The Employee Ownership Trust Survey Results

2015

Prepared by

Introduction

The Employee Ownership Trust (EOT) is one of the most important initiatives for encouraging more employee ownership and the Employee Ownership Association (EOA) is proud to have been at the forefront of lobbying for its introduction.

To encourage further adoption of the EOT, develop good practice, and provide a basis for potential future lobbying, the EOA is committed to developing an evidence base of businesses that have adopted the EOT model. Therefore, in partnership with RM2, the EOA started a national survey of companies that have been identified as having established EOTs.

Companies and their professional advisors were invited to take part in the survey to gather basic facts about their experiences of transition to the EOT model, including thoughts on potential improvements that could be made to the model.

The results of this survey have been analysed by RM2 and the results published in aggregate, with no single company's response being allowed to be identified.

Employee Ownership Trusts (EOT)

The Employee Ownership Trust (EOT) is a type of employee benefit trust created by government to encourage owners to sell a controlling stake in a company to its employees.

Provided that certain rules are met, the transfer of a controlling stake in a business to an EOT by a shareholder provides relief from any Capital Gains Tax (CGT) that might otherwise be paid.

An EOT can also be used to pay income tax-free cash bonuses to staff.

An EOT is a trust established to hold shares on behalf of employees in a company. To be treated as an EOT it must meet certain criteria:

It must have a controlling interest in the company – which means it must hold more than 50% of the ordinary share capital and the voting rights, and must be entitled to more than 50% of the company's profits and assets if the company is wound up;

It must be established for the benefit of all the employees (excluding, broadly, individuals who hold or have previously held 5% of the shares) in the company – i.e. this is not a discretionary scheme;

It must treat all employees on an equitable basis – i.e. if it applies property to employees it must do so on the same terms (although it can, up to a point, differentiate on the grounds of salary, length of service or hours worked);

Note that the company must be actively trading for the EOT to meet these requirements. If the EOT ceases to meet any of these tests, then the benefits attaching to it may be withdrawn, including the possibility of a clawback of benefits already received.

Who took part in the survey?

Together the EOA and RM2 identified 42 early adopters of the EOT up to August 2015 and invited them to participate in the survey.

Fig 1. EOT companies identified and responses

The responses were collated and supplemented with public domain information to provide a comprehensive insight into the successes, and challenges, of the EOT since its introduction in December 2013.

The response rate was 60% from companies that were EOA members and 20% from non-members.

66% of companies with an EOT structure operate within the professional and manufacturing industries.

