sectors, of companies that are achieving these benefits.
- 3.22. A Government awareness raising programme needs to draw in other stakeholders who can provide a different perspective, and to seek out 'multipliers' and other intermediaries who can often reach audiences better than the Government.

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<sup>6</sup> Available via: <http://www.dpm.cabinetoffice.gov.uk/news/deputy-prime-minister-s-speech-british-chambers-commerce-annual-conference>

- 3.23. The programme should be designed to reach broadly. Making employee ownership happen, and introducing it into the mainstream of the economy, involves a wide range of stakeholders. The awareness raising programme should aim to increase demand for employee ownership among:
- employers and owners;
  - employees and their representatives (including trades unions who often have a key role to play in facilitating employee ownership); and
  - entrepreneurs, in particular, to build on interest reported to this review in using employee ownership in business start-ups.
- 3.24. Furthermore, beyond the audiences directly involved in adopting employee ownership, there are many intermediaries that play a crucial role – either through directly advising or informing these audiences, or through providing finance or other resources. The media has an important role in reporting employee ownership.
- 3.25. There are a number of initiatives by the Government that could kick-start such an awareness raising programme. This review heard that a ‘year of employee ownership’ should be planned for 2013; or that an award could be established, provided by the Government to promising new employee owned companies. Business Link’s information can be reviewed and updated to include more express references to alternative business models such as employee ownership and adding a video case study to those for franchising and a social enterprise. There are newsletters from Government departments that can feature employee ownership.
- 3.26. There are other Government policies that can be linked to employee ownership. Awareness raising is also a key objective for advocates of public service mutuals, co-operatives, and the private-sector led employee engagement initiative led by the Employee Engagement Task Force. There are obvious synergies between awareness raising work associated with each, which should be reflected in the design and delivery of the employee ownership awareness raising programme. The awareness programme should not, however, be seen as restricting choice of the appropriate ownership model for a particular business.
- 3.27. The Office of Tax Simplification suggested that there is scope for a re-launch of tax advantaged share plans to encourage their use. Such a re-launch should be co-ordinated with raising awareness of the broader concept of employee ownership. There are other Government policies that could be linked to employee ownership. As set out in the Coalition Programme, the aspiration is for 25 per cent of Government contracts to go to small and medium sized enterprises. The informal consultation generated several suggestions that this aspiration could be expressed to include employee owned small and medium sized enterprises or, indeed, employee owned companies of all sizes. This review notes this idea and leaves it to the Government to decide to what extent other policies should be linked to employee engagement.
- 3.28. The awareness raising programme is, however, envisaged to go beyond what the Government can do on its own, and will involve other stakeholders.

## Recommendation B

Through the Minister for Employment Relations, the Department for Business, Innovation and Skills should design and lead an awareness raising programme aimed at promoting the concept and benefits of employee ownership and, in particular, of employee owned companies. The design and delivery of the programme should involve other Government departments and external stakeholders wherever possible, and be coordinated with wider Government messages on, for example, mutuals and co-operatives policy, plurality of ownership models and employee engagement.

## Raising awareness of employee ownership within the Government, and ensuring continuity

- 3.29. Raising awareness within the Government is another aim. Amongst experts and sector representatives with long-standing involvement in explaining employee ownership to the Government, the lack of consistency and continuity of knowledge in central Government was a key concern. Not having a single point of contact, or Government officials to call on with an appreciation of employee ownership, undermines the work of those who need the Government's assistance to overcome legal, tax and regulatory obstacles, or otherwise wish their views to be heard and understood. Too often, Government officials with relevant knowledge moved on and their expertise was not replaced.
- 3.30. The broader employee ownership sector would benefit from being supported by a clear Ministerial lead for employee ownership within the Government. Such an arrangement provides a focal point for employee owned companies and others to have their voice heard by the Government. There are also those involved internationally in employee ownership initiatives who would welcome a point of contact in the UK Government.
- 3.31. Greater understanding of employee ownership in central Government should also ensure policy development does not impose unintended consequences upon employee owned companies and others through ignorance of employee ownership – Government officials expert in employee ownership could, for example, work with colleagues from other Government departments to ensure their policy development was employee ownership compliant.

## Recommendation C

The Government should maintain the appointment of a Minister responsible for promoting employee ownership across Government.

## Recommendation D

The Department for Business, Innovation and Skills, Cabinet Office, HM Treasury and HM Revenue & Customs should report on steps taken to ensure continuity of knowledge in central Government on employee ownership, including though:

- official visits to employee owned companies;

- lead points of contact on employee ownership at each department;
- the content of HM Revenue and Custom's website and manuals;
- regular updates on Business Link; and
- policy on archiving employee ownership information.

3.32. One means of improving the understanding of employee ownership within the Government is to increase the data collected on the sector. The Government has a stated policy to promote employee ownership so that it enters the mainstream of the British economy. It cannot measure the success of this policy, nor the success of implementing the recommendations made by this review, without collecting data on the nature, extent and growth of employee ownership in the economy.

### Recommendation E

The Government should improve the data collected on the extent of employee ownership, for example, by adding new questions on employee ownership into Office for National Statistics surveys and the Workplace Employment Relations Study; and business surveys coordinated by the Department for Business, Innovation and Skills.

## Raising awareness of employee ownership at key points in the business lifecycle

3.33. This review received submissions and perspectives on the key points in the business lifecycle that are most relevant for employee ownership solutions. This review agrees there should be a particular focus on raising awareness of employee ownership at these points, to ensure it is given due consideration as an option. These key points are:

- start-up;
- expansion and growth;
- succession; and
- business rescue.

3.34. These points should serve to inform the general awareness raising programme described in recommendation B. Furthermore, there are particular initiatives the Government and others can take to raise awareness at these key points.

### Start-up

3.35. The Department of Work and Pensions is running a New Enterprise Allowance scheme which provides grants to unemployed people who want to set up a business, and who present a credible business plan. A network of local mentors support claimants to develop these plans. There is an opportunity for groups of claimants, should they wish, to work together on joint business plans, pool grants and establish

an employee owned company. Incentives of this sort can have a significant effect. In Spain the average number of employees in a *Sociedades Laborales* is 5.5. This is a special form of corporation in which the majority of shares are owned by employees. Unemployment benefit paid out as a lump sum can be invested in a start-up or an existing *Sociedades Laborales*. The number of such corporations is significant (13,465 by the end of 2011)<sup>7</sup>.

## Recommendation F

The Department of Work and Pensions should disseminate information to New Enterprise Allowance partnerships, aimed at promoting employee ownership solutions to groups of claimants eligible for the New Enterprise Allowance.

### Expansion and growth

- 3.36. As explained, employee ownership and the employee engagement inherent in it drives performance benefits. Companies looking at growth strategies should ensure they are achieving best practice in this area. MacLeod and Clarke set out what is behind successful engagement (see Table 4). Companies without employee ownership can achieve good employee engagement. However, employee ownership should be highlighted as a means of reinforcing and sustaining good employee engagement. Strong views were expressed during this review that employee engagement is much harder to dismiss as a management mechanism when it is underpinned by employee ownership. Employee owners are more likely to be engaged employees, freely and willingly giving discretionary effort, not as an ‘add on’ but as an integral part of their daily activity at work.

## Recommendation G

The Employee Engagement Taskforce should consider opportunities to build employee ownership into its work with practitioner panels and its forthcoming employee engagement website.

### Succession

- 3.37. The sector advocates business succession as a key opportunity for employee ownership solutions to be promoted and implemented.
- 3.38. The Employee Ownership Association for example believes that “[t]he most typical route to employee ownership is private owners – an individual entrepreneur or family business for example – deciding to sell the company to their own employees”<sup>8</sup>. Wales Co-operative Centre<sup>9</sup> makes the case for considering employee buy outs as

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<sup>7</sup> Lowitzsch, J.; Hashi, I. and others (2012). *Employee Financial Participation in Companies’ Proceeds*. (forthcoming)

<sup>8</sup> Employee Ownership Association, ‘Ownership Succession’, [www.employeeownership.co.uk/employee-ownership/about-employee-ownership/ownership-succession](http://www.employeeownership.co.uk/employee-ownership/about-employee-ownership/ownership-succession)

<sup>9</sup> Davies, W. and Michie, J. (2012). *Employee ownership defusing the business succession time-bomb in Wales*.

an alternative to either trade sales or continuing family ownership and refers to a 2001 survey that showed around 30% of closures might be regarded as ‘transfer failures’ – viable firms which close for lack of a suitable successor – rather than simple ‘business failures’. Chapter 4 highlights the importance of access to finance to ensure employee buy outs succeed.

- 3.39. This review heard employee buy outs make a neat succession solution. They have a good record of succeeding. This is important if there is any deferred consideration. An employee buy out avoids some of the difficulties that arise with other forms of exit. It avoids, for example, the commercial risk of disclosing confidential information to potential trade buyers. The terms of an employee buy out are, to a great extent, within the owner’s control. An owner can plan in advance as to when and how the sale occurs. This is a significant advantage over most other forms of exit. Employee buy outs can reduce the risk of dismissal of employees or the closure of premises that can occur following a trade sale. This business succession solution is also a way of recognising the contribution employees have made to the success of the business, and in ensuring continuity for customers and suppliers. Continuity is often crucial in service and knowledge intensive businesses.
- 3.40. Table 1 in the Introduction sets out how employee ownership might be achieved as a succession solution.

### **Recommendation H**

The Department for Business, Innovation and Skills, with external stakeholders, should promote employee ownership as a business succession solution.

### **Recommendation I**

The Department for Business, Innovation and Skills should promote the Business Finance Partnership to funds that support employee ownership and target employee owned companies.

### **Business rescue**

- 3.41. This review also considered whether employee ownership should be promoted as a solution in business rescues.
- 3.42. Evidence presented to this review on innovation in this field overseas, such as in France and Italy, does point to the potential for worker co-operatives and employee owned companies to be formed out of enterprises that would otherwise have closed. There are risks in considering such an approach, not least to employees, and it is not suggested that this cuts across the fundamental role of insolvency practitioners in achieving the best deal for creditors. Nevertheless there is scope to explore whether and how, when it comes to business rescue, employee ownership can be promoted as a solution in appropriate circumstances, taking into account these risks.
- 3.43. In 2009, the Insolvency Service discussed with the sector how employee buy outs could be used as a means of saving businesses in financial difficulty and preserving the jobs of the workforce. The Insolvency Service concluded that the best approach to promulgate the use of employee buy outs would be through dialogue and education, in conjunction with the professional bodies representing the insolvency

profession. It was noted that the relatively loose framework for insolvency processes introduced by The Enterprise Act 2002 allowed flexibility which assisted company rescues and preserved value from the insolvency. Changes to legislation or supporting regulations might make the insolvency framework more prescriptive.

