Employee Ownership Association

The voice of co-owned business

Andrew Bibby

From colleagues to owners

Transferring ownership to employees

ChildBase NURSERIES

About the author

Andrew Bibby is a professional writer and journalist, working as a freelance editorial consultant for a number of international and national organisations, and as a regular contributor to British national newspapers and magazines. He is also the author of a number of books.

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Publisher

The Employee Ownership Association is the voice of co-owned business in the UK. An association of companies in which employees own anything from a substantial to controlling stake in the business, EOA's members include the John Lewis Partnership; other long-standing co-owned companies such as Scott Bader, Tullis Russell and Arup; other major enterprises such as Unipart, Mott Macdonald, Pertemps and eaga; and a wide range of businesses from a diverse spread of sectors. EOA's purpose is to promote and grow the co-owned business sector and serve its member companies. EOA papers and guides are published by its charitable arm, Employee Ownership Insight.

For more information about EOA go to www.employeeownership.co.uk

Child Base Ltd – sponsors of From colleagues to owners

Co-owned Child Base was founded in 1989 by current chief executive Mike Thompson OBE and his father, former National Freight Corporation chairman Sir Peter Thompson. With a turnover of £25 million the company is today the UK's largest private childcare provider, employing over a thousand people and operating almost 40 nurseries.

Over the past decade Child Base has begun the transition from a family owned to employee owned business. Nearly half the company is now owned by individual staff shareholders or the employee benefit trust, a proportion the company intends to increase. Child Base is a member of the Employee Ownership Association. www.childbase.com

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From colleagues to owners: foreword

Why is the country's largest private childcare provider moving towards employee ownership? The family business we started 20 years ago as Child Base could have been sold to outside bidders long ago, but we decided on what has become known as the "we all contribute, we all benefit" option – ownership by the people who work in the company and make it the success it is today.

This report tells the story of how and why ten completely different companies, including Child Base, took the co-ownership route when it came to ownership succession.

No two stories are identical. Among the business transfers profiled in this report – alongside Child Base – are a large family owned cash and carry business, a private investment management company, the leisure services department of a local authority, a start-up science consultancy, a small private manufacturer rescued from liquidation, a globally recognised preserves brand and a group of management consultants.

What each story has in common is the conviction that sharing ownership with employees makes powerful business sense and represents a sound answer to ownership succession. The same conclusion, incidentally, as the Government's Business and Enterprise Department reached in their influential *Passing the baton* report published recently.

Why opt for a co-owned business transfer? At Child Base, we saw co-ownership as the best way to secure the company's long-term future. Why jeopardise years of effort building up a company by selling it to a competitor or private equity firm, for whom continuity and sustainability will never be a priority? I cannot guarantee your transition to employee ownership will be smooth and problem-free – business transfer is by its nature an unpredictable affair – **but there is first class advice and support to hand in the form of the Employee Ownership Association and the Baxi Partnership.**

From colleagues to owners demonstrates that other businesses take the same view as Child Base and the Government-backed report. It also shows how employee ownership motivates staff. A recent Parliamentary report, *Share Value*, confirms that the co-owned business sector is exceptionally good at generating real employee engagement or commitment.

A final word of encouragement to owners planning business succession. By opting for a co-owned business transfer you will be joining a sector of the economy now worth at least £25 billion in combined annual turnover. It is a sector boasting world-class retailers like John Lewis and Waitrose; global competitors such as Arup, Unipart, Mott MacDonald and PA Consulting; and a diverse mix of vigorous successful smaller enterprises.

I hope that this report will help you look at ownership succession in a new way.

Mike Thompson OBE
Chief Executive and co-founder, Child Base Ltd

Introduction

At the heart of this report are ten stories, accounts of ten enterprises that – despite the inevitable challenges and problems of everyday business life – are growing, making profits and contributing to the economic health of the country.

There is much that these ten businesses do *not* share in common. They differ markedly in size, their annual turnovers ranging from below £5m to a quarter of a billion pounds. A number have several hundred staff (in two cases, over a thousand workers), while others employ twenty people or fewer. They operate in very different sectors of the economy: three are engaged in particular parts of traditional manufacturing, one is a specialist food manufacturer, another runs a chain of children's day nurseries, and another a cash-and-carry business. Two of our case study organisations are professional consultancies and one an international investment fund management company. The tenth runs leisure centres, places where we can all go to relax and unwind when not working for our living.

Some of the companies featured here have well-known names and brands, others are little known outside their own particular trade sectors.

They are all successful businesses, but what unites them beyond this is that they are all employee-owned. All bar one belong to **the Employee Ownership Association (EOA), the organisation that acts as the national advocate for this form of business model.** All, too, have offered to be interviewed for this report because they feel they have something important to share about their experiences – and because, perhaps, they feel that the employee-ownership business model is not as well known as it should be.

There is another characteristic that several of these companies share – **employee ownership has provided them with a means and a method for the *continuation* of the business.** Much emphasis is, quite naturally, given by government and business advisers to supporting business start-ups. In contrast, rather less attention is paid to issues around business succession – how successfully established ventures can move forward when, for example, it is time for the original founder to retire, or when a family-run business no longer has family members willing to take up the reins.

Business succession can be a tricky process, regardless of the enterprise's profitability. Key individuals, including those who may have been instrumental in establishing and building the business, may leave the organisation. It is also a time when those individuals are likely to want to extract capital from the business, to realise the value of the stake they have created in order to help fund other interests or to see them through retirement. An outright sale of the business to a competitor, or to managers through a management buy-out, is a traditional way to achieve this, but can have a cost. All too often the original business disappears, work is relocated and jobs lost. The world of business may not be a place for sentimentality, but many business owners who see the companies they built up through hard work and commitment rapidly vanish from the scene have a natural sense of disappointment. Many too are sorry to see loyal employees face an uncertain future.

The Small Business Service report on business transfer, *Passing the Baton* (2004), made a valuable point in distinguishing traditional business failure, when a business becomes unsustainable for any number of commercial reasons, from what it called "succession failure" – where a viable business either closes or is diminished owing to a poorly handled succession. *Passing the Baton* suggested that Britain could do much more to improve its track record on business transfer. It also said that awareness needed to be raised about employee buy-outs as a possible model for business succession.

This report is an attempt to raise awareness of employee ownership as a route to business succession. It is aimed at business owners and entrepreneurs, particularly those who are beginning to think about future succession strategies. Employee ownership is a business model that, contrary to what some people believe, is not predicated on a requirement for owner philanthropy, **and this report looks at concrete examples of how businesses have found the necessary capital to become employee-owned, and at the issues involved in this process.**

There have been some intriguing funding vehicles created in recent years for employee-owned business. However, there is much more scope for creative initiatives here, particularly linked to the growing interest in broad ethical issues in investment. Those involved in corporate banking, investment and finance may find the business stories in this report food for thought.

This report will also be useful to business advisers and professionals. A number of reports in recent years – including a 2008 document *Share Value*, produced by the enquiry on employee ownership undertaken by an All-Party Parliamentary Group of MPs chaired by Sarah McCarthy-Fry MP – have drawn attention to the perceived lack of knowledge among some advisers of the employee ownership model. *Share Value* reported that knowledge was "at best patchy, and at worst non-existent". It called for the professional accountancy institutes and associations to encourage greater knowledge among their members, and conveyed the same message to advisers with regional development agencies, Business Link and their equivalents in Scotland and Wales. Business schools too, it said, need to integrate employee-owned case studies and materials into their curricula.

Fortunately, this message is getting through, and growing numbers of accountants, business advisers and tax specialists are ensuring that they brief themselves adequately in this area. Nevertheless, several of our case study organisations encountered a negative initial response from advisers towards the suggestion of employee ownership as a way forward. **In more than one case, owners themselves had to convince their advisers that the employee ownership route to business succession was the right one to follow.**

The *Share Value* report also found evidence of inadequate government appreciation of, and support for, the employee ownership business model. This is disappointing given that – as one of the case studies here demonstrates – employee-owned businesses can provide an effective and successful route for the delivery of services previously delivered directly by the state. It would be encouraging to think that this report may also have something of interest in it for policy-makers.

Those who work in employee-owned businesses, particularly when they believe they gain competitive advantage from their structure, are aware of the risk of appearing overly evangelical – or worse, of appearing to promote an experiment in social organisation rather than a different form of business model. The case stories below should allay any such concerns. These businesses understand, for example, the importance of allowing managers to perform their role without hindrance. However they also stress the advantages deriving, not just from their formal ownership structures, but also from the ways that their particular ownership is reflected in practice, namely, in increased employee participation and commitment.

The question to ask employee ownership sceptics is: "Why not?" As Willie Watt of Martin Currie succinctly puts it: "Every company has to be owned by someone – so why not by the people working in the business?"

A. Employee ownership – the basics

Quietly and without a fanfare of publicity, the employee-owned business sector has been growing.

There was a time only a decade or two back when the handful of trust-owned businesses such as the John Lewis Partnership were seen as quirky creatures, ploughing a lonely furrow well away from the mainstream of British business life.

Today, as this report demonstrates, employee-owned concerns cannot be dismissed so readily. The Employee Ownership Association (EOA) counts among its approaching 80 members not only the venerable John Lewis Partnership but also other highly regarded national firms, including advertising agency St Luke's and designers and consultants Arup.

The EOA also has members among smaller firms with national brand presence: Divine Chocolate, Loch Fyne Oysters and Wilkin and Sons (Tiptree jams), to give just three examples.

Many conventional businesses encourage employee share ownership, perhaps through tax-efficient methods such as Share Incentive Plans (SIPs).

However, the EOA means something more than this when it talks about employee-owned businesses. It means businesses that are primarily run for the benefit of the workforce, because the employees are – individually or collectively – owners of the business.

This does not necessarily mean that the employees are the only owners or shareholders in a business. In several cases, including a number of the case studies in this report, there may be minority shareholders.

Often, for example, when former family-owned businesses pass into employee ownership, the transfer of ownership may be staggered so that some shares remain with the family for a time thereafter.

