BEGINNING THE EMPLOYEE OWNERSHIP JOURNEY

Stephens Scown®

Employee ownership

Exploring the benefits – and challenges

One of the biggest challenges facing today's businesses is the need to engage, motivate and reward staff, while at the same time driving business performance.

For many organisations, the employee ownership model is an increasingly attractive option. It's not hard to understand why. When accompanied by real employee involvement and effective strategies to enable staff to participate in the business, those companies that embrace employee ownership generally produce superior performance and productivity.

In May 2016, Stephens Scown became the UK's first large law firm to embrace employee ownership. It has brought huge benefits to our business. Since then, we've helped other organisations to successfully navigate the same journey.

If you're thinking about introducing employee ownership into your business, few law firms are as well placed as Stephens Scown to advise and guide you through the process as smoothly as possible, minimising the risks and giving you the information you need to make the right choices for your business.

Stephens Scown®

Tangible Benefits

The business case for employee ownership

The benefits of employee ownership stretch beyond engaged staff and happy clients: they can be also be seen in improved business performance, even in testing times.

Between 2010 and 2017, employee ownership increased by 60 per cent in the UK. Half of all employee-owned companies operate in professional and business services, with a further 19 per cent in manufacturing.

It's not hard to understand why more and more organisations are choosing employee ownership as the best way to develop and strengthen their business. Proven benefits include:

Increased productivity
Productivity in the UK's top 50 employee-owned businesses rose 6.2 per cent in 2017, compared to a nationwide average of just 3.4 per cent.

Increased sales growth
In 2017, the growth in combined sales of the UK's top 50 employee-owned business outperformed the growth in GDP by 50 per cent.

Increased trust
The Edelman Trust Survey 2017 found that almost 60 per cent of respondents think employee-owned businesses are more trustworthy than businesses not owned by their employees. Forty-one per cent of UK adults claim they are more likely to buy products or services from an employee-owned business.

Increased resilience
Employee-owned businesses grew sales by 11.1 per cent in the last recession, compared to growth of just 0.6 per cent among non-employee-owned businesses.

Increased recruitment pools
Forty-four per cent of UK adults say they would be more likely to apply for a job at an employee-owned business, giving firms who take this route a much wider pool of potential recruits – perhaps because 80 per cent of employee owners are happy to recommend their organisation as a workplace.

Scownership definitely reflects the culture of the firm. It is a powerful motivator for staff and therefore has a direct impact on the growth and success of the business. We have a strong focus on client engagement, and I firmly believe that happy staff give better service, which results in satisfied clients.

Robert Camp – Managing Partner

CASE STUDY

Smile Together Dental CIC's story

Smile Together's employee ownership journey began in 2016 when it set up as a social enterprise and community interest company, having previously been part of the NHS.

Now with the autonomy to decide how to run its business, employee ownership offered Smile Together the chance to engage its people by giving them a greater understanding and more of a say in how the organisation is run.

Just two years since becoming employee owned Smile Together is already reaping the benefits.

Head of Marketing and Communications Tracy Wilson said: *"Many colleagues have worked here for a long time, so having access to financial information about the business and the opportunity to feed in ideas to the management team is a real change which they are embracing. Employee ownership also helps to differentiate us in a competitive national environment for recruiting dentists and other clinicians into Cornwall".*

Becoming an employee owned community interest company has allowed Smile Together to generate profits and invest surplus funds into programmes that benefit the local community. One example of this is its Brighter Smiles oral health programme in schools to help tackle preventable tooth decay. Another is its *#SmilesAtSea* initiative where a specialist dental team toured seaside towns and harbours across Cornwall and Brixham providing free dental treatment for fishermen and their families and further subsidised treatment with its Brighter Dental team as recommended by the dentist on the day.

Tracy adds: *"Whether clinicians or professional support colleagues, everyone who works in Smile Together is here because they care. Being able to invest our profits into our community to help those who need us most is a powerful motivator for us all."*

Employee ownership has seen Smile Together introduce a Staff Council, with representatives elected by their fellow shareholders. The group meets regularly to review policies, discuss fundraising ideas for the organisation's chosen charity, agree benefits for Smile Together's employee owners and feed ideas and concerns from colleagues to the management team.

Although it is relatively new to employee ownership, Smile Together has already been recognised for its work in the sector, receiving Highly Commended for 'Employee Owned Positive Impact of the Year' in the prestigious Employee Ownership Awards 2017.

www.smiletogether.co.uk

Understanding Your Options

Which model is right for your business?

