Foreword

I first became interested in employee ownership as a mechanism for everyone in my business to share in the success and wealth they create. In my mind staff are more important than capital. As an owner, I consider myself a custodian of the business for the next generation. There is no better way to exercise that role than to implement some form of employee ownership.

Employee ownership is proven to work. Employee owned businesses are characterised by high productivity, greater levels of innovation and higher resilience to economic turbulence. Over the last 15 years through to today, shares in employee owned businesses have considerably outperformed those in the FTSE All-Share Index.

This publication enables individuals and organisations who are considering a move to employee ownership to take the first necessary steps.

It bridges the gap between the wealth of material that is available on the business case for employee ownership and the fine, technical detail of legal and financial implementation. It provides clear information about the different models of employee ownership that are available and explains the key issues that need to be addressed in finding a way forward that fits individual contexts.

If you use the questions that are provided in this guide, you will be in a great place to start your own journey towards employee ownership.

As you take those first steps I encourage you to join the Employee Ownership Association (EOA), which has acted as a great source of advice and friendship to everyone at Gripple during our journey, and continues to do so.

We know that employee ownership was and is the right choice for Gripple. If this publication had been available when I was exploring employee ownership it would have been invaluable. So I very much welcome this document and I recommend employee ownership to all who read it.

Hugh D. Facey MBE, Chairman of Gripple & Loadhog

Thank you to everyone involved in the creation of this publication, in particular Gripple (www.gripple.com) for their kind sponsorship of it, Ken Symon of Symon Media Ltd (www.symonmedia.com) for his support in drafting some of the initial content and Ewan Hall of the Baxi Partnership Limited (www.baxipartnership.co.uk) for his professional review of it.
Introduction

Employee ownership is a business structure whose time has come.

The role employee ownership can play in boosting growth in the UK economy is recognised and agreed across the political spectrum. Crucially, there is a growing interest in adopting this form of business structure throughout the private sector and increasingly in public services. During 2012, there was a 10% increase in the number of employee owned companies created in the UK.

Businesses that operate employee ownership exist in virtually every sector of the UK economy, across every size and stage of business and across all parts of the UK.

From start ups seeking employee commitment to give the business a great beginning, to long-established businesses of all sizes seeking to handle a succession challenge, to new forms of public service delivery vehicles, employee ownership is a highly successful business structure.

The definitive overview of the economic and social benefits of employee ownership can be found in the EOA’s Employee Ownership Impact Report.

Employee ownership exists when those who work in a business also have a meaningful stake in it. This is typically achieved through significant or total ownership combined with high levels of employee engagement and participation in the business.

A proven form of ownership, used around the world, employee ownership is established on a number of clear, simple principles, using a small number of models, around which there is flexibility to suit the circumstances of any organisation.

There are three main types of employee ownership.

Direct employee ownership
Using one or more tax advantaged and other share plans, employees become individual owners of major shares in their company.

Indirect employee ownership
Shares are held collectively on behalf of employees, normally through an employee benefit trust.

Combined direct and indirect ownership
A combination of individual and collective share ownership.

For the purpose of simplification, this document discusses employee ownership assuming the governance is a company limited by shares. For the same reason, this document also only references a restricted number of examples of company structures including companies that are limited by guarantee (CLG) and employee benefit trusts (EBT).

In reality there are many forms of company structure that can be used to build employee owned businesses including industrial and provident societies (IPS), limited liability partnerships (LLP) and also some types of cooperatives. The choice of company structure is one of the specific details that will be decided upon during implementation.

Employee Ownership by Sector

- Professional and Business Services
- Manufacturing
- Public Services
- Construction
- Engineering
- Transport
- Agriculture
- Creative, Media and Leisure
- Information Technology and Telecom
- Retail

With the right quality of thought, the implementation of employee ownership can be simple and straightforward. This publication provides a clear overview of the features of each form of employee ownership as well as case study examples and a review of the governance and funding associated with such structures. It allows readers to get started with the process of making informed choices.

Employee ownership delivers better business. We hope you find this document to be an instructive and useful tool to help you and your organisation on your path to better business.