Some employee-owned businesses believe that 100% employee ownership is a key principle, but others see positive benefits in having external shareholders on board, complementing the stake held by the workforce.

There is a wide range of ways in which employee ownership is structured, although there is consensus that the principle that employees can own a controlling stake – or in other words, at least 50% of the voting shares – is a fundamental one.

One recent report defined *employee-owned businesses* as "companies wholly or majority owned by their employees, including management, either directly and/or indirectly via employee trusts".

The EOA also uses another term – *co-owned companies* – for those firms where employees have a significant stake in the business, but one that is less than 50%.

In a number of cases (including two of the companies featured in this report), co-ownership businesses are going through a process of transition which will lead them in due course to become majority employee-owned, and these businesses are welcomed within the overall EOA family of member firms.

(For convenience, this report avoids the term co-ownership, and uses employee ownership in a slightly broader sense to encompass these companies in transition).

Nevertheless, this distinction helps to remind us **that the transfer of a business into employee ownership can very often be a *process*, undertaken over a period of time.** As one of the business leaders interviewed for the report put it, the work of changing from a conventional to an employee-owned business is a "journey" that he and his colleagues are currently making.

The diversity of the employee-owned sector has already been mentioned. What may not yet be clear is the size of the sector. It has been suggested by the EOA that **the combined annual turnover of employee owned firms may be as much as £25 billion.**

Just as significant is the perceived opportunity for the sector to grow in numbers in the immediate future, as the relevance of the business model for mainstream business becomes more widely understood.

Certainly, there is considerable potential for employee ownership in situations of business transfer, and here there is a depth of knowledge and expertise in a range of agencies and organisations (including the EOA) that can be called on when needed.

The EOA member firms themselves offer a valuable repository of experience of what works well (and on occasions, what may not be quite so advisable!). It is this experience that comes through clearly in the case studies that follow.

B. From family business to employee ownership

A G Parfett & Sons Ltd

CONTEXT

- **Wholesale cash and carry (food, drink and tobacco)**
- **Majority employee-owned since 2008**
- **Collective ownership of shares**
- **Shares acquired (at discount) funded from bank loan**

Steve Parfett is the managing director of the Stockport-based wholesale cash and carry business that carries the family name. Set up in 1980, Parfetts is a well-known and well-respected wholesale cash and carry business that over the years has grown from one initial store in Stockport into a sizeable enterprise. The firm now turns over around £250m a year, and has around 600 employees based in six trading depots.

In most respects, it is a classic story of a successful family business, launched originally by Steve's father who – as Steve says – put "everything on the line" to build it up. Steve took the helm in 1989 when his father turned sixty. But now that Steve himself is in his fifties and looking to retire in around five years time, the question of the future of the business is one that has had to be addressed.

His own and his siblings' children – a potential third generation for the business – are still starting their careers or in education and, although they are interested in the family firm none has shown a strong vocation towards it, according to Steve. In any case, bringing in this generation would involve a potentially difficult interim stage when Parfetts would have to be led by professional management – with the risk that Steve would never really get to retire properly. What were the other alternatives?

"I called the members of my family together in late 2006, and said 'we don't have to risk precipitous decisions but we do need to think about this'," Steve says. The family agreed, and Steve was asked to look in detail at the options.

He took professional advice from a range of sources, including from a merchant bank who had worked with the business before and from Graeme Nuttall of solicitors Field Fisher Waterhouse. Parfetts also decided to commission an in-depth report from their accountants Baker Tilly, a significant expense but one that Steve feels was money well spent. All the usual exit strategies were assessed including a management buy-out, management buy-in, business sale to a competitor, and purchase by an overseas investor.

However Steve Parfett had begun his career as a graduate trainee with the John Lewis Partnership and was therefore also aware of the employee ownership model. He and Parfett's finance director, David Grimes, attended the Employee Ownership Association conference in 2007, and both came back impressed. Here was another option for Baker Tilly to assess, one which potentially offered a long-term secure future for the business.

The family met again in conference in January 2008, and took the decision that Parfetts would become employee-owned. The necessary legal and financial work was initiated quickly: the family holding would be bought out in two stages, with initially 55% of the shares passing to an Employee Benefit Trust (EBT). The purchase would be financed by a bank loan, secured primarily on the business's freehold properties. The firm's bankers Lloyds came up with a package over a fifteen-year term.

Mindful of the need not to overburden their business with debt, the Parfett family agreed a sale price for the 55% shareholding that represented a discount of approximately 20% on the full market value ("and possibly a bigger discount from what a competitor might have offered," Steve points out). A put and call option allows the remaining 45% to be sold to the EBT between four and eight years from 2008. In the interim, the family has agreed to forego dividends.

"We spent considerable time debating the different types of employee ownership, and a key consideration was whether to go for individual ownership of shares," Steve says. They decided instead in favour of the John Lewis model, where all shares are held collectively for the benefit of employees. It is more appropriate for a workforce like Parfetts that includes large numbers of shop-floor workers without ready access to finance, Steve argues. "In terms of explaining employee ownership to people, the more straightforward the better. The danger of direct shareholding is that there is always someone who gets excluded. We want all to be in it together," he says. Instead of share dividends, Parfetts is following John Lewis in planning to pay all staff an annual partnership bonus.

With the financial and legal work completed by April 2008, the task was then to brief the workforce on the radical changes which had taken place. "We put aside a full fortnight, and the whole executive board went around the business, meeting staff in groups of about twenty. We wanted to get across our passion and enthusiasm. People needed to understand. This was absolutely crucial," Steve says. About thirty-five meetings were held, and the board also chose to invite an independent consultant from Baxi Partnership's Baxendale consultancy service (see page 28) to attend with them.

Parfetts are now working hard to put in place new employee representative structures. The somewhat top-down liaison committees of the past are being replaced by a series of branch councils (one for each depot), which are to be solely comprised of elected staff. In turn, the branch councils will nominate two members each to a new company-wide council, which will have a watching brief over the strategic management of the business. "The normal executive board will run the business, but will be answerable to employees. I think we're open-minded about the question of employee participation on the executive board, but we don't think this is appropriate just at the moment," Steve says. The Employee Benefit Trust (EBT) has been set up initially with two employee representatives (one of them the current finance director), two family members and an independent chairman.

"In terms of explaining employee ownership to people, the more straightforward the better. The danger of direct shareholding is that there is always someone who gets excluded."

Wilkin and Sons

CONTEXT

- **Jam manufacture**
- **In transition to employee ownership since 1989**
- **Collective and individual employee ownership of shares**
- **Shares acquisition funded from trading profits**

The fruits of Peter Wilkin's business are readily visible on the shelves of delicatessens and supermarket chains. Wilkin and Sons has an enviable reputation for the quality of its jams and foodstuffs, sold under the familiar Tiptree brand.

Peter Wilkin is the firm's fifth chairman, following in the footsteps of his uncle, father, great-uncle and great-grandfather Arthur Charles Wilkin, who started the business in 1885. Although Peter believes that Wilkin and Sons' independence is a key factor in protecting the brand, this is not a family firm in the usual sense of the word. At the outset, Arthur Charles Wilkin persuaded friends and neighbours to join him as shareholders, and for a time in the twentieth century the company's shares were listed. The Wilkin family are shareholders, but external investors also hold significant stakes. For much of the last hundred years, a sizeable (and growing) shareholding has been held on behalf of the interests of the employees.

"My great-grandfather was a staunch non-conformist with a strong belief in business ethics and an enlightened social conscience, which included a genuine concern for the welfare of his workforce," Peter says. This led among other things to the creation of the Wilkin Provident Trust in 1917, to help employees and former employees in hardship. Unusually for the time, employees were formally involved in the Trust as both directors and trustees.

It was in 1989, however, that Wilkin and Sons underwent the key change that laid the foundation for the business to move towards becoming employee-owned. Holders of the principal class of voting share agreed that they would, over time, sell their shares to a newly created Employee Benefit Trust (EBT), held for the benefit of all the workforce. At the same time, most of the shares in the Wilkin Provident Trust passed to the new EBT. (The Provident Trust had evolved into a non-contributory pension scheme, which was proving extremely expensive to administer in the post-Maxwell pension environment).

Peter Wilkin identifies a number of reasons for the 1989 decision. One was the need to protect the independence of the company. "One major concern was that the company was very vulnerable to being taken over and asset stripped. We have always felt – and I still feel today – that our independence is what gives us credibility, and without it a lot of the strength of our name would be lost," Peter says. There was also a need to plan for the continuity of the business, and to find mechanisms for the Wilkin family to disengage. "There was concern for the future of the business, and the shrinking family shareholding. Although my son-in-law is in the business now, at that time no other family members were coming along," Peter adds.

Further, the Wilkin family had long held the view that employees as well as shareholders should have a say in the company's affairs. There was also a feeling that employee ownership would have direct business benefits: "There is good evidence that employees who work in a company in which they have a stake are more motivated and committed than those who do not," Peter explains.

The transformation of Wilkin and Sons towards employee ownership has been, deliberately, a slow and organic process. Twenty years on from 1989, the Employee Benefit Trust now holds about 45% of the votes, having gradually bought out existing shareholders in proportion to their holding. (Shares are purchased at market value, using an HMRC-agreed formula devised by the firm's auditors). With the company currently enjoying good trading results, Peter Wilkin feels that it may be possible to move forward very shortly, to cross at least the magic 50% mark. Longer term, there is room for debate: "Some directors would like to see all the shares bought back. I personally like the idea of there being some outside shareholders – I think it helps keep a sense of proportion," Peter says. He himself hopes to retain an interest in the business after his retirement.

As the Trust gradually moves towards majority ownership, its structure is also being re-examined, with Peter Wilkin keen to strengthen safeguards to prevent the firm falling prey to a would-be predator with deep pockets. At present the Trust has five trustees: two directors, two employees and a local retired JP, all appointed by the directors. "I think we need more independent trustees to help safeguard the business. We're the biggest employer in the village of Tiptree, and I would like more local people from all walks of life as trustees," Peter says. In practice, the Employee Benefit Trust currently takes a relatively backseat role in the company's affairs.

