Ownership at Work

EMPLOYEE OWNERSHIP TRUSTS

In search of best practice

Simon Carter and Sue Lawrence

In partnership with

Independent Directors & Trustees

Contents

EXECUTIVE SUMMARY

The employee ownership sector is growing at an incredible rate having doubled in size in just three years. That growth has been driven almost entirely by the introduction in 2014 of the Employee Ownership Trust (EOT). The vast majority of the businesses that make up the sector are small or medium-sized businesses (SMEs) who share ownership and voice with all employees via an EOT, but today we have very little insight into the ownership mechanics of those companies.

This short piece of research aims to lift the lid on what is happening inside those businesses and how they are bringing employee ownership to life. Independent Directors & Trustees Limited, working in partnership with the sector's think tank Ownership at Work, have conducted a small scale, deep dive study into SMEs who have recently adopted EOTs to better understand their governance and leadership practices. This report draws out common choices and structures, and raises critical questions on what best practice looks like.

Summary of key findings on common practice

- The most common level of equity transferred was either 100% or 51%, with the average being 76%.
- Of the various options available to fund a purchase of shares by the trust, the most common method was through a combination of drawing from existing cash in the business and a vendor loan. External financing was the least common route.
- The COVID-19 pandemic highlighted the flexibility of vendor loans, and a small number of companies took advantage of this to reduce payments over this period and maintain cashflow.
- Most respondents had three to four years left before their loans will be fully repaid, indicating five years as the common full term.
- Founders mostly retain some form of active role in the company on transition.
- Most also tend to feel more comfortable staying closer to the high-level decisions while there was still a significant proportion of the deferred consideration payable.
- Although most founders saw their medium to longer term future only as a trustee, few take this step immediately on transition. More prevalent is a middle phase where the founder reduces to part-time hours as a director whilst a new CEO/MD steps up.
- Most companies intend to involve their trustees in the recruitment and appointment of directors to the board of the operating company.
- Most companies have a formal schedule of matters that must be referred to the trustees, but the authority of the trust was often less explicit; whether approval or consultation was required.
- Trustees were commonly involved in EOT bonus distributions; the process was generally not laid down formally but tended to require approval.
- All respondents had a combination of founder, director/management, and employee members, and in most cases also an independent trustee on the trust board.
- Most trusts worked to a majority decision, with the chair having a casting vote, but there were examples where unanimous decision was the rule.

- Company updates at trust meetings were the primary means of trustees maintaining oversight of the current health and future prospects of the business. In most cases, this took the form of bespoke reporting by the CEO/MD who joined the meeting for that section of the agenda.
- The most common method for electing management trustees was by nomination from the operating board; for employee trustees via self-nomination and employee election.
- Most trustees serve for three or four-year terms, with the ability to be re-elected, although this was only established in the articles or trust deed in a minority of cases. Many respondents had however staggered appointments on the first round to maintain continuity.
- Most companies had appointed an independent trustee, and it was a remunerated role. Just under half of these appointees had no pre-existing relationship with the company or founder.
- The most common reasons for bringing in an independent trustee were following advice that it was best practice, providing an external challenge to the company board, and to access broader experience.
- Just under half of respondents had set their main eligibility criteria to become a beneficiary of the trust as 12 months employment with the company (the maximum allowable under current relevant legislation).
- Just over half of the companies had some form of employee forum, with the aim primarily being to create a channel for employee voice.
- There tends to be little direct communication between trustees and employees, beyond those trustees involved with an employee forum. Many companies had created opportunities for employees to 'meet the trustees' either through informal events, drop-ins, visits to the workplace or virtual meetings and felt employees had found this reassuring.
- Most trusts did not share the full minutes of their trust meetings with beneficiaries, mirroring company policy on not sharing operating board minutes.

Analysis of these summary findings seems to confirm common sense assumptions about what is driving the growth of EOTs and what emerging good practice looks like; but the report also asks important questions about the kind of support the sector will need as it continues to grow and highlights areas which will require further research to deepen our understanding.

The authors of this report are clear that a transition to an EOT model does not need to disrupt or distract from regular company activity, but importantly if this significant change is expected to deliver more than just a succession plan it appears to need more considered actions by trustees and management teams.

The Conclusions section of this report highlights areas where it is vital for the sector to build a body of understanding around best practice to support EOT businesses in the future, including how trust boards effectively exercise accountability, the essential role of the independent trustee particularly in the early years of an EOT, and the need to clarify early on the parameters of trustee decision-making.

This report reveals the extent of rich, largely unexplored company practice taking place in this unique and rapidly expanding corner of the economy and the authors hope it will encourage further examination over upcoming years.

Ownership at Work

Ownership at Work

Ownership at Work's mission is to generate new thinking and ideas on employee ownership's contribution to the UK economy. An independent think tank, Ownership at Work publishes policy papers, guidance and research on the fastest growing business model in the UK economy. Holding charitable status, Ownership at Work is a politically impartial research partner of the Employee Ownership Association, the national body which speaks for the UK's £30 billion employee ownership sector.

Other recent papers published by Ownership at Work:

Equity for All - *how a simple trust can spread ownership and wealth to millions*

Capital Partners? - *why it's time for finance and employee ownership to talk*

Redesigning the CEO - *how employee ownership changes the art of leadership*

A Partnership Fund for Jobs – *how government can help small business cope with the crisis*

Redesigning Work – *employee owners speak*

Build back together – *a recovery that works for everyone*

A shares for debt recovery plan – *converting Bounce-back loans into employee equity*

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Independent Directors & Trustees

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Independent Directors & Trustees Limited (IDT) provide directors to the boards of SMEs, UK subsidiaries of overseas companies, and independent trustees to the boards of EOTs. These individuals are based through England, Scotland and Wales working directly with their clients under the IDT umbrella.

As a collective of board and leadership practitioners, IDT colleagues share their knowledge collegiately for the benefit of their own development and in support of their clients. With governance systems at the heart of their expertise, their involvement in the employee owned sector has enabled an ability to share this knowledge more widely amongst the rapidly growing employee ownership community, through thought leadership pieces, client-specific workshops, personal appointments and broad engagement with employee owned companies and their advisors.

IDT have sponsored this report and partnered with Ownership at Work (OAW) in its delivery, including conducting the interviews with participating companies, collating the responses, providing the underlying analysis and providing the authors of the report.

Simon Carter

Simon has a background in leadership, training and systems of governance which he combines with broad experience of bringing in transformation and change. His current portfolio of SME non-executive and independent trustee appointments spans several sectors and follows an early career as an officer in the Royal Navy. He also acts as an advisor on strategy development to small charities whilst maintaining a wide range of volunteering activities.

Simon has been a member of the IDT team for two years where, alongside his NED appointments, he is appointed as an independent trustee on a number of EOT boards across various sectors, including technology, manufacturing and distribution across the UK.

