

EMPLOYEE OWNERSHIP

A successful succession solution



Why Employee Ownership?

With statistics consistently demonstrating that employee-owned businesses outperform their non-EO counterparts in terms of profitability, improved business resilience during times of recession, and increased productivity through enhanced levels of staff engagement and wellbeing, there is no better time for you and your clients to explore employee ownership as a viable succession route.

Lorna Jack is CEO of the Law Society of Scotland and chaired the Scottish Ownership Effect Inquiry.

EMPLOYEE ownership is a great way for your clients to do business. It's a tried and tested model, which has produced some excellent results and works for individuals, business and the wider economy. I was delighted to be invited to chair the Scottish arm of the Ownership Effect Inquiry, a year-long investigation led by business leaders and industry experts into the benefits of employees owning a stake in the business in which they work.

In that report, employee-owned businesses were identified as being more efficient and productive,

better able to withstand economic downturns and able to commit confidently to long-term strategies. Importantly, it was reported that employees in these firms were better placed to share in the success created, through profit sharing bonuses, dividend payments or increases in share value. It's just such a great succession option.

Scotland's advisers have a major role to play in ensuring that the employee ownership option is on the agenda, not just for succession planning, but also as an excellent way to structure a company. And I'm proud of how Scotland's solicitors have risen to the challenge, in being always ready to provide such advice.



Graeme Nuttall OBE, Partner with Field Fisher, has been active in employee ownership law for more than 30 years. As Government adviser on employee ownership to the Coalition Government, he is viewed as the architect behind the Employee Ownership Trust legislation.

The Employee Ownership Trust – Five years on

EMPLOYEE ownership is based on the premise that when all employees have a stake in the business in which they work, the results can be transformational. Employment is more fulfilling, businesses are more successful and the economy more resilient.

The Nuttall Review, published in 2012, identified a number of obstacles impeding the growth of employee-owned businesses in the UK. One of these obstacles was the perceived complexity of converting to employee ownership. The Employee Ownership Trust (EOT) was introduced in 2014 as a specific vehicle, with accompanying tax exemptions, to simplify the move to employee ownership for businesses.

Advising the Westminster Government on the introduction of this groundbreaking legislation in 2014, I was keen that the principles of employee involvement and inclusion were at the very heart of the law. As we know, merely changing the legal form of a business is unlikely to deliver on these principles. My vision was that this law would pave the way for a sounder, fairer way to operate a business. As such, to qualify for the tax incentives attached to the Employee Ownership Trust, certain requirements have to be met:

- **The controlling interest requirement:** The EOT needs to acquire a controlling shareholding in a trading company or group. This ensures employees,

via the EOT, have the necessary substantial stake in their company.

- **All employee benefit requirement:** Broadly, all employees are beneficiaries of the EOT, not just a select few. The trustee of the EOT acts as the steward of the company, ensuring the company is run in the best long-term interests of the beneficiaries, the employees as a whole. This doesn't preclude individual performance rewards as part of a company's remuneration strategy. But the income tax free bonuses that EOT controlled companies can pay must, in broad terms, be paid to all employees. All employees contribute to a company's success and all employees should enjoy rewards from that success.

- **Equity of reward:** Income tax free bonuses must be distributed fairly to the employees. This can be done by equal payments or bonuses based on length of service or hours worked, or proportionately to salary.

The EOT has been very successful; the number of employee-owned companies in the UK has tripled since 2014, and Scotland is clearly leading the way. But more can be done and you all have a part to play in that. Supporting clients to implement employee ownership structures will pay dividends for your clients, and will result in a stronger fairer economy.

Scotland – Leading the Way

Sarah Deas is Director of Co-operative Development Scotland, the arm of Scotland's enterprise agencies that supports company growth through collaborative and employee ownership business models.

THERE has never been a more exciting time to be involved in employee ownership. There are now around 100 employee-owned companies operating in Scotland, with approximately 7,000 employee-owners generating a combined turnover of £940 million. I'm delighted to say that Scotland is leading the way!

