Each to their own

Granting staff a stake in your firm can not only be a good way of ensuring its continued viability after you exit, but can also make sound business sense as you're building it up. ***Peter Crush*** outlines why more firms are considering the concept

WHEN EAST LOTHIAN-based Simon Poole decided to convert his old campervan and kit it out with better fixtures and fittings in 2006, little did he know he'd have a business on his hands. A friend saw it, asked if Mr Poole would do his, and it snowballed. This year, Jerba Campervans will finish 53 jobs (with an average order value of £57,000), and next year the plan is to sell more than 60.

While turning a hobby into a business was an unexpected perk for Mr Poole, who now has 12 staff, it's also meant he's had to face a decision he never expected to have to make: how to exit a business he never thought he'd have.

"Three years ago, when I was 51, I knew I wanted to be doing other things by the time I was 55," he says. "My children were too young, liquidation didn't feel comfortable to me, but neither did a management buy-out seem possible – my staff just wouldn't have had the cash to do it."

Just as his options appeared to have run out, a chance encounter with Scottish Enterprise changed everything. He discovered employee ownership (EO) – defined as when staff themselves directly hold a majority of shares in their firm, or shares are owned on their behalf via an employee trust. In January 2018, the firm officially switched to be 100 per cent employee-owned, managed by a trust comprising an elected employee plus the firm's accountant.

'When you give people ownership, you really do create people who want to come into the office on a Monday morning'

According to statistics from the Employee Ownership Association (EOA), Jerba is far from the only business going down this route. Jerba is one of around 100 Scottish firms that are owned by their staff, while in the rest of the UK, EO is the fastest-growing form of business ownership: it is growing at a rate of 10 per cent a year, and delivers 4 per cent (£30 billion) of UK GDP annually.

Its biggest selling point in recent years is that it taps into, and fosters, that elusive sense of employee engagement – which results in improved business performance. "Giving staff a stake in the business is the most powerful thing any employer can do," argues Deb Oxley, EOA CEO. "The analogy I use is this – who ever washes a hire car? If something doesn't belong to someone, they care about it less. When it's theirs, though, a mental change occurs in people's minds; they can see how every contribution they make potentially feeds back to them."

Business case

Research bears this out. According to Cass Business School, EO firms grew sales by 11.1 per cent during the recession, compared with just 0.6 per cent from non-EO ones. Edinburgh Napier University has found that 80 per cent of EO staff say that because they are stakeholders, they feel a sense of achievement from their jobs (traditionally, only around 30 per cent of employees say they are highly engaged, according to Gallup). The EOA suggests 58 per cent of consumers see EO businesses as more trustworthy, while 41 per cent of consumers say they are more likely to buy from EO firms.

While all this might be good news, there are concerns among SMEs that EO won't work for them and their size, or bring the benefits widely espoused. It was partly for these reasons that FSB was asked last year to contribute to The

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Ownership Effect Inquiry, the results of which were published in June this year in the report *The Ownership Dividend*. It clearly found that the UK's productivity problem could be improved with more EO, but that it could make an even greater contribution if "it were better known and understood", especially by small businesses and those that advise them at key points in their lifecycle.

"A worrying finding is that only a third of SMEs said their accountants had even suggested EO as an option," says Ms Oxley, who wants to see the development of a Government-led national strategy for promoting EO. "This is despite our, and the FSB's, conclusion that EO is an extremely useful option when owners are thinking of exiting their business."

Martin McTague, FSB's Policy and Advocacy Chairman, adds: "There's a clear finding that awareness of EO as an option is low – so there is a barrier that prevents it reaching its potential."