Sue Lawrence

Sue is a published author on governance topics commissioned by The Chartered Governance Institute, as well as a Chartered Director with the Institute of Directors. She founded IDT in 2018 at the culmination of a career spent in professional services, most latterly leading UK subsidiaries of multi-national organisations.

Sue is appointed to the board of SMEs and UK subsidiaries in investment, finance, and commercial distribution. She is also the independent trustee on a number of EOT companies spanning architecture, construction, professional services, and regulated businesses throughout England.

Our immense thanks to all the respondents and contributors who so generously shared their time, experience, and accrued knowledge, as well as to Simon Carter for conducting all the interviews to ensure consistency in approach and content.

BACKGROUND

Introduction

The UK's employee ownership sector has seen continued and unprecedented growth since legislative changes creating Employee Ownership Trusts (EOTs) were implemented in 2014. In the 12 months up to June 2021, there had been an increase of 31% in the number of employee owned companies across the country, which now total well over 700. Today this sector is worth approximately £30 billion in combined annual turnover and accounts for a bigger share of GDP than the aerospace or agriculture sectors.

Much of this growth has been in small and medium size businesses (SMEs), with at least 567 employee owned SME organisations in the UK at the time of this survey and their number continuing to grow.

This survey looks at how these small and medium sized companies who make up the majority of the sector govern themselves within the few years after moving to so-called 'indirect' employee ownership, in this case via an EOT. The aim is to track how companies in this fast-growing sector run themselves and to give all employee owned firms – whatever stage of employee ownership they're at - new information and insight to help them benchmark good practice.

What is an Employee Ownership Trust?

This note is an extract from Ownership at Work's 2019 paper *Equity for all: how a simple trust can spread ownership and wealth to millions*, by Nigel Mason.

An EOT is a restricted type of employee benefit trust. The trust holds company shares for the benefit of all employees of a company. The trust creates a form of employee common ownership that provides the basis for employee participation in both profits and corporate governance.

The EOT is a separate legal entity controlled by its directors, the trustees. The EOT legislation is silent on the question of their identity and composition. Usually, they are a combination of employees and independent individuals. The original business owner can also be a trustee. To ensure that they properly represent the company's employees, EOT trustees in larger companies will often create an employee council to help appoint and advise the employee trustees.

There is no requirement for the EOT to distribute its shares to employees and in practice very few do. In fact, doing so can be problematic: employees would have to pay income tax and the company would have to pay national insurance contributions on the market value of the shares at a time when they might not be readily convertible into cash. Instead, the EOT would usually hold the shares indefinitely for the long-term benefit of the employees as a whole, or until the EOT-owned company is sold. Thus, all employees of the company are beneficiaries of this trust and indirect owners of the company.

Until then, the company remains independent and the employees are the ultimate beneficiaries of the business in a sustainable ownership structure. Profits are either reinvested in the company or distributed to employees as bonuses.

All this would technically be possible to achieve with an EBT. What is unique to an EOT is the attachment of two powerful tax incentives.

- The first tax relief is aimed at business owners. In the tax year when an EOT acquires a majority of a company's issued share capital, the outgoing shareholders can claim exemption from capital gains tax on the disposal of their shares.
- The second tax relief is aimed at employees. Employees of a company that has become EOT-controlled may receive income tax free bonuses (currently up to £3,600 per person per annum), provided the company pays those bonuses to all employees on similar terms.

It is these two powerful tax reliefs, and the simplicity of the EOT structure itself, which are signalling to business owners that EOTs are an exit route to be considered seriously.

The governance factor

In the context of this survey, governance is defined as the interaction between the three main components of an employee owned organisation, namely:

a. the operating board (and/or senior leadership team)

b. the trust and trustee directors who represent the employees as its beneficiaries

c. the employees themselves in their day-to-day roles

Good governance successfully weaves culture, values, leadership and organisational structure around collective purpose. It should create alignment, trust, teamwork and strength through the combined effect of legal frameworks, codes and working practices. The range of variables means that there is no governance blueprint, but it is possible to derive guiding principles from the structure employee ownership offers.

Within employee ownership structures there is a common legal framework under legislation plus the addition of bespoke company articles for the organisation and the trust company, as well as a documented trust deed. Hence, there is some semblance of consistency in the typical employee ownership legal framework that organisations within the sector can draw on and learn from.

Why the survey?

There will inevitably be greater scrutiny of employee ownership as it continues to rise in prominence as an ownership model. There will be more interest in how these companies are run, their adherence to the intended principles of employee ownership, and whether it is generating the economic and employee benefits envisaged. There will be growing expectation for more established employee owned companies to be underpinned by sound governance, and for those seeking to transition to learn from those who have gone before.

Growing interest in employee ownership, combined with too little hard evidence on practice, means that a survey on EOT governance is timely.

Ownership at Work and the Employee Ownership Association (EOA) have therefore supported this initial pilot survey. It has been instigated and sponsored by Independent Directors & Trustees Limited to identify common themes or good practice which help define the sector, and that companies could draw from when adopting an employee owned model or reviewing their existing structure.

The findings are also intended to inform ongoing exploration of what good employee ownership governance looks like; what generates connectivity, participation, and the better company performance evidenced across the sector.

This initial work has been commissioned to provide an exploratory baseline. The conclusions will shape how its scope and extent can be widened when repeated in future years.

Survey methodology

For this report, we have used the EOA definition of employee ownership as companies where 25% or more of ownership is broadly held by most or all employees (either directly or indirectly, for instance via an EOT) and employees as owners have structural channels through which to exercise influence.

To involve companies in this research, the EOA identified from amongst its members organisations that had transitioned to an EOT model in the past two to five years, with a headcount of between 50-150 employees.

This cohort was targeted to represent the recent SME sector growth which has been seen. Also, insights here are all the more valuable as SMEs do not have their own legislation on governance standards, or published guidance and expectations directed at them in the same way as exists for large or listed companies.

The window of two to five years sought to ensure new governance structures had been given time to embed while early lessons or observations remained fresh. As events transpired, many companies found themselves balancing employee ownership with a pandemic which reduced the number of respondents where systems had been given the chance to bed-in as planned. As a result, this initial study has deliberately looked at a small pool of nine employee owned companies only and will use these preliminary findings to help scope future, larger scale research.

Data was collected in two stages:

a. a survey questionnaire given to respondents, split into four sections to collect both data (company name, key dates, etc) and free text descriptions of company practice:

- **Section 1. Company context and background (the foundations of the model)**
- **Section 2. Company (operating) board (leadership and management)**
- **Section 3. Trustees and the trust board**
- **Section 4. The employees**

b. the questionnaire was followed-up by a 90-minute confidential interview to probe deeper into company practices, application and insights.

Responses have been anonymised and the findings synthesised into a general overview emerging from this snapshot. They are reported in the next section of this report under their respective headings, with findings on internal communications further broken out.