The employee ownership model is viewed by the Scottish Government as a means to root businesses in their communities, drive productivity and share wealth more widely. Scottish success stories include Jerba Campervans, which has seen a 10% increase in profits since its move to employee ownership, and Aberdeen's Woollard & Henry, which has transformed itself from servicing the domestic papermaking market to supplying a wide range of products worldwide.

These examples reinforce the evidence that employee-owned companies perform well in terms of productivity, inclusion and innovation. And importantly for the Scottish economy, there is less likelihood of these companies moving out of Scotland.

In 2018 we reached an important milestone when we saw the launch of 'Scotland for Employee Ownership' (SfEO); an industry leadership group formed by employee-owned businesses with the support of the Scottish Government. SfEO was launched by the First Minister at Auchrannie in Arran, the award-winning hotel and resort group that moved to employee ownership earlier that year.

The aim of SfEO is that Scotland becomes known internationally as a country that overindexes in terms of employee ownership. Consequently, there is a more proactive approach to tackling the corrosive effects

of inequality and lack of inclusion. And, business performance and innovation levels are enhanced.

SfEO has set an ambitious target of 500 Scottish based employee-owned businesses by 2030. Our experience at Co-operative Development Scotland suggests that, whilst this will be stretching, it is achievable. We have seen a significant rise in enquiries, and the conversion rate of these enquiries is increasing.

This growth represents a significant opportunity for advisers and, indeed, it has been recognised that Scotland's lawyers are more aware of the workings of the Employee Ownership Trust model than their colleagues in the rest of the UK. As we continue to focus on increasing the number of employee-owned companies in Scotland, alongside the efforts of SfEO, demand for employee ownership expertise will continue to rise. I'm pleased that you are well placed to rise to this challenge.

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Right: John Clark, SfEO Board Member, Nicola Sturgeon, First Minister, Sarah Deas, Co-operative Development Scotland



Bentleys Dundee

Bespoke joinery manufacturer and interior fit-out specialist, Bentleys Shopfitting Ltd, moved into employee ownership in 2016, with 50 former staff members now owners.



ESTABLISHED in 1987, the Dundee-based company specialises in the management and completion of interior fit-out projects, creating high quality bespoke furnishings at its in-house manufacturing facility. It has evolved from specialising in the retail sector to expanding its expertise across the education, leisure, hospitality, corporate, residential and oil and gas sectors, with notable projects including The Old Course Hotel and Spa in St Andrews, Gleneagles Hotel in Auchterarder and the Balmoral and Sheraton Grand Hotels in Edinburgh.

Bentleys' three directors were keen to continue the trend in growth since the recession and wanted a succession plan which would allow them to continue to be involved in the business over a period of years whilst supporting a management team that would continue to drive the business forward. The priority of the board was to ensure the business remained local – and that's what employee ownership has delivered.

Bentleys was supported in its transition to employee ownership by CDS with the process managed by Ownership Associates, legal services by Lindsays and accountancy services by EQ.

Palimpsest Falkirk

Falkirk-based Palimpsest Book Production Ltd, one of the UK's market leaders in book production, transitioned to employee ownership in September 2018 – giving 21 employees a stake in the business.

ESTABLISHED in 1994 by Craig and Ruth Morrison, Palimpsest provides the full range of pre-press services, including typesetting, proofreading, digital publishing, design and reprographics, to the UK publishing market. When Craig and Ruth started to think about their future retirement they wanted to guarantee that Palimpsest would continue to operate successfully, and not be relocated. Craig attended a seminar on succession planning organised by CDS, and was immediately attracted to the idea of employee ownership because it would enable them to realise part of their investment while continuing to work in the business until



retirement, and would also ensure that Palimpsest would continue to thrive, offering employment and careers in Scotland into the future.

Craig and Ruth have now sold a controlling interest in the business to an Employee Ownership Trust which will hold the shares on behalf of the 21 employees.