41%

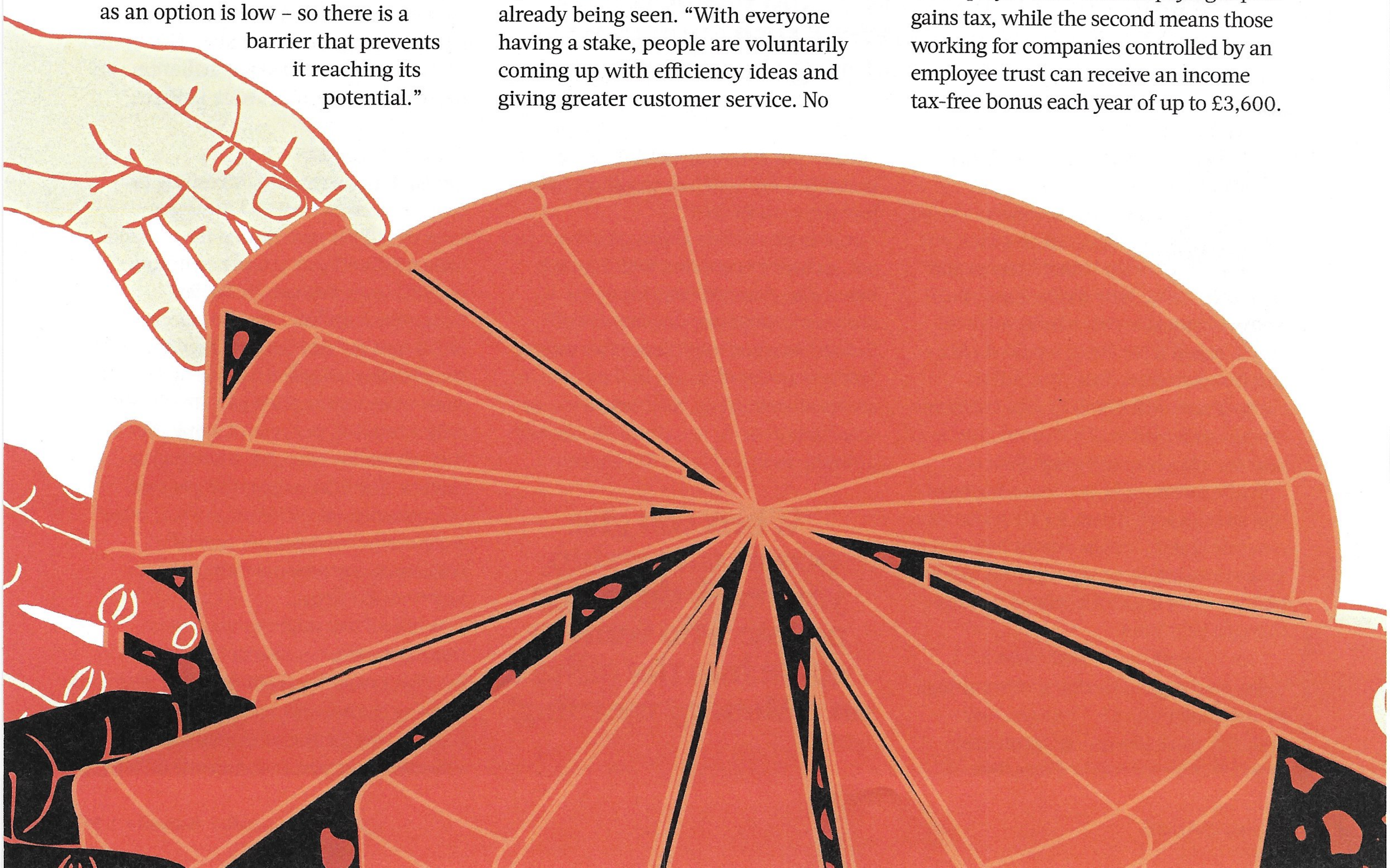
The proportion of consumers who say they are more likely to buy from employee-owned firms

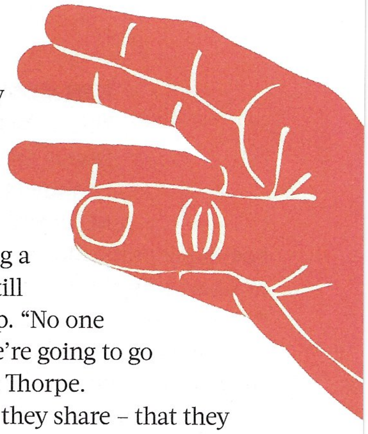
Mr Poole is in no doubt the model is win-win all round. "I receive a deferred consideration over the next five years, which is basically a wage to slowly exit, after which I have zero ownership," he says. Meanwhile, staff receive a year-on-year escalating dividend, based on the profitability of the business. He says the transformative impact is already being seen. "With everyone having a stake, people are voluntarily coming up with efficiency ideas and giving greater customer service. No one's left the business either, because there is a clear motivation to stay."

Tackling misconceptions

Despite the attraction of EO, there are critics who argue that paying staff a bonus is a much simpler option, which links performance to what staff see in their back pockets. Mr Poole is adamant, however. "What we've created with EO is an arrangement where staff will receive around £1,700 this year, rising to close to £5,000 in successive years," he says. "Already, their first-year bonus will be double our existing bonus system, and by coming from the trust, it means it can be paid tax-free." Previously, staff paid tax on their bonuses.