Organisations are welcome to use and reference the findings in this paper but are asked to attribute them to the authors.

KEY FINDINGS

Why governance matters

Employee ownership offers founders and vendors a way to protect the values, culture and principles that have built the business and created its ethos, while giving the employees who've been part of that journey a voice and stake in its future.

A firm governance structure is a means of reinforcing that ethos, and future proofing it for when the founders and the first generation of trustees and directors have moved on. The survey findings suggest that levels of guidance and direction enshrined in the documents and systems that protect the company's founding principles vary greatly across the sector.

Employee ownership is characterised by a collegiate approach but few of the companies surveyed had reached a point where there had been substantial turnover of individuals from pre-transition, or where the capacity of reference documents to arbitrate tensions had been tested.

Creating a trust does not necessarily change everyday business and operations. But the fact is that nearly all companies spoken to had, in the process of transition, introduced change into the workplace; from the way the senior management was structured, to more communications being pushed out, creating an employee council and appointing employee trustees.

Hence, transition to employee ownership does not need to disrupt or detract from company business, but if it is to deliver more than just a succession plan it appears to need more considered actions.

Foundations of an EOT Model

This part of the survey focused on the moment of transition; the transfer of shares and associated new structures, the initial documentation and its fitness over time, financing the transfer, and the role of the founder going forward.

Levels of equity transferred: Legislation requires more than 50% of the company shareholding to be transferred to the trust under an indirect ownership model for the capital gains tax exemption to be available.

From the companies interviewed, the most common level of equity transferred was either 100% or 51%, the average being 76% - reflecting the predominance of companies where multiple shareholders sought to retain part of their share ownership. Adopting this approach was seen as enabling the required majority holding to be transferred to the trust, with the original shareholders retaining a level of equity and influence.

The extent of Enterprise Management Incentive (EMI) or uncontrolled share options in existence was outside the scope of this survey. But from the companies surveyed, it was more common for such schemes to have been in existence prior to transition rather than introduced subsequently and, in the companies where they operated, they were still seen as important incentivisation for key members of the leadership team.

Naming the Trust company: The trust was universally incorporated under a variation of the trading company name, generally as an automatic and logical extension aligned with company and public records:

- ABC Employee Ownership Trust(ee) Limited
- ABC EOT Limited
- ABC Trust(ees) Limited

Employees were generally more concerned with understanding the role of the trust and trustees than its name when it came to internal messaging.

EOT documentation: The legal bundles produced for transition are substantial and most companies found themselves led by their legal advisors and adopting the trust company articles and trust deed as provided. The few companies who had brought in an independent trustee during the drafting process used them as an external cross-check of interpretation and practical application against the founder/seller's intentions.

The companies surveyed are not generally finding that the 'model' documents have constrained activity; the triggers for amending documentation in the few companies where it had been necessary were all structural and centred on changes within the minority shareholdings.

Over half of respondents were discovering that:

a. whilst founder owners had rarely referred to company documentation in the past and had been able to run the company largely on their own terms, employee ownership introduces a different set of checks and balances and some trustees do refer to them; and

b. whilst the 'model' documents are generally less, rather than more, prescriptive on certain aspects of employee ownership, this could enable flexibility in the future as employee ownership matures.

The most common areas where it was felt the documentation could be more explicit were:

- composition of the trust board
- succession of a founder trustee (once the deferred consideration had been repaid)
- frequency of trust ordinary meetings
- matters to be referred to trustees / the trust

Financing the transfer of shares: Of the various options available to fund a purchase of shares by the trust, the most common method was through a combination of drawing from existing cash in the business plus a vendor loan. External financing was the least common route.

There did not seem to be a particular correlation between the method selected to fund a purchase and percentage of shares being bought, nor any pattern to whether interest is charged on the vendor loan or not, or the type of loan vehicle.

The evidence confirms that the factors surrounding how the purchase will be funded are unique to the vendor(s) and company in each case, or reflect the breadth of advice received. Given the timing of their conversion, in 2018 to 2019, it may also reflect the limited availability of EOT knowledgeable funders, other than those with a specific focus on the sector. With the subsequent increase in funder understanding and mainstream as well as bespoke funders now being available to offer financing, subsequent reviews may find the use of third-party borrowing being more prevalent.

The COVID-19 pandemic highlighted the flexibility of vendor loans, and a small number of companies took advantage of this to reduce payments over this period and maintain cashflow. More widely however, a number of companies have managed to accelerate their repayment schedules.

The evidence confirms that the factors surrounding how the purchase will be funded are unique to the vendor(s) and company in each case, or reflect the breadth of advice received.

The COVID-19 pandemic highlighted the flexibility of vendor loans, and a small number of companies took advantage of this to reduce payments over this period and maintain cashflow. More widely however, a number of companies have managed to accelerate their repayment schedules.

Most respondents had three to four years left before their loans will be fully repaid, indicating five years as the common full term. Those approaching the end of their repayments were generally those that had managed to accelerate payments or started with high levels of initial payment at the time of transition.