As well as the EBT, however, the company operates a Share Incentive Plan (SIP), run using the government's tax-efficient SIP rules for all-employee share schemes (see page 37). Under the SIP, all employees receive free shares twice yearly, their allocation being linked to the salary or wage band they fall within. Dividends have recently been a healthy 10%. "Rather than all employees' shares being held in trust, these are employees' own shares, and they get dividends on them. It's a little more personal," Peter Wilkin says.

"There is good evidence that employees who work in a company in which they have a stake are more motivated and committed than those who do not."

Child Base

CONTEXT

- **Children's nurseries**
- **In transition to employee ownership: new memorandum and articles in 2007**
- **Collective and individual employee ownership of shares**
- **Shares acquisition funded from trading profits**

What began twenty years ago as a single nursery for around twenty children in the village of Sherington near Milton Keynes is today a major business. As Child Base's chief executive officer Mike Thompson explains, his company now operates thirty-six nurseries for children across the whole of south-eastern England, employing a thousand staff and turning over around £25m a year.

Child Base's growth has been dramatic and Mike Thompson is clearly proud of what has been achieved. But he is just as proud of the radical change in the long-term direction of the organisation, designed to carry Child Base forward into the future as an employee-owned business. Child Base's last AGM saw the company adopt new memorandum and articles of association, which commit the directors to acting in the interests of the firm's employees, present and future.

For much of its early history, Child Base was a family business – Mike Thompson was in day-to-day charge and his father Sir Peter Thompson was the chairman. The Thompsons were the major shareholders, although the company also had a number of external investors, mainly friends and former work colleagues who chipped in some capital in the early days of the business. But over the past ten years this has changed. Staff at each of the nurseries have been encouraged to acquire shares in the venture, initially on a "buy one, get one free" basis, but most recently on a three-for-one basis. Close to 50% of the shares are now held either by individual employees or by the Employee Benefit Trust, whilst the Thompson family holding is down to around 28%. The target for the next decade is to see the employee share holding increase to 100%.

As Child Base's web site puts it: "There are several reasons why shared ownership is good for everyone at Child Base. Firstly, a spread of ownership secures the company's long-term future. For instance, the company can only be sold to a third party if the majority of shareholders want it to be. Secondly, shared ownership is a great motivator to everyone to make the company a success – because that success is shared." Mike Thompson points out that shares have increased in value from £1.60 to £4 over the past six years, with dividends increasing from 6p to 12.5p. "When people receive the share certificate they think, well, OK, but when the dividend cheque arrives they love it," he says.

Nevertheless, Mike Thompson says that it is taking time for the message of employee ownership to get through to people. "The educational process is tough, very hard work, but at the end of the process we'll get where we want to be," he says. Child Base organises share dealing days twice a year, in May and November, when shares can be bought or sold at the value set by the company's accountants. The new memorandum and articles of association sets a maximum individual holding eventually of 2.5%.

Child Base claims that its rates of pay are some of the highest in the childcare sector, and staff are given extensive training and encouraged to build their career with the company. Prizes for the best employees and best overall nursery are awarded each year at the Annual Ball. But for Mike Thompson, the employee ownership aspect of Child Base is central to its efforts to make the company a good place to work – and by extension, a good place for parents to leave their children. One in four of its nurseries are rated "outstanding" by Ofsted, compared with an industry average of one in 50.

Mike Thompson's interest in employee participation may be partly hereditary. His father was the Chairman of the National Freight Consortium (NFC) and oversaw the privatisation of NFC into a unique venture where all its drivers and staff were encouraged to invest in the company. Although later acquired, NFC's success at that time as a privatised employee-owned business is legendary, with drivers' initial £500 investments rapidly growing to be worth thousands of pounds. Sir Peter says that, since then, all the businesses that he has been associated with have included some element of direct employee participation.

Child Base now includes elected representatives on the Employee Benefit Trust, and as Mike Thompson points out, these days he has to justify his position as chief executive by ability and not simply by the size of his share stake. Child Base's profits, currently around £2m a year, have provided a mechanism for the company (via the Employee Benefit Trust) to buy out some of the existing shareholders, including part of the Thompson family's own holding, an arrangement which Mike says offers investors a fair and equitable exit route.

Arguably, a sale of Child Base to one of the other large child nursery providers might have valued the business higher than the new arrangements. But for Mike Thompson this is not the point – he talks of his own legacy from his involvement in Child Base being the satisfaction which comes from building a successful business where the people who have worked with him receive some of the benefit as well. "I think it's fairer, and it makes my life happier," he says simply.

"Shared ownership is a great motivator to everyone to make the company a success – because that success is shared."

Herga

CONTEXT

- **Switch manufacture**
- **Majority employee-owned since 2006**
- **Collective ownership of shares; some individual share holdings**
- **Shares gifted by owner**

For forty years Peter Tracey put his "heart and soul" into his family-owned business Herga, a specialist switch manufacturer based in Suffolk. The business is successful: the workforce of six employees in 1969 has grown to around 130 today. Turnover is £5m, and Herga has twice received Queen's Awards for enterprise.

Now past retirement age and with no family members interested in taking over the business, Peter Tracey has solved the succession problem in an innovative and radical way. He rejected firmly the idea of a trade sale or traditional management buy-out, which he believes too often leads to factories being closed and production transferred elsewhere, and has chosen instead to donate his 51% personal shareholding in Herga to his employees, transferring the shares to an Employee Benefit Trust in 2006.

His decision is designed to secure the long-term independence and sustainability of the business to which he admits to having a strong emotional attachment. Gifting, rather than selling the shares, means that Herga is not burdened by a heavy level of debt.

Peter Tracey says that the John Lewis Partnership model influenced his thinking and – as at John Lewis – the key instrument for maintaining employee ownership at Herga is a Partnership Trust. Unlike John Lewis, however, Herga has also made arrangements for employees to own shares in the company directly. As part of the 2006 change, Peter Tracey gifted 4% of the shares to all staff who had been with Herga for at least a year. The company also operates a Share Incentive Plan (SIP) for employees who want to buy further company shares in a tax-efficient way.

Richard Chatham, Herga's managing director, describes the process of converting a family business into an employee-owned concern as a fascinating, challenging and exhilarating journey, and one that continues today. "The key thing in this process is to keep everyone informed," he says. "People need to feel involved in the journey. It does take time." He and Peter Tracey worked closely in the period before the 2006 change to prepare for the transition, talking informally to the long-established Northamptonshire employee-owned business Scott Bader as well as to the Baxi Partnership. Wrigleys solicitors offered specialist advice, including the recommendation that a limit should be put on the Board's future ability to borrow without permission from the Partnership trustees, a sensible safeguard designed to protect the long-term security of the business.

Richard Chatham also ensured that employees were briefed on the developments. He talks of the value that came early in the transition from taking three volunteer members of staff to the annual Employee Ownership Association conference. He also met the workforce in groups of about eight people to explain exactly what was changing, as well as holding an informal lunchtime training session on the duties of trustees. The Partnership Trust has been established with three trustees, one of which is elected directly by the workforce (the other two are Peter Tracey himself and Richard Chatham as managing director). The first election to the Trust in 2006 was keenly contested with seven employee candidates – the successful candidate came from a supervisory position.

The actual transfer of Herga into employee ownership was marked with a special launch event in the presence of BBC television cameras. There was, Richard Chatham says, a real sense of expectation – and therefore, perhaps naturally, a slight sense of disappointment when, the next day, the same work had to be undertaken as usual. He has been at pains to explain the difference between employee ownership and management, where he and his senior management colleagues have a role and responsibility to play. ("This isn't the sort of co-op where everybody votes on everything," he says). However, he says that Herga's open management culture has helped him in his work. "You need a different kind of leadership, one which isn't based on command and control," he explains.

Herga, like John Lewis, intends to share the fruits of its success with the workforce. For many years, 10% of the company's profits have been shared amongst the team. This year sees the first Partnership Bonus, when a further 10% of the company's profits will be paid to all Herga's employees who have taken individual shares in the business. External shareholders (in practice a Tracey family trust which holds a residual 32% shareholding) will not receive dividends, however, in line with Peter Tracey's wishes. The aim is for the company to buy out the family trust over time, so that eventually 100% of Herga's shares are owned by employees, both collectively and individually.

"The key thing in this process is to keep people informed. People need to feel involved in the journey. "

C. Back from the brink: employee-owned phoenix businesses

UBH International

CONTEXT

- **Steel tank container manufacture**
- **Employee-led rescue in 1999; subsequent capital injection from Baxi Partnership**
- **Individual employee ownership of shares; Baxi Partnership shareholding held in trust for employees**
- **Internal market in shares; one free share issue**

UBH International, based in the Lancashire town of Burscough a few miles inland from Southport, demonstrates that there can be life after death for British manufacturing companies. The present company rose, phoenix-like, from the ashes of a liquidated business called Universal Bulk Handling in 1999, and was able to start trading only because ninety UBH employees each chipped in capital of £5,000. As with the better-known example of Tower Colliery, management, workforce and unions were united by a determination to ensure that the business – and the jobs – did not disappear.

Now, almost a decade on, UBH International is trading profitably, employing just over a hundred employees and turning over around £12m annually. Pre-tax profits in 2007 were £1.9m, almost double the 2006 figure of £1m. Shares, originally at par £1, are now worth a healthy £1.81.

But nobody would deny the fact that it has been a rocky ride since 1999. The company specialises in manufacturing steel tank containers for transporting liquids and gases, a part of the manufacturing sector which has experienced – in the words of one director – an "absolutely horrendous recession". One major UK competitor of UBH failed to survive, and UBH itself turned in losses for its first few years. In 2000-2001, there was a very real risk that UBH too would collapse – taking with it the money its employee owners had invested.