1 This breakdown is indicative of the sectoral bias of UK employee owned companies, based on an assessment of EOA membership, and informed by trend data from Co-operatives UK (in their report “The UK co-operative economy 2012 – alternatives to austerity”) and Field Fisher Waterhouse LLP (who compile and manage the UK Employee Ownership Index – an index of the share prices of selected UK public companies quoted on the London Stock Exchange and AIM).
Direct Employee Ownership

Employees become individual owners of shares in their company, often using one or more of the tax advantaged share plans that are available.

Features

A key feature of this approach is that employees will have their own shares and therefore the financial rewards of capital growth and/or dividend payments are directly linked to the success of the company.

This provides a very direct and tangible expression of employee ownership because employees can benefit financially as a company grows. Alongside this, other forms of financial reward such as bonus payments on personal or corporate performance may also be made.

In addition, as direct shareholders, employees usually acquire voting rights within the governance of the organisation and also rights of access to information.

Because many employees are familiar with the idea of share ownership, concepts about direct forms of employee ownership are often relatively easy to communicate. Currently, for instance, more than four million UK employees participate in one or more share ownership plans.

In support of direct share ownership, the Government has approved a small number of tax advantaged schemes which provide incentives for such share ownership. The shares in most employee owned organisations are classified as unlisted because they are not registered with a stock exchange and they are not offered for sale to the general public. Most organisations with forms of direct employee ownership oblige employees who leave the company to sell the shares they have in the business. Most relevant companies value their shares annually but it can be done as often as required.

Employees normally acquire shares in their business in one of three main ways:

1. **Buying shares**
   Employees buy shares in the company in which they work, sometimes through a tax efficient Share Incentive Plan (SIP).

2. **Being given shares**
   Employees can be awarded free shares, again often through a SIP. Gifts of shares can be tied to the performance of the business and are sometimes awarded as part of a bonus scheme.

3. **Share options**
   Employees are awarded share options, often through one of the HMRC tax advantaged schemes that allow them to buy shares by exercising options when they have the money to afford them.

Establishing and managing direct ownership

In considering if the direct form of employee ownership is most appropriate for your business, it is vital to reflect on the following initial questions:

- Do all staff have sufficient funds to purchase shares and do you think they would they want to?
- Would the company be willing to make a repayable loan for staff to buy the shares?
- Does the company wish to and can it afford to match share purchases or give free shares?
- How might the shares be purchased from the current owner(s), over what period of time, and at what value?
- Is the company able to operate an internal share market to enable staff to buy and sell shares and can the company afford to purchase shares from those who wish to sell them if there are insufficient buyers?
- How might the company provide up to date reporting of financial performance to its new employee shareholders?
- Will employees have to meet certain eligibility criteria before they are invited to become shareholders?
- Will the overall structure be a company limited by guarantee?
- Have you considered the tax implications of this model of ownership for the company and the employees?
Direct Employee Ownership

Gripple is a very successful international precision engineering and manufacturing business based in Sheffield. It was established in 1988 and is one of the best known exemplars of the direct form of employee ownership.

All employees at Gripple directly own some of the equity of the business. It is compulsory for employees to own at least £1,000 worth of shares, beyond the first year of their service. The company will lend employees money to enable them to purchase shares if so required.

A company limited by guarantee called GLIDE exists in which all shareholders of Gripple are automatically equal members. The Chairman and Vice Chairman have pledged over ten years to donate half their equity to GLIDE. GLIDE holds a ‘golden’ share which ensures that Gripple can never be sold.

Employee ownership at Gripple has enhanced its culture of innovation by allowing its employees to take control of the destiny of the company. Employee ownership is also ensuring that the principles on which Gripple was founded will be maintained by future generations of employees for decades to come.

Indirect Employee Ownership

Indirect ownership is when all or a percentage of the shares of the company are held indirectly on behalf of and for the benefit of the employees with the most common mechanism being an Employee Benefit Trust (EBT). Most of the longest established employee owned businesses in the UK deploy the indirect form of employee ownership in at least part of their ownership structure.

