EMPLOYEE OWNED

A guide to Employee Ownership

Empowering our people matters.

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Proudly employee owned.

Certified B Corporation

INTRODUCTION

Many business leaders are now asking themselves and their board: is employee ownership something we should be considering?

Employee ownership is not new. The John Lewis Partnership is reputed to be the oldest and largest employee owned business in the UK. Very many businesses have opted for an employee ownership model since the inspirational work of John Spedan Lewis in the 1920s.

The perceived benefits of employee ownership have seen household names follow suit in all sectors. Retailers, designers, manufacturers, engineers, professional services, healthcare, construction, fast-moving consumer goods and leisure businesses can be found in the UK's largest employee-owned companies. They include household names such as Go Ape, Riverford Organics, Richer Sounds, Aardman Animations (the creators of Morph, Wallace, Grommit and Chicken Run), Arup and Mott MacDonald. The model can flex for most businesses.

Thanks to the changes brought about by more recent legislation, popularity in employee ownership has surged. Many business leaders are now asking themselves and their board: is employee ownership something we should be considering?

FROM THE ROARING 20s TO TODAY

Tax changes introduced in 2014 provided good reasons for employee ownership structures to be re-visited more earnestly. The changes meant that owners selling their businesses to the employees, could benefit from zero per cent capital gains tax and the employees could share in the fruits of the company's profits without paying income tax on the first £3,600 per year.

In 2016 Stephens Scown was the first large law firm in the UK to become employee owned. We have championed the growth of employee ownership through advice to clients and engagement with the sector, we're proud to say, to award winning levels. We advise and support businesses across England and Wales in providing not just legal advice but also drawing on insights from our own experiences as an employee owned business.

Employee Owned Businesses (EOBs) are 8% - 12% more productive than non-EOBs.

Statistics from the Employee Ownership Association in 2023 show that, in terms of:

Productivity

- Employee Owned Businesses (EOBs) are 8% - 12% more productive than non-EOBs.
- 73% of those surveyed reported increased job satisfaction since adopting an employee ownership model.
- 83% of those surveyed reported increased employee engagement and motivation since adopting an employee ownership model.

Sustainability

- 35% of EOBs are more likely to have an "environmental sustainability" accreditation (compared to 16% in non-EOBs).
- 43% of EOBs are more likely to offer volunteering days (compared to 15% in non-EOBs).
- 54% of EOBs are more likely to have a net zero or carbon management strategy in place (compared to 30% in non-EOBs).

Surge in popularity

- Approximately 330 new EOBs were created in the 12 months from October 2022 to October 2023.
- In October 2023, there were over 1,650 EOBs in the UK.

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WHAT IS EMPLOYEE OWNERSHIP

For the owners and the business, an employee ownership model can be a tool to help drive growth.

There is no strict definition of employee ownership. A business in which a significant part is owned by the employees can be described as "employee owned". For some, a tangible and direct shareholding in the company by every employee is critical; for others, an indirect ownership (whereby employees are the beneficiaries of a trust which holds shares on their behalf) is sufficient. A mixture of both (direct and indirect holdings, often referred to as a "hybrid" model) is also possible.

WHY CONSIDER EMPLOYEE OWNERSHIP?

An employee ownership model may not be the right model for your business, however the benefits that such a model can bring make it one of a range of options to explore. Typically, the structure is used as a succession plan however companies can be incorporated with an employee owned structure or can transition as the natural next step of the business.

Employee ownership can be found in a variety of business structures. However, to obtain the tax benefits (referred to below), the "business" needs to be a trading company (or the holding company in a trading group).

Some of the key indicators that might tend towards a move to employee ownership include:

Company owners

- Feel a strong loyalty towards the employees.
- Have values that are not just about profit.
- Might be looking to retire but are worried about what might happen to the employees once the business is sold.