The solution for UBH came in the form of investment from the Baxi Partnership, the capital fund established to support employee-owned businesses (see page 28). Baxi Partnership agreed to inject £1m of equity capital (plus £500,000 in debt support), in return for an equity stake of 50% in the firm. In line with its obligation to operate specifically in the interests of the employees of the companies in which it invests, Baxi was able to pledge to UBH that it would remain a business run for the benefit of its workforce.

"I have to say that if it were not for the investment by Baxi Partnership, the company would not be where it is today. In fact, the company wouldn't be here today," says Jim Lyon, UBH's current managing director. Since 2001, UBH has effectively been a three-way partnership between the company, its employees and Baxi. As well as representation from Baxi, the nine-person Board includes three directly elected employee directors. The Baxi investment, together with the development of a licensing agreement with a Chinese tank manufacturer to produce tanks to UBH designs, has been key to the company's success.

“Partnership isn’t easy, it’s a difficult concept – in some ways, it’s more difficult for senior and middle management,” Jim Lyon says. “You have still got to have a professionally managed company within a partnership environment, and that can be difficult to understand, particularly if people have invested their own money. “

The Board aims to make sure that it communicates its debates and decisions to the workforce. Each board meeting is followed by a short “Toolbox Talk” briefing with all employees, at which Jim Lyon spends time sharing information on profits, potential orders and potential problems ahead, and leads a question and answer session. Key management data – on production, profit and HR, including sickness absence – are posted on a workplace notice board, and a laptop in the canteen provides a further potential source of information through the firm’s intranet.

Originally, all 90 of UBH’s initial staff were required to put in £5,000 to become shareholders, but this position has changed. Currently, about half the workforce hold shares, although all are welcome at the company AGM at which they have speaking (if not voting) rights. A share-trading day is held once a year, with the share value determined by the company’s auditors.

In addition to individual shareholdings and the Baxi stake in the business, UBH also has some of its shares held in an Employee Benefit Trust (EBT). In UBH’s case, this is run effectively as a mechanism for ensuring a well-functioning market in buying and selling shares, and the Trust does not have a wider role in the company’s governance. The company became profitable for the first time in 2005 and was able a year later to fund a free share issue through the EBT on the basis of length of service, not wage levels. There was a reward for those who held on to their shares in 2007 when continuing profitability enabled a dividend of 13p to be paid.

“You have still got to have a professionally managed company within a partnership situation, and that can be difficult to understand.”

Woollard and Henry

CONTEXT

- **Specialist suppliers to the paper industry**
- **Baxi Partnership-led assisted buy-out in 2002**
- **Collective and individual employee ownership of shares; Baxi Partnership shareholding held in trust for employees**
- **Former owners bought out through Baxi Partnership investment**

Outside the paper industry, not many people understand what is meant by the term dandy roll. However, for the long-established Aberdeen company, Woollard and Henry, dandy rolls (used for improving paper quality and adding watermarks) are the core product. The firm has an enviable reputation for its contribution to the manufacture of very high-security papers, including bank notes.

Despite a history dating back to 1878, Woollard and Henry nearly disappeared in 2001. Indeed, the closure of the business was announced to the trade by the then majority shareholder, who was suffering from ill health and keen to relinquish his management responsibilities.

However, Woollard and Henry found a future, with the business restructured as an employee-owned concern. The agent was the Baxi Partnership, which at that stage was just beginning its role as a dedicated capital fund for employee ownership. Baxi's £1.3m injection in the business – used to buy the firm from its previous two owner-managers – was one of its very first investments.

Fred Bowden, Woollard and Henry's managing director, joined in April 2002 when the Baxi buy-out was being completed. The task facing him and the workforce was a formidable one: the market was going through difficult times, and several key clients – having been told that the business was closing – had found new suppliers. "It had been the two previous owners' business, and when they left the knowledge went with them. We had to rebuild the management team, and the office team too," Fred says.

There was also the task of making the business work effectively as an employee-owned concern. In line with the model it has employed in several businesses, Baxi took 50% of the shares and under the terms of its operating trust it is required to hold these to promote the interests of the employees. The remaining 50% of shares were placed in an Employee Benefit Trust, of which a small percentage has now been distributed to individual employees through a share incentive scheme.

"People had big expectations from employee ownership, but of course our first few years were very difficult. It's important to manage people's expectations," Fred says.

Through hard work and determination the company has turned the corner, developing a new strategy to concentrate on its core strengths, particularly in relation to high-security paper production. Turnover has increased from £1.2m at the time of the buy-out to £2.7m today, and the numbers employed have also climbed slightly, to around thirty.

"Previously, any financial information was kept as a guarded secret. One of the biggest changes we introduced – perhaps in hindsight a little bit late – was to get everyone together every Friday tea break for half an hour or an hour. It's an open forum. We talk through the jobs, quotes and possible problems, the whole financial briefing. It's a very good tool for us," Fred says. Important strategic decisions are discussed at separately arranged meetings, when feedback and contributions are welcome. "Managers still have to manage, but have to involve people much more," he maintains.

Under the arrangements introduced in 2002, two employee directors are on the company's Board. The directors are chosen by open ballot of the workforce, and the entire workforce is eligible to stand. Fred Bowden says that the arrangement has worked well, with the directors elected turning out to be of high calibre. Baxi also has a representative on the Board.

Woollard and Henry has introduced a share incentive plan, under which staff who purchase three company shares at market value are given a fourth share free. At present about 60% of the workforce have chosen to buy shares, with about 16% of the total company share issue now in the hands of individual employees. Dividends are payable at the Board's discretion, depending on profits.

But profits are also needed for developing the business. One challenge for Woollard and Henry, under its new ownership arrangement, is to ensure that it can find the money to continue to invest as necessary in the new technology needed to maintain its competitive position. Fred Bowden acknowledges this, though he points out that his company is fundamentally in the same position here as any privately owned business, but with the benefit of a workforce with a direct interest in making sure it succeeds.

"It's important to manage people's expectations and to understand the implications of any financing agreements."

D. Employee ownership for knowledge-based business

CPCR

CONTEXT

- **Specialist management consultancy**
- **Employee-owned since 2007**
- **Collective ownership of shares; residual individual shareholders bought out**
- **Shares acquired (at partial discount), funded from trading profits**

It was CPCR's very success as a business that seemed to be creating difficulties in securing its long-term future. Originally established in 1989 with three shareholders, CPCR rapidly developed a strong reputation for providing consultancy advice to a range of major private and public bodies in the areas of organisational development, leadership and business partnering. But after almost twenty years, with one of the founders retired and the remaining two desiring a clear exit route, a real problem emerged: how could the original shareholders withdraw their equity stake in the business?

As CPCR's current managing director Jenny Charteris tells the story: "For a time we all scratched our heads, and things felt rather stuck". The company's value had grown and the current directors and staff faced a seemingly impossible task in finding finance to buy out the founders. "One retired shareholder and two other founder owners held about 60% of the shares, but the rest of us couldn't afford to buy them at the value they wanted to realise," she says. The original £1 shares were valued by the founders at twenty-five times this value. "Our position was that we wanted to meet their need to realise the capital, but not in a way that bankrupted either ourselves or the business."

The position was even more complicated because other employees had acquired small shareholdings at market value (apart from a very small early distribution offered at £2.50 a share). For Jenny Charteris herself, when she joined the Board about six years ago, part of the deal had been that she would invest in the company's shares: "I'd paid £25 a share for most of the shares I owned, and mortgaged to pay for them to the tune of tens of thousands of pounds," she says. Her investment, and that of another colleague in a similar situation, depended on the share value being maintained.

As a consultancy business, CPCR faced a particular problem in that most of its value was tied directly to its human capital – in other words, to the consultants' own expertise and knowledge. A situation where a significant share of the profits generated would go to external shareholders was not one likely to appeal to existing staff. As Jenny Charteris says, people would begin to question the incentive to stay with the firm. Furthermore, CPCR was unlikely to grow to any great extent. "Our model is to provide very high quality work, and a closely knit team is very fundamental to how we work," Jenny says. "We intend to be small and profitable. This isn't the conventional private shareholding model where the aim is to grow the business and increase its capital value."

There were other problems that had to be wrestled with in trying to fix an agreed valuation for the company's shares. "The day the founder members walk out of the building, the share value drops anyway," Jenny says. "The discussions were good-humoured, but still quite tricky."

An answer eventually emerged, however, which enabled all parties to achieve most of their outcomes. It involved CPCR becoming a fully employee-owned business, with all the company's shares held by an Employee Benefit Trust (EBT). "The founders agreed to gift a significant number of shares to the EBT. This considerably reduced what we needed to pay them, without reducing the headline share price. It was a big-hearted gesture, which will keep the business going with a level of debt which is manageable and sustainable," Jenny explains. The remainder of the buy-out is to be staged, and funded by the company out of trading profits – fortunately recent years have seen the business performing well. Staging the buy-back was also helpful for capital gains purposes.

The arrangement protects those staff who had paid the higher value for their shares and who will now also be bought out in due course by the EBT. It also tallies very well with the way in which the company has tended to operate. "The ethos of the business has always been quite inclusive and reasonably open. Now the degree of involvement has increased. We have a collective responsibility to look after each other," Jenny says.

The new arrangement for CPCR was formalised in a legal constitution approved in September 2007 by both the company's shareholders and the trustees of the CPCR Partnership Trust.

CPCR's purpose is set down in the following way: "The Partnership's mission is to create a better world of work. The Partnership values courage, excellence, happiness, learning and prosperity for the partners and our clients.

"The purpose of the Partnership is to build a successful business wholly owned by its employees. The shares shall be held in trust by the Partnership Trust on behalf of, and for the benefit of, Partners. Its members share the benefits of owning the Partnership – profit, knowledge and power – and they also share the responsibilities of ownership with as much equality as business efficiency allows."

CPCR has decided that the EBT itself will be run as a purely technical agency. The first formal partners' meeting held early in 2008 clarified that CPCR's Board will remain the body responsible for running the business, and as Jenny Charteris explains, the new structure does not diminish the leadership role which is demanded of the Board – albeit she and the other directors are now responsible ultimately to the partners rather than the previous shareholders. Partners' meetings will be held approximately every three to six months.