### **Recommendation J**

Co-operatives UK, the Department for Business, Innovation and Skills and the Insolvency Service, should assess the scope for a pilot scheme, running from 2013, to test the potential for employee buy outs as a solution in relevant business rescue situations.

## **Raising awareness of the support and guidance provided through the tax system**

- 3.44. The UK tax system already does much to help establish and maintain successful employee ownership. It does this through how the tax system works and information and guidance provided by HM Revenue and Customs. Ensuring that businesses are aware of this support and guidance, and that it is effectively linked to other sources of information is an important part of raising awareness overall.
- 3.45. The HM Revenue and Customs website already contains a great deal of information on employee share plans, including a number of publications. HM Revenue and Customs approach to support and guidance is focused upon tax advantaged plans, which is a consequence of successive Governments support for individual financial participation through such plans.
- 3.46. However, we received representations that employee owned companies and their advisers would benefit from improved guidance and support on the wider tax issues that they face.
- 3.47. Sector organisations have expressed a willingness to work with Government to develop materials to help present existing information more clearly, and to raise awareness of the sector and the wider agenda. These representations will form part of the evidence that this review passes on for consideration as part of the HM Treasury review.

## **Raising awareness and demand through a Right to Request employee ownership**

- 3.48. This review considered what further, more ambitious, means the Government has to facilitate awareness of employee ownership. In particular, to provide a 'nudge' to ensure it is a more routine consideration in business; building upon the groundwork laid by the general awareness raising work described above.
- 3.49. In other contexts, the Government provides such a 'nudge' through various policies based around a 'right to request'. There is a statutory 'right to request' to enable an employee to discuss flexible working with their employer and also to discuss time off for study or training. The Department for Health's 'Right to Provide' allows NHS and

public sector social care workers to make a request to take ownership of a public sector service and run it in the private sector. This Right to Provide is now integrated in the Cabinet Office's mutuels programme which is working with individual Government departments to develop and implement other Rights to Provide.

- 3.50. There are strong merits in the Government adopting a similar approach in the context of employee ownership in the private sector. Awareness of the concept and benefits of employee ownership is low. This review makes several recommendations aimed at changing this through promoting the concept and better information provision. There is a role for the Government to ensure employees and their employers can discuss employee ownership and make a reasoned judgement about whether the model is right in their particular circumstances. The 'nudge' policies described above encourage greater discussion and information exchange between employers and employees; and a similar outcome should be sought for employee ownership.
- 3.51. This review has considered therefore how a Right to Request employee ownership in the private sector might work. Based on the existing statutory 'right to request' models in employment law, any Right to Request employee ownership would broadly involve a group of employees developing a proposal for employee ownership, discussing it with their employer, and the employees having an expectation that the employer should reasonably consider the proposal and respond to it. However, there would be no 'right to have' and therefore there must be an equivalent expectation that the employer can turn down the proposal.
- 3.52. Based on the perspectives of most stakeholders consulted during this review, the principles underpinning a Right to Request are that it should:
- focus on the private sector, and cover all forms of employee share ownership;
  - be aimed at encouraging discussion and information exchange, not creating confrontation between employees and their employers;
  - require a sufficient group of employees to make the request;
  - be light touch and minimise regulatory burdens, and allow broad grounds to turn down the request; and
  - be of no detriment to employees who make a request.
- 3.53. Beyond these principles, there are several questions of detail the Government would need to consider, in consultation with stakeholders, on how a Right to Request would be designed and implemented.

**Table 5 – Design of a Right to Request employee ownership**

**Who can receive a request?**

How widely should this Right to Request apply? The Information and

**Table 5 – Design of a Right to Request employee ownership**

Consultation of Employees Regulations 2004 can apply to any public or private undertaking carrying out an economic activity whether or not operating for gain. Should a new Right to Request employee ownership apply as broadly? The Cabinet Office mutualisation programme is already enabling public sector employees to make mutualisation proposals and it is implementing this programme in individual Government departments. It is envisaged that a Right to Request employee ownership should therefore focus on the private sector.

The concept of employee ownership in this report embraces a plurality of legal forms. It includes, for example, companies limited by guarantee where all employees are members of the company. Nevertheless, should a Right to Request employee ownership apply only to companies limited by shares? It is envisaged it should do, at least initially. This would avoid the complication of designing and explaining how the right would apply to different legal forms.

Although employee ownership can be introduced in subsidiaries, in a group of companies employee ownership will generally be of shares in the holding company. Should every employer be expected to consider an employee ownership proposal or only central management? It is envisaged the Right to Request would apply only to employee ownership in a holding company, at least initially.

Employers should not be subject to repeated requests. There should be a limit on how often a request could be made. A request might be made, say, no more frequently than every three years unless there is a change in control of the company, when the time period starts running again.

#### **What could the request cover?**

Employee ownership takes many forms. It includes tax advantaged and other employee share plans as well as employee benefit trust ownership of shares in a company. There will be varying degrees of employee engagement and financial participation. This review recommends that the definition of what could be requested is left broad. It should cover requests for conventional employee share ownership. The onus should be on the employees to develop a proposal.

The Companies Act definition of "employees' share schemes" is broad and includes share ownership "on behalf" of employees, through employee benefit trusts, as well as by employees directly. If the Right to Request applies only to companies with shares, then this definition could be used. The only additional requirement would be that the proposal must cover the offer of participation to all employees.

#### **Who would be eligible to make a request?**

The Right to Request should be exercised by a group of employees, not individually. It would be convenient to follow precedent. Under the Information and Consultation of Employees Regulations 2004 a request must come from at

**Table 5 – Design of a Right to Request employee ownership**

least 10% of the employees (subject to a minimum of 15 and a maximum of 2,500).

There probably needs to be a requirement that all those making the request certify they have a minimum period of employment, such as the 26 weeks' continuous employment needed before a right to request flexible working is made. The proposal needs to be made by employees who have worked long enough to understand the business in which they work.

A simple approach to determining how many employees have to make the request is needed, such as by reference to data in the latest accounts of the relevant employer.

#### **What form should the proposal take?**

The idea is that employees should prepare a proposal in their own time, unless agreed otherwise with their employer. Regulations or guidance could provide for a template to be submitted to the employer similar to the "expression of interest" expected from NHS employees who exercise the Right to Provide.

#### **What is the employer required to do?**

This review favours an approach which is as 'light touch' as possible for employers. The key is to encourage a discussion. Under a statutory Right to Request, the key duty upon the employer might be to 'consider the request reasonably' and that the employer should be encouraged to meet with employees or their representatives.

#### **What would the grounds be for turning down a request?**

The simplest approach would be to require only that the main reason or reasons for turning down the proposal are given.

This review heard clear concerns that a Right to Request could be unwieldy and impose an expensive administrative burden on an employer. Experience of the rights to request in employment law show that the majority of costs to business arise from needing to undertake, and demonstrate, reasonable consideration of the request. This review favours drawing the grounds for turning down a request broadly. It could be that the timing is wrong. It may simply be that the owners of the company are not prepared to make shares available. The key is to ensure a reason is provided.

#### **What protections would employees need?**

The design of the Right to Request should limit the scope for employees to misuse the Right to Request. Employees will also need some protection. Employees should not to be subjected to a detriment or dismissed for exercising their Right to Request. As with other statutory Rights to Request, employees would need to be able to enforce their right and an employer would face some

**Table 5 – Design of a Right to Request employee ownership**

redress if it failed, for example, to show proper enquiry and reasonable consideration of the employee ownership proposal, but this redress could be minimal in keeping with the principle of a light touch statutory provision.

**How should the Right to Request be introduced?**

This review is sympathetic to the concerns expressed by business groups about introducing a Right to Request employee ownership. The Government should consider phasing in any statutory Right to Request by initially limiting its application to companies (with a share capital) with, for example, over 250 employees, such that at least 25 employees would have to make the request, and introducing a ‘sunset’ provision to enable the impact of the Right to Request to be reviewed. In time, and subject to review, the policy could be extended beyond this initial category.

**Should the Right to Request apply only at particular moments in the business lifecycle?**

This review proposes that the Right to Request would apply at all times, subject to the limit on how frequently requests may be made.

- 3.54. This review concluded a statutory Right to Request would provide a necessary ‘nudge’ given the lack of awareness of employee ownership.
- 3.55. This review also considered a non-regulatory alternative to a Right to Request. A non-regulatory alternative would be to publish guidance on how employee ownership proposals are raised and discussed by employees and their employers. ACAS has existing guides setting out best practice on engagement between employers and employees. This review considered similar guidance would be useful in the context of employee ownership, whether or not there is a statutory Right to Request. Such guidance could also help owners wishing to take the initiative and introduce employee ownership, as well as employees wishing to raise the idea. An example of what guidance could include is presented in Table 6.
- 3.56. Should the Government introduce a statutory Right to Request this guidance would provide practical advice on how to observe and comply with the Right to Request. The statutory duty would be explained and the guidance would demonstrate how employers could go about meeting that duty.

**Table 6 – Guidance for requesting employee ownership**

ACAS provides guidance, including Codes of Practice, which cover a number of employment relations circumstances. Their aim is to help employers and employees understand the law and provide a guide on good practice.

The purpose and content of guidance for requesting employee ownership will

**Table 6 – Guidance for requesting employee ownership**

depend on what regulatory approach the Government wishes to take.

Whether or not a statutory Right to Request is implemented, guidance could explain what employee ownership is, its advantages, and advise on how best to reach agreement between the employer (including the company's owners), the employees and their representatives.

Key points could be to: -

- involve all concerned, as much as possible, perhaps through a joint working party;
- changes can make people anxious, and so employee ownership should be kept as simple as practicable and agreed with all concerned;
- prepare the way carefully with briefings to the owners, employees and management;
- document the proposals and, if possible, start with a trial initiative; and
- make arrangements for maintenance, monitoring and evaluation.

3.57. Given the issues and challenges set out above, the Government's approach should be to take evidence and consult further on the detail of a Right to Request, in the context of developing ambitious measures to raise awareness of employee ownership and facilitate more discussion around it.