Each EBT will normally have its constitution outlined in a Trust Deed. In some cases the Trust Deed is also used to define the future of the business. For example, it could protect the business from asset stripping, or ensure the longevity of the employee ownership by stipulating that the interests of the future employees are considered alongside those of present ones.

Many companies use an EBT to hold all of the shares, often purchasing them from the existing owner(s) over a period of years.

The EBT model is one which provides every qualifying employee with the same rights and benefits without the obligation to purchase shares directly from their own funds. It does not prevent the receipt of direct monetary reward for corporate or personal success through mechanisms such as bonus payments.

Shares are held collectively on behalf of employees, normally through an Employee Benefit Trust.

**Features**

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Establishing and managing indirect ownership

In considering if the indirect form of employee ownership is most appropriate for your business, it is important to consider the following initial questions:

- Over what period of time do the current owner(s) wish to sell or gift their shares to the EBT?
- What percentage of the owners’ shares will ultimately be sold?
- Who should represent the owner(s) on the EBT?
- Are there any special conditions that are required in the Trust Deed to protect the future of the business?
- How will the business fund the purchase of shares from the current owner(s)?
- Is there confidence that employees will feel a sense of real ownership of the business in the absence of direct ownership?
- Have you considered the tax implications of this model of ownership for the company?
- Have you considered the tax implications of this model of ownership for employees, particularly in relation to issues such as profit related pay?

Make is a market leading architectural design consultancy based in London that provides services to individuals and businesses in the UK and overseas. Established in 2004, since its launch Make has consistently outperformed many of its competitors. It is a high profile example of the indirect form of employee ownership.

The entire share capital of Make is held in an Employee Benefit Trust on behalf of and for the benefit of employees, both now and in the future. There are safeguards to ensure that the company cannot be sold. There are no ownership rights and the Trust has been deliberately structured in such a way that nobody can obtain ownership rights in the future.

Every employee receives an annual profit share if a profit has been made that year. The governance arrangements legally prescribe that the company cannot be sold. The Trust also has a Protector without whose consent Trustees cannot act, to ensure that future Trustees uphold the vision. The vision is that all employees, senior or junior, are partners in the business and share in its profits.

Employee ownership at Make engenders a genuine sense of ownership and entitlement, creating an egalitarian working environment with a united sense of purpose and commitment. As a result Make is able to attract and retain the very best talent to enable it to compete successfully in its chosen markets.
Combined Direct and Indirect Employee Ownership

There is a combination of individual direct and collective indirect share ownership.

Features

Many companies find that a hybrid model which combines direct and indirect ownership provides the best solution.

In these cases, the EBT or an equivalent vehicle will often hold a majority of the shares in order to ensure stability of ownership in the company. A tax efficient share scheme such as a Share Incentive Plan or Enterprise Management Incentive may then be used to distribute and manage the remaining shares to the employees.

In this hybrid environment those individuals who partake in direct share ownership are able to make capital gains on their ownership and there is scope for additional payments to be generated in a tax efficient way in the form of dividends on the employee owned shares.

The EBT or equivalent vehicle ensures at the same time that there is a clear focus on the long term. All employees are able to share in success regardless of their personal ability to purchase shares but can still receive direct monetary reward for corporate or personal success through mechanisms such as bonus payments.

Establishing and managing a combination of direct and indirect ownership

In considering if the hybrid form of employee ownership is most appropriate for your business, it is important to consider all of the initial questions that were cited in the sections of this document that cover direct and indirect employee ownership.

In addition it is vital to reflect on:

- Whether the potential complexity and additional administration that can be associated with the hybrid form of employee ownership fits with the scale and capacity of the organisation that is becoming employee owned; and
- The proportion of ownership to be held indirectly by the EBT or equivalent vehicle compared to the proportion to be held directly by employees

Accord, based in Aberdeen, was established in 2010 to provide specialist hydrocarbon accounting services to help upstream oil and gas companies realise the true fiscal value of their production.

Today Accord is a highly profitable multi-million pound business with an array of quality clients. Accord is an excellent example of a hybrid form of employee ownership.