Palimpsest's move to employee ownership was supported by CDS, with the process managed by Ownership Associates and legal services provided by Lindsays.

“EO would ensure that Palimpsest would offer employment and careers into the future”



Auchrannie Resort Arran

Luxury resort Auchrannie completed its transition in January 2018, with 160 members of staff becoming owners.

LOCATED in Brodick on the Isle of Arran, Auchrannie, which has an annual turnover of £8 million, is an award-winning resort comprising two 4-star hotels, 30 5-star self-catering lodges, two leisure clubs, three individually branded restaurants, a children's Playbarn, a destination spa and Arran Adventure outdoor company. It was established by Iain and Linda Johnston in 1988. Linda has headed the company as managing director and board chair since Iain passed away in 2015.

The family considered many exit options, but none protected the ethos of the company, the team or the community use of Auchrannie's facilities for future generations like employee ownership. An Employee Ownership Trust was formed and holds 100% of the shares on behalf of the employees. The deal was structured to make it affordable to the business without affecting its ability to reward the team and reinvest for the future. It was the first resort in Scotland to become employee-owned.

Auchrannie's transition to employee ownership was supported by Highlands and Islands Enterprise and CDS, with the process managed by Co-ownership Solutions LLP and legal services by Burness Paull LLP.

"The deal was affordable to the business without affecting its ability to reward the team"

Chemco International Coatbridge

Christmas came early for 24 employees at the Chemco International Head Office in Coatbridge, after it became 100% employee-owned in December 2018.

REGARDED as a market leader in the design and manufacture of state-of-the-art protective coatings, Chemco International is at the forefront of delivering environmentally friendly products for a wide range of industries throughout the world.

The move to employee ownership came as the company was going through one of the most successful spells in its history. It was really important to the owner, Manny Khorasani, who decided that he wanted to take a back seat in the business, that the company not only stayed within the local community, but that the jobs and the skills of the staff, who all live locally, were retained and protected. Employee ownership provided the security that he wanted and, most importantly, would allow the employees, who have all played a key role in the growth of Chemco International, to have a real say in its future.



An Employee Ownership Trust was formed which holds 100% of the shares on behalf of the employees.

The transition to employee ownership was supported by CDS with the process managed by 4-consulting, legal services by Blackadders Solicitors and accountancy support from Charles Chartered Accountants.

"Employee ownership provided the security that he wanted"

A Lawyer's Perspective

Bruce Farquhar is Corporate Partner and Chair of Anderson Strathern - and one of Scotland's most experienced lawyers when it comes to advising on employee ownership deals.

“A sale to an Employee Ownership Trust can fit well with the owners' expectations of the deal and bring benefits for the employee and for the company.”

SUCCESSION planning is never an easy topic for business owners to address. However there is an alternative to selling the business. Employee Ownership Trusts are now becoming established as a succession option for businesses.

Sometimes a sale to a trade buyer can be challenging for business owners. The due diligence process can be long, with many constraints on the sellers. Moreover, many business owners just don't want to see someone else's name over their door, especially if that door is likely to be relocated many miles away, leaving loyal employees without jobs.

Selling the shares to the company's management team can ensure the business remains local, in the hands of people who understand how the business works, but there are downsides. Management buyouts can put a lot of stress on individuals, and sometimes the expectations of the funders are not aligned with the leadership team.

Employee Ownership Trusts

There is another solution: one that maintains the independence of the business, allows the owner to exit at their own pace, and protects the employment of the workforce for as long as the company continues to be viable. Since its introduction in 2014, the Employee Ownership Trust has become established as a feasible succession option and is proving popular with business owners. If key qualifying conditions are met, the following tax benefits are available:

- Full capital gains tax relief for the owners on the disposal of a controlling interest to an Employee Ownership Trust
- Employees can benefit from a bonus, of which £3,600 per annum will be tax free.

A flexible model

The business outcomes of employee ownership are well documented. It makes sense, if the employees have a stake in the business, that they are more likely to work harder to make the company

successful. And this fits with our experience: when a company moves to employee ownership we often see an uplift in corporate performance.

