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MUTUALLY ASSURED GROWTH?

Employee ownership and the UK economy

Nigel Keohane

ISBN: 978-1-904899-85-3
£10.00

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Kindly supported by

John Lewis Partnership

FIRST PUBLISHED BY
The Social Market Foundation, November 2013
ISBN: 978-1-904899-85-3

11 Tufton Street, London SW1P 3QB

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DESIGN AND PRODUCTION
Soapbox
www.soapbox.co.uk

PRINTED BY
Repropoint – Digital Print Solutions
www.repropoint.com

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ACKNOWLEDGEMENTS

The publication of this report has been made possible by the generous support of the John Lewis Partnership.

I would like to take the opportunity to thank attendees at the events we held on the topic of business ownership diversity in spring / summer 2013. Particular thanks are due to the speakers at the three events: Iain Hasdell, Martin Horwood MP, Tristram Hunt MP, Professor Joseph Lampel, Patrick Lewis, Sir Charlie Mayfield, Jesse Norman MP, Graeme Nuttall, Chi Onwurah MP, and John Woodcock MP.

I would also like to thank those who have fed ideas into the report and looked through drafts, including Nida Broughton, Jeff Masters, Leonora Merry, Emran Mian, John Soutar, Neil Spring and Dr Ruth Yeoman.

Any errors or ommissions remain my own.

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EXECUTIVE SUMMARY

In the wake of the financial crash there has been much soul-searching by politicians as to how failures in the market economy can be resolved. Each party has expounded its own version of renewal: the Liberal Democrats have spoken of 'responsible capitalism', the Labour Party of 'good capitalism' and the Conservative Party of 'popular capitalism'.

Appalled at the irresponsibility displayed by senior executives in the lead up to the crash, at the excessive salaries extracted by bosses and by financial speculation, policymakers have sought to boost employee engagement within firms, to strengthen accountability, and to encourage more diverse forms of ownership. The measures have not been insignificant. Just as the Cabinet Office has promoted mutuals as providers of public services, so the Department of Business Innovation and Skills has sought to stimulate interest in employee ownership following the Nuttall Review of Employee Ownership.

The fallout from the Co-operative Bank scandal now challenges the very premise for these reforms and brings us to a fork in the road. Even when the Co-op Bank started to stutter in summer 2013, some dismissed the potential of alternative business forms more generally, describing those seeking to promote co-operative and employee-owned forms as guilty of 'ideologically-driven delusion'.[1] The poor leadership, bad debts and apparent regulatory irregularities displayed by the UK's largest co-operative firm have subsequently triggered widespread dismay and lent weight to questions about the validity of initiatives undertaken to diversify business ownership in the UK.[2] And, the big question left hanging

1 Allister Heath, 'Time for the coalition to abandon its obsession with mutuals', *City AM*, 18 June 2013.

2 James Ashton, 'The first banking crisis was the root of Co-op's troubles', *Evening Standard*, 21 November 2013.

is: should governments worry about business ownership? Some think not.[3]

So, does business ownership matter? And, if so, why? What benefits if any would greater plurality of ownership structures bring at an economy-level and firm-level? Is it the business of policymakers to concern themselves with this or can the market be left to decide? These are the questions this paper seeks to address, with a particular focus on employee ownership.

BUSINESS OWNERSHIP IN THE UK: THE STATUS QUO AND ITS IMPLICATIONS

As Chapter 2 shows, businesses can be owned by a range of stakeholders: shareholders; private equity firms; partnerships; families; government; consumers; or employees. But, despite the crash in which it was implicated, the PLC model continues to dominate the UK economy. Family firms tend to be smaller than in many comparator countries, and the sector employs a smaller proportion of employees than its European comparators; the co-operative sector contributes only 3 percent to UK GDP. Meanwhile, evidence suggests that the number of firms offering share schemes has declined markedly and that the number of firms offering tax-advantaged schemes to all their employees has also fallen in recent years.

As the reviews of John Kay, George Cox and the Ownership Commission show, the PLC and the equity markets that support them have been beset with problems, such as short-termism and insufficient regard to sustainable growth. Part of the remedy lies in reforming the PLC itself.

However, there are compelling reasons to go further than this and diversify the ownership structure of UK businesses. These are

3 'Turning workers into capitalists', *Economist*, 22 November 2013

described in Chapters 3 and 4. Perhaps most importantly, due to a wider range of financing patterns and risk profiles across different firms, an economy with greater diversity of ownership is likely to display a less uniform response to economic booms, financial crises and recessions. Quantitative evidence shows that employee-owned firms fared better in the downturn than other types of businesses. Such resilience would put the economy in a better position to ride out another crisis if and when it comes. Beyond this, an economy with greater diversity of business ownership could be imbued with longer-term investment horizons and can benefit from higher levels of investment in human capital.

A second rationale for diversifying business ownership is that alternative business forms can generate a productivity premium at the firm level. Large level studies have estimated this as a one-off gain of between 2 and 5 percent. This premium is most clearly evident for employee-owned businesses, where the firm is small and where employee ownership is accompanied by employee participation and voice. The premium emerges more strongly as ownership is more dispersed across the firm and where the stake owned by employees is significant.

