EMPLOYEE OWNED

A guide to Employee Ownership

Stephens Scown an Employee Owned law firm

Stephens® Scown


Never be afraid
to do things
differently

CONTENT

Introduction

Employee Ownership has become headline news in the last few years. The media has followed with keen interest the succession of announcements that businesses like Riverford Organics, Richer Sounds and Aardman Animations have become Employee Owned. They followed in the footsteps of John Lewis, one of the most loved retailers in the British market, which had spearheaded Employee Ownership in the late 1920s, joined later by the likes of international engineering and design business Arup and Mott MacDonald.

Reports of greater employee engagement, surges in profitability and enhanced staff retention have piqued the interest of the media and in turn the owners and founders of businesses across the United Kingdom. Many business leaders are now asking themselves and their board: is Employee Ownership something we should be considering?

Productivity in employee ownership Top 50 has risen year on year – 9.7% in 2018 and 7.7% in 2019 compared to 0% growth for the latest UK productivity reports

2014 marked a key turning point in the interest in Employee Ownership. Tax changes introduced that year meant that owners selling their businesses to the employees through an Employee Ownership Trust, could benefit from zero per-cent Capital Gains Tax and the employees could share in the fruits of the companies profits without paying income tax on the first £3,600. Though it took some time for professional advisors to become aware of these opportunities (and some are still in the dark) a ground swell of interest has developed which has led to numerous companies successfully obtaining Employee Owned status.

While the tax incentives may have been the catalyst in moving Employee Ownership to the forefront of business discussion, it is the positive culture shift in the business, which in many cases is cemented by Employee Ownership, which delivers real growth and success for the business.

Employee Ownership is now becoming one of the fastest growing succession and growth strategies for ambitious companies that are looking to create a business model fit for the rest of the 21st Century.

Stephens Scown spearheaded the adoption of Employee Ownership by a law firm in 2016 and has since championed the growth of Employee Ownership. Stephens Scown advises and supports businesses across England and Wales in providing what we believe is the most comprehensive and insightful support to ensure that founders and their companies that choose to become employee Owned do so efficiently, effectively and ultimately successfully.

£30bn GDP the employee ownership sector contributes to the UK economy annually

69% of employee owned businesses are professional services or manufacturing companies

80% of employee owners experience a sense of achievement from their job

58% of consumers agree that employee owned businesses are more trustworthy

54% agree that it would be better for the UK economy if there were more employee owned businesses

80% of employee owners are happy to recommend their organisation as a place of work

Statistics from the Employee Ownership Association


Empowerment
= Growth and
Success

What is it?

In simple terms Employee Ownership is the sector of the business world in which the business has wholly, or in part, become owned by its employees. There is no strict definition of Employee Ownership and there are differences of opinion within the sector about what is "true" Employee Ownership. For some, a tangible shareholding in the Company by every employee is critical and that has certainly been successfully adopted by companies like Gripple. But for the majority of businesses, the simple arrangement whereby employees are the beneficiaries of a trust which holds shares on their behalf is sufficient, John Lewis, Riverford Organics, Aardman Animations and Richer Sounds being well-known examples.

The changes to the tax legislation in 2014 give the greatest clarity to the definition and it is arguable that any model of ownership of a company which qualifies for the beneficial tax treatments will be defined as Employee Owned.

To qualify under that definition, and which is therefore likely to be the critical point for most founders, the companies and ultimately their employees, must own more than 50% of shares directly or through a qualifying Employee Ownership Trust (EOT). Details on qualification are set out below.

Why consider it?

Employee Ownership has relevance to every business in every sector and a quick web search will almost certainly reveal an Employee Owned business in your business sector at all sizes of turnover and employee numbers. From architects to animators, retailers to programmers there is no sector which does not have a presence.

Size matters not either. The smallest have under ten employees with the largest operating in excess of 80,000 employee owners.

1

Succession without trauma

Invariably founders of a company will, in time, either wish to move onto other opportunities or take a well deserved retirement. For many years the options available were limited to a trade sale or sale to Private Equity, a management buy out or winding up. All of which have their significant drawbacks, be it the price chipping through the due diligence process, the personal debt concerns of the management buyout team or the inevitable redundancies which arise on a winding up (and to a lesser extent a trade sale as "synergies" are implemented).