It's a flexible model that can be shaped to suit the aspirations of the business owner as seller, and also the employee group as buyers. The Employee Ownership Trust can sit alongside executive share schemes such as EMI options, and with all-employee share schemes such as share incentive plans. The business owner can retain a shareholding if that's what they want to do, although they do have to consider how that shareholding can be divested in future.

Funding

Funding for employee ownership deals is now more accessible. Until recently, most of these deals were vendor financed. We have seen a significant shift in the attitudes of lenders in recent months and there is now more likely to be an element of external funding.

Engagement

For the corporate lawyer, employee ownership transactions are a dream to work on. It's a collaborative deal; everyone wants what is in the best interest of the company. They are very different from trade deals, where the seller wants the best price and the buyer wants the top deal. Many firms like to involve employees in the negotiations; the increased understanding can smooth the process. The deal completion is often a reason for the whole company to celebrate, and there is something very special about being part of that.

A viable option for business owners

The Employee Ownership Trust is here to stay. Interest in employee ownership continues to increase, and these deals comprise a growing proportion of our corporate transactions. There is now no need for business owners to shy away from the succession conversation; there will be a solution and the role of the adviser is to support the business owner in making that informed choice. A sale to an Employee Ownership Trust can fit well with the owners' expectations of the deal and bring benefits for the employee and for the company. It's not going to be the answer for everyone, but it's an option that should be on the table.





Managing the transaction

Once your client has decided that he/she wants to explore Employee Ownership as a succession route, what are the next steps? **Glen Dott**, an Employee Ownership Specialist with Co-operative Development Scotland, explains.

SUCCESSION planning is often overlooked and it's my job to work with business owners to help them through the process. When business owners engage with CDS, we offer a free Ownership Succession Review and an Employee Ownership Feasibility Study. The ownership review provides information on all exit options and the objective is to work out which option best suits the client's needs.

If employee ownership is an option, we undertake an Employee Ownership Feasibility Study. This outlines how an employee-owned business might be structured, normally via a trust and defines the governance relationship between the operating business and the trust. It would also recommend employee engagement mechanisms, including use of share schemes to attract and retain staff. Lastly we would examine how a sale to an Employee Ownership Trust (EOT) may be funded - normally the owner converts his shares to a loan which is paid back by the company from future profits over a number of years.

Should the owner believe that a sale to an EOT is their best exit option then they would proceed with implementation using a project team comprising three specialist advisors:

- **Employee ownership specialist.** manages the project in line with the feasibility study recommendations and communicates this effectively to all parties.
- **Lawyer.** the legal adviser would revise the articles of association, set up a trust deed, draft a sale and purchase agreement, set up warranties and indemnities and produce ancillary legal documentation including ranking agreements.
- **Accountant.** undertakes business valuation and applies for HMRC tax clearance. The accountant may also be asked to structure any vendor loan or to assist with securing external funding.

Most projects of this nature are part grant supported by Scottish Enterprise and Highlands and Islands Enterprise via a simple application and appraisal process

Some owners will involve the employees when the idea is in its infancy, others will wait until the company is fully committed to the path of employee ownership and there is a clearer picture of the shape of the new structure. It's good news for employees; however, it's likely to be a new idea and it's important that any concerns are addressed openly and honestly.

A key component in a successful employee ownership transition is having a robust succession plan in place for the key roles in the company. The former owners may not be exiting immediately, and a good succession plan will make sure there is time for the necessary development of internal candidates and sufficient time for a selection process and induction for external candidates.

Of course, it's critical for anyone who is thinking about succession planning to surround themselves with the right team, people who can provide professional advice and support and that's where you come in!