Fig 1: How the purchase was funded

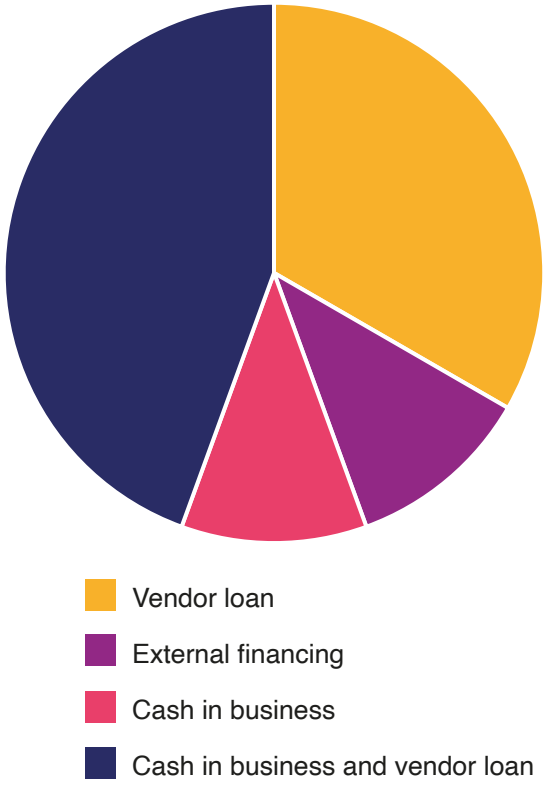


Fig 2: Relative number of companies who have extended their loan schedules

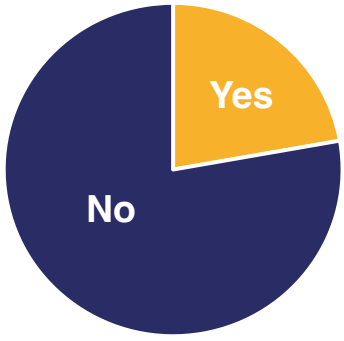


Fig 3: Relative number of companies who have accelerated their repayments

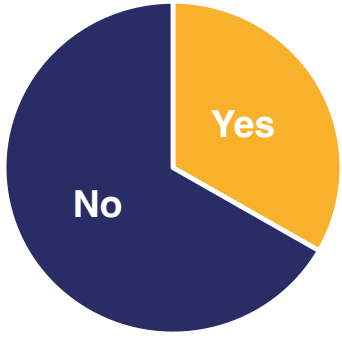


Fig 4: Remaining term for outstanding payments

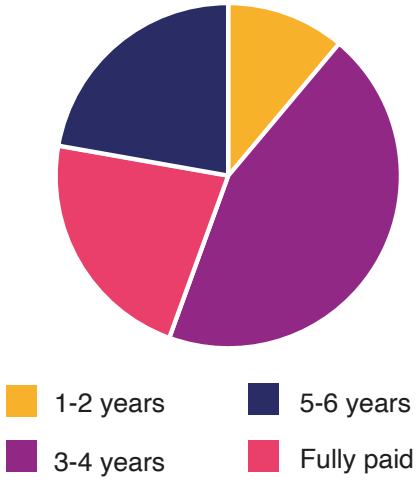


Fig 5: Founder involvement post-transition

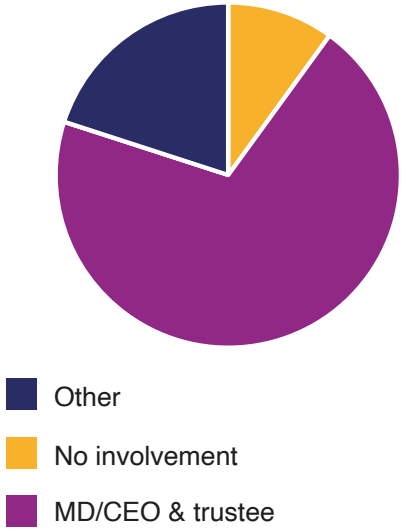
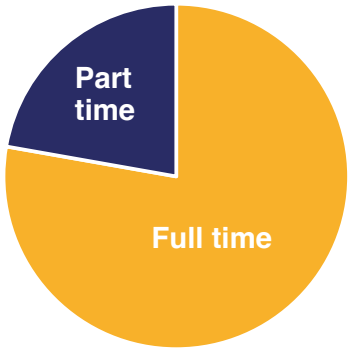


Fig 6: Full/Part time



More broadly, the day when all loan repayments have been made ('financial freedom day') signals a new phase for employee ownership. Those companies and trusts where this is on the horizon have found themselves having to think about how they will manage more distributable profits and the expectations of employee-owners.

Role of the Founder: The indications are that founders almost universally retain some form of active role in the company on transition and whilst the precise range of motivations varies, the aim for a smooth succession tends to be a central facet of the employee ownership route. On a pragmatic level, founders tended to feel more comfortable staying closer to the high-level decisions whilst there was still a significant proportion of the deferred consideration payable.

Almost all founders saw stepping back as a phased process with the majority continuing in a full-time role whilst also taking up a trustee position. Although most founders saw their medium to longer term future only as a trustee, the evidence suggests that very few take this step immediately on transition. More prevalent is a middle phase where the founder reduces to part-time hours as a director whilst a new CEO/MD steps up. The conditions that needed to be in place for each role adjustment and step back were rarely set out for the company, and if anything, were more based on arbitrary or personal timelines.

Leadership and management

The transition to employee ownership and implications of eventual succession provides impetus and opportunity to review the organisation's leadership. This part of the survey looked at where any common changes were made in companies at operating board level (or the equivalent highest decision-making forum in the trading company).

Board composition: The majority of companies changed the composition of their operating board on transition to employee ownership, predominantly through promoting members of the senior management team into executive board positions. This was largely seen as an element of succession planning and had often been prepared for prior to the transition. Few companies had implemented their trust board or had trustees to consult at the time of deciding these changes.

Few respondents appointed non-executive directors as part of the process of updating their board for succession, but those with one already in place maintained the appointment.

Companies generally had between three to eight members on the board.

Organisational leadership: Most respondents had a separate senior management team in support of the top-level board; statutory directors met as a formal board to discuss strategic issues, the executive directors also met in a separate forum where they are joined by functional leaders/ executives (eg the heads of Operations, Sales, Marketing, HR) to focus on operational matters.

Some companies created a separation between strategic board-level functions through a system of distributed responsibility, with high levels of delegation to functional or regional teams.

A small number of respondents had formally implemented committees with specific, delegated functions (eg remuneration, audit & risk).

Fig 7: Board changed on transition

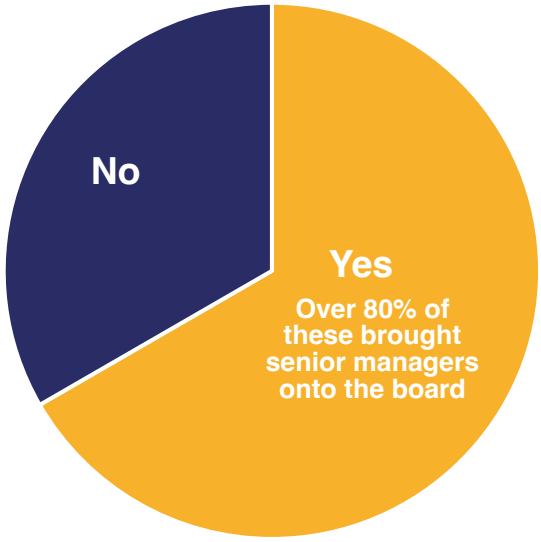


Fig 8: Frequency of board meetings

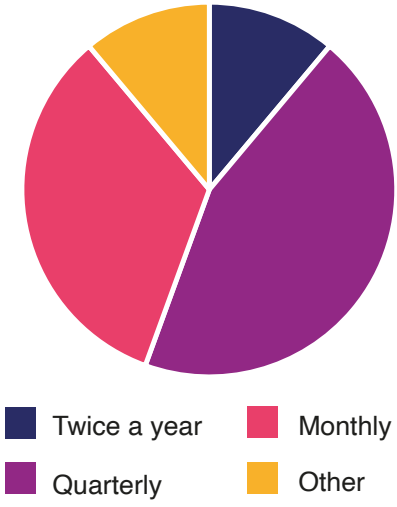
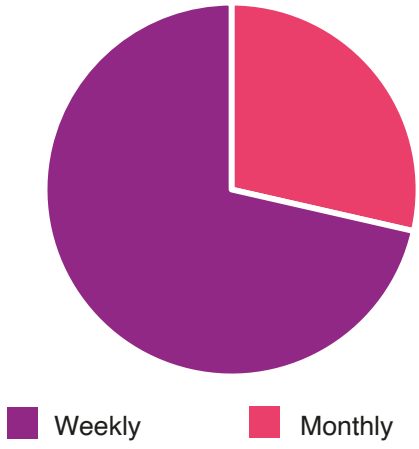