The business

- Has employees that are engaged with the values of the business (for example a B Corp).
- Has significant levels of transparency.
- Has engagement with all stakeholders (including the wider community).
- Is keen to ensure staff retention and low employee attrition rates.
- Has a good management team or the makings of one.
- Might be (but does not necessarily have to be) debt free.

For the owners and the business, an employee ownership model can

- Be a tool to help drive growth.
- Help to incentivise employees to deliver the ambitions of the business.
- Be a plan that benefits more than just the owner.

EMPLOYEE OWNERSHIP AS A SUCCESSION PLAN

Added considerations for those looking to use employee ownership as a succession plan include:

Timing

There is no need to wait for a potential purchaser or engage a broker or corporate finance team to approach competitors. Consider also the added costs of such an engagement and the business risks associated with making it known that the business is “up for sale”.

Value

A move to employee ownership may not yield the highest value for the business (compare a strategic purchase by a third party). However, in the scenario of a succession, it is worth preparing a cashflow plan for the lifestyle needs of the sellers in retirement as well as possible costs/taxes incurred on a trade sale. The net payment outcomes might not be that different.

Complexity

Employee ownership is not without its complexities. However, there are generally fewer stakeholders, parties and advisers involved in an employee ownership transaction (than say, a management buyout or trade sale) which makes the resolution of complexities that little bit easier.

Costs

A move to an employee-owned structure can proceed on a less adversarial and inquisitive basis. If the transparency and culture is already in place, there is potentially less need for deep due diligence which is pursued in other transactions, not just for investigative reasons but also to find reasons to reduce the price. With fewer commissions, reduced negotiation and due diligence, an employee ownership transaction can have fewer professional costs than more arm’s length deals.

TIMESCALES

Once content that employee ownership is the right step, sellers can (with the help of professionals) plan an appropriate timescale which allows them to integrate the change to employee ownership while still having sufficient time to do the day job. Unless there are exceptional reasons, trying to complete a transition to employee ownership in too short a timescale misses the opportunity to build engagement and excitement with employees. In our experience, spending some time engaging with the employees helps to take them on the journey and means that the employees can get behind the process and relish the concept of being part owners of the business.

WHAT OUR CLIENTS SAY

Hear the motivations behind some of our clients moving to an employee ownership model:

> **“People would frequently ask me, ‘What’s your exit strategy?’ My answer had always been, ‘There’s no exit strategy, I’m going to work here forever.’ I created the business to create an excellent workplace; I didn’t create it as a way of selling out for a big payoff.”**

> **“Employee-owned businesses tend to excel in engaging employees, who in turn drive performance, innovation and service excellence, with the opportunity to share in the wealth they create.**
>
> **As well as rewarding our existing team and giving them the opportunity to shape the future of the business, we hope employee ownership allows us to attract even more talented new recruits to help us grow the business.”**

> **“For me there were two driving forces behind employee ownership over any other exit strategy.**
>
> **Firstly, I didn’t like the idea of selling the business to a competitor. I’ve seen many times the negative affect this can have on a business and its staff. It was also important for me to create a personal legacy.**
>
> **I’ve spent 35 years building up this business which my dad started and I wanted to find a way to preserve that for the benefit of everyone who works here.”**

> **“Employee ownership allows us to give our people a bigger stake in the business. Many of our team have worked with us for a long time, and some of them have been with us since the business was established. Employee ownership roots these jobs in the region for the longer term.”**

WHAT IS AN EMPLOYEE OWNERSHIP TRUST?

As employees join the business, they will have an interest in the shares.

As a reminder, a trust needs trustees (those who hold the assets of the trust) and it needs beneficiaries. In the case of an EOT, the assets will comprise the shares in TradeCo (held by the trustees, almost as stewards of those assets); the beneficiaries of the trust will primarily be the employees of TradeCo. As employees join the business, they will have an interest in the shares (held by the trust); when an employee leaves, that interest in the shares will automatically cease. No shares actually transfer; they remain with the trust. The employees don't pay for the shares themselves.