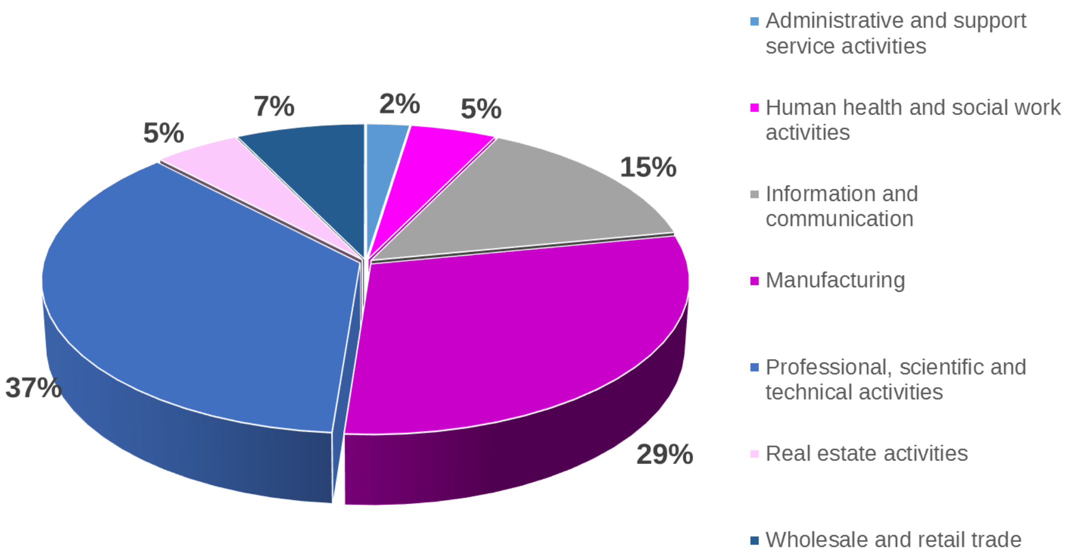

Fig 2. EOT companies industry classification

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Over half of these companies were categorised as small businesses (with fewer than 50 total employees). In aggregate, the companies had over 5,000 employees.

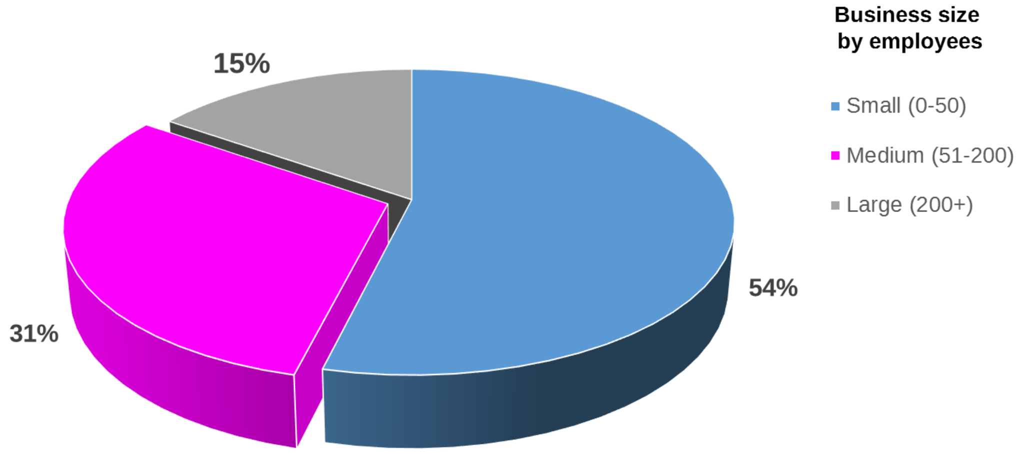

Fig 3. EOT companies business size

Of the 21 companies who responded their turnover ranged from £150,000 to £143.8 million.

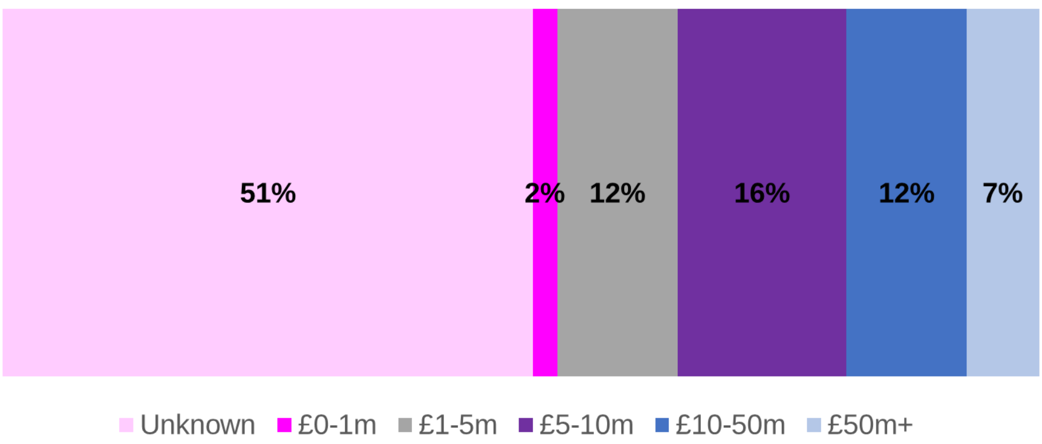

Fig 4. EOT company turnover

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About their Employee Ownership Trusts

Of those surveyed 90% had implemented EOTs which held more than 50% of the company's total shares. 24% had EOTs which already owned 100% of the company's total shares and of the remainder, 50% stated they had definite plans in place to increase their EOT's shareholding.