Fig 9: Frequency of management team meetings

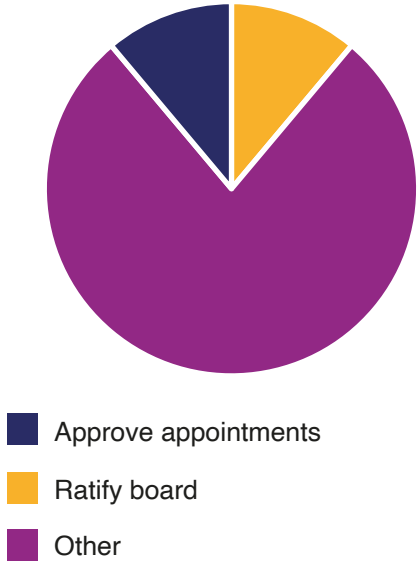


Board meetings: Most companies either held a monthly or quarterly board meeting cycle with any supporting management forum running more frequently, usually weekly. Operating boards sat more often when the situation demanded, such as during the COVID-19 pandemic. Committees, where in place, generally met monthly or quarterly.

Appointing directors: Most companies intended to involve their trustees in some way in the recruitment and appointment of directors to the board of the operating company, although very few had, to date, conducted recruitment or formally documented the expected process.

Most envisaged the trustee role being one of ratification, with the remainder split between expecting directors' appointments to be formally approved by the trustees, or board recruitment being a combined trustee/board responsibility.

Fig 10: Trustee involvement in director recruitment



Matters referred to the trust *(as distinct from matters that must be referred to sellers whilst there is still a deferred consideration outstanding):* The majority of companies did have a formal schedule of matters in place that must be referred to the trustees, but the authority of the trust was often less explicit; whether approval or consultation. Most of the respondents had referred matters to trustees at some point and the examples cited tended towards a process of consultation.

Common matters for referral were:

- Significant capital expenditure
- Acquisitions or disposals
- Organisational restructures
- Capital investments
- Further sale of shares
- HR policies
- Strategy or business plans
- Relocation
- Director remuneration

Trustees were commonly involved in EOT bonus distributions; the process was generally not laid down formally but tended towards one of approval.

Fig 11: Matters to be referred to the trust

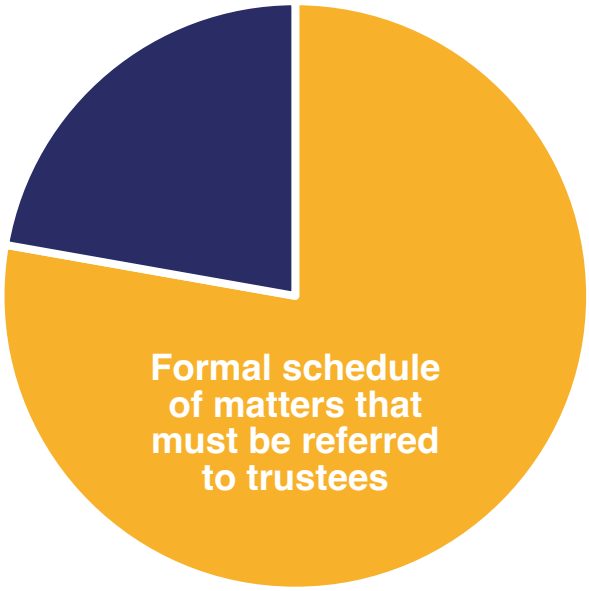


Fig 12: How often they have arisen

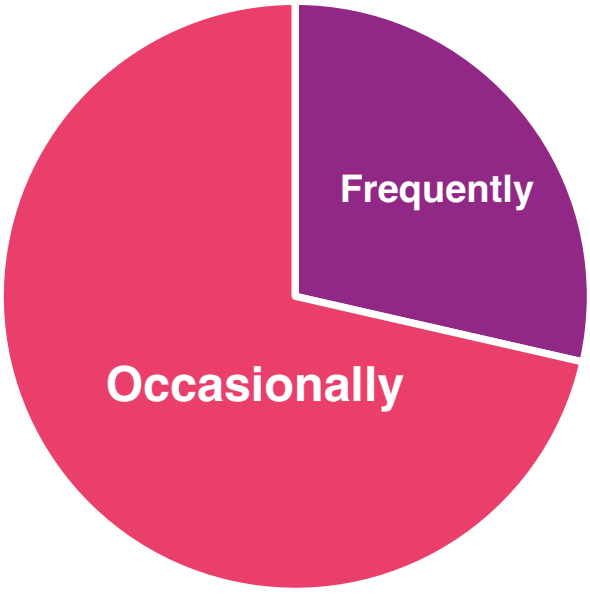


Fig 13: Total trustee board size

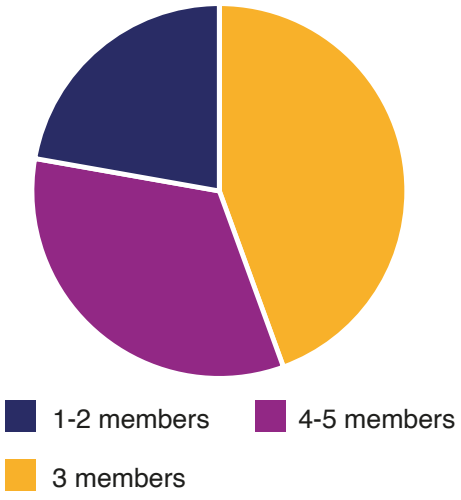


Fig 14: No. of trustees who are management

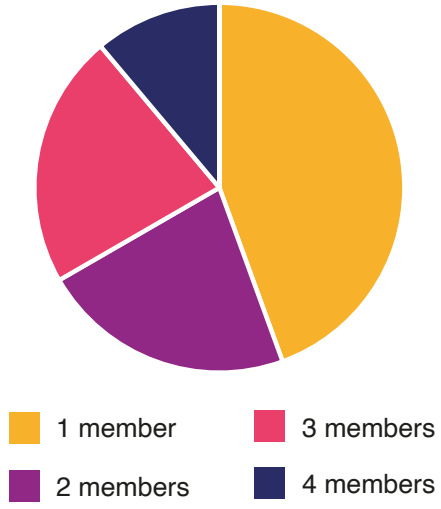
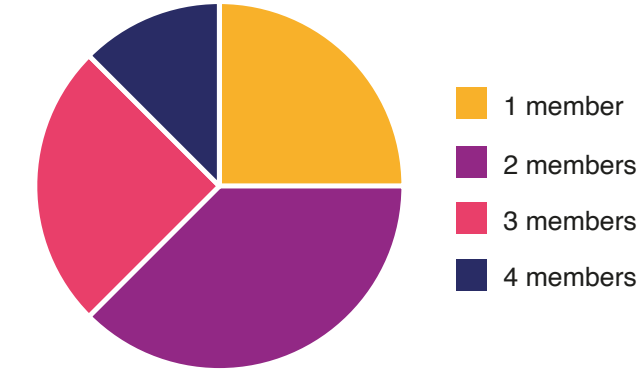


Fig 15: No. of trustees who are employees



Trustees and the trust

Trustees have a duty to ensure the trading company is being managed effectively and to manage any assets the trust may own. They must find a way that monitors rather than duplicates the work of the operating board, working to provide oversight and challenge to get the best outcomes for the trading company and its employees. This part of the survey looked at how trusteeship works in practice and how trustees are appointed.