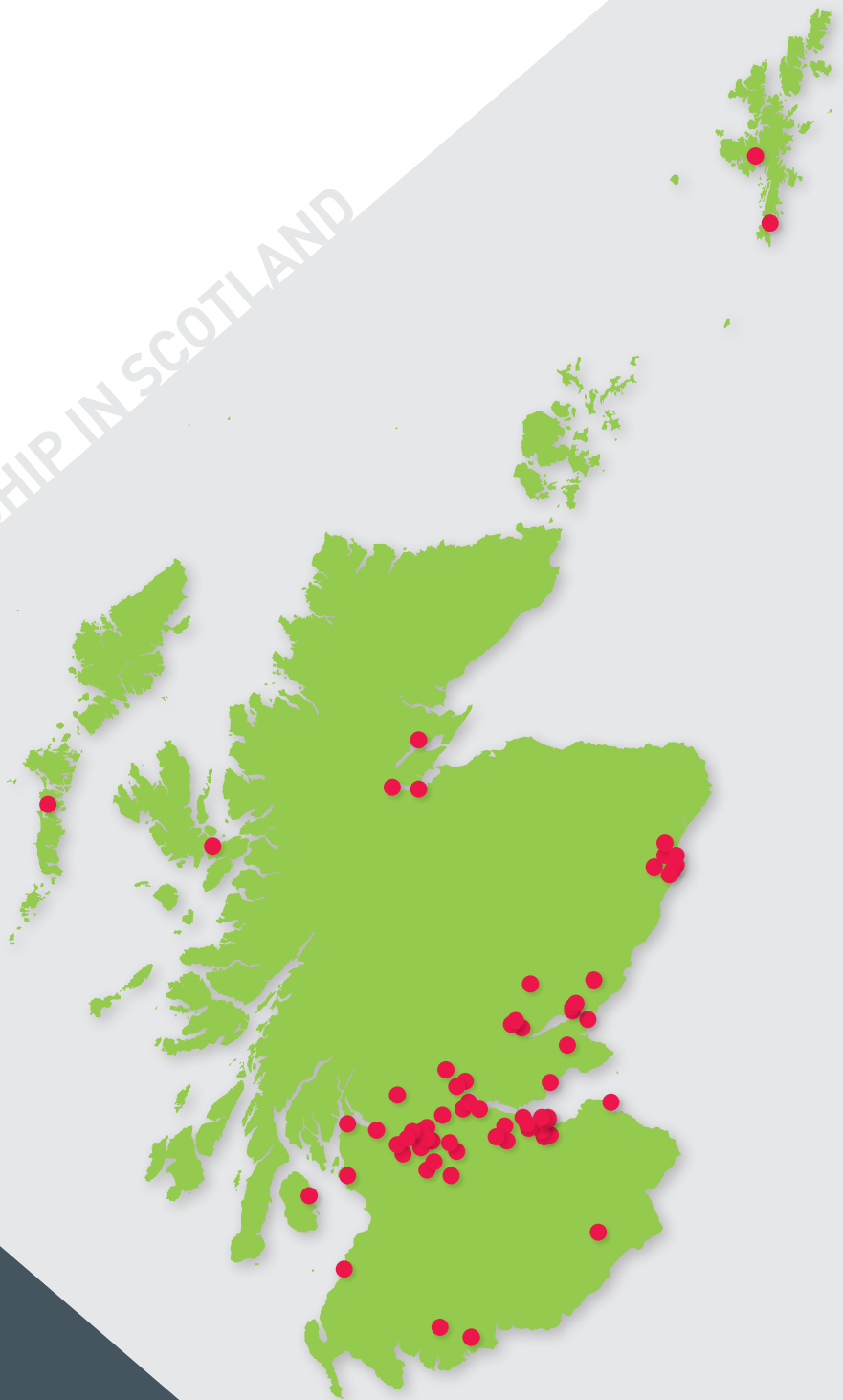
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development
scotland



Co-operative Development Scotland is the arm of Scottish Enterprise working in partnership with Highlands and Islands Enterprise that supports company growth through collaborative and employee ownership business models.

EMPLOYEE OWNERSHIP IN SCOTLAND



Front cover image: Jerba Campervans

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