The arrangement and share valuation received HM Revenue and Customs approval – it was reassured that the proposal was not simply a tax avoidance plan for the owners. Ironically, the only organisation that appeared to find the scheme hard to comprehend was CPCR's accountants. "They fundamentally didn't get it, didn't get what we were trying to do," Jenny Charteris says. (CPCR has since found a new accountancy company).

"Our model is to provide very high quality work, and a closely knit team is very fundamental to how we work."

Martin Currie

CONTEXT

- **Investment fund management**
- **Employee-owned since 1984**
- **Individual employee ownership of shares; external investors (25%)**
- **External capital injection to assist transfer of shares from retiring to younger employees**

Martin Currie is an investment fund management company, based in Edinburgh and with offices in London, New York, Shanghai and Melbourne. It is responsible for managing funds of about £9.8bn for a range of clients, including pension funds, foundations and charities, and investment trusts. First established as a conventional partnership in 1881, it incorporated as a limited company in 1984, at which time it also took the decision to become an employee-owned business. Martin Currie currently employs about 270 staff around the world.

"We are committed to employee ownership, it's not a flag of convenience. We make a lot of it when talking to clients and potential clients," says Martin Currie's chief executive Willie Watt. "The company has to be owned by someone, and I'd rather it was by the people working in the business. We believe employee ownership is the best way to fund, retain and develop talent. The implication is that investment management is something of a team game, and that it's inappropriate just to have five or six people as owners."

As Willie Watt points out, the value of an investment management firm like Martin Currie lies primarily in the quality of the human capital which it has available to it. Fund managers are relatively footloose, and remuneration packages tend to be strongly incentivised, making Martin Currie's ownership structure a strong advantage for the business. An individual's potential ownership stake in the company is linked to their level of responsibility and skill, though individual shareholdings are now capped at a maximum of 6%. Shares are held by around 230 of the staff, from the chief executive to the office receptionist.

Martin Currie's preferred route to employee ownership is based entirely on individual shareholdings by staff, and the Employee Benefit Trust (EBT) acts simply as a warehouse, enabling shares to be available for sale and for buying back as necessary. Staff who leave employment or wish to sell shares are required to sell their holding back to the EBT. The share value is calculated twice a year, using a formula based on the P:E ratio of quoted peer companies, applied to Martin Currie's own profit and loss account (and discounted to allow for the fact that shares are not readily tradable). "We believe that individual employees should have the ability to generate capital gains directly. We're working in a different market from a firm like John Lewis, one where competition on remuneration is more intense. We build capital gains into how we reward employees," Willie Watt explains.

Individual share ownership in an employee-owned business does, however, raise issues of how shares are passed down between generations of staff, an issue that employee-owned firms with shares held collectively do not face. Willie Watt outlines the situation Martin Currie found itself in recently: "We'd grown quite strongly from 2001 to 2007. When a company grows, the shares are worth more than they were, and that's a good thing for an employee who's retiring. However, it's hard for younger employees to be able to afford to buy the shares. It can also become a destabilising issue: retired employees' interests are not the same as current employees', and this can lead to current staff asking themselves 'Why are we working for retired employees?'" he says. He was anxious to avoid the situation where the older generation were sellers in order to realise their capital gains, but where younger employees could not afford to buy the shares.

The solution devised by Martin Currie was an innovative and radical one, which at first sight appeared to dilute the company's employee ownership tradition. In 2007, the company effectively sold a 24.9% stake in the business to two outside investors. A New York investment firm bought 17.43%, whilst a 7.47% stake was taken by family interests of Lord Jacob Rothschild. The transaction was arranged by creating a new holding company for the firm.

According to Willie Watt, this injection of capital enabled both older shareholders to realise in full some of their capital gains, and allowed younger employees to afford more easily to buy in, at what was effectively 75% of the previous share value. The expectation is that the outside investors will maintain their interest for five to ten years, at which time they will exit. The agreement requires the company to arrange the buy-back. Martin Currie is currently building up its cash reserves to produce the funds it will need for such a transaction.

Willie Watt says that Martin Currie investigated other possible ways of achieving the same result, including the option of becoming publicly listed. He says that he and his colleagues felt that employee ownership would be harder to maintain if the company's shares were openly traded. Another route considered was to enter into partnership with another investment management business, which would have become a minority shareholder. ("We didn't find the right partner," Willie Watt explains.) Raising the capital solely through borrowings rather than equity was seen as too expensive and risky.

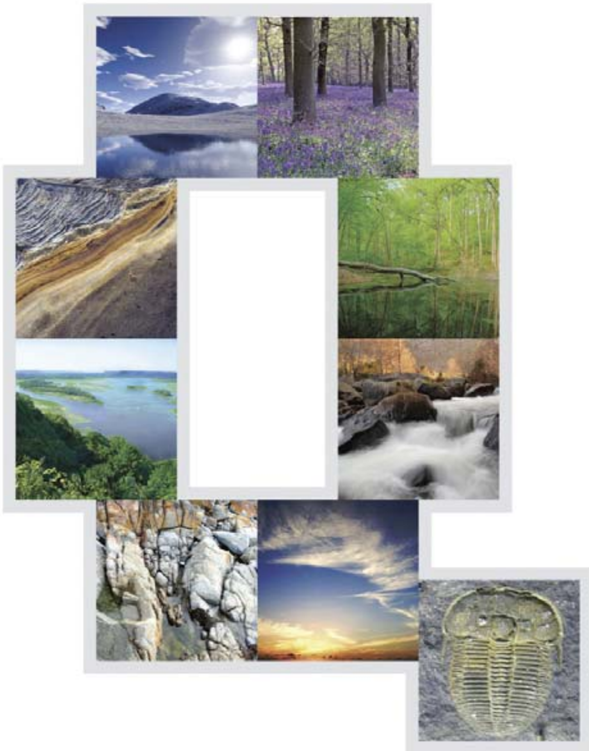
This is the second time in its history that Martin Currie has followed the same path – an external shareholder held over 20% of the company's stock in the 1990s before the firm reverted to 100% employee ownership. Willie Watt seems relaxed that the essential principle of employee ownership has not been compromised. He says that the key in arrangements such as these is to avoid parting with too large a stake in the company. "You've always got to be able to return it to 100%, and for every 5% of equity that goes it becomes harder to bring it all back," he says. "My own personal view is that for a business to be employee-owned, the employee ownership share has to be at least 50%, and with a substantial buffer."

"The company has to be owned by someone, and I'd rather it was by the people working in the business. We believe employee ownership is the best way to fund, retain and develop talent."

Quintessa

CONTEXT

- **Specialist scientific and mathematics consultancy**
- **Established by founder in 1999 to be employee-owned**
- **Individual employee ownership of shares; currently one majority shareholder**



"We are a natural employee-owned business," says David Hodgkinson, director of the specialist professional consultancy Quintessa. His colleagues in the business – about twenty in the UK and ten in Japan – are highly educated professionals with backgrounds in mathematics or science, such as physics, chemistry and earth sciences. According to David, it is in their expertise and knowledge that the company's strength lies. "In these days of the knowledge economy, it's the people who are important," he points out.

Athough Quintessa has been an employee ownership venture since it was established in 1999, it was David Hodgkinson who founded the business, doing so in the time-honoured way of raising business capital against the value of his own home. It was, he recalls, a potentially frightening prospect: "it really concentrated the mind".

Given this, most people in David's position would have chosen to establish the new venture as their own private business. A previous work experience had left David convinced, however, that this was not the way he wanted to do things. Before Quintessa he had managed a consultancy division of a company operating in the environmental sector – 95% of this job had been excellent, he says, but the problem had been the ownership structure, which meant that the company's owners had been able to sell the business to an external buyer, leaving David and his division high and dry.

"The 5% that was wrong had got me. I let it be known that I would share the ownership of the new business, that this would be an employee-owned company. So some very highly valued people came in who were instrumental in building the company and bringing clients and expertise," David says.

His desire to establish his business in this way was sorely tested, however, by the responses he encountered. "I went to the accountant and said I was going for employee ownership and he advised me not to do it. The bank manager too said, 'are you sure you want to do this?' It wasn't so much that they were hostile, it was that they didn't know about the concept." David himself was struggling to find the advice he needed – he recalls that a web search brought him US-specific information but unfortunately he failed to make contact with the Employee Ownership Association's predecessor body JOL. "I had very little support – that's why I'm such a big supporter of the EOA," he says.

Quintessa offers scientific and mathematics consultancy services worldwide to a range of government agencies and commercial organisations, focusing particularly on specialist areas such as radioactive waste management and disposal, carbon dioxide sequestration and other long-term environmental problems. Last year, turnover (including from a Japanese subsidiary set up in 1999 by David in conjunction with a Japanese colleague of his) was about £3.8m, of which around £2.2m was generated from the UK offices. The international element of the work brings welcome revenue, and is also enjoyable. It is important, David feels, to create work that is fun.

Quintessa recently opened a second UK office in Warrington to complement its original base in Henley-on-Thames but unlike many conventional businesses, growth at all costs is not the driving force. "As we have no external shareholders, we don't necessarily have the object to get bigger. In fact, the profit per capita would only go down if we got bigger," David says.

The current size of the business also helps maintain the participative feel that David believes is so important. "There is so much bad management around, based on the principles of decide, announce and defend. We practise consultative management – listening to people before decisions are taken. We do this informally every day of the year. More formally, we have meetings of all the UK staff three or four times a year," he explains. As the staff handbook puts it, "There are no secrets within Quintessa. All information on the company and its work for clients is available to all employees. All staff are empowered to contribute to the strategy and operations of the business".

Forced very much to work out for himself how to establish Quintessa as an employee ownership concern, David chose to follow the route of individual shareholdings, using a share options scheme. Ironically, the problem now is that the success of the business has increased the market value of Quintessa to the extent that it is now extremely expensive for staff to buy the company's shares. Even with David's strong philosophical commitment, he remains at the end of the first decade of trading the majority shareholder, with just over 53% of the stock.