### Recommendation K

The Department for Business, Innovation and Skills, working with ACAS, should encourage employer and employee groups (including trades unions) to develop a voluntary Code of Practice setting out best practice on requesting and agreeing employee ownership in a company. In parallel the Department for Business, Innovation and Skills should consider what further role Government has in providing statutory support, through Recommendations L and M.

### Recommendation L

The Department for Business, Innovation and Skills should issue a call for evidence on the introduction of a statutory Right to Request consideration of an employee ownership proposal, covering the issues and challenges covered in Table 5.

3.58. This review also heard evidence that it is good to review employee ownership when the future ownership of a company or business is already under consideration. There is a precedent, for example, in the Transfer of Undertakings (Protection of Employment) Regulations for ensuring that employee representatives are informed and consulted in relation to certain business transfers. An employer has a defence if

it can show there were special circumstances making it not reasonably practicable for information to be given or consultation to take place, and that it had done the best it could to comply in the circumstances. Should there also be a similar obligation on an employer to inform employees that change of ownership of their employing company is envisaged, so that they may then exercise a Right to Request employee ownership? Ensuring employees are told, at the right time, of the possible sale of the company for which they work would provide them with the opportunity to consider whether to make, say, an employee buy out proposal.

- 3.59. In light of the call for evidence recommended above, the Government should also test whether and how to encourage employee buy outs in this way, for example, as part of the 'one year on' report (see recommendation AA).

### **Recommendation M**

The Department for Business, Innovation and Skills should issue a call for evidence on the best means to encourage owners and employers to make information available to employees, if a change of control of a company or sale of the business in which employees work is envisaged, in order to allow employees to consider an employee buy out.

## 4. Increasing the resources available to support employee ownership

This chapter:

- sets out the evidence and perspectives this review heard on how a lack of awareness and other factors means employee ownership is under supported, particularly in the information and guidance available on setting up and operating an employee owned company;
- recommends that a new Institute is established to provide a centre of expertise and that business intermediaries are supported to better advise on employee ownership; and
- outlines access to finance options available to support employee ownership.

### The need for change

- 4.1. Lack of resources was reinforced repeatedly in this review as an obstacle to achieving employee ownership, in terms of access to information and guidance, and finance. Lack of resources is a challenge today – and will become greater as the demand for employee ownership grows.
- 4.2. This review heard several examples from recently established employee owned companies that the specialist information and guidance necessary to explore, implement and maintain employee ownership is hard to find. The type of guidance most frequently cited as needed by respondents is the legal and tax advice necessary to structure an employee owned company, but financial advice and guidance on management skills and employee engagement were also cited. There is, for example, almost no information currently available on Government websites on employee ownership for private companies. The main source is a Business Link description of employee ownership models as part of its guide to employee buy outs (which was written with Employee Ownership Association help in 2007).
- 4.3. These are long-standing concerns raised by employee owned companies – recorded, for example, by the sector’s representative organisations over the last decade<sup>10</sup>.

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<sup>10</sup> For example, Postlethwaite, R.; Michie, J.; Burns, P. and Nuttall, G. (2005). *Shared Company* and Reeves, R. (2007). *CoCo Companies*.

- 4.4. The risk is that opportunities are missed as those who are interested in adopting employee ownership fail to find the necessary information and guidance to support them. Information and guidance on more conventional business models is, unsurprisingly, in greater supply, and this no doubt encourages most into keeping with familiar modes rather than 'riskier' employee ownership. Many respondents from the employee ownership sector could cite examples of owners giving up on employee ownership for that reason.
- 4.5. The impact of a lack of information and guidance also affects existing employee owned companies. Respondents claimed costs were higher as they needed to spend more time, and pay more, to assemble the support network of advisers and intermediaries required by all businesses.
- 4.6. This review also gathered evidence on the access to finance challenge faced by employee owned companies and those wishing to convert into employee owned companies. Employee owned companies are associated more often with debt finance insofar as the employee owners are reluctant to have their ownership interest diluted by seeking out equity capital. We heard some smaller employee owned companies had problems accessing bank lending, particularly due to a lack of familiarity with their business model amongst banks. A similar problem emerges for employee owned companies wishing to expand. These views were also confirmed in a survey of employee owned companies carried out by Cass Business School<sup>11</sup>.
- 4.7. Furthermore, this review heard a number of particular challenges that mitigate against financing employee ownership:
- the lack of a clear sense of the market opportunity to finance employee ownership;
  - the perception that employee owned companies involve a broad range of difficult stakeholder relationships; and
  - the lack of a clear 'exit route' for private equity.

## Creating a sector-led Institute to support employee ownership

- 4.8. There is a well-established model for the development of professional knowledge and dissemination of advice and guidance. Typically, an independent Institute is established. This body develops and maintains a syllabus and accredits individual professionals. The Institute also offers continuous professional development to its members and may undertake or commission research. It acts as the focus for a community of interest, often with an international reach. Collectively, institutes play a vital role in underpinning the UK's pre-eminent position in professional services.

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<sup>11</sup> Lampel, J., Bhalla, A. and Jha, P. (2012). *Working paper*. (see chapter 2)

4.9. This review established that the employee owned and co-operative sectors would welcome a new Institute whose primary role would be the dissemination of knowledge in relation to employee ownership, in particular to:

- managers and employees in that sector;
- managers and owners of businesses wishing to adopt employee ownership;
- legal, tax and financial advisers; and
- policy-makers, education providers and academics.

4.10. The areas covered by the new Institute would include those that this review has identified as being most in demand – the range of legal structures that can be used for employee ownership; options for financing employee ownership; the values and principles that underpin the sector and the specific management challenges raised by employee ownership. Existing sector bodies would continue to perform their separate roles, including advocacy, in relation to employee ownership issues.

4.11. The Institute could also take forward broader issues related to promoting employee ownership. Examples raised during the course of this review which the Institute may wish to cover include:

- developing evidence on the proportion and depth of employee ownership for listed and privately owned companies needed to secure the full benefits of employee ownership;
- developing the links between employee ownership and other aspects of corporate governance including accountability, transparency and corporate social responsibility;
- working with the Charity Commission to provide guidance on social investments and their significance in employee ownership business models; and
- extending participation in employee ownership arrangements to workers in a business other than employees.

4.12. A new Institute could also work well as part of a European Parliament initiative. On 21 October 2010 the European Economic and Social Committee approved an own-initiative opinion on employee financial participation in Europe. This included employee ownership as something to be promoted, as well as employee financial participation. The European Economic and Social Committee called on European institutions and Governments for a renewed initiative in this matter supported by the European Union budget through a dedicated budget heading to set up a European centre for employee ownership in each European country.

4.13. This review has also established the widespread goodwill towards the values inherent in employee ownership that is present among all stakeholders. This bodes

well for the collaboration that will be necessary between the employee owned and co-operative sectors (through the Institute) and professional bodies. This collaboration will be necessary to ensure that advisers are able to look to their own professional bodies as well as the Institute for support in developing their awareness and knowledge of employee ownership.

- 4.14. Business schools and professional bodies have an important role to play in ensuring that the lack of awareness of employee ownership typical among today's managers and advisers is remedied for future generations. The Institute will wish to consider how best to bring this about; for example, through promoting research and through collaboration to provide case studies and visiting speakers.
- 4.15. The constitution and governance of the Institute will be for the sector itself to determine, as will the arrangements for accreditation of learning and experience leading to individual membership. The organisations collaborating to create the Institute will want to consider how to reflect the principles and values of employee ownership in the Institute's own governance. The Institute's objects could be to advance the education of the public on the subject of employee ownership and to promote research for the public benefit in all aspects of employee ownership. It may wish to establish itself as an employee and member owned charity or community interest company.

## Recommendation N

Key organisations from the employee ownership and co-operatives sectors should develop and deliver an independent Institute to:

- provide guidance to businesses making the transition to employee ownership, including on standard models (see recommendation T);
  - provide a membership organisation for individuals interested in employee ownership;
  - consider providing accreditation associated with employee ownership;
  - advance generally the education of the public on employee ownership; and
  - promote research in all aspects of employee ownership.
- 4.16. Before the Institute is established, an information service should be put in place drawing on the expertise of existing organisations and experience of delivering the Mutuels Information Service. Provision of the service could eventually transfer to the proposed Institute but should not be delayed while the Institute is being set up. Similarly, work to develop standard document templates, information resources and training courses should take place in parallel with the development of the Institute rather than waiting until this is established.

## Recommendation O

The Department for Business, Innovation and Skills should collaborate with the employee owned and co-operative sectors to set up and publicise a single point of contact providing information and guidance on employee ownership to the private sector. This website and telephone service would be similar in scope to the Mutuals Information Service, which is available to public service providers.

## Recommendation P

The Department for Business, Innovation and Skills should collaborate with the employee owned and co-operative sectors and relevant professional bodies to support the development of the Institute and, in particular, the creation of information resources on employee ownership to be transferred to the Institute in due course.

## Ensuring employee ownership and employee buy outs are well known business concepts

- 4.17. This review found a widespread perception amongst those not directly involved in the employee ownership sector that employee ownership is complex and difficult to set up.
- 4.18. This perception of complexity is amplified by the lack of awareness among advisers. This is highly significant given that 83% of companies use professional advisers<sup>12</sup>. Advisers and their professional bodies this review spoke to were alive to their central role, and their possible contribution to the Government's growth agenda.
- 4.19. A transaction such as the sale of a limited company to a trade buyer may be objectively just as complex as the creation of an employee benefit trust. However, because it is familiar, the adviser knows the process for a trade sale and has all the necessary resources, such as model heads of terms, on which to base the transaction. As noted above, this lack of familiarity – which gives rise to the perception that employee ownership is 'difficult' – leads to missed opportunities and ultimately to a less diverse economy.
- 4.20. The existence of a single Institute as recommended above will go some way towards changing this perception. The Institute will offer a single point of contact covering all models of employee ownership, so that advisers and business people can make a straightforward comparison between, for example, a worker co-operative and a limited company with all its shares held in an employee benefit trust. An Institute will provide step-by-step guides and case studies of businesses that have made the transition.
- 4.21. This type of material is necessary but insufficient if intermediaries are to provide advice to their clients as readily as they would in a flotation or trade sale. Advisers

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<sup>12</sup> Department for Business, Innovation and Skills (2010). *Evaluation of the Companies Act 2006*. (Volume One, p.141)

can draw on a wealth of experience in conventional transactions. They will, for a period, need the support of their own professional bodies, working with the proposed Institute, to scope and deliver the necessary resources including model documents, templates and training resources if they are to advise on employee ownership. There is a need for a one-off, time-limited exercise to create a suite of materials that would subsequently be maintained and updated in the light of experience.