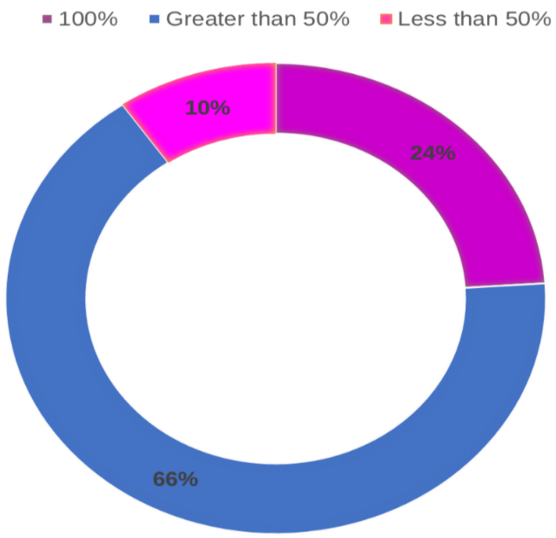

Fig 5. EOT shareholding

Why an Employee Ownership Trust?

We were keen to identify the reasons why companies had chosen to transition to the EOT model. Encouragingly, companies' motivations were about more than the CGT (Capital Gains Tax) relief and tax-free bonus benefits.

Improved performance and the ability to share rewards and benefits realised. As well as clear succession planning and a controlled exit for the founders.

To ensure the long-term future of the company by safe-guarding our Independence and fully engaging our employees to ensure decision-making is solely focussed on the long-term benefit of customers and employees

To improve employee engagement, provide for profit share bonuses to employees and ensure the longevity of the company.

Future development, empowering the workforce and succession planning.

Fig 6. EOT company quotes

Companies were keen to use the EOT to increase employee engagement and ensure a successful, independent future for the business. 28% stated employee engagement was a key motivation for introducing their EOT; over 25% use their EOT as part of their succession planning and just under 25% said they felt the EOT helped them to retain their independence.