Employee Ownership, by contrast, offers an appealing exit plan for founders without the need to find a buyer, without a heavy due diligence process, on a timeline that suits the owners, while securing the future employment of the employees. Add to that 0% Capital Gains Tax on the sale price (at market value) compared to the current 10% – 20% standard CGT rates on a sale and it is hard to see why Employee Ownership is not the No1 succession plan.

An emerging trend is for equity investors to utilise Employee Ownership as an exit opportunity, rather than looking for a trade sale.

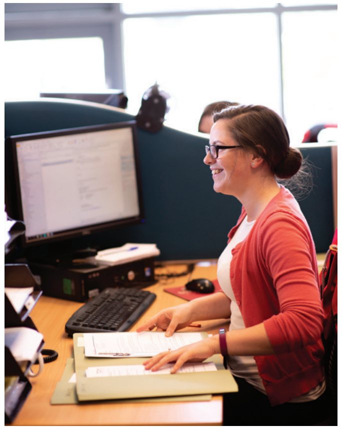
2

Growth Acceleration

Every Company that has become Employee Owned (even with a 10% shareholding) has encountered what is known as the "Whoosh Effect"; an unexpected surge in productivity as the Company becomes owned by its employees. Becoming an Employee Owner, it appears, has an empowering effect on employee engagement and their willingness to provide discretionary effort for the benefit of the business. There are few growth strategies which can provide a similar return for no significant outlay.

A number of founders who are not ready to retire, have sold a majority stake in their company to an EOT so that the fruit of any future growth in the firm is not simply enjoyed by them alone, but by every employee as well. Such a founder can honestly affirm that "we really are all in it together".

There are tax advantages for the employees as well. Once the EOT holds more than 50% of the shares in the company, the employees can share in the profits of the business and receive up to £3,600 each per year free of income tax, provided it is a payment arising from the profits of the business.



Build Back Better

Aside from the two core reasons outlined above it is also worth mentioning a shift in the tide of business caused by the dramatic events predicated by COVID19. The global pandemic has changed the face of business: the way businesses operate, the values embraced by companies and reinforced the notion for many business owners that things need to change.

In just over a decade, the country has experienced bank collapses, credit crunch, austerity, Brexit, and now a global pandemic requiring businesses to take unprecedented actions. All of which have been overshadowed by the fears and concerns of a looming environmental crisis.

These experiences and challenges have focussed the minds of many business owners and fostered a sense of needing to strive for better, for their business, for their families, their employees and ultimately the environment both locally and globally.

Informed and visionary business leaders have always wanted to ensure that their businesses are fit for the future and the mantra “people, purpose, planet” now resonates with many. Business does not need to be about profit alone; business can be a force for good, and profit with purpose can in fact deliver better financial results than chasing profits alone.

The rise of B Corporation status, purpose driven business and employee ownership are at the vanguard of business models that seek to meet the challenges of the next generation. In setting goals that support the environment alongside the business, in giving companies a belief in their purpose for existing and in giving everyone a tangible stake in the success of the business. Accordingly, if a third reason were needed to consider employee ownership – then it is as part of the “build back better” campaign to create businesses capable of addressing the state of the business environment now and fit to take a long lasting place in the future shape of commerce.

When to introduce employee ownership

There is no right or wrong time to consider becoming employee owned. Part of the beauty of succession through employee ownership is that the timing is completely in the hands of the founder shareholders.

For many owners, the timing is often aligned with a desire to take a step back from the business, perhaps to take a long overdue sabbatical or a missed "gap year" or spend time with growing families or aging relatives. The business itself, in such situations will likely be mature, often debt free and will either have a good management team or the makings of one. The founder will likely know all of the employees personally and will feel a strong loyalty towards them as an influencing factor in any succession plan. A step into employee ownership for this business will sit very comfortably with both the employees and the founders as being in everyone's interest.

For a founder looking at EO as a tool to help drive growth, this may well form part of a strategy that engages employees to help incentivise them to deliver the ambitions of a business plan. It could therefore form part of a business review and growth plan that benefits more than just the founder.

But EO is not limited to mature businesses and many companies are being organised as employee owned from day one, so that all participants share in the success right from the outset. EO is therefore available to all businesses wherever they are in the business lifecycle.

Added advantages for timing is that there is no need to await a potential purchaser or engage a broker or corporate finance team to approach competitors with the added costs of such an engagement and the business risks associated with making it known that you are "up for sale".