Trustees of the trust can take the form of several individuals, a company or both. For an EOT, the trustee is usually a company ("TrustCo) which, like other companies, has a board of directors. The board will often comprise a group made up of the seller, a representative of the employees and an independent trustee (who is neither an employee nor a seller). These are colloquially known as the "trustees" but strictly, they are the directors of TrustCo.

HOW IS AN EMPLOYEE OWNERSHIP MODEL IMPLEMENTED?

Using a simple example, assume a company ("TradeCo"), owned by one person with a workforce. Thus:

The owner of the business wishes to move to an employee ownership model. In an indirect (or hybrid) model of employee ownership, the owner will sell some or all of the shares in TradeCo to an EOT with the result (assuming a 100% transfer) being:

Note that the EOT is not a trading entity and therefore not deriving any income; its primary role is to look after the interests of its beneficiaries (the employees). It is very unlikely to have the funds to pay the debt to the sellers. It is reliant on gifts from TradeCo to meet the debt that the EOT (as buyer) has to the selling shareholders.

Initial payments could come from any excess cash in TradeCo. The balance of the price is often payable in instalments by the EOT (as buyer) supported by TradeCo. As is the case with the vast majority of share sales, agreement on, and payment of, the sale price is fundamental. A professional valuation and cashflow analysis of TradeCo is important to ensure that the buyer (the EOT) and the seller are comfortable with the price and how it is to be paid.

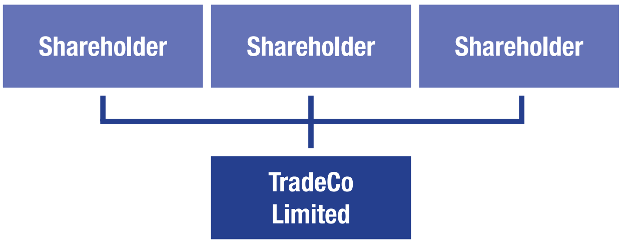
Clearly, this puts the sellers at a degree of risk, as much of the purchase price may be outstanding for some time. But for many sellers, their confidence in a company that they have built is more than sufficient to address this concern. There are measures which can be implemented to mitigate against this risk.

Interest may be chargeable on the purchase price, though it's important to ensure that the interest payments do not add too much additional burden on TradeCo. Specialist bank funding is also available in the sector.

In general, the trustees of the EOT and the employees do not take on personal liability for the purchase price.

DIRECT OWNERSHIP

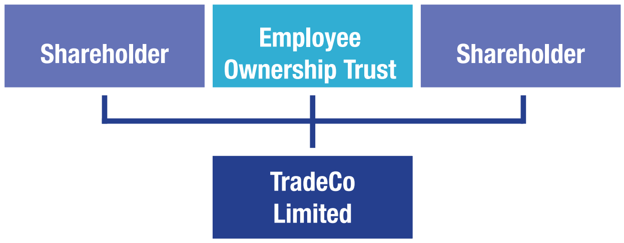
Using the simple example of TradeCo owned by several shareholders, the ownership is with those shareholders. Imagine if they were also the sole employees of the business; there is an argument to say that the business is employee owned through a direct ownership model (each employee owns the shares in his/her own name).



The direct model of ownership can be useful for those with (or considering) share schemes such as Share Incentive Plans and Enterprise Management Incentives. These can provide useful tools to allow TradeCo to confer share options on key management personnel. However, in contrast with an indirect model, if the employee leaves the business as a shareholder, s/he might take the shares with him/her (unless this is prohibited under a contract or elsewhere).

Ownership of shares can be a personal decision; retention of shares is possible in an employee ownership model, as demonstrated in the hybrid model below:

Hybrid model:



The hybrid model can be useful where:

- The business cannot afford to buy all the shares.
- A minority may benefit from future growth.
- In a family business, shares might wish to be retained within the family.

WHAT ARE THE TAX BENEFITS?