- 4.22. Specifically, this review heard concerns that for a number of years accounting standards had lacked clarity regarding their application to companies with employee ownership because of the focus in such rules on employee financial participation arrangements. More significantly we heard that a proposed new single UK accounting standard (FRS 102) may not adequately take into account the various forms employee ownership can take and, in particular, when an employee benefit trust holds shares permanently on behalf of employees. In this situation, the shares held by the trustees are not in substance the company's own shares and so the new standard should not require them to be accounted for as such. Again, as a general proposition, if a broader base of professionals understood employee ownership it is less likely that other regulatory bodies will inadvertently cause difficulties for companies with employee ownership.

### Recommendation Q

The Department for Business, Innovation and Skills should convene a time-limited taskforce of legal, tax, accountancy and other professional bodies and representatives of employee owned companies to identify how employee ownership can be a more integral part of advice provided by intermediaries, including through supporting intermediaries with training resources on employee ownership.

## Improving employee owned companies' access to finance

- 4.23. Many respondents we spoke to recognised the access to finance challenge inherent in employee owned companies, whether for existing or new employee owned companies.
- 4.24. There are practical steps that can be taken immediately, around raising awareness amongst financial institutions and the investment community. This review heard evidence for example that it was not easy to find someone to talk to at a bank or other financial institution about financing an employee buy out. Analysts may not include employee ownership models in the diagnostic tools used to assess investment propositions. The measures to raise awareness in this review should help overcome such problems.
- 4.25. However, a more fundamental problem of a lack of finance was regularly cited. A lack of finance was often the main challenge at succession stage, as well as when employee owned companies wish to grow and expand. A related question is whether an employee buy out can ever match the price achieved via a trade sale.
- 4.26. There are clearly owners who are satisfied with receiving a 'fair' price for their shares when they are bought out, without testing whether a higher price could be achieved through a trade sale. This is because many who choose this route place value on the

non-financial advantages of an employee buy out, such as leaving a legacy and giving an opportunity to their employees to take the company onwards.

- 4.27. Financing problems are recognised in the US. This review heard of various initiatives to address difficulties in financing employee ownership from the US. The National Center of Employee Ownership summarised the types of services some states have provided or funded to encourage employee ownership as including funding feasibility studies, creating loan funds and providing guarantees where private funding may not be available and also linked deposit programmes.
- 4.28. In relation to employee ownership there are a few specialist providers of finance in the UK. Existing employee owned businesses need working capital and finance to acquire fixed assets. There is nothing particularly to suggest that such companies have general problems raising this sort of finance. Instead it is growth capital that can be an obstacle because this necessarily means giving up equity, and doing so runs contrary to the idea of employee ownership. This review heard evidence that funding problems can lead to the end of employee ownership and there were repeated calls for an investment product and investment funds that are sympathetic to employee ownership.
- 4.29. Many of the obstacles identified in relation to the emerging social investment market can be seen to exist in relation to employee owned companies, such as a small market size, fragmented deal flows, lack of standardised deals, high transaction costs and confusion over terminology<sup>13</sup>. The state of knowledge in relation to finance for employee owned companies and the market's response so far lags behind that in relation to social investments. More information and awareness of financing options for employee owned companies is required.
- 4.30. This review examined particular routes and under-appreciated opportunities employee owned companies have in accessing finance. Employee owned companies possess characteristics making them potentially more suitable for certain specialised types of financing. For example, research undertaken by Cass Business School<sup>14</sup> shows that employee owned companies are, in general, less prone to volatility and fare better during economic crises. This should make them attractive to investors seeking to preserve their capital and earn stable, fixed returns.
- 4.31. Tables 7 – 9 below describe some of the opportunities open to employee owned companies. Through this review, and the awareness raising programme recommended in the previous chapter, these opportunities should be promoted to employee owned companies to consider.
- 4.32. The Mutuels Taskforce has drawn attention to the need to change existing tax reliefs such as the Enterprise Investment Scheme, to make them accessible to non-

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<sup>13</sup> HM Government (2012). *Growing the Social Investment Market*.

<sup>14</sup> Lampel, J., Bhalla, A. and Jha, P. (2012). *Working paper*. (see chapter 2)

shareholder companies<sup>15</sup> to help with access to finance. It was highlighted to this review that even with employee owned share capital companies there are difficulties in complying with the eligibility requirements.

## Recommendation R

The Employee Ownership Association should consider what measures there are to communicate financing opportunities directly to employee owned companies, building on company case studies where appropriate.

- 4.33. The Government has an active programme on improving access to finance in the UK, building on, for example, the progress made by the Breedon Review of finance options for business<sup>16</sup>. The Breedon Review identified lack of awareness of alternatives to bank finance, lack of expertise and a lack of confidence in securing such finance as obstacles facing all small to medium sized enterprises. The Government should therefore ensure that the access to finance challenge facing employee owned companies is included within its programme.

## Recommendation S

The Government should consider to what degree there is a lack of funding for employee buy outs and employee owned companies, for example through the advice of the Small Business Economic Forum, and make recommendations.

**Table 7 – Opportunities through transformation capital**

In traditional buy out situations, the equity stake is assumed by management (and, very often, a private equity firm supporting the transaction), and the remaining funds are provided in the form of debt by banks and specialised private debt funds.

During an employee buy out, this structure might differ depending on how much equity the employees would like to acquire and their medium term objectives. If they do not want to buy the entirety of the company and are contemplating a subsequent sale of the equity in a trade sale or a stock exchange listing, they might be able to seek assistance from a private equity fund.

However, if the employees acquire the majority of the equity and do not envisage a sale of the company, private equity firms will be reluctant to support them because they will not be able to sell their stake to achieve an exit from the transaction. (Although there is a small market of ‘patient capital’ private equity funds which target employee buy out transactions without requiring an exit strategy.)

<sup>15</sup> Mutuels Taskforce (2012). *Public service mutuals: The next steps*.

<sup>16</sup> Breedon, T. (2012). *Boosting finance options for business*.

**Table 7 – Opportunities through transformation capital**

An alternative is to examine forms of ‘vendor finance’ whereby the company owner, rather than selling immediately, retains an equity stake and sells it in stages to the employees or sells it for deferred consideration. This review describes elsewhere how the trust model of employee ownership can help support employee buy outs.

**Table 8 – Opportunities through patient capital**

Chapter 2 indicated some of the evidence on the long-term focus of employee owned companies. Employee owned companies responding to this review cited ‘long-termism’ as one of the consequences of their employee ownership and one of their strengths. We also heard that, as a consequence of this focus, employee owned companies were particularly attracted to longer term ‘patient debt capital’ (with a maturity of more than five years). This can be obtained in a number of ways.

*Retail bonds*

A bond is a debt instrument which is sold by the issuing company to bondholders, which effectively lend money to the issuer. The amount subscribed is usually repaid upon maturity, but the issuer pays the bondholders interest throughout the life of the bond. Bonds are almost always issued on a public exchange, such as the London Stock Exchange, and traditionally have been purchased by large institutional investors focused on large bond issues, rarely smaller than £100m, and often amounting to billions of pounds.

While traditional bond issues therefore tend to be by large companies regardless of their ownership structure, they are difficult to adopt for small and medium sized companies. This is due to the high advisory costs, and to institutional investors’ preference towards buying large tranches of bonds, which often are bigger than the entire pool of bonds a smaller business may want to issue.

However, retail bonds may be an attractive alternative. The Order book for Retail Bonds run by the London Stock Exchange allows individual (rather than institutional) investors to purchase corporate bonds directly. These investors are not likely to demand large bond tranches, which gives companies an opportunity to issue pools significantly below £100m. This potentially opens up the market for employee owned companies. In addition, retail investors often prefer to invest in stable companies with which they can identify, and many popular employee owned companies may be able to offer that.

*Mini-bonds*

Another similar instrument suitable for smaller businesses is the ‘mini-bond’,

**Table 8 – Opportunities through patient capital**

which was pioneered by the John Lewis Partnership. Mini-bonds leverage on the investors' attachment to the issuing company. The investors, as was the case with John Lewis Partnership bond, may be the employee owners or the customers of the company.

*Private debt placements*

Private debt placement refers to a fixed coupon debt instrument, akin to a public bond, but issued directly to institutional investors without involving the public debt markets. As these instruments tend to have a long maturity (5-10 years) and be relatively illiquid compared to, for example, publicly traded bonds, investors buying them prefer to deal with stable companies, often coming from traditional sectors of the economy.

The stability and counter-cyclical performance of employee owned companies, as described in chapter 2, may make them attractive candidates for private debt placement investors. Furthermore private debt placement is attractive to employee owned companies: given it is debt, it does not dilute the equity and is a longer term, patient form of finance.

**Table 9 – Opportunities through short and medium term capital**

*Sponsor-less mezzanine funds*

Mezzanine capital is a hybrid of debt and equity (sharing certain characteristics of both of these) and is usually used in financing buy out transactions. In this context mezzanine is often referred to as 'sponsored', because it tends to be brought in by a 'financial sponsor', typically a private equity fund.

The flexibility in design of mezzanine capital means that it is particularly suited to relatively new companies with high growth potential; investors are happy to trade low interest rates for a share of a borrower's growth at a later date. Where fund managers provide mezzanine capital as a form of lending through a direct relationship between the borrower and the fund manager this is referred to as 'sponsor-less' mezzanine and it is particularly attractive for small and medium sized businesses which cannot raise additional bank debt and do not wish to take on extra equity.

Sponsor-less mezzanine funds predominantly target companies with stable management and good growth potential. For employee owned companies, which often match these conditions, this may be an attractive solution.

*Receivables finance*

Receivables finance is a form of debt finance secured on the company's receivables, or invoices. It is an increasingly popular alternative to traditional

**Table 9 – Opportunities through short and medium term capital**

factoring, and to an extent to overdrafts. Provided by invoice finance houses as well as more innovative, on-line platforms, this form of capital is predominantly used by small and mid-sized companies which supply goods and services to larger, solvent corporates.

Receivables finance is slowly gaining popularity amongst larger businesses too, who use it to assist their own supply chains financially. Larger employee owned companies with an interest in their wider socio-economic environment may be particularly interested in such supply chain finance programs.