By contrast a trade sale or a Management Buy Out often arise as a consequence of an unexpected personal issue, an unsolicited purchase offer or a management team anxious to get going and they each bring with them their own timing agendas, meaning that a decision has to be made about whether or not to accept the offer even if the timing may not be perfect. However, in Employee Ownership, there is no one to force you to move forward meaning that it is easy to park the idea, missing the opportunity to begin to grow the business with the employees or indeed take some time to enjoy a partial or full retirement to do something for yourself and your family.

Timing is therefore wholly in your hands, just don't forget to begin it!

Timescales

Once you are content that Employee Ownership is the right step for you and your business, you can choose the length of the transition. It really is a case of finding a timescale that works for you and allows you to integrate the change to employee ownership while still having sufficient time to do the day job.

Unless there are exceptional reasons, trying to complete a transition to employee ownership in too short a timescale misses the opportunity to build engagement and excitement with your employees. In our experience, spending some time engaging with the employees helps to take them with you on the EO journey and means that the employees can get behind the process and relish the concept of being part owners of the business, delivering that magical discretionary effort long before completion.

We therefore recommend a timeframe of 6 – 12 months.

How is it implemented?

An employee ownership project has many similarities to a management buyout, but without quite as much stress, sweat and tears.

The reason for this is that an EO project does not have an adversarial approach with competing teams of lawyers, accountants and professional advisers battling it out to demonstrate flaws in the business and ultimately identify the “value” that they bring to the process.

The founders will sell the shares in the company to a qualifying EOT (see further below). As mentioned above, it is not necessary to sell all of the shares and it can be useful to retain shares for the benefit of the founder personally, or family members or a family trust. Retention of shares can also cater for direct ownership of shares by senior management where it is felt useful to have a direct capital stake in the company to help deliver strategic results. The value paid will generally be market value. Despite much media hype of companies being “gifted” to the employees, the vast majority are sold at market value determined by professional valuers. That said there are certainly one or two philanthropic owners who have chosen to take considerably less payment than the company was worth.

The sale price is documented as any sale would be, but taking account of differences in the nature of the EOT as the purchaser. Other adjustments are made to the company and its organisation to reflect its new status.

Payment of the sale price is a key element. If there is excess cash in the company this can be utilised to make an initial payment on completion. The balance of the price is then structured into a repayment plan by the EOT supported by the company (which it then owns). This might entail repayment terms of 5-10 years, because the payments will derive from profits of the company. It’s important that the repayment plan does not put undue pressure on the company as sufficient monies should be left with the company to reinvest and potentially make modest profit shares to the employees as part of demonstrating true employee ownership.

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

Interest may be chargeable on the purchase price, though it’s important to ensure that the interest payments do not add too much additional burden on the company in the early years. Bank funding is now available in the EOT world, though this has only recently come to the fore. It is likely that a lender would facilitate a modest amount of the purchase price (perhaps 50%) unless there were more tangible assets to secure debt against. One of the benefits of an Employee Ownership process is that the trustees of the EOT and the employees do not take on personal liability for the purchase price which is a major factor and stress inducing element in a management buy out where the management team may have to put personal assets at risk to facilitate the funding.

The Employee Ownership Trust

The Employee Ownership Trust is in many respects a trust like any other. In simple terms the trustees of the trust hold the assets of the trust for and on behalf of the beneficiaries as set out in the Trust deed. The assets will likely simply comprise the shares in the company.

However, to obtain the tax advantages outlined below, the trust must have some very specific features which then qualify it as a tax advantaged employee ownership trust. Those requirements are as follows:

- *All employees must be beneficiaries of the trust (however, this will generally exclude the founder(s)).*
- *The employees must be treated equally – there is no discretion to prefer some employees above others in respect of any profit share*
- *It is permissible to allow the trustees to allocate profit shares based on:*
    - *A multiple of salary*
    - *A flat payment*
    - *Pro-rating*
    - *Years of service*
    - *Qualification period*

The trustees of the trust will generally comprise a group made up of the founder, a representative of the employees and an independent trustee who is neither an employee nor a founder. The trustees will often be appointed to a company specifically formed for the purpose of being the corporate trustee of the EOT. This has advantages of simplifying the operation of the trust in respect of appointing and removing trustees while conferring a further level of protection from personal liability of trustees. It's important to note that the EOT does not run the company – that is for the directors and board of the company. The board of the company may report back to the EOT, but this should be limited to 3 – 6 times a year unless circumstances suggest a need for additional meetings.