Put simply, providing the EOT holds more than 50% of the shares in TradeCo and has more than 50% control, the following tax benefits are available (as at 1 January 2024):

- The shares sold to the EOT in the year that the 50% threshold is crossed will not attract Capital Gains Tax for the selling shareholders. The tax incentive is not capped.
- The employees can receive a profit share from TradeCo and pay no income tax on the first £3,600 each per year.

In order to obtain the tax advantages, the trust must have some very specific features for it to qualify as a tax advantaged EOT. Those requirements include:

- All employees must be beneficiaries of the trust.
- The employees must be treated equally in respect of any profit share: there is very little discretion to prefer some employees above others.

Specific tax advice is strongly recommended.

THE START (OR CONTINUATION) OF A JOURNEY

It is said that "everything changes but nothing changes" when moving to an employee ownership model, which is a concept that is hard to grapple. For TradeCo, nothing should really change since it needs to continue to be a successful business and manage the debt (if there is one) in a planned way. It will continue to be answerable to its owner; the identity of the owner has changed and (like any person) that new owner might wish to see management information presented in a different way.

The more noticeable change will be for those with the new role as trustee or directors of TrustCo. They will need to think more like owners, understand the governance, learn how to hold meetings and work with the TradeCo board to ensure the continued success of the business for the benefit of the employees. In our recent experience, we have helped businesses post-transition work such as:

- Appointing and electing trustees and drawing up their terms of reference.
- Company secretarial services – helping with the administrative aspects of meetings.
- Post-transition support.
- Trustee support – through a governance review, our trustee networking group or otherwise.
- HR support – ask about our HR*Express* package for employee-owned businesses.
- Reviewing the documents that were put in place at the time of the transition to make sure they remain fit for purpose (eg once the debt has been paid off).
- Implementation and flexibility of profit share policies.
- Other issues to help get the most out of employee ownership.

WHY STEPHENS SCOWN?

We are a leading South West law firm with a reputation for doing things differently.

Doing notable work for notable clients, building our skills with talented people and having a positive impact on our communities sits at the heart of everything we do.

We invest in People, Community and Planet

We are leading on positive change within the legal industry, as the first B Corp™ law firm in the South West and with only a handful of UK law firms to have been certified. Gaining B Corp™ Certification underlines our long-term commitment to meeting high standards of social and environmental impact and to balancing people, planet, purpose and profit as part of the B Corp™ Community, because Doing Good Matters.

We're Employee Owned

We're the UK's first large employee-owned law firm. But more than this, we're people-centred, people-powered. Together we celebrate the wins and learn from the losses. We do what it takes to help each other overcome every challenge and to go beyond our clients' expectations. Whatever's happening in the world, empowering our people is what matters.

We go above and beyond for our clients

Our people are committed to delivering above and beyond for our clients. With Client Service one of our key strategic pillars, whatever the client or sector, we push, improve and deliver. We proudly go beyond expectations and achieve things that matter.

We make the most of every day

We might have the expertise of a top city firm, but outside our offices there's not a skyscraper in sight. And this means we get something out of every day that we can't get anywhere else. Whether we're getting to know our clients on our local beach, getting together in the park to hit a ball around, or getting in the sea before getting to the office. We're all about living a life enriched by work. Making the fun matter.

CONTACT US

If you have found this brochure helpful, and would like to discuss your succession and growth plans, please get in touch. We would be happy to help.

Stephens Scown:

- Successfully took the journey into employee ownership itself.
- Has a group of trustees that adds value to our firm through employee engagement and otherwise.
- Advises clients on their transition to employee ownership.
- Provides post transition support to clients seeking to embed the employee model into their businesses.
- Hosts an online forum for trustees looking to share knowledge and best practice.
- Has trusted relationships with providers of related services within the industry.
- Is a member of the Employee Ownership Association.
- Has a number of employees with independent trustee training who accept independent trustee appointments.

Empowering our people matters.

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