Trust board composition: The articles or trust deed set parameters for the trust board in all cases, with approximately half of the companies surveyed going on to establish its composition beyond the defined minimum number of trustees. An equivalent had considered the mechanics of trustee rotation.

All respondents had a combination of founder, director/management, and employee members, and in most cases also an independent trustee on the trust board.

Trust boards tended to be in proportion to the size or complexity of the trading company and generally slightly smaller or comparable to the size of the operating board.

All had at least one management representative, commonly in addition to the founder/seller trustee.

It was common across the respondents who had two to three employee trustees to draw them from different functional/geographical groups or teams across the trading company, in most cases as a deliberate policy.

On trust board meetings: Trusts tended to align their meeting cycles to that of the operating board, and the majority met quarterly.

In most trusts, either the independent trustee or management trustee acted as board chair, although there were examples where the chair is elected meeting by meeting.

Most trusts worked to a majority decision, with the chair having casting vote, but there were examples where unanimous decision was the rule. This was invariably established in the articles or trust deed.

Holding the operating board to account: Company updates at trust meetings were the primary means of trustees maintaining oversight of the current health and future prospects of the business. In most cases, this took the form of bespoke reporting by the CEO/MD who joined the meeting for that section of the agenda.

There was an occasional flow of information passed to trustees between meetings in some companies, most commonly from being added to the distribution of other materials in circulation rather than specifically produced. Just under a quarter of the companies surveyed gave trustees wide access to management data which they could pull information from.

A small number of respondents conducted regular chair-to-chair or chair-to-CEO/MD calls outside of formal meetings as a means of maintaining high-level dialogue.

When probed, levels of holding to account varied, highlighting the practical challenges of turning principled concepts into practice. For some, this had been achieved early through design, but for most it had taken time to experience the pivot where discussion around company updates was no longer a duplication of other management meetings and instead started holding to account. Several companies admitted to still building to this point.

The majority were reliant on a subjective feel on how effectively the company was being run rather than any evidenced approach.

And very few had actively considered the matter.

The reality is that many trust boards are still bedding into their role 12-24+ months after transition and some have deliberately taken a phased approach to maturity. From the other side of the coin, while employee ownership is continuing to bed in across the organisation and is still relatively novel, trust boards appear not to be coming under any particular scrutiny from the beneficiaries they represent.

Fig 16: Frequency of formal trust meetings

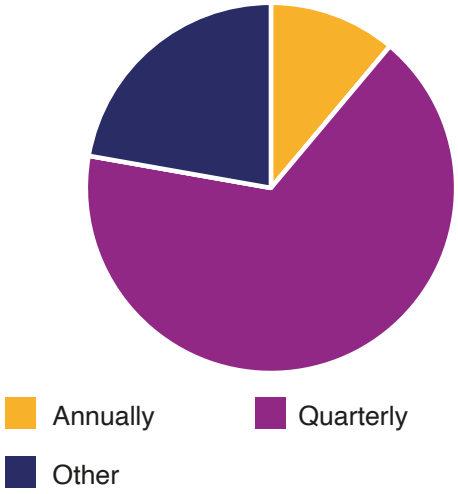


Fig 17: Forming an opinion on company board effectiveness

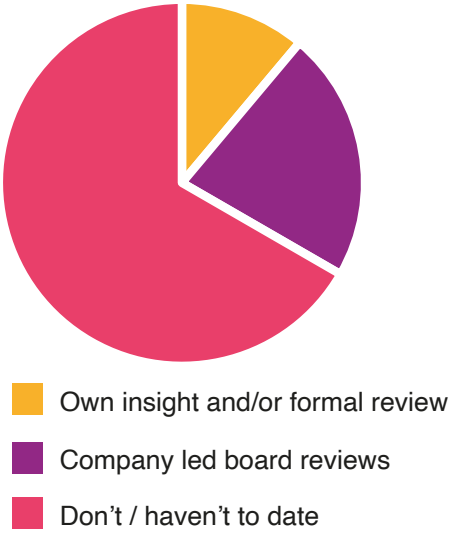
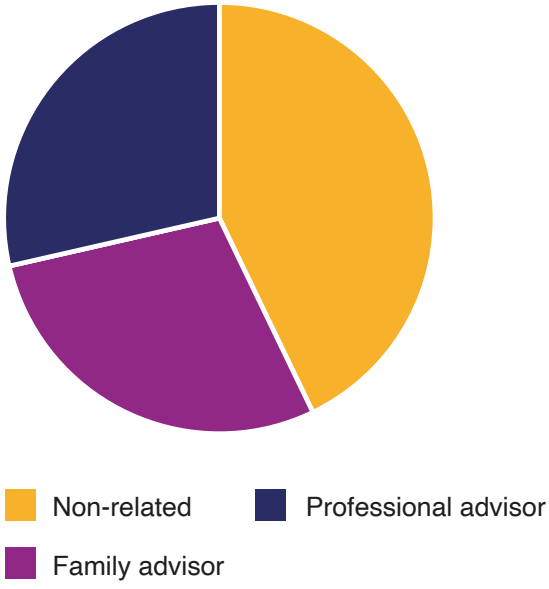


Fig 18: : Sources of independent trustee director



Appointing trustees: Initial trustees tended to be appointed by the company but there were examples where employee trustees had been elected by employees from the outset.

Thereafter, the most common method:

- for electing management trustees was by nomination from the operating board; and
- for electing employee trustees was through self-nomination and employee election.

Whilst the company invariably selected the initial independent trustee, most companies anticipated the trust board selecting their successors.

Most trustees were expected to serve for three or four-year terms, with the ability to be re-elected although this was only established in the articles or trust deed in a minority of cases. Many respondents had however staggered appointments on the first round to maintain continuity.