This will pose a problem when David (now sixty) wishes to retire, at which point he is likely to want to extract at least some of the value locked in his own shareholding in the firm. He says that Quintessa is currently storing up reserves to help facilitate this, although as he wryly points out he will be being paid partly with his own money. "The preferred solution might be a fresh start, where the shares were totally owned by a Trust and where there weren't individual shareholders. But getting from here to there is very difficult," he says. And he is critical of a 2003 change in the tax rules that prevents companies from making tax-free transfers to employee benefit trusts. "Someone in government has to think about this more, and help facilitate the employee ownership model," he adds.

In general, he has absolutely no regrets about structuring Quintessa as an employee-owned company. He argues strongly that at present too much of the reward of business goes to the investor rather than those undertaking the work. "People who start businesses deserve a bit more than people who don't, but at present the whole thing is out of kilter. It doesn't make sense, particularly as we move to a knowledge economy. The capitalist system in the twenty-first century needs to adapt, and be more fair in the way it operates," he says.

"I went to the accountant and said I was going for employee ownership and he advised me not to do it. The bank manager too said, 'are you sure you want to do this?'"

E. The employee-led route to public service delivery

GLL

CONTEXT

- **Management of public leisure centres**
- **Established 1993, as an Industrial & Provident Society**
- **Employees on permanent contracts encouraged to be members of society**
- **Majority employee representation on Board**

The success of Greenwich Leisure Ltd (GLL) demonstrates that employee ownership offers an effective route for services formerly delivered by the public sector. Today, GLL is a major player in the management of leisure centres and leisure facilities across London and South East England. Its turnover is £70m (and growing annually), and the organisation employs 1,400 employees on permanent contracts, as well as nearly 3,000 seasonal, sessional and casual staff.

With some justification, GLL claims that it is London's most successful social enterprise. For GLL's managing director Mark Sesnan, there is one simple explanation for his organisation's achievement. "The reason why we're the most successful social enterprise is because of our staff-led structure," he says.

The GLL story began in 1993 when severe local authority funding pressures appeared to be about to devastate the ability of the London Borough of Greenwich to operate its leisure centres. The solution, devised in collaboration with the local authority, was to set up an autonomous not-for-profit enterprise, which would take over running the centres from the Borough's own in-house team. GLL was established as an Industrial and Provident Society, the form of legal incorporation most frequently used for consumer and worker cooperatives. Its eighteen member Board was designed to give representation to all the new enterprise's stakeholders. Eleven board members were elected directly by the employees, and other board members included three Greenwich councillors, a trade union representative and the managing director. In another innovative twist, members of the public using Greenwich's leisure centres directly elected two board members.

Because of a quirk in the way in which business rates relief could be claimed, the creation of GLL effectively meant that the threatened £400,000 cuts in Greenwich's leisure service could be circumvented. But GLL rapidly went on to demonstrate that it was much more than just a convenient solution to local authority funding problems. In particular, Mark Sesnan has been concerned to see a distinct GLL culture developing, based on a non-confrontational management approach and on staff engagement, in contrast to the often difficult approach to labour relations in some local authorities.

GLL has also rapidly developed beyond its Greenwich origins. It currently holds the management contracts for leisure centres in fourteen local authority areas, although it has deliberately restricted its growth to London and the immediate surrounding area. Its target is to increase its tally of 70 leisure centres and £70m turnover to 100 centres and £100m turnover by 2012, and it is actively engaged in work towards the London 2012 Olympics. "Our ambition is to get the social enterprise message within the Olympic Park, and on to the world stage," Mark Sesnan says.

The original Board structure has remained fundamentally unchanged during this period of growth, though GLL has instituted local Boards for many of the other authority areas it operates within, which have a degree of autonomy. GLL membership is open to all the organisation's permanent staff, wherever they are based, in exchange for a one-off £25 membership payment. To become members, staff have to agree to move to GLL employment terms and conditions, which may be more flexible than the former local authority employment terms. There is also a year's qualifying period of employment for membership.

The GLL target is to have at least 50% of permanent staff in membership, although as Mark Sesnan points out this can be challenging as GLL takes on new contracts in completely new areas. Currently about 53% of eligible staff have chosen to join (sessional and casual staff are not eligible for membership).

Elections for the staff members on the Board are held each year at the GLL AGM. "You have to be at the AGM in order to vote. We probably get about 60%–70% of our members attending – certainly there are quite a few hundred there each year," Mark Sesnan says. Elections are typically keenly contested, and include a hustings session. Directors serve three-year terms, with a third retiring each year. Mark Sesnan adds that GLL does what it can to ensure that the composition of its Board comprises a good cross-section of people, with appropriate gender and ethnic representation.

He is convinced that the presence of people on the Board who are directly employed by GLL gives his organisation an edge over companies with non-executive directors from outside their business. "All the Board and senior management go away once a year for two or three days, to look at the plan and budget for the year. The business plan is hammered out, and then the corporate plan is produced," Mark says.

Expansion beyond Greenwich means that GLL relies on electronic communications to reach its employees, and the organisation has followed John Lewis's approach in establishing a regular newsletter which is not simply a management tool and which is open for critical comments. Once a year, GLL also brings together all permanent staff for a major conference, held in the Dominion Theatre in London's West End. "The conference is important for us, and we get all our partner councils to arrange for their leisure centres to close on that day," Mark Sesnan says. The 2008 conference focused on a series of short presentations by each staff team, discussing their working situations and responsibilities.

For Mark Sesnan, GLL is proof of the advantages of staff-led enterprise. His organisation faces a potentially difficult problem, however, as the result of an unintended outcome of the recent Charities Act that will see Industrial and Provident Societies for the first time regulated directly by the Charity Commission. Charity trustees have, under traditional charity law, not been able to be employed by their organisation. Mark is now in discussions to attempt to maintain both GLL's charitable objectives and the principles of employee control.

"The reason why we're the most successful social enterprise is because of our staff-led structure."

F. The role of the Baxi Partnership

Baxi Partnership has played a unique role in the development of employee ownership in Britain. Since 2000, when the assets of the original employee-owned Baxi boiler company were sold, Baxi Partnership has used its £20m fund to support companies that decide to move into employee ownership.

As an investment vehicle solely dedicated to investing in employee-owned businesses it has provided a valuable source of patient capital to several enterprises, including businesses which would otherwise have gone under.

Baxi Partnership's highest profile investment has been in the Loch Fyne Oyster company, converted to employee ownership after the death of one of the founder owners. It is also an investor in UBH International and in Woollard and Henry, two firms described in more detail in this report.

In its first years of operation, Baxi Partnership's standard model has been to take a 50% equity stake in the businesses in which it is investing (it would also take up a non-executive board seat). In this it is not dissimilar to conventional venture capital funds.

Unlike venture capitalists, however, Baxi Partnership's governing document obliges the organisation to operate for the benefit of the employees in the companies in which it has invested. The remainder of each company's shares are required to be in the hands of the employees, either collectively through an employee benefit trust or individually.

Baxi Partnership's managing director, John Alexander, explains that his organisation's 50% stake is a way of protecting the concept of employee ownership. "We're about businesses staying as employee-owned for all time, with no ability for the business to be sold – barring circumstances of economic necessity," he says. He also stresses that the companies Baxi invests in must be genuinely employee owned.

"All employees should have the right to own shares in their company. It might be that they decide they don't want to take up that right – but the right is crucial. A hundred-person business where only five employees are the shareholders isn't employee-owned."

Baxi Partnership Ltd now employ a variety of investment models but the commitment to genuine employee ownership underpins each one.

Although Baxi Partnership's capital fund has been highly important to the companies in which it has invested, the original £20m is now partly committed and the fund size is in any case small for major financial restructurings.

In the past year, Baxi has been developing a new strategy to leverage mainstream funding for employee ownership businesses. The challenge, as John Alexander explains, is that most unsecured capital comes in as equity and as such usually fatally damages the possibility of employee ownership.

"We have set ourselves the task of creating deals with external funding which do not jeopardise the ownership structure," he says.

The good track record of employee-owned businesses in terms of employee motivation, productivity and profitability make these companies potentially attractive for investors, he adds.

Baxi Partnership's longer-term aims are to establish a Venture Capital Trust for employee ownership businesses, and to run an ethical investment fund, primarily geared for the investment needs of pension funds.

With the creation of its own consultancy arm, Baxendale, Baxi Partnership is also looking to help employee-owned businesses in other ways.

"You can't just shove money in and expect employee ownership to work. We are giving far more effort now to working with employees, providing training in the role of trustees or elected directors on Boards, working with owners who are staying on or with managers who may feel threatened, helping to look at management techniques which work for employee ownership," John Alexander says.

There is recognition, in other words, that a top-down financial transaction that leads to employee ownership on paper by itself is not enough: work also has to be undertaken to make employee ownership work effectively in the day-to-day operation of the business.

Baxendale's consultancy work is also geared towards helping owners of small family businesses looking to explore exit routes and business succession arrangements.

John Alexander anticipates that Baxi Partnership's investments in particular employee-owned businesses will increasingly be time-limited (already one early investment is being restructured through an equity-to-debt deal, for example). The Baxendale consultancy service, by contrast, will be available at all stages of a business's development as an employee ownership venture.

G. Issues in business transfer to employee ownership

Some readers may have been surprised not to find among the ten case studies in this report the one company that, for many, typifies the concept of employee ownership. The John Lewis Partnership has an enviable place in British retailing – its department stores and Waitrose chain of supermarkets consistently make it one of the sector's most profitable operators. But it also has a deserved reputation for the way in which its employees – the "partners" in John Lewis parlance – are engaged in the business's affairs and are rewarded with a share of the firm's profits.

The John Lewis Partnership owes much of its continuing success to the principles of its founder John Spedan Lewis, who handed over control and ownership to an employee trust in two settlements in the early years of the business. As part of these transactions, the Partnership drew up its own constitution that includes the famous sentence "The Partnership's ultimate purpose is the happiness of all its members, through their worthwhile and satisfying employment in a successful business".