He is also making use of two changes introduced by the Government in 2014 to encourage EO. The first allows company owners to sell their controlling interest to an employee trust without paying capital gains tax, while the second means those working for companies controlled by an employee trust can receive an income tax-free bonus each year of up to £3,600.



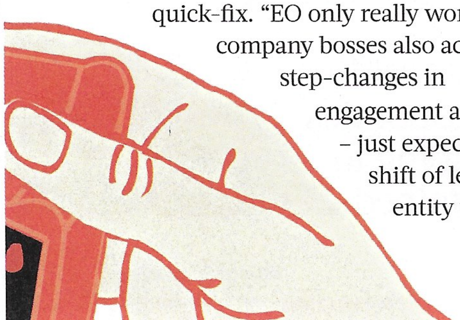


Ms Oxley is keen to point out that EO needn't only be an option when a founder wants to leave. "Giving a stake doesn't just work for succession planning; it's a good idea in its own right," she says. "It's great at a start-up stage, for new firms to attract talent with equity in the business; it can also be used at a growth stage, as well as the final succession point," she says. "I call it the three 'S's – start-up, scale and succession."

In the devolved nations, moves to promote EO have gone even further. Scotland has its own dedicated unit, the Co-operative Development Scotland – a team within Scottish Enterprise whose entire remit is to promote awareness of EO and other co-operative models. It actually covers a third of the cost of transferring a business to an EO model, and further support was signalled last summer with the launch of Scotland for EO, a leadership group tasked with increasing employee and worker-owned businesses to 500 by 2030. It is being backed with £75,000 of Scottish Government funding and is co-chaired by Jamie Hepburn, Minister for Business, Fair Work and Skills. Wales, too, has its own Welsh Cooperative Centre.

Going down the EO route isn't necessarily straightforward. "Advocates will claim transferring a business to EO status is easy," says Edward Pearce, employment law solicitor at Markel Law LLP. "But unless comprehensive rules are formed, there could be arguments about the worth of shares, and we find there are often problems when staff do leave and want to extract the value of them."

Robert Postlethwaite, a lawyer with Markel who specialises in this work, also says the concept on its own is not a quick-fix. "EO only really works if company bosses also activate step-changes in engagement anyway – just expecting the shift of legal entity to do this won't help," he warns. "A lot of thought needs to go into setting up the procedures – for instance what the new leadership will do and whether they have the right to sell the business later down the line, and if employees can veto matters."



Practical details

For his part, Mr Poole says the process of moving to an EO model cost £18,000, and required no more than two or three days of his active time. At the moment, however, there is no provision for employees to be able to buy shares, and employees can't directly make investment decisions. These aspects, he says, are the small details that need deciding upfront.

David Thorpe, founder of DBS Internet Marketing, went down the EO route in 2017, and has done things slightly differently. Rather than move the business to 100 per cent trust-owned, 51 per cent is controlled by a trust (the legal minimum) and the remaining 49 per cent owned directly by staff; the split in share ownership is based on seniority. "I feel this way, every month the business grows, people can see the value of the company improving, giving all my staff the incentive to keep growing the business," he says. "But you have to set it up in a way that feels right to you. What works for some may not for others."

Both small business heads admit the driver for EO was for exiting purposes, rather than seeing it as a good idea from the off. But they argue this is no bad thing, because staff don't have the worry of owning a business they still need to build up. "No one has to worry we're going to go under," says Mr Thorpe.

500

The target number in Scotland for employee-owned businesses by 2030

Another trait they share – that they care about their people and the role the business has in the local community – prompts questions about the degree to which altruism is needed too, because EO involves signing away a chunk of a business to other people.

"I think small business CEOs definitely need a mindset that everyone's efforts deserve their equal share, which may not suit those who want to make as much personal fortune from their business as possible," says Mr Postlethwaite. Ms Oxley disagrees. "This is an urban myth," she argues. "I haven't yet met a small business owner who doesn't care about their people – those who help grow a business to what it is. The days of the 1980s, where the boss keeps it all, are gone."

Perhaps the best way to view EO is that it is simply another way of thinking about how a business could be structured, and that just knowing it's an option is a good starting point. As Ms Oxley herself admits, she's "passionate about EO but not a zealot either". She adds: "I'm not saying everyone should do it, but what I'm asking is that more SMEs think about it, or maybe find out more about it. Because when you give people ownership, you really do create people that want to come into the office on a Monday morning. That's surely a powerful reason to consider it."

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