# 5. Reducing the complexity of employee ownership

This chapter:

- **reviews the legal process for setting up and operating employee ownership, and whether it can be made easier and less daunting;**
- **recommends a simplified ‘off the shelf’ model for how an employee owned company is created, to give a head start to those interested in adopting employee ownership; and**
- **examines other regulatory and tax related barriers facing employee ownership, which will be reviewed by Government in due course.**

## The need for change

- 5.1. Another strong theme in this review was that employee ownership is held back by its legal, tax and regulatory complexities. Employee ownership was described as ‘unusual’ and ‘difficult to do’, which often led to the conclusion that it was too hard to be worth considering. The contrast between employee ownership and the familiarity and ease of forming a conventional ‘off-the-shelf’ company, or achieving succession through a trade sale, was often made. The lack of a preferred model of employee ownership was frequently mentioned too.
- 5.2. Complexity can create costs for existing employee owned companies and those wanting to introduce it – they have to spend time and resources on compliance or taking professional advice. In smaller companies or start-ups, this can present a significant barrier to adopting employee ownership. This review also heard that potential employee owners could be discouraged by the perceived complexity of the legal and tax implications of employee ownership.
- 5.3. If employee ownership becomes more familiar then some of the problems described by respondents are likely to be eased as the concept of employee ownership and the models for achieving it are demystified and become more routine. However, the balance of evidence we heard suggested there was scope to simplify the legal, tax and regulatory issues relevant to setting up and operating employee ownership. This review therefore has taken the approach that whatever can be usefully simplified and made easier, should be.

## Providing simplified ‘off the shelf’ models for employee ownership

- 5.4. The precise model a company will use to adopt employee ownership will differ according to the objectives of the company and its circumstances. This diversity is a

strength, and reflects the dynamism of the sector. There was a clear message in the informal consultation that this diversity must be maintained.

5.5. This review considered the merits of establishing some form of simplified model of employee ownership, and established these as:

- reducing the time and cost of introducing employee ownership;
- demystifying how employee ownership works so more can learn easily how they could achieve employee ownership; and
- creating a 'product' that a much wider constituency of business advisers and intermediaries can refer to and advise upon, and that can be easily incorporated into training materials.

### **The value of the trust model of employee ownership**

5.6. This review has described how employee ownership can be achieved through either direct share ownership, indirect share ownership (the trust model), or a combination of the two. This review received several responses advocating the particular value of the trust model of employee ownership, and there is a well developed discussion of its benefits in achieving long-term employee ownership. These reasons fall into four categories.

5.7. Firstly, the trust model provides a solution to the challenge of financing employee ownership. In most circumstances, employees are unable to raise sufficient capital personally to purchase a significant proportion of their company's share capital. The existence of an employee benefit trust allows employee ownership to be financed over a longer period of time and opens up access to more sources of finance. A trust is able to borrow funds to finance employee ownership – and then pay these loans back over a longer time period, for example, through company contributions derived from normal cash flow and profitability. Furthermore, during employee buy outs, it is easier to manage negotiations if they are with trustees rather than directly with all employees.

5.8. Secondly, the trust model provides a more stable and long-term structure for employee ownership. Under direct share ownership, employee owned companies face the pressure of employees seeking or requiring to sell their shares and 'cash out'. Shares held by a trust need not be sold again. In this way, employees have a permanent stake in the company.

5.9. Thirdly, an employee trust provides a vehicle for employees to make their collective voice heard throughout the company and to act as 'custodian' of the company's employee ownership ethos. The trustees may be appointed by the employees. This encourages and entrenches employee engagement into the structure of the company.

5.10. Fourthly, the tax position of shares held permanently in an employee benefit trust is straightforward. An employee benefit trust is usually drafted so that inheritance tax is not payable on the shares held in the trust and the shares are held on discretionary

trusts (and not ear-marked for any particular employees), so that there are no employer or employee tax liabilities. This also makes the trust model easier to apply to employees in other jurisdictions.

- 5.11. Trusts are in use in a wide variety of ways in the UK. Nevertheless this review considered if there is anything inherently complex in using a trust. This review noted that the possibility of using an alternative to a trust was considered when the Share Incentive Plan was introduced but it was found at that time that most companies were familiar with trusts and already operated some kind of trust arrangement. As such the trust requirement would not considerably increase the complexity of the plan. In the course of its review of tax advantaged share plans the Office of Tax Simplification found no compelling reasons to indicate both that the removal of the trust requirement for Share Incentive Plans and the introduction of an alternative structure to hold shares would lead to simplification.
- 5.12. The simplicity of the trust model is highlighted in a start up situation. A conventional 'off the shelf' company can be used for the trading company. If all its shares are held by the trustee of an employee benefit trust then the company is immediately an employee owned company. This is the model adopted by employee owned companies such as Make Architects Limited. There are no external shareholders. There is flexibility as to who are the trustees (or directors of the trustee company).

#### **Creating an 'off the shelf' employee owned company model**

- 5.13. The trust model therefore provides a good starting point when considering the best employee ownership model. This review concluded that the Government should promote the trust model as a means of encouraging long-term employee ownership, and should focus upon producing simplified 'off the shelf' models for achieving it.
- 5.14. There were frequent calls during this review for assistance with model constitutions for companies with employee ownership. There is a strong case for a unified set of model documents with official endorsement. This is part of the reason why community interest companies have been successful. There is a suite of model constitutions and accompanying guidance available from the Community Interest Company regulator's website.
- 5.15. This review therefore considered what templates and models could be produced to create an 'off the shelf' employee owned company.
- 5.16. A company with employee ownership will have its own constitution, separate from that of any employee benefit trust. If the company has conventional articles of association and is 100% owned by an employee trust then the trustee will have full control of the company under company law. Some trust models rely on company law and make no changes to the articles of association of a wholly owned company. However, even in this situation it would help to adapt conventional articles to:
- provide recognition of the employee ownership ethos; and
  - identify certain decisions that cannot be taken by the board of directors and that must be taken by shareholders.

- 5.17. In practice, many employee owned companies have an employees' committee or council, with which the board of directors can or must liaise on various matters. This is also provided for in the company's articles.
- 5.18. If a company is not 100% owned by an employee benefit trust then changes to the articles of association are likely to be needed to provide, at the least, for:
- a share valuation methodology;
  - ensuring mandatory transfer provisions apply when an employee shareholder leaves and to give, the priority to, say, the trustee of an employee benefit trust to buy those shares; and
  - all in a way compatible with any tax advantaged share plan.
- 5.19. There are other provisions that would have to be optional in a set of model articles but could be adopted should it be desirable, such as an article limiting pay differentials. There could be 'drag and tag' provisions (to deal with compelling or permitting minority shareholders to participate in a sale of the company should this ever occur).
- 5.20. A clear principle emerged from this review that an employee owned company should not have restricted objects, in contrast to, say, a community interest company. As one respondent commented "the beauty of this model (potentially) is that it operates in terms of creating conditions, structures, constraints and resources, which then get mobilised in various directions, depending on stakeholder priorities".
- 5.21. There are provisions that may have to operate externally from model articles of association but could be considered as optional provisions. For example, an owner and the trustee of an employee benefit trust may wish to have 'put and call' options in place, so that there is a legal framework for the sale and purchase of the owner's shares at agreed prices and within a set time frame. There could also be standard anti-embarrassment provisions, to provide for additional consideration for a former owner if the employees wish to sell on the company within a short period rather than retain it.
- 5.22. Another important issue for employee owned companies is that of entrenching share rights. Under company law there is scope to entrench share rights but ultimately if all shareholders agree the constitution can be changed. Finally, given the importance of ensuring employee engagement, information and guidance on achieving engagement – through management style as well as management structure – is another component of an 'off the shelf' model for an employee owned company.

## Recommendation T

The Department for Business, Innovation and Skills, working with HM Treasury and ACAS as necessary, should develop simple employee ownership toolkits including 'off-the-shelf' templates, to cover legal, tax and other regulatory considerations set out in Table 10.

**Table 10 – Employee ownership templates and toolkits**

The toolkits would cover:

1. Setting up an employee benefit trust and trustee company;
2. Giving shares to an employee benefit trust;
3. Making cash contributions to an employee benefit trust;
4. The trustee of an employee benefit trust subscribing for shares;
5. The constitution for an employee owned company and guidance on entrenching share rights; and
6. Guidance and best practice on achieving employee engagement.

The first toolkit will comprise: (i) a model employee benefit trust deed; (ii) model articles of association for a trustee company (a company limited by guarantee); (iii) standard supporting documents to enable the employee benefit trust to be established with a nominal cash trust fund; (iv) a guide to the legal, tax and regulatory aspects of the model documents; and (v) a guide to the next steps in implementing employee ownership including enhancing employee engagement.

The model employee benefit trust deed would be based on best practice and include constitutional provisions that:

- require the 'beneficiaries' to be all the employees of the defined employer;
- must promote employee share ownership by all and not just by some employees;
- emphasise the importance of ensuring the employer has an employee ownership ethos including effective employee engagement;
- provide optional provisions regarding the composition of the trustee directors including a 'paritarian' composition of trustee directors (that is equal numbers from management and staff with one or more independents); and
- emphasise the importance of acquiring and holding a significant shareholding stake.

The second toolkit will make various assumptions to ensure the gift is tax free but, assuming these assumptions are satisfied, will enable a shareholder to give shares to an employee benefit trust. This toolkit will comprise: (i) a pro forma stock transfer form; (ii) standard supporting documents to enable the shareholder's transfer of shares to be approved by other shareholders, accepted by the trustee of the employee benefit trust and registered; and (iii) a

**Table 10 – Employee ownership templates and toolkits**

guide to the legal, tax and regulatory aspects of this gift including company secretarial tasks and claiming tax relief.

A third toolkit will assist a company to make cash contributions to an employee benefit trust. This toolkit will comprise: (i) model minutes of meetings of the board of directors of the company and the trustee of the employee benefit trust. This is to record the decision of the company to make the contribution to the employee benefit trust and of the trustee to accept it for that purpose; and (ii) a guide to the legal, tax and regulatory aspects of such contributions, including the alternative of the company providing a loan to the trustee.

A fourth toolkit will assist a trustee to subscribe for shares in a company. This toolkit will comprise: (i) model minutes of meetings of the board of directors of the company, its shareholders and the trustee of the employee benefit trust to record the decision of the trustee to subscribe for shares and for the company and its shareholders to agree and implement this; (ii) standard supporting documents such as the required Companies House return and pro forma share certificate; and (iii) a guide to the legal, tax and regulatory aspects of such contributions.