It is perhaps true that, for every company which is moving towards employee ownership, it helps to have a John Spedan Lewis figure, to act as a champion for what is still an unusual form of business organisation. Nevertheless, as this report makes clear, there are many different ways to create employee-owned businesses. The John Lewis approach is a powerful one, but not the only choice.

In particular, advocates of employee ownership are keen to make the point that **this is not a business model that requires owners to give away their businesses to their employees.** In fact, even John Spedan Lewis, when he first set up the Partnership and enshrined the principles of profit sharing in 1929, did not at that point gift his shares in his business to the Partnership – the arrangement gave him the right to be paid back. But there is a lingering myth that employee ownership inevitably has to be linked to an act of philanthropy.

This may be the case, as the story of Herga demonstrates. Herga has benefited from Peter Tracey's decision to gift his personal (majority) shareholding in the business, in that it is able to trade without the requirement to service excessive business debt. But the Herga example, whilst inspiring, is not necessarily typical. For each Herga there are many others where business owners have successfully transferred their business to employee ownership, whilst not denying themselves the reward for the capital stake they have built up.

Finding the finance

It is appropriate at this point to say something more about the finance options for businesses considering a transfer into employee ownership. There is, of course, a certain difficulty here that we need to tackle head-on. Equity capital, by definition, involves taking an ownership stake in the business, which immediately challenges the very concept of employee control. Loan capital, by contrast, leaves share ownership unaffected, but can leave a business burdened with the on-going requirement to service the debt. Too much borrowing of this kind can leave a previously successful venture weakened and potentially unprofitable.

In practice, imaginative ways are being found round this dilemma. The employee ownership sector in Britain is certainly fortunate to have Baxi Partnership's investment fund available (see page 28) – Baxi effectively introduces equity capital into an employee-owned business, but because of its own objectives, does so in a way that permanently safeguards the element of employee ownership. The only drawback (apart from the element of extra complexity which Baxi's share stake creates) is that the fund which Baxi has available is relatively limited in size. The organisation's new strategy to explore ways to leverage mainstream funding into the sector will be watched carefully by many, not least mainstream lenders who certainly should be taking an interest in the commercial possibilities which successful employee-led businesses offer.

There may be a certain satisfaction in having 100% of a business's share capital fully employee-owned, but these case studies demonstrate that this is not an essential condition for businesses to be effectively in employee ownership. **There are several examples where a majority of the shares have been passed into employee control, leaving a minority of the shares held elsewhere, typically to be bought back over a period of time.** Provided the existing shareholder(s) are happy to wait – and many previous business owners are willing to maintain a continuing link with their old firm – this provides a welcome way of avoiding the pressures which can come from an attempt to recapitalise a business at a stroke. It means that future business profits can be employed to buy out the residual shareholders gradually. This is the route being followed in companies such as CPCR, as well as in Herga, where a minority stake remains with a family trust.

Other employee-owned businesses have looked to bank borrowings or other loan finance to help recapitalise a business on the exit of the former owner. This was the decision taken at Parfetts, for example, where the firm's bankers came on board with a fifteen-year funding package.

Notwithstanding these various solutions, existing owners and shareholders in a number of cases have agreed as part of a move towards employee ownership to sell their stakes at a discount to market value. This approach helped broker a deal at CPCR, for example, and it has also been the case at Parfetts. An element of flexibility over share value certainly can help in a business transfer situation, and those selling a business need to have a realistic approach when valuing their stake. It is appropriate for exiting founders to remember, for instance, that their company may well lose some of its value the moment that they step out of the picture. Certainly, the more the value of a business is linked to its human capital – as in the case of businesses in the knowledge economy – the more possibility there is of that human capital simply moving elsewhere, leaving just a shell of a company behind. Business transfer in this case involves finding a solution that also satisfies the key workers left behind, so that they do indeed choose to stay.

Collective and individual share ownership

Studies often point out that there are two ways to achieve employee ownership: through collective holding of shares by an employee benefit trust (EBT), or through individual share holdings by employees themselves. These routes are sometimes described as the "indirect" and "direct" approaches and historically there has been a philosophical debate about which method is the more principled.

In practice, as we have seen, many employee ownerships choose to combine both approaches, with some shares held collectively by an EBT whilst others are made available to individual employees (often through a tax-efficient method such as a Share Incentive Plan – see appendix 3, page 37).

Nevertheless, whilst the distinction between collective and individual ownership often becomes blurred, there are real issues to address here, and advantages and disadvantages in both approaches to consider.

Companies such as John Lewis (and Parfetts, CPCR and Herga in this report) that have chosen to opt for collective share ownership have the advantage of a structure that should provide permanent protection for the principle of employee ownership. Once established, the company remains permanently in the control of the employee benefit trust (or at least for as long as the underlying business remains profitable).

As Steve Parfett points out, this approach has the benefit of being simple to explain and to understand. It also means that all employees are party to the arrangement, something that is not necessarily the case when staff hold individual shares. Interestingly, David Hodgkinson at Quintessa now wonders whether, ideally, his own firm might have been better structured in this way, rather than through the direct share ownership route he chose when Quintessa was first established.

There are, however, disadvantages to the collective ownership approach. As a result of changes introduced by the Finance Act 2003, companies no longer benefit from corporation tax relief if they contribute shares to an employee benefit trust, where these are to remain held by the trust collectively.

This change in the tax regime, introduced to prevent a tax avoidance ploy in the City, has been criticised by many in the employee ownership sector. It was the focus of comments by the All Party Parliamentary Group in their 2008 report *Share Value*: "The impact of the change is that it has made the financing of employee benefit trusts considerably more expensive for businesses considering the creation of a co-owned enterprise... It has also undermined one of the key foundations of many employee owner structures." **The Employee Ownership Association is continuing to lobby the Treasury for a solution to this issue.**

An employee-owned business has much to gain by offering staff the opportunity to hold their own options and shares, particularly in sectors where such options are a traditional part of the overall remuneration package. This is clearly the case with investment management company Martin Currie, and it is likely to be true too for consultancies and other businesses dependent on knowledge workers.

Advocates of the "direct" route to employee ownership through individual shareholding maintain that it provides a clear way for employees to feel a part of their company, and to benefit, too. Mike Thompson of Child Base describes the effect of dividend cheques on employee-shareholders. Shares (including, if desired, free shares and matching shares, funded by the company) can be distributed to employees through the tax-efficient mechanism of a Share Incentive Plan. There can also be access to other tax-efficient arrangements, such as the Save As You Earn share option scheme.

Individual share ownership can also be a way of raising capital. It was the method chosen by the workers at Universal Bulk Handling, the predecessor to UBH International, when – as reported above – ninety of them each agreed to contribute £5,000 in order that their business and jobs could be saved.

However, employee ownership companies that choose the direct route of individual shareholding need to ponder the future implications of this approach, in particular, the need to pass company shares down through different generations of employees. It is generally considered good practice to require employees who retire or leave to sell their shareholding (sometimes after a period of grace). A rule of this kind helps preserve the essence of employee ownership, and prevents the shares from gradually passing into the hands of external shareholders.

Nevertheless, this means that a type of business transfer situation can arise every time an employee with a significant shareholding in the business comes to retire or leave the firm. Particular problems occur if a company has performed well and share value has increased markedly, when a sizeable capital injection may be needed to buy out the shares from the member leaving – one beyond the financial reach of younger employees, who might otherwise be the obvious purchasers of the shares. As we have seen, this became a somewhat thorny issue at CPCR and was also a dilemma at Martin Currie. Martin Currie's interesting solution – one of a number the firm considered at the time – was to agree to a dilution in the 100% employee-ownership of the business by selling a 24.9% stake to outside investors.

It is clear, therefore, that within the overall family of firms that would accept and identify with the employee ownership term lie a wide range of different ownership structures. **The diversity reflected in the wide range of sectors represented is mirrored by the equal diversity in the routes companies have chosen to become employee-owned.**

Employee engagement

There is a risk in concentrating too much on formal legal structures, however. Just as important is the way that, hopefully, the principles of employee ownership are carried through into the culture and daily life of the business.

Professor Jonathan Michie, who has looked at this issue for the Employee Ownership Association, has talked of the feeling of "psychological ownership" which can come in employee-owned firms. He has written: "The extra effort that a committed and motivated employee may make is referred to as 'discretionary effort', since it is the additional effort that may be produced at the discretion of the employee, in the sense that 'going the extra mile' cannot be made an enforceable requirement.… It refers to the sort of contribution that a motivated workforce will put in because of the psychological rewards that will be derived from contributing to what is believed to be a collective effort to achieve shared goals and outcomes".

A 2006 survey of 96 co-owned businesses (summarised in the report *Good Business*) certainly found that employee-owned businesses believe that the top advantage they gain from their ownership structure is extra staff commitment. More than nine in ten of the firms surveyed identify this as an advantage. In addition, more than 80% said staff are prepared to take on more responsibility, 72% said employees tend to work harder, and 67% believe that their workers are more creative as a consequence of their firms being employee-owned.

This sounds encouraging, and it also appears to be backed by other studies carried out by academics, particularly in the US but also in Britain and Japan. The handbook *Shared Company: how employee ownership works* available from the Employee Ownership Association identifies several corporate advantages of employee share ownership, including higher rates of productivity, greater innovation and lower staff turnover. *Shared Company* also suggests that customer loyalty can be greater.

But the caveat seems to be that **benefits such as these apply reliably only if the formal element of employee ownership is combined with participative management.** This is the point made by John Alexander from Baxi Partnership (page 28) when he comments that: "You can't just shove money in and expect employee ownership to work."

It is the same point made by several of the business leaders interviewed in the case studies. Steve Parfett talks, for example, of the series of thirty or more meetings he and his colleagues held with Parfetts staff during a hectic fortnight in early 2008 and Richard Chatham did something very similar a short time earlier when Herga became employee-owned. There is clearly a particular challenge if, as is often necessary, the transfer into employee ownership is a top-down initiative led by an owner and/or senior management. Often, too, the details of such a deal will have been thrashed out behind closed doors, in a forum where staff are not represented. The task afterwards is to make employee ownership real, and to demonstrate that it does make a difference in the culture and daily life of the business.