Whilst most trusts ran some form of induction, it was generally not formalised. The independent trustee, where one was appointed, was commonly used in a mentoring role. Just under half the respondents invited trustees to observe a meeting prior to taking up their appointment, and approximately one-quarter included briefings by the MD/CEO and Head of Finance in their induction package.

Independent trustees: Most companies had appointed an independent trustee, and it was a remunerated role. Just under half of these appointees had no pre-existing relationship with the company or founder.

The most common reasons for bringing in an independent trustee, in order of commonality, were:

- professional advice that it was best practice
- external challenge to the company board
- to bring in broader experience of trusteeship

The employees

Employee ownership aligns employees more closely to the company, via involvement in its dialogue through to the potential to share directly in its success. This part of the survey concentrates on these facets of company practice.

Building collective identity and purpose: There was no single term commonly used to describe employees (as beneficiaries) in an employee owned company although, in nearly all, the term adopted served as an underlying statement on ethos. Responses ranged from employee owners, partners, colleagues, to staff or a play on the company name. Many companies had involved staff in selecting what they best identified as collectively.

There was widely held confidence that strong, lived values and a culture of openness have contributed to better alignment and promoting collective identity. Several companies saw transition as a time to reflect on what their values really were and had involved their employees in the process of reaffirming the values they wanted to live by as part of the transition process.

Many companies had also created their own customs and cultures to foster team identity and inclusivity, and reflect their particular language or character. Although most of these had existed pre-transition. Many also used cross-team familiarisations to build internal understanding and transcend internal silos to create greater teamwork and sense of collegiality.

The majority of respondents felt their company had already been founded on strong values; employee ownership was a model to enhance, develop and further enshrine rather than create from new.

Employee eligibility as a beneficiary of the trust: Just under half of respondents had set their main eligibility criteria to become a beneficiary of the trust as 12 months employment with the company (the maximum allowable under current relevant legislation).

The remainder had adopted one of:

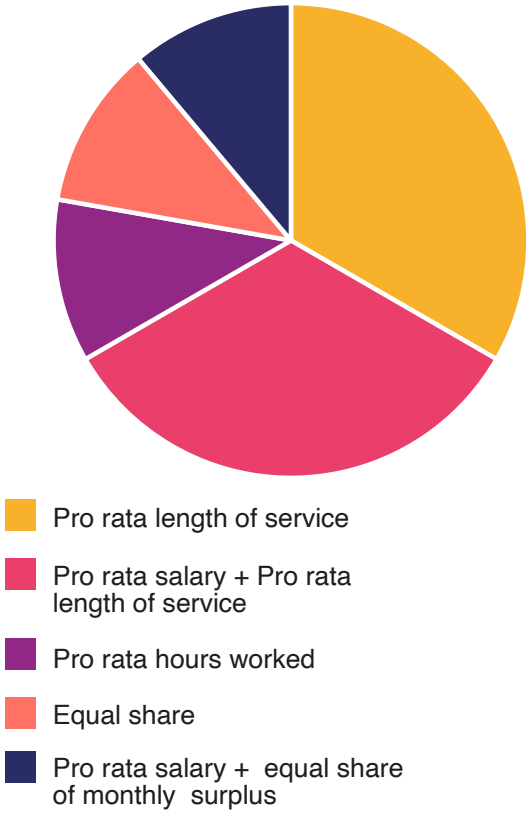
- a period equal to the probation period, or completion of a probationary period
- any period of employment during the respective financial year
- three months or six months employment with the company

Bonus payments under the trust: All respondents had paid an EOT bonus since transition, the majority on an annual basis.

Companies that had pre-transition bonus schemes generally retained them. Some, those mainly performance or incentive based, were embedded in employment T&C but the main impact of employee ownership has been to formalise payments that had previously been discretionary.

The three prescribed methods for calculating EOT distributions had not constrained how companies have wanted to use bonuses. There was no single common approach but only a few had adopted equal share.

Fig 19: Methods for calculating EO bonus



Other benefits: Just under half of respondents had brought in new employee benefits since transition, although few directly attribute their introduction to employee ownership. Common examples were more contextual, such as leave and travel carry-over, and flexible working practices.

Some companies had reached a point where sustained increased profits were prompting a review of base salaries rather than inflating bonuses or adding to benefit packages.

Employee forums: Just over half of the companies had some form of employee forum, with the aim primarily being to create a channel for employee voice.

'Employee Council' or 'Employee Forum' were the most common names for the group, although the notion of an internal advisory board was also encountered; shifting emphasis from a group that in most cases delivered a HR/wellbeing focus to one that brings employee insight to strategic challenges.

All companies felt they derived value from the forum, although most had evolved through custom rather than from the basis of considered or set outputs.

The size of the group was, in all cases, proportionate to the complexity of the organisation with the aim of ensuring key functional or geographical groups had a voice. Most employee forums in the companies interviewed comprised a trustee and employees, often with a trustee as chair or co-chair although a small minority invited trustees in the capacity of observer rather than full member. This combination was by no means universal, there was also an example of an employee forum running without any trustee or senior management involvement.

The procedure for becoming a member was generally quite formalised, with the most common being a process of self-nomination and election. Terms of office ranged from one to three years.

Employee participation: All companies were able to cite examples of employee-generated ideas that could, in part, be attributed to a culture of employee ownership and the confidence to speak up.

Ideas and topics included:

- on internal processes and organisation
- proposing new products or services
- suggesting efficiencies
- observations on facilities and internal office designs
- ideas for community involvement projects

Many used focus groups to inform big decisions. All felt there was still substantial reliance on an individual's intrinsic motivation to engage with company dialogue, however informed employees were. The companies who seemed to be achieving most impact were the ones where there were active questions from management with which employees could engage.

Internal communications

Employee ownership encourages greater engagement and participation from all, which places emphasis on high-levels of individual awareness and effective two-way communications. This section draws out findings on internal communications from across all parts of the survey.

Communications between the board and trustees: In all of the companies surveyed, a company director attended trustee meetings to provide company updates, although some place emphasis on the individual being able to separate roles where that director was also attending as a trustee. Their reports commonly covered:

- financial performance, projections (and annual accounts)
- operational pipelines
- project updates
- progress against the plan
- succession and HR updates
- auditors' reports (where applicable)
- risks

Whilst all companies considered transparency as implicit, very few broke out a straightforward 'view from the board' as a discrete item within the format of their updates. Neither did they share operating board minutes as part of this transparency of the issues being considered.

Communications between trustees and the board were largely confined to the interaction at trust board level.