The Accord model has an Employee Benefit Trust that holds, on behalf of the employees, a controlling 51% interest in the company. The EBT has founder shareholder, employee, and independent external representation on its governing board. Accord also has an HMRC approved Share Incentive Plan that holds equity on behalf of employee stakeholders. It will eventually hold 20% of the equity of the company and has founder shareholder, employee representation plus an independent external trustee on its governing board.

The remaining equity in the company is owned by the founder shareholders and the hybrid framework allows them to sell shares to employee stakeholders, the EBT or both.

Employee ownership at Accord has consolidated the culture of openness and staff participation within the organisation by giving employees a long term stake and involvement in the business along with two employee elected employee directors on the board. This has unlocked outstanding productivity, innovation and financial results for the company.
Employee ownership is not restricted to businesses that originate in the private sector. There are increasing numbers of organisations being spun out of the public sector to become what are described as public service spin-outs and for most of these, employee ownership is their preferred route.

Health, local government and central government services have all taken this route. Over the last 10 years, many front line employees have taken over the running of services they deliver, giving employees a meaningful stake in the new businesses that are created, helping them to achieve service improvements and cost savings. More than £1 billion of health services are now provided by such spin outs and there are many different models and approaches to it.

Establishing and managing public service spin outs

In considering if the public service spin out model is an appropriate choice, you should reflect on the following:

- Have you conducted an audit of the current service to assess your strengths and capacity to deliver the service in the future?
- Have you considered the competitive environment in which the service will operate?
- Have you developed a business case for the service which demonstrates financial viability?
- Will the spin out be permanently dependent on the continuation of one or two key public service contracts funded by Government?
- Have you considered the tax implications of this model of ownership for the company and the employees?

There are some key stages to be considered when considering employee ownership in this sector and these are reviewed more fully in the publication ‘How to become an employee owned mutual’ which can be downloaded from the EOA website. Further information about establishing public service spin outs is also provided by the Cabinet Office.

CSH Surrey (previously known as Central Surrey Health) is a ground-breaking, employee-owned organisation that provides therapy and community nursing services to central Surrey’s population of 280,000 people. It is a pre-eminent example of an employee owned business that provides public services but that has spun out from its original public sector host organisation, in this instance the National Health Service (NHS).

CSH Surrey emerged from the East Elmbridge and Mid Surrey Primary Care Trust when Jo Pritchard and Tricia McGregor, with backgrounds in nursing and speech and language therapy, identified an opportunity to create and lead a spin out social business, the first to do so in the NHS.

CSH Surrey is owned and run by the 800 nurses, therapists and supporting teams it employs.

The shares in the organisation are held indirectly on behalf of employees and are ultimately in the hands of Guardian Shareholders, four employees selected by their peers. A Trust ensures that the values and principles of employee ownership are upheld by the Guardian Shareholders. No dividends are paid to employee owners. Instead all profits are invested back into patient care. Elected representatives sit on a co-ownership council called ‘The Voice’. They challenge the Board on behalf of all the employee owners on strategy and performance, and raise their questions and views directly with the Board.

Employee ownership at CSH Surrey provides the main platform for its progress. The ethos of the organisation is to empower its employee owners to consistently deliver exceptional care for a healthier community. By listening, responding and working together with partners and each other CSH Surrey continues to deliver ever better patient care and benefits to the wider community. CSH Surrey has won a glittering array of awards for its efficiency and effectiveness.
Governance and Engagement in Employee Owned Organisations

Employee ownership has the potential to deliver significant benefits for the organisations which employ it and when implemented well, is evidenced to deliver improved profitability, productivity and innovation.

Employees with an ownership interest in their organisation are generally more committed to delivering for the organisation as they see the opportunity to employ their talents and expertise to create benefits for themselves. However, the ownership element must be accompanied by the most effective forms of governance and engagement if the employee ownership model is to deliver such benefits and employees are to have a meaningful stake in their organisation.

Governance addresses how decisions are made within an organisation. Traditionally company shareholders appoint directors to decide on strategy and managers to make day-to-day decisions and guide and supervise the activity of the employees in pursuit of this strategy.

