Guide to: Employee Ownership

With well-known names such as Go Ape joining the likes of John Lewis and Richer Sounds as companies owned by their Employees, Employee Ownership is becoming an increasingly attractive option for Business Owners looking for a route to exit from their business.

The most common route to Employee Ownership is through an Employee Ownership Trust (EOT). One big advantage of a qualifying sale of shares in a company to an EOT is an exemption from Capital Gains Tax.

There are many things to think about when considering whether a sale to an EOT is right for you, these include:

Will Employee Ownership allow a smoother exit?

A Business Owner’s exit from their company can be hindered by many factors ranging from a lack of a suitable third-party buyers (including not wanting to sell to a competitor) to there being no suitable management team for a buy-out.

A sale to an EOT, however, could provide a ready-made market for the shares in the company whilst solving succession issues at the same time. Also, the sale process should be friendlier compared to a sale to a third party, with less negotiation and potentially fewer warranties.

Will an EOT be able to pay the purchase price?

With a sale to an EOT there are several options as to how the transaction can be financed, these include:

- Some or all of the purchase price being paid after completion over a number of years. The EOT will fund this through the profits of the company.
- Part of the company’s excess cash may be gifted to the EOT on or shortly after completion to give the exiting shareholder an initial payment.
- Director’s loan balances could be settled as part of the payment mechanics.
- Bank financing could possibly be obtained based on the performance of the company.

There could be a combination of the above funding options, often the Seller/company effectively funds the transaction.

Given the advantages of an EOT, the Owner Manager may be prepared to accept longer payment terms than with a traditional sale, especially as the profits of the Company are not going to be paid to a new third-party owner.

How important is the continuation of the Business?

Many Owners have spent a great deal of time and effort building up their company. When it is time for them to sell, whether due to retirement or them wanting to realise some of the value in their business, they often have little to no idea how the Buyer will run their company in the future. When an Owner sells to an EOT, as there is no external third party taking over, this avoids parts of the business being hived off or the company split up to suit the Buyer's business plans.

If a Business Owner is concerned that a Buyer will change the way the business has been run or ruin its culture, then an EOT would allow them to ensure (within reason) that the business can be run with the same ethos and ideals they started it with.

As an EOT is run for the benefit of the employees of a Company as a whole, it can take long term decisions in the best interest of the Company and the Employees even if it could impact on the short-term profitability.

How much involvement does the Owner want to have in the Business?

The EOT model allows Owners to remain involved at various levels within the business after completion. This could be as a trustee of the EOT, a director of an EOT trustee company, a director of the trading company or an employee/consultant of the trading company. The way that the EOT purchase is financed will also have an impact, if the majority of the purchase price is to be paid after the sale, the Business Owner may wish to remain involved in the day to day running of the business to help ensure it performs as well as possible.

Do you want to have a partial exit?

Provided the EOT meets the relevant conditions, an EOT does not have to own all of the shares in the company as long as it holds a controlling stake. This means that an Owner could realise some of the value from their shareholding in a tax advantageous manner, while retaining some ownership of the company.

How do the employees benefit?

EOTs are able to provide their employees with a bonus of up to £3,600 free from income tax each financial year (although national insurance contributions still apply). A bonus must be paid to all eligible employees on the same terms, but bonus levels can be set by reference to remuneration, length of service or hours worked.

Employee Ownership has been shown to motivate employees, increase productivity, help with employee retention and drive increased profits, so the Employee Ownership model has advantages for both the Business Owner and the employees.

There will be a range of factors an Owner will need to consider in relation to their exit from their business and engaging with their advisors as early as possible is important.

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