A fifth toolkit would comprise: (i) model articles of association for a share capital company (a) wholly owned by an employee benefit trust in which no individual share ownership is intended, and as an alternative (b) partly owned by an employee benefit trust in which there is individual share ownership; (ii) model minutes of meetings of the board of directors of the company and its shareholders to adopt new articles; and (iii) a guide to the legal, tax and regulatory aspects including entrenching share rights.

A sixth toolkit would include contemporary best practice on achieving employee engagement, linking for example to the guidance produced by ACAS or the Employee Engagement Task Force.

### **Strengthening the trust model further**

- 5.23. There is another change that will enhance and secure the long-term benefits of the trust model. This is to solve the problem that under English trust law an employee benefit trust cannot exist forever and therefore cannot achieve what it is expected to do under the trust model, namely secure perpetual employee ownership.
- 5.24. There is a general question as to how far into the future the law should allow someone to reach when tying up property in trust. Since the end of the seventeenth century, there has been a rule against perpetuities which has prescribed a time limit, known as the perpetuity period, in which dispositions must take effect<sup>17</sup>. The rule is

<sup>17</sup> In addition to the rule against perpetuities there is another rule that has evolved which has a related but distinct objective. This is the rule against inalienability, often called the rule against perpetual trusts. This

justified by the need to place some restriction on the freedom of one generation to control the devolution of property (so called 'dead hand control') at the expense of the generations that follow. However, the rule is not limited to family settlements. In response, in particular, to difficulties caused by this rule in the context of commercial transactions the Law Commission made recommendations to reformulate the rule against perpetuities (and the rule against excessive accumulations of income) to meet contemporary needs<sup>18</sup>. Its recommendations were enacted in the Perpetuities and Accumulations Act 2009. A major change was to provide for a single perpetuity period, a fixed period of 125 years. The only cases in which the need for dead hand control appeared to the Law Commission to require the application of the rule against perpetuities were, essentially, in relation to future estates and interests arising under trusts or wills but with an exception for pension schemes.

- 5.25. Statutory exemptions from the perpetuity rule for certain types of pension schemes have existed since 1927. The main argument for doing this is that the need to place limits on the extent to which one generation can control the devolution of property for the future has no relevance to pension funds which provide contractual benefits to members and their dependants. Following the Perpetuities and Accumulations Act 2009 the rule does not now, in broad terms, apply to an interest or right arising under any relevant pension scheme (as defined by reference to the Pension Schemes Act 1993).
- 5.26. Employee benefit trusts are essentially commercial in nature. They are usually established by a company, rather than an individual, and the main beneficiaries of such trusts will be beneficiaries because they hold contracts of employment. The Law Commission considered that, as a matter of principle, transactions of a commercial character ought not to be impeded by the operation of the rule against perpetuities. However, it decided not to create a general exception. The principal reason for this lay in the difficulty of defining the transactions to exclude. Although an exception for employee benefit trusts was considered it was thought that the rule against perpetuities did not cause undue difficulty in practice and some assistance was provided in that the 125 years fixed period was substantially longer than previously available, although this longer period does not assist existing employee benefit trusts.
- 5.27. Those creating new employee benefit trusts under English law as part of a permanent employee ownership solution want their trusts to last forever. In practice, founders typically work on the basis that either the law will have changed or a solution will be found when the fixed perpetuity period is reaching its end to enable shares to be re-settled for another 125 years. There are such solutions available but

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rule does not restrict the future vesting of estates or interests, but the duration of trusts established for non-charitable purposes. Employee ownership would be such a non-charitable purpose under English law. Non-charitable purpose trusts are usually void because there is no beneficiary who can enforce them, but they are also objectionable because they may be perpetual. This rule was excluded from the scope of the consultation leading to the Perpetuities and Accumulations Act 2009. Any consideration of a change to this rule is part of a wider discussion on whether a new legal entity is needed to promote employee ownership.

<sup>18</sup> The Law Commission (1998). *The rules against perpetuities and excessive accumulations*.

this review believes this is an unnecessary risk and complication and that employee benefit trusts should be another exclusion from the rule against perpetuities.

5.28. This review believes the law and practice has moved on since the Law Commission's consideration of the case for an employee benefit trust exemption:

- Other jurisdictions have adopted a different approach when reforming their trust law. Since 27 October 2006, unless its terms provide otherwise, a Jersey trust may continue in existence for an unlimited period and no rule against perpetuities or excessive accumulations shall apply to a trust or to any advancement, appointment, payment or application of assets from a Jersey trust. Guernsey law has similarly changed; and
- Scottish law has developed so as to permit perpetual trusts. The Law Commission found that the mere fact the law in Scotland allows the creation of perpetual trusts does not lead settlors to create them; and perpetual trusts, when created, tended to be confined to public purposes. This review found the situation to be different now and that employee benefit trusts established under Scots law may now be established as perpetual trusts.

5.29. There is a power to create additional exceptions under the Perpetuities and Accumulations Act 2009. It was thought conceivable that situations may arise in future where the rule against perpetuities would apply, but where that might be undesirable. In order to meet this possibility changes may be made by statutory instrument. An exemption could apply to any new employee benefit trust established under English law unless its terms provided otherwise. Consideration should also be given to permitting existing employee benefit trusts to opt in to any new exemption. Alternatively, there might be scope for existing employee benefit trusts to be exempted specifically.

5.30. There is a generally applicable definition of employee benefit trusts. Employee benefit trusts are practically always drafted so as to meet the definition of a trust for the benefit of employees in section 86 of the Inheritance Tax Act 1984, because of the inheritance tax advantages this brings. Although not required under section 86, employee benefit trusts are also almost always discretionary trusts. The Law Commission believed its changes could have had retrospective effect only if there had been a saving for what are known as vested rights. In a discretionary trust no beneficiary has any vested rights.

5.31. Subject to consultation, it should be possible to define an exemption for employee benefit trusts by cross-reference to section 86 with a further condition that the trust is a discretionary trust.

## Recommendation U

The Ministry of Justice should exempt employee benefit trusts from the 125 year perpetuity period in the Perpetuities and Accumulations Act 2009, to enable perpetual ownership of shares in employee owned companies by employee benefit trusts. Existing employee benefit trusts should also be permitted to benefit from this exemption.

### **Simplifying processes around direct share ownership**

- 5.32. This review received several submissions on the operation of tax advantaged and other share plans. In some companies there is a strong belief that employee ownership has to be based around some degree of individual share ownership. There are employee owned companies established on the basis of all employees acquiring shares directly through tax advantaged share plans, and which may or may not also have shares held in an employee benefit trust.
- 5.33. There are some companies for whom direct share ownership, of a small percentage of the company's share capital, will be as much employee share ownership as desired. This review has therefore considered removing complexity associated with direct share ownership and, in particular, the operation of internal share markets.
- 5.34. Under direct employee share ownership, when individual employees hold shares themselves, there needs to be an easy way for employee shareholders to sell their shares. A gain an employee can make when they sell their shares may be the main financial benefit of employee ownership. Most companies with employee ownership require an employee to sell all their shares when they leave. This is to avoid the obvious problem of a company becoming owned more by its former employees than its current employees. Other companies offer employees regular opportunities to buy and sell shares on an internal share market.
- 5.35. We heard from private companies that wanted to know why internal share market arrangements could not operate on a simpler basis. Companies explained the difficulties they encountered under company law. We heard from private companies that wanted to know why shares could not be bought by the employing company itself and held for redistribution to employees. UK company law does recognise this concept of treasury shares. However, the relevant Companies Act 2006 provisions do not apply to private companies.
- 5.36. As an alternative to a company buying its own shares and holding them, it is possible for a company to buy its own shares and cancel them. Share cancellation has to follow a formal procedure because a company's share capital is reduced. Again, we heard concerns over the complexity of this procedure, such as:
- under section 694 of the Companies Act 2006 buy back contracts must be approved by a special resolution of shareholders. This requirement cannot be disapplied by companies;
  - when a company buys back its own shares, under section 691(2) of the Companies Act 2006 the company must pay in full for those shares. We heard that companies would like the facility to buy shares by paying for them in instalments; and
  - regarding the restrictions on how share buy backs must be financed and the suggestion was made that there should be an exception to these restrictions if the buy back is pursuant to an employees' share scheme.

- 5.37. An employee benefit trust may, in effect, carry out the treasury function described above. The trustee can buy shares from employees wishing to sell and hold them pending their re-use under the relevant company's individual employee ownership arrangements. The trustees may also buy shares on a more flexible basis than a company buying back and cancelling shares. The trustees may pay for shares in instalments.
- 5.38. However, some companies may prefer not to use an employee benefit trust. The Government should consider regulatory reform to improve the operation of internal share markets, and increase the flexibility for companies. Although it would require primary legislation to change the requirement for a special resolution for a buy back contract, other changes may be made in secondary legislation, such as extending the definition of qualifying shares for treasury purposes to include shares bought for the purpose of an employees' share scheme in a private company.
- 5.39. In 17 other European member states private companies may buy back and hold shares in treasury<sup>19</sup>. The requirement for shares to be fully paid when bought back is similarly one that may be changed by secondary legislation.

## Recommendation V

The Department for Business, Innovation and Skills should consult upon improving the operation of internal share markets to support companies using direct share ownership, including holding private company shares in treasury and facilitating share buy backs.

### Is a new legal entity for an employee owned company required?

- 5.40. This review generated a good deal of support for creating a new legal entity for employee ownership. One submission sought to "design a corporation that is in its nature owned by all who work in it, and that cannot be owned by outsiders". This aspiration is not new. This was expressed by Lord Eustace Percy, a Conservative government minister under Baldwin, as far back as 1944, who said in his Riddell lecture:
- "The human association which in fact produces and distributes wealth, the association of workmen, managers, technicians and directors, is not an association recognised by the law. The association which the law does recognise – the association of shareholders, creditors and directors – is incapable of producing and distributing and is not expected to perform these functions. We have to give law to the real association and withdraw meaningless privilege from the imaginary one."<sup>20</sup>
- 5.41. Further concerns expressed with existing legal models used for employee ownership include:

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<sup>19</sup> Lowitzsch, J. et al. (2008). *Financial Participation for a New Social Europe. A building block approach*.

<sup>20</sup> Oakeshott, R. (2000). *Jobs and Fairness: the logic and experience of employee ownership*.