If you're keen to embrace employee ownership, your first major decision is choosing the specific model that best suits your business.

There are three main forms of employee ownership:

- *Direct*
- *Indirect*
- *Hybrid*

All three have their own advantages and potential disadvantages, depending on your objectives, your priorities and the nature of your business. It's important to take time to understand each option, and the implications of choosing one over another, before making your final choice.

1. Direct (individual) share ownership

Under this model, employees directly hold shares in the company. Every employee can receive dividends, sell their shares, transfer their shares into an ISA or pension, and enjoy voting rights like any other shareholder. Many businesses also find this route attractive due to the tax breaks available for individual share ownership.

Benefits: Because they feel they have a stake in the company's success, employees in direct ownership schemes often feel particularly close to their business and do everything they can to help it succeed.

Best suited for: Companies with low staff numbers and turnover. Every shareholder (employee) can receive a regular share of the profits through dividends. They also have voting rights and can sell their shares for a profit if their value increases.

2. Indirect ownership

Company shares are held on behalf of employees as a whole in a trust. The trustee(s) is tasked with managing the shares in the best interests of the trust's beneficiaries – the employees. The trustee(s) cannot gain any personal benefit from the shares. This allows a long-term view to be taken, with the trust able to influence the company's direction to the employees' benefit.

Benefits: Employee cash bonuses (up to a certain value) can be paid free of income tax, providing the trust owns more than half of the company's shares. The possibility of a company takeover is also reduced, while employees feel they have a collective 'voice' through the trust.

Best suited for: Larger businesses with relatively high staff turnover. This model is often used by businesses looking to benefit employees over the long term through the trust influencing the company's direction, rather than individual employees earning profit from dividends or a rise on the value of their shares.

3. Hybrid ownership

By combining individual share ownership with a large number of shares held on behalf of employees in a trust, a business has the flexibility to provide some capital growth and an enhanced feeling of company ownership among employees. In general, the trust will own a controlling stake of the company.

Benefits: Employees can still receive dividends and exercise voting rights, while long-term employee ownership remains secure through the trust having a majority stake.

Best suited for: Companies looking to combine the benefits of direct and indirect employee ownership models.

Getting the Timing Right

When is it best to move to employee ownership?

Although the simplest way to establish employee ownership is to implement it from the very beginning of a business, relatively few organisations think that far ahead. Most organisations that introduce an employee ownership model do so with an already-established business.

Embracing employee ownership early, when share values are almost certainly to be low, has the benefit of avoiding tax complications. But for reasons such as founders retiring from or leaving a business, or because management recognises the need to more substantively engage a large workforce, employee ownership is an increasingly common direction being looked at by businesses with many years of successful trading.

Inevitably, introducing employee ownership into an existing organisation is more complicated. As well as deciding which model of employee ownership to pursue, you will also have to consider how much of the company you want to be employee owned, what the price will be, how the transaction will be financed and what the tax implications will be, for both employees and owners. If there are other shareholders in the business, it is also essential to gain their support for the changes.

Depending on which model of employee ownership best suits your circumstances, there are a number of key issues to consider.

Direct (individual) ownership

How will your employees secure their shares? Will they be given them, buy them, or simply be given the chance to acquire them in the future?

If your employees will be given their shares, there are tax implications. A Share Incentive Plan (SIP) could avoid your employees having to pay more income tax (and possibly national insurance, too). However, this comes with conditions of its own. In particular, it usually means that employees are not permitted to sell their shares for at least five years.

Alternatively, employees could be granted 'options' to receive their free shares in the future. This would defer their tax liability, but could mean that the liability increases over time, if the value of the shares increases by the time the employees receive them.

If you intend your employees to buy their shares, they will not face any tax liabilities (as long as they buy the shares at market value) – but they will face the challenge of raising the money to purchase the shares in the first places. Using an SIP can enable employees to buy shares and pay in instalments from their wages, with full relief against income tax and national insurance.

If your employees are granted to options to acquire shares in the future, it's important to take steps to guard against tax liabilities on the difference between what they pay for the shares, and what they are valued at. There are several ways of doing this, including Save As You Earn (SAYE) options, Company Share Option Plan (CSOP) options, and Enterprise Management Incentive (EMI) options.

Indirect ownership

Creating a trust requires a trust deed, which includes details of the trust's terms. These each require thought and consideration. How, for example, will the trust appoint its trustee(s)? And if limits are to be put on what the trust can do with its shares, what will these be?