Such evidence doesn't imply that all firms should adopt such ownership structures. It should, though, require industrial strategists to ensure that where these models would be optimal they can and are adopted by firms that are starting, expanding or transitioning.

IF IT'S SO GOOD WHY DON'T WE HAVE MORE OF IT?

Despite the advantages set out above, growing competition in the business world does not result necessarily in organisations adopting optimal ownership structures. Instead, a set of factors have accumulated over time steering the market towards adopting certain ownership. For instance, the role and structure of the banking and financial sector affects financing opportunities and

the market for mergers and acquisitions; dominant businesses can lobby in favour of regulation that reinforces the path.

This suggests that the market cannot be allowed to steer itself and that the impulses that converge to guide firms to develop in the way they do require serious attention. Chapter 5 sets out a number of specific barriers that prevent greater diversity of ownership structures from emerging and suggests methods for going beyond current initiatives in order to overcome them.

ACCESS TO FINANCE

Access to capital is a fundamental barrier to the expansion of the employee-owned sector, especially when firms are trying to grow or when companies wish to convert to employee ownership. The evidence suggests that the problem stems both from the firms themselves – who do not where to go to seek out finance – and from the financial markets – who struggle to engage with the sector. Survey evidence from 2006 found that four in ten of employee-owned businesses reported that it was hard to generate investment and that this was a disadvantage of their firm structure. In addition, 37 percent cited a 'lack of understanding by banks and other financial institutions' and 37 percent also cited 'Difficulty generating/accessing finance for investment' as barriers they faced. A more recent survey comparing the institutional barriers faced by employee-owned businesses and other firms shows that the former experience greater difficulty in obtaining capital from banks than the latter. In addition, the products that such businesses need are more specialised than for more common types of firms. Therefore, as well as acting to boost awareness among employee owned businesses of the options available, the Government should consider a number of options for addressing the lack of appropriate supply of finance.

This report recommends that the Government should consider initiating an **Employee Ownership Lending Bank**. This would

mirror the specific lending provision for the green sector (the Green Investment Bank) and for small businesses (the 'Business Bank'). An 'Employee Ownership Lending Bank' (EOLB) could resolve several existing constraints, including boosting awareness of financing opportunities within the sector; increasing the amount of patient capital available to viable but under-served emoployee-owned businesses; and overcoming fragmentation by providing a platform for aggregating demand for finance (e.g. for pension funds). Not only would it help employee-owned firms expand where viable, but it would also nurture new employee-owned firms by offering finance to firms that are seeking to convert into majority employee-owned businesses. In addition, the EOLB could be used by government to pursue additional policy objectives, such as setting conditions for employee participation, corporate governance and voting rights for any firms applying for money. Such an institution would serve to kick-start the market, whilst developing institutional knowledge about lending to the sector. The Bank would provide loans and guarantees to firms that were at least 50 percent employee owned or to facilitate succession and majority employee ownership. There may be operational efficiencies in delivering this scheme as part of the Business Bank.

In addition, the Government could look to develop more localised financial institutions that would be better-placed to possess the intelligence and awareness of less standard and more localised businesses than the current centralised model of risk analysis and finance provision. Given that many firms with alternative ownership structures (such as co-operatives, community-interest companies and employee-owned firms) are specific to a place, a more localised financial function would be able to respond better to their needs. Lessons could be imported from Germany's Sparkassen which are obliged to support their local economy, with responsibilities falling to Local Enterprise Partnerships or new institutions.

TAX REFORM

The current tax policy disincentivises the creation of employee-owned businesses. To address this, the Government is consulting on two new tax reliefs for firms adopting the Employee Benefit Trust model: a Capital Gains Tax Relief on the sale of a controlling interest in a business into an employee ownership structure; and, an income tax and National Insurance Contribution exemption for employees of employee-owned firms.[4] How these operate in practice, what types of firm are eligible and how they are designed with the future in mind will go a long way to determining their success in encouraging a more plural economy. This report recommends that the Government:

- limit new tax concessions to indirectly-owned employee ownership where the firm is majority-employee owned
- use this tax lever to encourage effective corporate governance by limiting eligibility to those firms that have appropriate governance structures in place, give voting rights to employees and have meaningful methods for employee participation.
- commits to expanding additional Exchequer resources (beyond the earmarked £50m) to the scheme in line with growth in the sector, otherwise the scheme could become a victim of its own success with more employee-owned firms receiving each a smaller share of the incentive.

In addition, the Government should consider consolidating the four existing tax-advantaged share schemes. If designed correctly this could help achieve the aims of tax simplification and deliver productivity benefits.