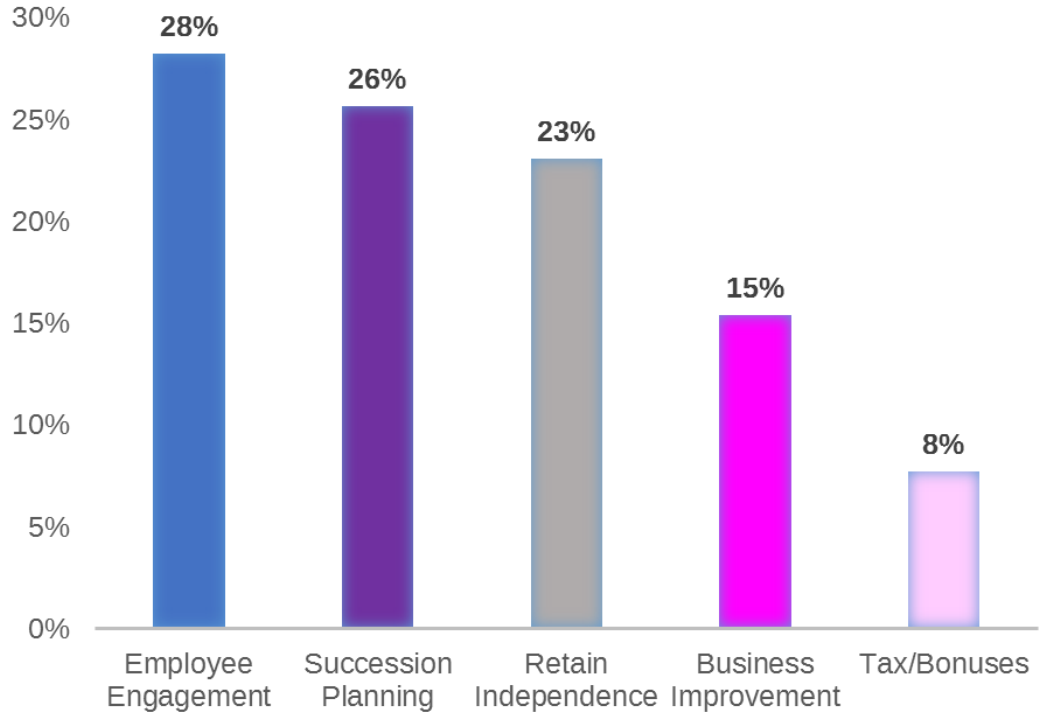

Fig 7. EOT company motivation

What was the significance of the tax reliefs? 76% of companies said they were already committed to employee ownership before the new tax reliefs were introduced but that these were a welcome additional incentive. More than 60% of companies who had implemented their EOT after April 2014 stated that CGT relief was a factor in their decision-making. 86% of companies took advantage of, or planned to take advantage of, the opportunity to pay their employees income tax-free bonuses.

How did they make the transition?

There is a variety of ways to transfer share ownership to an EOT; directly from founders or existing shareholders, by transfer from an existing Employee Benefit Trust (EBT) or through issuing new shares which can be bought by the EOT.

We found that over 90% of EOT shares were acquired from company founders and existing shareholders, with only 4% being newly issued for this purpose. This is consistent with the main purpose of the EOT being a structure to facilitate ownership succession.

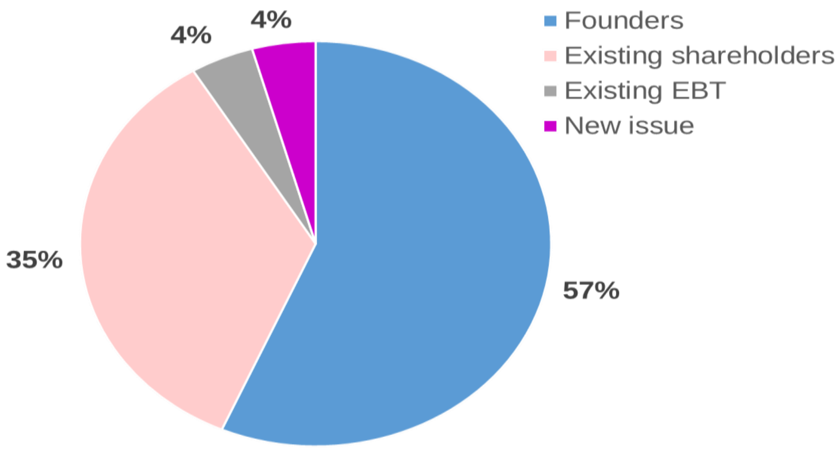

Fig 8. EOT share acquisition

65% of companies bought shares into the EOT at fair market value, with only 10% of EOTs receiving them as a gift from the vendor.