Hybrid ownership

While there are few issues to address that are specific only to the hybrid ownership model, each of the individual concerns associated with direct and indirect ownership must still be addressed.

Things to consider

Whichever model you opt for, you must work through several fundamental issues before successfully implementing employee ownership. These include:

- [ ] Have your company's existing shareholders approved the plan for employee ownership?
- [ ] How will your employees acquire their shares?
- [ ] What conditions will be attached to share ownership (for example, what happens if an employee leaves the business)?
- [ ] Do you need to change your company's articles of association?
- [ ] Have you explained employee ownership – and its implications – to your employees? Do they understand?
- [ ] Have you told HMRC about any employee share ownership plan or trust?
- [ ] If you are opting for indirect employee ownership, is your trust's bank account in place?

7 Top Tips

How to avoid any nasty surprises when you embrace employee ownership

1. Research some other businesses that have already embraced employee ownership. What went well, and what could you do better?

2. Carefully consider your objectives and your business's situation, before deciding which employee ownership model is best for you.

3. Regularly communicate with employees about the business's financial situation. Remember, your employees are like any other shareholders: whether the news is good or bad, they should be told quickly and accurately.

4. Ensure you receive expert advice on the tax consequences of your chosen model before you make any final decision on which route you will pursue.

5. Do everything possible to avoid conflicts of interest, and pay particular attention to who you appoint as trustee(s).

6. Establish an independent remuneration committee to determine senior pay. This helps to strengthen transparency and maintain the support and faith of employee shareholders.

7. Always opt for simple arrangements where possible, and communicate everything you do in clear, easy-to-understand language. As shareholders, all your employees should always understand what is happening.

"I'm on a mission to show that a better way of doing business is commercially possible – and desirable,"

says Guy Singh-Watson, Riverford Organics

Grappling with Tax Consequences

What are the tax implications of employee ownership?

As a result of implementing employee ownership, employees, employee trusts, existing shareholders, and the overall business are all likely to face some kind of taxation consequences. These can often be mitigated through tax reliefs, but doing so is still going to require thought, effort and specialist advice from experienced professionals.

Employees

Using the indirect model of employee ownership will avoid most tax issues for your employees, although cash bonuses could still be an area of potential complication.

Under either the direct or hybrid models, employees could face new liabilities when they acquire or dispose of shares. However, these can often be relieved through SIP, SAYE, EMI or CSOP options.

Employee trusts

Income tax, capital gains tax (CGT) and stamp duty are all potential costs for employee trusts. There are, however, steps that can minimise those liabilities, such as basing the trust offshore, and a company making gifts rather than using a trust to pay dividends.

Existing shareholders

While the normal sale of shares would result in a CGT liability, specialist advice and guidance could reveal ways to reduce or avoid these costs. Existing shareholders looking to reduce their shareholding, or sell all their shares entirely, should seek professional guidance to explore and understand their options in full.

The business

Corporation tax relief is available to companies on a range of issues relating to shares in an employee ownership programme, including gains made by employees through the exercise of options. A business can also avoid employer's national insurance on the value of shares awarded under a SIP.

The taxation implications of employee ownership need not be onerous, but they will inevitably be complicated. You should seek advice from a specialist professional at the very start of your employee journey to avoid incurring unnecessary costs further down the line.

Our Story

Why – and how – Stephens Scown became the UK's first large law firm to establish employee ownership

On 1 May 2016, Stephens Scown created a small piece of history. After years of investigation, planning and preparation, we introduced 'Scownership' – an employee ownership scheme that breaks free of the traditional structures seen across the legal sector.

With more than 290 employees, including 50 partners, it was not a straightforward task. As well as engaging and enthusing our own staff, our ground-breaking initiative also needed approval from the Solicitors Regulation Authority (SRA).

Robert Camp, managing partner at Stephens Scown, says: *"No matter what role someone has, we're all part of the same team. That's why I wanted part of everyone's remuneration to come from an equal sharing of our profits."*

Inspired by the much-lauded John Lewis model, our senior management invested time and energy into letting staff know our plans and answering their questions. This allowed our employees to understand and buy into our vision.

Camp adds: *"One of the key benefits (of employee ownership) is that staff feel more engaged. It makes no difference if someone is in a fee-earning position or a support role: their contributions to the firm are equally important."*

As well as a positive reaction from employees and the wider legal sector, Scownership has also been welcomed by our clients, who receive better service from happy and motivated staff, and potential recruits, who are impressed by our common purpose.