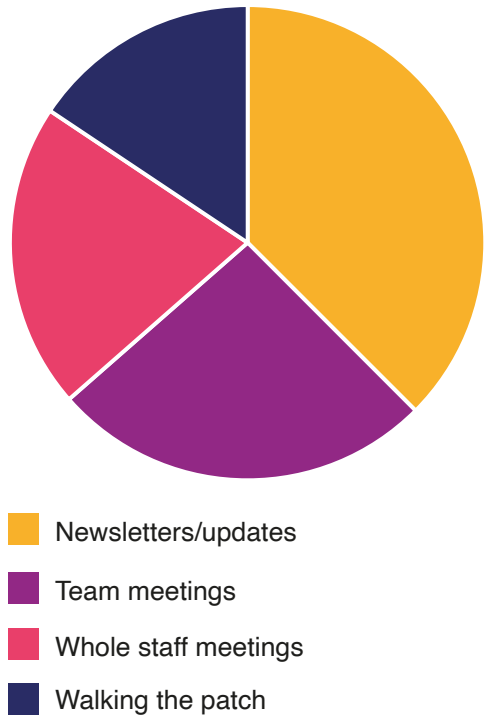
Communications between the board and employees: All companies felt downward internal communications had increased with employee ownership, whether by design or sub-consciously. In particular, it had prompted greater transparency of company finances and pipelines and, in some, more focus on employee good news stories and human factors. Some companies had also widened access to management information on transition.

Familiar avenues for generating shared awareness existed in every company, ranging from team and whole-staff meetings to newsletters, open access to management, anonymous feedback channels, and founders 'walking the patch' to name but a few.

The frequency of team and staff meetings varied greatly, notwithstanding the impact of COVID-19 on usual workplace routines, yet they were seen by the majority as the main vehicles for internal communications and engagement. Companies where team meetings were regularised, prioritised and with defined purpose and outcomes seemed to be achieving the greater value.

As at board to trust level, very few companies routinely cascaded the 'view from the board' as a distinct insight to the company's rolling context and challenges.

Fig 20: Main methods of internal communications



Communications between the trustees and employees: Across the respondents, there was little direct communication between trustees and employees, beyond those trustees involved with an employee forum. Many companies had created opportunities for employees to 'meet the trustees' either through informal events, drop-ins, visits to the workplace or virtual meetings and felt employees had found this reassuring.

All companies had found the employee trustee in particular often played an important bridge in communications, especially where they had been in place during the early stages of transition. However, their potential was dependent on how much priority had been given to identifying and growing their role as a representative of the employee constituency.

Most trusts had established an avenue for direct contact, but the key dynamic in ensuring the right link between trustees and employees was understanding the other avenues of communications in play and where they led. Many companies had found it important to be clear to employees (and sometimes trustees) about what was still internal management business under employee ownership.

Mostly, trustees sifted employee mood from the outputs from an employee forum (where one existed), from matters brought to the trust board via the operating board, from issues picked up through company updates, or from internal trustees picking things up in their normal work. About a third of respondents had implemented a regular routine of trustee-led 'coffee & chat'.

All companies had used or envisaged trustee-led focus groups in the event of debate on strategic proposals, such as those in the matters to be referred, which had enabled trustees to understand their beneficiaries' wishes on issues with direct impact.

Most trusts did not share the full minutes of their trust meetings with beneficiaries, mirroring company policy on not sharing operating board minutes.

Conclusions

This research snapshot identifies a solid range of emerging common practice around the establishment of EOT company shareholding and the extension of employee ownership in SME businesses. At the same time, the findings certainly suggest a handful of areas where early stage EOT businesses are having to feel their way and where there is an important role for the sector to play in supporting businesses to better understand what good practice looks like.

For instance, the report seems to confirm that almost all businesses deploying an EOT transfer at least 51% or more of equity to be held on behalf of employees (it is the case for all the businesses who participated in this study). This makes sense given the EOT needs to hold a majority shareholding before the tax benefits are triggered for both the selling owners and the new employee owners.

Currently most SMEs seem to require cash reserves in the business to help fund the initial purchase of the shares by the trust. As the size of the EOT market grows, it will be interesting to see whether demand from businesses without significant cash reserves drives more popular and innovative external financing options.

Digging between the lines of the common practice identified, there are some obvious areas of evolving practice that the sector should continue to track and explore. The authors of this report are clear that a transition to an EOT model does not need to disrupt regular company business, but importantly if it is expected to deliver more than just an effective succession plan there should be more considered actions undertaken by management teams.

It is encouraging that a transition into employee ownership tends to be accompanied by change at operating board level, with almost all companies re-styling senior management and executive roles to grow or formalise an operating board. Companies appear to progress fairly quickly with transferring responsibility from founder to MD and establishing a directorship function, although few of those surveyed had gone back to formally evaluate leadership effectiveness as part of the journey, either from their own initiative or prompted by trustees.

However, it is interesting that founders tend to stay active in the company for some time post-transition before fully stepping back into either a trustee role, minority shareholder position, or exiting. It is clearly a welcome feature that the governance model allows significant flexibility in this respect. However, it is a topic worthy of further examination to establish whether this continued strong presence of founder-owners (who pre-transition have typically been ‘all-powerful’) has a positive or negative impact on whether employees feel they have a meaningful voice as new owners in the business.

Those companies introducing an employee forum saw relatively quick impact in generating dialogue and a greater feeling of inclusivity in employees, who could see the issues impacting them at work being aired publicly. Nevertheless, many respondents were also finding that combinations of more communications pushed out, an employee forum, and a cycle of team and staff meetings did not, in themselves, generate greater participation. The governance system, even under employee ownership, seems to need something more to spark an ongoing conversation.

Effective trusteeship seems to bind the system and is its safeguard. The role of independent trustees appears to be critical, particularly in new EOT businesses where the independent often undertakes a mentoring role in their interaction with fellow ‘internal’ trustees and the leadership team. Taken alongside the finding that founders are tending to stay very active in their businesses after the introduction of an EOT, and putting themselves onto trust boards, this suggests the actual and perceived independence of those independent trustees may prove critical to employees.

Companies have not generally struggled to maintain the distinction between operations and oversight, but the practice of trustees holding operating boards to account for how effectively they run their businesses is still an area of development. A number of trust boards spent time in their early years clarifying what matters came to them for approval versus consultation, and what issues raised to them by employees were

operational matters for the management team.

Trustees are, in the majority of cases, focusing on the same sets of management information as the operating board. Trusteeship suggests a broader set of metrics establishing how the company is being run rather than just its performance output. On the face of this snapshot, trusteeship could prove to be the component of employee ownership that takes longest to evolve and deliver its fullest potential.

In conclusion, there are some consistencies across these SMEs in their approach to how employee ownership can work for them and the governance framework in place to create this. However, at this early stage in their development there is also a recognition that areas remain where greater attention or understanding would be helpful and could deliver the significant benefits that employee ownership can bring for the business and its people.

What is evident from this small survey is that there is a desire within EOT businesses to embrace these opportunities. In the experience of the authors, the companies surveyed here are typical of the sector in that their ethos and underlying core values drive them to want to make employee ownership work, and for the company to build on its past in a more collegiate and transparent manner.

Ownership at Work