Forms of formal employee participation

Different employee-owned businesses choose to adopt widely differing ways of representing employees in formal management structures. Some companies have chosen to have directly elected employee representatives on their Boards. Mark Sesnan of Greenwich Leisure Ltd (GLL), where staff-elected directors constitute a majority of the Board, argues that it is the fact that its Board is staff-led which has given it particular strength. Of the other case studies here, UBH International and Woollard and Henry are among those who have employee elected representatives on the main company Boards. Such an idea may seem highly unusual for mainstream UK business (although it would seem much more natural for an audience of German business leaders), but reflects the fact that shareholders' and employees' interests are one and the same. There is no implication of any change in the key principle that, whilst the Board oversees the strategic development of the company, senior management's role is to manage.

The role of the Employee Benefit Trust (EBT) varies widely, too. For some firms, the EBT is the central forum for the expression of their employee ownership status, with some of the trustees directly elected by the workforce. For other employee owned businesses the EBT is simply a necessary legal entity, performing a purely mechanical task in distributing shares or facilitating an internal share market.

In this respect too, **there is no one "correct" model which employee ownership companies are obliged to adopt.** In each case, structures can be developed which suit the particular circumstances of the business. There may well be value, however, for employee-owned firms to have in place mechanisms for measuring the success or otherwise of their strategies for employee engagement. It would be possible to develop a number of key performance indicators in this respect. GLL already informally attempts to maintain a minimum 50% rate of take-up of membership by permanent staff. Other indicators could be the degree of interest in contested elections for trustees or Board members, the number of staff holding shares, or the numbers attending company AGMs or EBT meetings. Benchmarking between employee ownership firms in these respects might be a valuable management tool.

A successful employee-owned business, where staff are actively engaged and involved, is a business that should gain a healthy performance dividend. Its reward should be there for all to see, in the profit and loss account and balance sheet. But there are other reasons for choosing this route.

Work is a central part of our lives, a key part of being human. It does not hurt to make the work experience as pleasant as possible for all, and whilst employee-owned businesses are, correctly, concerned to focus on the business case, a little idealism can perhaps be allowed as well. As CPCR have put it in their new constitution, adopted – with half an eye on the John Lewis Partnership's similar document – to mark their conversion into an employee-owned venture: "The Partnership's mission is to create a better world of work. The Partnership values courage, excellence, happiness, learning and prosperity for the partners and our clients."

H. Appendices

Appendix 1: Checklist for business transfer into employee ownership

This checklist is designed particularly for owner-managers and family businesses considering business transfer options.

Forward planning

Consider business succession issues in good time. What key future events (for example, retirement) can you already anticipate, and how can you prepare for them?

Informal discussions

Talk through the options as appropriate with other shareholders/family members. What are the aspirations of your key senior management team?

A clean break or continuing links?

Are you looking for a clean break with the business, or would you welcome on-going involvement, for example by switching roles to become the non-executive chairman? Will you require an exit route that realises all your capital at once, or is a phased withdrawal of capital desirable/appropriate?

Tax implications

Take professional advice, particularly in relation to Capital Gains Tax.

Consider all options

Explore with your professional advisers all business transfer options. What are the prospects for a trade sale or MBO? How much would a sale realise? What would be the likely implications for the future of your business (for example, relationship with existing clients, reputation, company name, location, staffing), and are you happy with these? Weigh up at the same time the advantages and disadvantages of a transfer into employee ownership.

If employee ownership is a possible option, seek specialist advice from EOA or the Baxi Partnership.

Management engagement

When assessing employee ownership as an option, consider the views of your senior management team; they will need to be happy with what is being considered.

Direct and indirect employee ownership

If the decision is taken to proceed towards employee ownership, what form appears most appropriate? Will shares be held collectively, individually or in a combination of the two? What role will the Employee Benefit Trust (EBT) play? Will tax-efficient share ownership schemes (such as Share Incentive Plans) be used? Are there existing employee ownership companies which you can visit or use as models of what you hope to achieve?

Raising capital

If implementing an employee ownership transfer, what capital needs to be raised in order to buy out existing shareholders? Where can this capital be found? Can the process be staged over a number of years? The best option is for shareholders to convert equity to debt, and to be paid interest over the period that this debt is slowly and flexibly paid out, for example, as at Tullis Russell.

Legal changes

Are changes to your memorandum and articles necessary? What sort of rules should the EBT have, and should there be space for a set of employee ownership principles?

Employee participation and engagement

What strategy do you need to develop for employee engagement in a transfer to employee ownership? Do you need specialist advice in this area?

Appendix 2: Useful sources of information

Two Organisations

Employee Ownership Association

www.employeeownership.co.uk.

Mezzanine 2, Downstream Building,
1 London Bridge, London SE1 9BG
+44 (0)20 7022 1960
info@employeeownership.co.uk

The EOA is the business association representing enterprises substantially or majority owned by the people who work in them. It has approaching 80 member firms, including a majority of the UK's largest co-owned companies, including Europe's largest single-entity co-owned corporation, the John Lewis Partnership.

Baxi Partnership/Baxendale consultancy

www.baxipartnership.co.uk,
www.baxendale.co.uk

Evans Business Centre, Pitreavie Business Park,
Dunfermline,
Fife KY11 8UU.
+44 (0)1383 749670
mail@baxipartnership.co.uk,
support@baxendale.co.uk

For more information, see page 28

Six publications

Structuring Employee Ownership: a guide to trusts, shares and tax help for employee ownership

by Robert Postlethwaite, published by Employee Ownership Association, 2009

Making Employee Ownership Work: a benchmark guide

by Sarah Silcox, co-published by Employee Ownership Association and Baxendale, 2009

Share Value: how employee ownership is changing the face of business

Short Inquiry, the All Party Parliamentary Group on Employee Ownership, May 2008

CoCo Companies: work, happiness and employee ownership

by Richard Reeves, published by Employee Ownership Association, 2007

Shared Company: how employee ownership works

by Robert Postlethwaite, Jonathan Michie, Patrick Burns, Graeme Nuttall, published by Job Ownership Limited (now EOA), 2005

Passing the baton – encouraging successful business transfers

published by the Small Business Service (DTI), 2004

(All publications except 'Passing the Baton' can be downloaded from the EOA website, www.employeeownership.co.uk)

Appendix 3: Some tax-efficient share schemes

There are currently four principal ways in which shares can be offered by companies and acquired by employees in tax efficient ways. Details of these plans can be accessed at http://www.hmrc.gov.uk/shareschemes/employer_schemes.htm. Companies are advised to take professional advice before establishing plans.

Share Incentive Plan (SIP)

Share Incentive Plans offer tax and national insurance (NI) advantages. There are three main types of SIP awards that can be used:

- free shares: employers can give each employee free shares worth up to £3,000;

- partnership shares: employees can buy company shares worth up to £1,500 each tax year out of their gross pay (that is, before tax and NI); and

- matching shares: employers can give matching shares at a ratio of up to two matching shares for each partnership share bought by the employer.

Various combinations are possible; company dividends up to £1,500 each tax year can also be used to buy further shares in the company (so-called dividend shares).

Share Incentive Plans must be open to all employees, though the number of free shares allocated to employees can vary on the grounds of remuneration, length of service or hours worked. Performance conditions are also possible, as long as this complies with the SIP legislation.

Companies can require employees to give up some or all of their free or matching shares, if they leave, for certain reasons, within three years.

Shares are distributed via a special SIP trust (HMRC makes model trust deeds available). Shares allocated to employees must normally be held in this trust for the first five years, to ensure the income tax relief.

There is provision for companies to receive immediate relief against Corporation Tax if at least 10% of a company's share capital is transferred to a SIP trust. These shares must ultimately (within ten years) be fully transferred to employees.

More information on SIPs can be found at: http://www.hmrc.gov.uk/shareschemes/share_incentive/sip-guide-employers-advisors.pdf

Save as You Earn (SAYE) share option scheme

Approved savings-related share option schemes are established by employers, and offer employees the right to exercise an option to purchase company shares, using the proceeds of a linked special Save As You Earn savings account. Approved schemes must be open to all employees on similar terms (though participation is not obligatory). The maximum monthly savings allowed is £250, and the set savings period is either three or five years, with a provision for the savings fund to be held for another two years.

The price at which shares are bought, if the option is exercised, is set at the start, and can be no more than 20% below current market value. Options can be exercised within six months after the end of the three, five or seven year term, providing the employee is still an employee. (Options do not have to be exercised, and would normally not be if share values have fallen).

Employees do not pay income tax when the option is first received, or, in most circumstances, if it is exercised to buy shares. Capital Gains Tax (CGT) applies on gains made if shares are subsequently sold.

The employer can treat gains made by employees as a tax-allowable expense for Corporation Tax purposes.

Company Share Option Plan (CSOP)

By contrast with SIPs and SAYE share option schemes, the Company Share Option Plan gives employers the opportunity to offer options in company shares to selected employees, rather than to all employees. CSOPs are limited to share options worth no more than £30,000 per employee.

With a CSOP, any gains in share value during the period since the options were granted are not subject to employee income tax or NI, as they would be in normal circumstances. A potential CGT liability remains when these shares are finally sold.

The employer can treat gains made by employees as a tax-allowable expense for Corporation Tax purposes.

Enterprise Management Incentives (EMI)

EMI is available for companies whose gross assets are no more than £30m and which have fewer than 250 employees. Companies must be independent and operating mainly in the UK and certain business sectors are excluded.

Individual employees may be granted options over shares worth up to £120,000, and there is a maximum for options granted under the scheme of £3m. There must be a right to exercise the option within ten years, though options can be exercised later.

Tax and NI is not payable by the employee on gains in the share price between the date of grant of the option and its exercise (unless the option exercise price is below market value at the start). CGT is payable when shares are finally sold.

The employer can treat gains made by employees as a tax-allowable expense for Corporation Tax purposes.