The EOT may adopt the concept of preserving the values and principles espoused by the founder or alternatively a set of values determined by the employees. The EOT may expect to engage with the board about decisions which may have a significant bearing on the employees' working environment and welfare.

What are the tax benefits?

Providing the EOT holds more than 50% of the shares in the company and has more than 50% control, the following tax benefits arise*:

- *The shares sold by the founder to the EOT in the year that the 50% threshold is crossed will not attract Capital Gains Tax for the selling shareholders. The tax incentive is not capped and nor does it impact on Entrepreneur's Relief*

- *The employees can receive a profit share from the company and pay no income tax on the first £3600 each per year*

It is important to note that there are tax avoidance rules meaning that the CGT can be reclaimed if the company loses its majority EOT ownership in the year after becoming employee owned.

Is employee ownership a permanent step?

While employee ownership provides a great succession plan for an owner who wishes to cement their legacy and look after their employees, it is not limited to that path alone.

A number of founders have left the door open for the employees to choose to sell the business should an offer arise that is welcomed by the employees. This would likely require a significant growth in the business for it to be worth considering, but for smaller businesses that become employee owned it may be that such an option could deliver lasting financial security for all of the employees.

Direct share schemes

Alongside the EOT the company may still consider implementing direct shares schemes such as Share Incentive Plans and Enterprise Management Incentives. These can provide useful tools to allow the company to confer share options for key management personnel who may only be attracted to working at the business if they believe that they can take a share in the enhanced value that they help deliver.

***As at 1 November 2020**

Why Stephens Scown?

Stephens Scown LLP is a regional firm acting across the country for national and international clients. With over 50 partners and 300 staff across its offices in Exeter, Truro, St Austell and satellite office in London, we are one of the largest law firms in the South West and ranked in the top 150 in the UK.

EO - We talk the talk and have walked the walk!

Being the first law firm in the UK to become Employee Owned and full members of the Employee Ownership Association, we understand first hand what it takes to make a successful EO transition.

We have learnt a few lessons on the way as well and have learnt much from working with over 40 companies exploring and commencing EO projects alongside building national connections with long established EO businesses. We understand both the technical aspects of the journey, but perhaps more importantly, the core principles and underlying values, which drive the founders who choose employee ownership above all other succession options. We believe that EO has an important part to play in the future shape of business and it's our intention to provide the best support to companies taking that journey.

Our values

We believe that our values and culture sets us apart. We have an inclusive and supporting culture which is underpinned by behaviours to others and our six core values:

- *Dynamic*
- *Supportive*
- *Reliable*
- *Commercial*
- *Integrity*
- *Friendly*

We live and breathe our values and they are reflected in everything we do – from the people we recruit to the way we service our clients. The firm has been ranked for six consecutive years in the Sunday Times 100 Best Companies to Work For.

A high-quality service - going the extra mile

We independently benchmark our client service against more than 100 other legal firms in the country. We consistently come top in all categories, including result for fees, clear communication, and speed of response. And we're delighted that:

- *91% of clients are satisfied overall*
- *96% like the way we treat our clients*
- *89% would recommend our services to others*

We'll always listen to your comments and ideas – because we're genuinely eager to keep improving.

Case studies

Smooth Employee Ownership transition for Bluefruit Software

Technology organisation Bluefruit Software has enabled its employees to acquire 51% ownership of the business, using an employee ownership trust (EOT).

In October 2019, Bluefruit Software business owners Paul and Joanna Massey decided to take the leap and sold over half their shares to the people who made the firm such a success in the first place, forming an Employee Ownership Trust (EOT).

Having made the transition to an Employee Ownership model in 2016, the first law firm to do so, Stephens Scown was perfectly positioned to advise Bluefruit on the move.

Paul says: *"Having founded Bluefruit Software 20 years ago in my spare bedroom, initially working for myself, we continued to see growth and now employ 70 people, all of whom embody what makes Bluefruit such a fantastic place to work."*

"But despite all this success, people would frequently ask me, 'What's your exit strategy?' My answer had always been, 'There's no exit strategy, I'm going to work here forever.' I created the business to create an excellent workplace; I didn't create it as a way of selling out for a big payoff.

However, forming the EOT has now become part of my 'exit strategy', just not in the way most tech company founders think of their exit, and I'm not going anywhere else soon."