- employee benefit trusts provide an imperfect intermediary between the employees and their business and under English law cannot last forever;
- partnerships involve personal liability and the loss of employment law protections;
- unincorporated associations involve personal liability;
- limited liability partnerships involve the loss of employment law protections;
- companies limited by guarantee provide insufficient financial participation for employees as members; and
- community interest companies require the community interest to take priority over employees' interests.

5.42. Once created the new legal entity could be the focus for raising awareness of employee ownership and would help channel resources effectively. The community interest company, for example, shows that a concept can be promoted successfully if it takes a tangible and easy to implement legal form. The community interest company can be used to illustrate a key challenge when considering if a separate legal entity for employee ownership can be made to work. A community interest company is a limited company, formed under the Companies Act 2006, that has special additional features to provide a purpose-built legal framework for social enterprises that adopt the limited company form. In practical terms, community interest companies are for the use of people who want to conduct a business or other activity for community benefit, and not purely for private advantage. There is flexibility as to who those people are. The ownership of a community interest company is left open. In contrast, and this is the key challenge, any new legal entity for employee ownership necessarily involves restrictions on ownership, whilst its activities can be left open.

5.43. There was particular support for the idea that a new legal entity should be able to reproduce in some way the individual accounts held by workers in the Mondragon co-operative model<sup>21</sup>. In broad terms, under this well respected model, net profits are allocated to accounts which a worker is not expected to withdraw until retirement. These accounts, which earn interest, are regarded as a loan from the worker. The idea submitted to this review is that in addition to a 'membership share' which provides an employee with a vote (or votes) but no economic participation there would be 'partnership shares' which provide economic rights, such as those in the Mondragon model. In a share capital company this might involve the issue of redeemable bonus shares annually to employees, which are then repaid on retirement. A new legal entity might also involve setting aside permanent reserves, to ensure financial stability, which would be paid out to, say, charity if the entity is dissolved rather than distributed to employees. Although, it was also recognised that

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<sup>21</sup> Nelson-Jones, J. and Nuttall, G. (1987). *Employee Ownership – legal and tax aspects*.

the new legal entity would need to raise finance in other ways compatible with employee ownership such as by issuing preference shares or loan notes.

- 5.44. The assumption, of course, is that it is possible to devise a significant improvement on existing legal models, so as to justify the Government introducing new law. Those asking for a new legal entity accept that this is not a straightforward request. There is much that can already be done through the use of existing legal models. There are already employee owned companies that use redeemable shares, for example, to provide voting rights (but no economic rights) to employee shareholders. Companies could if they wish issue bonus shares to employees. There are worker co-operatives and types of social enterprise (with model rules) that already achieve some of the aims of those asking for a new legal entity. Furthermore, this review also heard perspectives that adding a new legal entity would create complexity without sufficient benefits to justify the change.
- 5.45. This review's response to requests for a new legal entity therefore is that there is still work to be done to establish the case for such an entity and that there are, for now, other priorities.
- 5.46. This review heard further evidence and discussion on whether employee ownership needed a regulator. The community interest company regulator has, in particular, to monitor compliance with the community interest test. It was generally accepted by those who considered this idea that there is nothing equivalent to the community interest test that needs regulating in relation to existing legal models of employee ownership. The idea was raised of a regulator having a role in relation to entrenching share rights in a company. A company could provide under its articles that the regulator's consent is needed to any change to such rights. If there is a demand for such a third party to assist with entrenching share rights then the Institute (see recommendation N) might consider fulfilling that role.

#### **Is a new legal entity for collective ownership required?**

- 5.47. This review also considered if a new legal entity for collective ownership of shares on behalf of employees is needed, instead of an employee benefit trust. This new entity would be capable of lasting forever, rather than be subject to the Perpetuities and Accumulations Act 2009 and limited to 125 years. Another advantage would be to remove complexity in comparison to existing trust structures.
- 5.48. In order to avoid the risk of personal liability when individuals act as trustees, a corporate trustee is needed. This means two legal constitutions are required when the trust model is implemented; a trust deed for the employee benefit trust itself and the articles of association for the trustee company. The trust and the company each have a separate legal existence requiring administration. Could the two be combined to create a legal model that is easier to introduce and administer? As a precedent, an incorporated charity contains its own charitable objects and does not require a separate trustee of those objects. The tax treatment of such a new entity would need careful consideration. An important design issue would be, as with a trust, the extent to which provisions can be made permanent, or entrenched, to ensure the continuation of the arrangement.

- 5.49. This review considered if a community interest company could be used as an alternative to an employee benefit trust. Co-operatives UK holds the model articles of association for a co-operative community interest company and many employee-led public sector mutuals have structured themselves as community interest companies. But could a community interest company be used as the collective ownership entity? Although there is scope to use this model, the employee ownership ethos must necessarily be compatible with achieving a wider community interest and so this review calculated such a model is unlikely to be widely accepted as a replacement for the employee benefit trust.
- 5.50. This review received evidence that it is time consuming and difficult to explain the two component parts to establishing an employee benefit trust. However, as with the request for a new legal entity for an employee owned company, this review concluded that there are, for now, other priorities.
- 5.51. This is subject to one important qualification. This review also received tax driven requests for a new legal entity for collective ownership, or for an existing arrangement such as the Share Incentive Plan to be adapted to provide for the permanent ownership of shares. These requests proposed that, in order to avoid the abuse of any new employee ownership tax reliefs, a new or adapted legal entity would be needed that had built into it all the necessary safeguards to prevent such abuse. If new tax reliefs are introduced then the creation of a new legal entity or the adapting of an existing arrangement should be considered to try to prevent abuse of the reliefs.

### Recommendation W

The Institute (see recommendation N) should provide evidence to Government on whether a new legal entity for either or both employee owned companies or collective ownership is needed, three years after the implementation of the template documents (see recommendation T).

## Avoiding unintended regulatory burdens upon employee owned companies

- 5.52. This review heard mixed evidence and perspectives regarding the overall non-tax regulatory burden falling upon employee owned companies.
- 5.53. Given the lack of awareness of employee ownership it is conceivable that law and regulation may place unintended regulatory burdens on employee owned companies. In comparison, the modern co-operative movement started in 1844 but this review heard that the movement still feels it is playing catch-up with Government, in that successive Governments have failed to take into account the particular legal models that co-operatives may adopt when introducing new law and regulations.
- 5.54. Employees in companies with employee ownership may, in particular, have in addition to their normal employment law relationship with their employer, rights or benefits in their capacity as owners, which in broad terms are:

- access to dividends or their equivalents such as annual bonuses or additional benefits;
- voting rights; and
- a collective stake in their company (which can have a capital value).

5.55. Government regulations may fail to take these additional rights or benefits into account.

5.56. Specifically, this review heard from employee owned companies who explained that by virtue of their ownership structure and their emphasis upon employee engagement they achieve the outcomes some Government regulation is designed to enforce. It was argued that the Government should either exempt these companies from such regulations or find ways to lighten the rules on demonstrating compliance. There is an hypothesis that given the interests of employees and employers are more aligned in employee owned companies than in other companies, it follows that employment regulations to protect employees from exploitation from the employer could be revoked or lightened for employee owned companies.

5.57. Whilst this is an attractive concept this review has not received many concrete examples of regulations that could fall into this category. The Information and Consultation of Employees Regulations 2004 provide for employee rights to information and to be consulted. It is likely that for many employee owned companies these rights are enshrined into their structure and so regulation to enforce this is unnecessary and burdensome. Another example given was of a redundancy situation where employees were consulted as owners and then again under the formal collective redundancy consultation process.

5.58. Implementing any exemption from these or other regulations would be challenging. Unless all employees are owners there would be a risk of removing regulatory protection from other employees who were not owners. Employee owners in existing employee owned companies would not necessarily wish regulatory protection to be removed from them. Furthermore the hypothesis is based upon employee owned companies achieving a high standard of employee engagement. Whilst this is undoubtedly the case in many employee owned companies, there is no guarantee it is the case in all circumstances: the rationale for an exemption works best when the employment rights exempted are guaranteed by virtue of the employee ownership. There are also considerations of European law.

5.59. This review heard from other employee owned companies and their representatives who did not agree that there were, or could not cite, regulations that disproportionately impacted them. Although it was often emphasised that the burden of regulation should be minimised as far as possible, for employee owned companies as for any other business. Others regarded employment rights derived from regulation as integral to their companies, and did not want to be associated with a de-regulatory approach that removed them.

5.60. There is another aspect to note. It is standard practice in tax advantaged share plans and other share plans to provide that the employment rights of a participant are not

altered in any way by participating in the plan and that similarly any benefits of participating are not taken into account when deciding on pension or similar benefits. This review did not hear any suggestions that this approach is an obstacle to promoting employee ownership. The general view is that it is for each company with employee ownership to decide on how, if at all, its employee ownership arrangements might impact on employment and pension rights. Although US employee stock option plans are part of US retirement plan law this review heard that this is incidental because the people promoting this idea were doing it at a time US retirement law was being reformed.

- 5.61. In light of this evidence, this review favours an approach by which the Government remains focused upon regulating in the least burdensome way possible, but takes account of the impact of regulation on employee owned companies as part of its consultations on future changes to employment law.

### **Recommendation X**

The Government should, when devising regulation, ensure that employee owned companies do not suffer unintended burdens due to their structure; and the Department for Business, Innovation and Skills should take into account regulatory impacts on employee owned companies as part of its consultations on future changes to employment law.

### **Recommendation Y**

As part of a 'one year on' report (see recommendation AA), and in light of the results of recommendation X, the Department for Business, Innovation and Skills should assess whether a further review of the impact of regulation upon employee owned companies is warranted, and keep an open invitation in the meantime to receive evidence on regulatory barriers faced by employee owned companies.

## **Reducing the complexity of the tax system**

- 5.62. The Office of Tax Simplification recently carried out a review of tax advantaged share plans and its many detailed recommendations are intended to improve and simplify the operation of these plans. The Government is consulting on 16 of these recommendations.
- 5.63. As announced by the Chancellor at Budget 2012, HM Treasury is conducting an internal review to examine the role of employee ownership in supporting growth. In assessing the evidence, HM Treasury's review will examine options to remove barriers to its wider take-up, including barriers relating to tax policy and administration. This work will draw on the materials used to produce this report, including the views of those who contributed to it and of Graeme Nuttall, and will conclude ahead of the Autumn Statement.
- 5.64. Respondents to the review made well-evidenced observations on the operation of the tax law as it affects employee owned companies. The representations we received highlighted that tax is an inevitable consideration for employee owned companies and their advisers. Ensuring that tax does not create a barrier is an important

consideration for the Government, and this review welcomes HM Treasury's commitment to review the matter.