You'll be in good company - they come in all shapes and sizes

John Lewis Partnership

Lush Fresh Handmade Cosmetics

Riverford Organics

Smile Dentistry

AB Architects

Gripple Ltd

Wilkin & Son – jam makers

Cambridge Weight Loss Plan

Barnard & Westwood - bespoke bookbinders

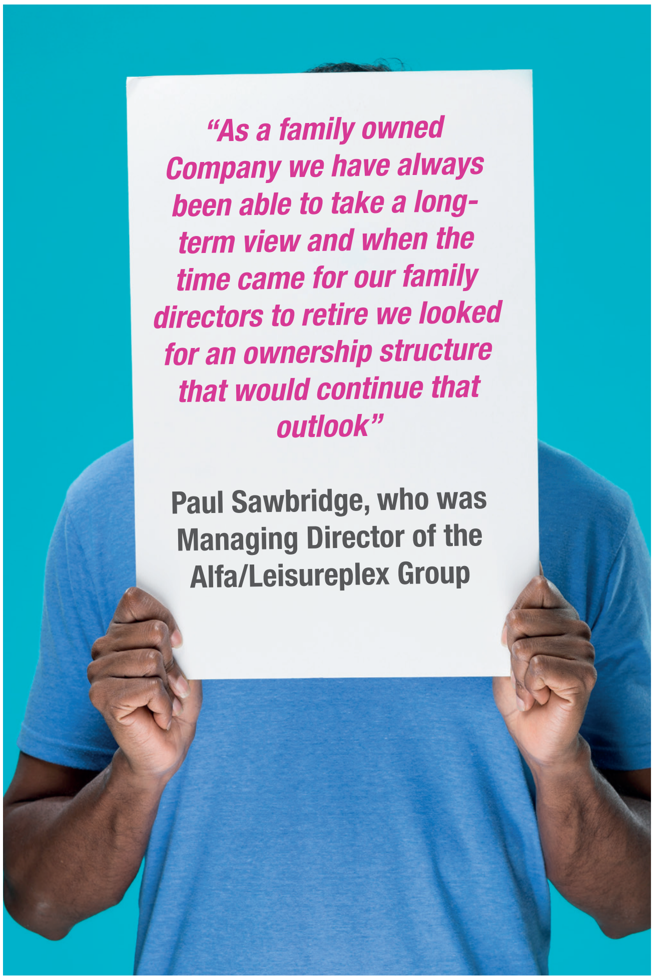
The Nuttall Group

Eagle Plant

Optimum Brasses Ltd

Clevedon Hospital

Alfa Leisure Complex



Tailored Support

Legal advice and practical insight for the switch to employee-owned status

Employee ownership is a significant step for any business. It's not something that should be rushed, either in the initial decision or its implementation. We know this, because we've been through the process ourselves.

Reports have found that employee-owned businesses frequently lead others in terms of employee engagement and satisfaction, and employee-owned businesses are now found in almost every sector of the UK economy.

According to the Employee Ownership Association, business operating under employee ownership models could deliver 10 per cent of the UK's GDP by 2020. However, employee ownership is better suited to some situations than others. Establishing employee ownership within a company, rather than a partnership or limited liability partnership, is often the most effective corporate setting.

As part of a pioneering legal firm, Stephens Scown's team of astute and knowledgeable lawyers can consider all aspects of employee ownership with the benefit of first-hand experience. We can also discuss how employee ownership impacts on staff engagement and customer service.

From the initial, exploratory stages of employee ownership through to securing staff support, rolling out the new model and managing its success on an ongoing basis, our team has years of involvement to call on – both internally, and with our clients across the country.

We advise businesses on the legal aspects of employee ownership, provide marketing and communications support as well as working with them to leverage EO through improved engagement with your people and customers.

- How to transition to EO
  - *Full single exit*
  - *Partial transition*
  - *Phased transition*
- Consultations on the most appropriate structure
- Advising on creating the structure
  - *Employee Councils*
  - *Business boards*
  - *Voting and representation*
  - *Governance*
- Zero Capital Gains Tax for Sellers
- Tax free bonuses for employees
- Advice on taking the business through the process once the decision is made
  - *Preparing the business agreements*
  - *Protecting the original owners*
  - *Developing the employee group(s)*
  - *Producing a communications plan (internal and external)*
  - *Improving staff engagement*
- Support the business going forward
  - *Professional Trustee*
  - *Company Secretarial*

GET IN TOUCH

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