Employee Ownership offered two key advantages for Bluefruit owners Paul and Joanna Massey, who had borne the financial burden since launch: firstly, the business would be less financially reliant on the owners personally, and secondly it allowed Paul to take on a more technical role, which was a personal goal. For the business, it enabled the board to establish a success strategy to preserve the business and its culture in the long term.

Paul says: *"Thanks to superb legal and accounting advice, we were able to get to a point where we were ready to launch. The EOT means Bluefruit's future is no longer tied to mine – it's a way of the business surviving beyond me. Bringing the EOT together means that our clients are now dealing with a business that has the structure in place to be here for many years to come."*

www.bluefruit.co.uk

Employee Ownership success for international recruitment firm

International recruitment firm Damia Group is now 100% employee owned following its transition to an Employee Ownership Trust (EOT) with the support of expert legal advice from Stephens Scown LLP.

Established in 1995, Damia has its headquarters in Guildford, with offices in Edinburgh and Portugal. The specialist IT recruitment and IT managed services firm's 15 employees now own the business through an Employee Ownership Trust, and will all enjoy equal shares of its profits, as well as having a say in the business through the EOT.

"Employee ownership allows us to give our people a bigger stake in the business," explains Chris Bardoe, founder of Damia Group. *"Many of our team have worked with us for a long time, and some of them have been with us since the business was established. Employee ownership roots these jobs in the region for the longer term."*

The decision was supported by the knowledge that employee-owned companies which have a large and significant employee ownership stake now contribute £30bm to the UK's gross domestic product, according to the Employee Ownership Association.

Chris continues: *"This marks an exciting new chapter for Damia Group. Employee-owned businesses tend to excel in engaging employees, who in turn drive performance, innovation and service excellence, with the opportunity to share in the wealth they create. As well as rewarding our existing team and giving them the opportunity to shape the future of the business, we hope employee ownership allows us to attract even more talented new recruits to help us grow the business."*

Damia Group's EOT implementation, announced in August 2020, was advised by Stephens Scown in collaboration with BoardroomAdvisors.co, and was advised on the tax and financial aspects by Price Bailey.

www.damiagroup.com

Altec & Victoria preserve business legacy with Employee Ownership

Employee Ownership has provided an answer to the question of business succession for family-run firm, Altec & Victoria. The 25 staff of Altec & Victoria, a family-run business in Cornwall, now own 100% of the Group through an Employee Ownership Trust with the help of professional advice from employee-owned law firm Stephens Scown and PKF Francis Clark.

Altec & Victoria operate two businesses; Altec Extrusions is a manufacturer of tubing, extrusions and 3D printing filament, while Victoria Offices provides flexible office space plus conference and training facilities.

The business was originally started by current Managing Director Graham Honey's father in 1972 and Graham joined in 1985. As Graham began thinking about succession and his own retirement, he started looking into employee ownership.

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

Your key contact

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Christian is a Partner in our corporate and commercial team with more than 20 years' experience. He's recognised in both the Legal 500 and Chambers as a 'leader in his field' and is a Chambers Leading Individual for 2021.

Christian has extensive experience of corporate and commercial matters affecting the SME market and in particular advises in the following areas:

- *Employee Ownership (Christian contributed to the Ownership Effect inquiry led by Baroness Bowles of Berkhamsted & CBI panel on inclusive ownership)*
- *Business Transfer through share or asset sales*
- *Management Buy Outs*
- *Business Succession*
- *Shareholder and governance issues*

Christian is a trustee of the Stephens Scown EOT and an Independent Trustee of two other EOTs.

Outside of work, Christian is a Non-Executive Director of the Eden Project, former chair of I-sight Cornwall and chair of the Sir William Matthews Pension Fund.

He is a keen runner, cyclist, surfer, band member and sailor… if only time would allow.

Chambers 2019:
"always calm and measured with a very reassuring manner."

Legal 500 2018:
"A tough, results-driven negotiator', Christian Wilson has spearheaded the department's burgeoning employee ownership practice."

Chambers 2020:
"He is approachable and someone you can comfortably work with."

Legal 500 2020:
"Christian Wilson made what could have been a stressful and tedious process feel well managed and enjoyable. Not only incredibly professional but clearly a thoroughly decent individual who was a pleasure to spend time with during the transaction."


Sharing ambitions makes business sense
Empowerment = Growth and Success
One team
Never be afraid to do things differently
Stephens Scown