Generally in an employee-owned company, the same processes occur, although in this case the employees are also shareholders and therefore have rights and responsibilities that come with that role. At the same time the directors will also usually be employees and also shareholders so the roles overlap.

Whilst the directors will still run the business day to day, in an employee ownership structure, there are normally formal processes and structures in place to ensure that they are held accountable to the employee owners.

The employee ‘voice’ is extremely important in employee owned organisations and is normally represented in a formal way, such as through the Employee Benefits Trust trustees (if there is an EBT), via Employee Forums or Councils and through high profile information sharing and greater transparency, employee involvement and increased levels of trust. However, it is always important that this is balanced with the need to have effective decision making within the organisation; a business managed by committee is rarely successful.

Funding Employee Ownership

There are six usual sources of funding for moves into the various forms of employee ownership that exist.

1. **Funding from the company**: there may be enough current and predicted disposable cash within the company to finance all or part of the purchase price, either in one lump sum or over a period of years.

2. **Funding by employees**: the employees raise funds from their personal resources. They may be given incentives to do this by awarding them special shares or additional rights not available to later employees. However employees need to realise the money can be tied up for an indefinite period of time.

3. **Gifting shares**: where the owners, over a period of time, gift shares, saving the company the burden of finance interest and repayments.

4. **Vendor finance**: where an entrepreneur, management team or a family are selling a business, they may be prepared to take their cash over time. Deferring payment of part of the sale price until later is a common feature of employee buyouts. However, it is not an essential feature of an employee buyout and many are paid up front.

5. **Loan finance**: borrowing from a third party, usually a bank, can form part of the purchase price. Normally the lender will take security for its loan over the company’s assets and will require priority for its money over any other provider of funds.

6. **Mezzanine finance**: this is funding from a finance house which is prepared to take a greater deal of risk than a high street bank and so requires a greater rate of return.

To ensure the long-term stability and sustainability of the employee ownership of the business it is usually important that shares are not sold to external shareholders. Even if a funding option like mezzanine finance seems expensive it does mean that the funding can be paid off with no outside body having a stake in the business.
Conclusion

Employee ownership is an incredibly effective ownership model. It has seen unprecedented growth in recent years as businesses, the public sector and politicians become increasingly aware of the positive effects and the advantages it brings.

It is an established business model that works around the world and is increasingly being adopted in the UK. It has been shown to boost profitability, productivity, job security and employee wellbeing. It is making a vital contribution to economic growth in challenging economic times. Employee owned businesses are at the forefront of innovation not only in the private sector but also in public services too.

Employee ownership can be implemented easily and can be readily tailored to the circumstances of an individual organisation. It is a model that works across a whole range of sectors and at any stage in the life of a business from start-up to mature businesses seeking a viable succession route. Direct, indirect and hybrid models of employee ownership can be seen in a range of highly successful exemplar organisations across the UK.

This publication provides a valuable tool for getting started on the path to employee ownership. It enables individuals and organisations to consider key issues and to begin to decide what type of employee ownership they want.

The next steps beyond getting off the starting line must include detailed dialogue with carefully selected existing employee owned organisations and, ultimately, the use of lawyers and accountants to undertake technical implementation work including taxation planning.

Most organisations that become employee owned are guided and assisted in those key next steps by the Employee Ownership Association (EOA), the publisher of this document. The EOA helps individuals and organisations to choose the right model and brokers visits to leading employee owned businesses and introductions to the EOA’s approved specialist advisors.

So if you have found this document useful and are eager to get on with the next phase in moving to employee ownership please do get in touch with us at the EOA via the details opposite and we will be delighted to help.

Employee ownership is a better form of business, is simple and straightforward to implement and has the potential to deliver 10% of UK GDP by 2020.

The Employee Ownership Association is the voice of co-owned businesses in the UK – a network of more than 160 companies with significant employee ownership and a sector of the economy worth more than £30 billion annually.

With members that include co-owned John Lewis, Waitrose, Unipart and Arup, plus a host of successful enterprises from many sectors, the Association’s role is to service its member companies and promote the growth of employee ownership in the UK.

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