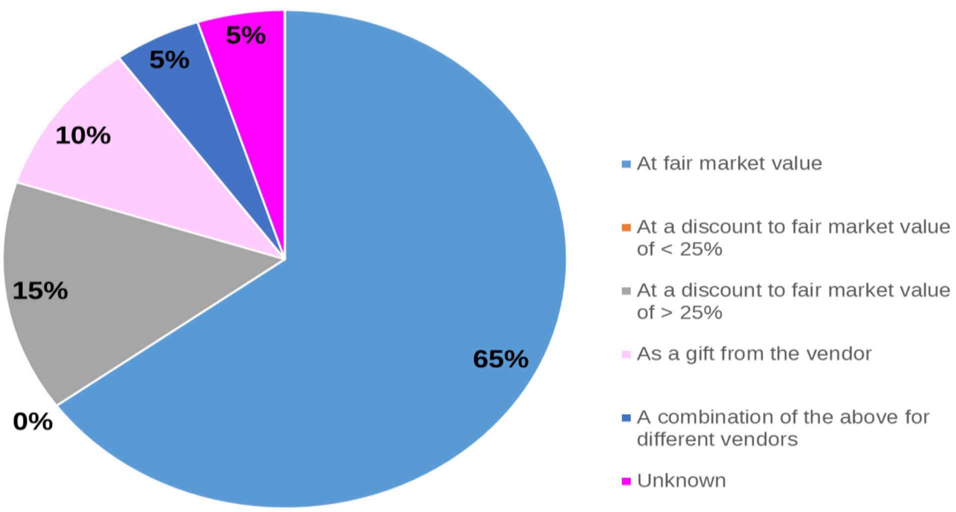

Fig 9. EOT financing

Of the 75% of acquisitions which involved some payment to the vendor, almost half were provided through a vendor loan agreement.

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How did they structure the EOT?

For trustees, companies used two options; using an external professional trustee or creating a separate trustee entity. The majority of those surveyed had chosen the latter.

All but one of the companies have their trustees constituted as corporate trustees and only one company chose to base their trust offshore. The trustees were drawn more or less equally from three categories: company directors, employees and external professionals.

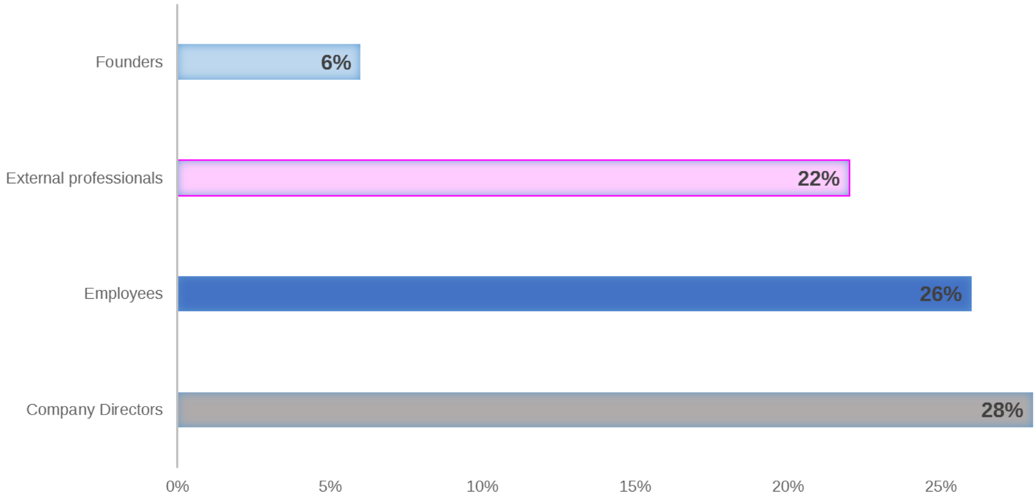

Fig 10. EOT trustee allocation

Would they recommend the EOT model?

The companies we spoke to have all experienced success to date with their transition and 95% of those surveyed said it is a business model they would recommend to others and is a fundamental part of their future business planning. (the other 5% said they had not had the EOT in place for long enough to comment).

Even with the best model, there is room for improvement. As the first companies to 'test' the whole process, the survey respondents were the best people to ask about improvements. Only five suggested improvements were mentioned:

- Standardisation of the transition process and associated documentation
- Some flexibility on the 'equal treatment' rule
- Tax exemptions for the EOT itself
- Reducing the ownership threshold for tax reliefs to below 50%
- Providing loans to participators without adverse tax consequences

If you would like more information on establishing an EOT, find all the information here or, if you would like a copy of the survey please email sarah.bladen@rm2.co.uk and get involved for next year.

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