5.65. A full consideration, as part of the Treasury's internal review, would also need to consider Exchequer costs and the overall impact on the tax system.

5.66. There is evidence for how the tax system can be used to make employee ownership and participation more attractive. The US National Center for Employee Ownership has provided evidence on the point; and we have experience in the UK of the success of the tax advantaged share plans.

5.67. The submissions received in this review on tax can be grouped under the following themes, and will form a part of the evidence that this review passes onward to HM Treasury for consideration.

- improving the guidance that HM Revenue & Customs provides specifically on employee ownership and ensuring employee ownership is considered when general guidance is provided;
- reviewing how trust-based employee ownership is dealt with in the tax system;
- reviewing the tax treatment of employee benefits in a 100% employee trust owned company, compared to conventional corporate business models;
- identifying whether the tax system could assist with financing of employee buy outs; and
- identifying whether employee ownership can be made more attractive from a tax point of view than other business models.

5.68. Moreover, we should see tax within its wider context and acknowledge it is not the only lever to promote employee ownership. The Government's agenda for promoting employee ownership should be coordinated so that any tax initiatives are linked with wider work undertaken to promote awareness of employee ownership. This will help ensure the full potential of employee ownership is realised.

## 6. Implementation

### Action plan

- 6.1. The real test for Government will be if it follows its political support for employee ownership with concrete actions that lead to genuine change. Whilst some work can be – and has been – started straight away, other recommendations entail several years of work. The Government should maintain its support and see this programme through. The sector should support and challenge the Government to do so.

### Recommendation Z

Through the Minister for Employment Relations, the Department for Business, Innovation and Skills should, within three months of this review, publish an Action Plan showing actions taken to implement its recommendations and others aimed at promoting employee ownership.

### Recommendation AA

The Minister responsible for employee ownership (see recommendation C) should produce a ‘one-year on’ report 12 months after the formal Government response to this review, reporting publicly on progress made on promoting employee ownership and the implementation of these recommendations.

### Support from sector representatives

- 6.2. The publications recommended above offer the opportunity to test publicly the Government’s progress in promoting employee ownership, and to show the overall direction the Government is taking. They allow the sector’s representatives and others to hold Government to account. Such an arrangement could usefully be formalised to ensure the Government also has the advice and support of sector representatives to guide future policy development.

### Recommendation AB

The Minister for employee ownership should convene a small ‘sounding board’ of sector representatives to advise him or her periodically on the direction of implementation and on new opportunities to promote employee ownership.

### The Government response

- 6.3. The recommendations set out in this review make up an ambitious and wide-ranging package of measures. This review asks the Government to build on the unprecedented political support it has offered to employee ownership in 2012 by implementing these recommendations in full.

# Annex A: Background to the review

## The review's remit

Norman Lamb, Minister for Employment Relations, announced on 8 February 2012 that Graeme Nuttall a partner in the law firm Field Fisher Waterhouse LLP had been appointed the Government's independent adviser on employee ownership. This appointment followed the announcement by Nick Clegg, Deputy Prime Minister on 16 January 2012 at Mansion House of a Government drive to introduce the concept of employee ownership into the mainstream British economy. Norman Lamb is leading the cross-Whitehall work to investigate how Government can support this growing business model, and this review is submitted to him.

The review's remit has been to "work with Government to identify the barriers to employee ownership and help find the solutions to knock them down".

The Mansion House speech referred to what the Government is already doing in relation to employee ownership in the public sector. In particular, it referred to the work of the Cabinet Office on employee led mutuals, based upon advice from Mutuals Taskforce under Julian Le Grand. It also referred to the reform of Royal Mail and its transformation into an organisation in which staff have a meaningful stake. This review focuses on employee ownership in the private sector and not the transformation of public sector activities into private sector companies with employee ownership.

The 21 March 2012 Budget Report announced HM Treasury will conduct an internal review to examine the role of employee ownership in supporting growth and examine options to remove barriers, including tax barriers, to its wider take-up, and which will consider the findings of this review.

## Glossary

**Co-operatives** – member-owned, member-controlled enterprises which operate for member benefit. On international definitions, many of the UK's companies which are majority owned by employees would be classified as co-operative. Compared to other countries, the UK has a relatively strong consumer-owned co-operative sector, as well as worker co-operatives. Worker co-operatives adhere to an additional code, beyond the core international principles, focused on democracy and participation in the workplace. All co-operatives are mutuals, but not all mutuals are co-operatives.

**Employee benefit trust** – typically, a discretionary trust for the benefit of employees of a company or group of companies. The beneficiaries may extend to former employees, charity and other beneficiaries as permitted under section 86 of the Inheritance Tax Act 1984.

**Employee ownership** – means a significant and meaningful stake in a business for all its employees. If this is achieved then a company has employee ownership: it has employee owners.

What is 'meaningful' goes beyond financial participation. The employees' stake must underpin organisational structures that ensure employee engagement. In this way employee ownership can be seen as a business model in its own right.

This review has a particular emphasis on the employees' stake being a substantial or controlling stake. There is no set rule as to what percentage of issued share capital is a substantial stake. Over 25% is substantial from a company law perspective. This review heard evidence that the full benefits of employee ownership can be achieved at lower percentages.

A company in which a controlling stake is held by or on behalf of all employees is an employee owned company.

If a company has one or more employee share plans, which could include an employee benefit trust, that do not provide a substantial stake these can still be part of an employee ownership business model, if they go beyond just providing financial participation.

This definition also includes employee share ownership in listed companies. What is 'a substantial stake' in the context of listed companies is likely to be a lower percentage of issued share capital than in private companies, and to be linked more to the percentage of employees participating in the employee ownership arrangements.

References to share ownership by all employees assume such ownership is voluntary. Share ownership must be made available to all employees on the same or similar terms but this can be subject to a minimum period of employment or other reasonable qualifying conditions. Entitlements often vary on a fair basis according to length of service, remuneration or similar factors.

In the right context in this review employee ownership includes legal models other than companies limited by shares, such as the various other legal models used for worker co-operatives. Also, references to shares can include membership of a company limited by guarantee. This form is taken by some employee owned companies including public service mutuals.

**Employee share ownership** – employees own shares in the company for which they work. The aggregate employee shareholding may be an insignificant proportion of the total equity or provided only as a tax effective bonus arrangement, and therefore not count as 'employee ownership'. In this review the expression employee share ownership can be taken as referring to either or both employee ownership and employee financial participation arrangements depending on the context.

**Mutual** – an organisation that is owned by its customers or its employees or some combination of the two.

**Shared capitalism/employee financial participation** – company profits are shared with employees. This may be achieved through employee share ownership. Not all forms of shared capitalism or employee financial participation necessitate any direct or indirect form of employee ownership. A large number of businesses remunerate senior managers in proportion to profits (often with equity-based remuneration packages) but without extending this to all employees.

**Tax advantaged share plan** - any of the three HM Revenue & Customs approved share plans or the Enterprise Management Incentives arrangement. The three HM Revenue & Customs approved share plans are the Company Share Option Plan, the Share Incentive Plan and Save As You Earn. The latter two plans operate on an all-employee basis. All qualifying employees must be eligible to participate on the same or similar terms (a test defined by statute). There are descriptions of these plans in the Office of Tax Simplification's final report on these plans.<sup>22</sup>

**US employee stock ownership plan** – The National Center for Employee Ownership describes this US plan as a type of retirement plan that invests primarily in company stock and holds its assets in a trust, in accounts earmarked for employees. Plan participants do not directly own the stock and are, for the most part, paid out after they leave the company. This is the main vehicle for all employee share ownership in the US.

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<sup>22</sup> Office of Tax Simplification, *Review of tax advantaged employee share schemes: Final report* (2012)

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# Annex B: Respondents to the review

We would like to thank all who responded to the review. Many individuals responded as well as the following organisations:

A G Parfett & Sons Limited

Advisory Conciliation and Arbitration Service (ACAS)

Arup Group Limited

Association of Business Schools

Association of Chartered Certified Accountants (ACCA)

Baxi Partnership Limited

Bird & Bird LLP

Boydell & Brewer Group Limited

The Capital Group Companies, Inc

CASS Business School, City University London

Castlefield Investment Partners LLP

Cavendish Place Communications

Centre Forum (Centre for Reform)

Chartered Institute of Taxation

Childbase Partnership Limited

Circle Partnership

Confederation of British Industry (CBI)

Co-operative Development Scotland (Part of Scottish Enterprise working in partnership with Highlands & Islands Enterprise)

Co-operative Education Trust Scotland

Co-operative Energy

Co-operatives UK Limited

Co-ownership Solutions LLP

The Employee Engagement Taskforce

The Employee Ownership Association (EOA)  
The ESOP Centre Limited  
ESOP Services, Inc.  
European Federation of Employee Share Ownership (EFES)  
European University Viadrina  
Field Fisher Waterhouse LLP  
Gripple Limited  
Henderson Group Plc  
Highland Home Carers Limited  
Ifs ProShare  
Institute of Chartered Accountants in England and Wales (ICAEW)  
Institute of Chartered Accountants of Scotland (ICAS)  
Institute of Directors (IoD)  
Institute of Financial Accountants (IFA)  
John Lewis Partnership Plc  
Kellogg College, Centre for Mutual and Employee-Owned Business, University of Oxford  
Loadhog Limited  
London Stock Exchange Plc  
Make Architects Limited  
McCarron & Co Limited  
MM&K Limited  
Mutuo  
National Center for Employee Ownership (NCEO)  
Norton Rose LLP  
Odey Asset Management LLP  
The Ownership Commission  
Pett, Franklin & Co. LLP  
Postlethwaite & Co  
Project 650

Prospects Services Limited

Quantum 90

The Quoted Companies Alliance

ResPublica

Royal Holloway, University of London

Rutgers University School of Management and Labor Relations

Rynda Property Investors LLP

Scott & Fyfe Limited

Scott Bader Company Limited

The Share Plan Lawyers Group

Sheffield Hallam University

Social Enterprise UK

Steria

Svenska Handelsbanken AB

Trace Group Plc

Trades Union Congress (TUC)

Tullis Russell Group Limited

University of Leeds

Vitsoe Limited

Wales Co-operative Centre (Canolfan Cydweithredol Cymru)

Wright, Johnston & Mackenzie LLP

WT Burden Limited

Yorkshire Building Society





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