4 HMT, *Supporting the employee-ownership sector* (2013)

CHAPTER 1: INTRODUCTION

> *Britain is in a global race for the jobs and opportunities of the future. We cannot afford to ignore the potential of co-operative and mutual business models to drive growth and help build a more resilient economy.*
>
> Francis Maude MP, Minister for the Cabinet Office and Paymaster General[5]

In the UK, many have held that ownership matters little: foreign or domestic; public or private; PLC or mutual. However, there is growing debate about the ownership structure of the UK economy. Failures in the market economy have led to calls from all political parties for reform, whether it is Vince Cable's 'responsible capitalism', Ed Miliband's 'good capitalism' or David Cameron's 'popular capitalism'.[6]

These all reflect concerns that the market economy has failed to deliver on its inherent social, moral and economic objectives and pose major questions about business ownership in the UK economy.

What Jesse Norman has criticised as 'Crony Capitalism' has been characterised by ineffective oversight and control of executive pay, stemming from a flawed form of accountability.[7] In 2011, the High Pay Commission reported that a majority of the public agreed with the sentiment that 'management will always try to get the better of employees if it gets the chance'.[8] The reviews by John Kay and Sir George Cox revealed the short-termism endemic in the PLC structures and the equity markets that support them. As the

5 Foreword in *Making it Mutual: the ownership revolution that Britain needs* (Respublica, 2013

6 Ed Miliband speech to Social Market Foundation, November 2011; High Pay Commission, *Cheques With Balances* (2011); Vince Cable Speech to Lib Dem Party Conference, 2010 and speech to the Social Market Foundation, 24 January 2012.

7 Jesse Norman, *Conservative Free Markets, and the Case for Real Capitalism* (2011)

8 High Pay Commission, *Cheques With Balances* (2011)

economy returns to health, there is also an important debate about the proceeds from growth. Debates about zero hours contracts and about pay inequality pose challenges to the established methods of doing business. Recent research, for example, has demonstrated popular support for the idea that all employees contribute to the performance of an organisation and should, therefore, be rewarded accordingly, such as through the distribution of profits as a percentage of salary.[9] Alternative ownership structures – such as mutual and co-operatives – potentially ensure that businesses are run in the broader interests of employees and that the proceeds of growth are distributed more widely.

The Government has therefore sought to reform corporate forms, to boost employee engagement within firms, to strengthen accountability, and to encourage more diverse forms of ownership. There has been a proliferation of initiatives, including proposals to enhance trust and transparency by requiring companies to obtain and hold information on who owns and controls them.[10] The Department for Business, Innovation and Skills has also consulted on actions to boost corporate responsibility.[11] Following the Kay Review, the Government has sought to resolve failures in the equity markets that drive short-termism, including broadening the stewardship code, removing mandatory quarterly accounting and establishing an investors' forum to facilitate collective engagement by investors in UK companies.[12]

Beyond this, the Government has also looked to develop a more plural business ownership structure, and employee ownership in particular. Four specific developments stand out. First, the Government has viewed the expansion of mutuals as a

9 Kayte Lawton and Tess Lanning, *Sharing profits and power* (IPPR, 2013)

10 BIS, *Transparency and trust: enhancing the transparency of UK company ownership and increasing trust in UK business: discussion paper* (2013).

11 BIS, *Corporate Responsibility: a call for views* (2013)

12 BIS, *Ensuring Equity Markets Support Long-term Growth: The Government Response to the Kay Review* (2012)

route to achieving greater diversity and competition in previously state-delivered public services.[13] There are now over 70 public-service mutuals in operation, with more to launch next year, employing some 35,000 staff, and with combined annual revenues of £1.2 billion.[14] Second, in 2012, the Government published the Nuttall Review of Employee Ownership which made proposals for boosting awareness of the sector. This has subsequently fed into a range of proposals, including the first Employee Ownership Day in July 2013. Third, following an announcement by George Osborne in 2011, the Government has recently introduced its Employee Shareholder status. Under this policy, in return for surrendering specific employment rights, employees can be given shares in their company of between £2,000 and £50,000 that will be exempt from capital gains tax.[15] Finally, the March 2013 Budget proposed a £50m tax relief for capital gains and income tax / national insurance for employee-owned firms, a proposal that the Treasury consulted on over the summer.

These are significant developments, which have stimulated additional interest in alternative business forms. This interest has been mirrored in the Labour Party with a drive to boost the role of mutual providers in the financial sector and a proposal by Sir George Cox to provide additional incentives for firms to run share schemes.

However, as will be illustrated below, it remains the case that the UK economy continues to suffer from insufficient plurality of ownership structures. Given the early and fragile nature of the economic recovery, it is important to understand more fully the case for plurality of ownership for the productivity and resilience of the economy. It is also important to understand how the

13 Julian Le Grand, *The Recommendations: One Year On* (Mutuals Taskforce, 2012)

14 Adrian Brown and Louis Watt, *Soft Finance, Hard Choices: A review of the finance market for public service mutuals* (2013)

15 BIS, *Implementing Employee Owner Status Government Response to Consultation* (2012)

Government can build on its steps thus far to nurture more diverse business ownership.

This research assesses the economic case to reconsider the ownership constitution of the UK, with a particular focus on employee ownership. Drawing on the existing evidence and three policy events, this short paper sets out:

- the status quo and its problems;
- any advantages at an economy-level and firm-level of plurality of ownership structures;
- and, potential policy responses to deliver a more diverse economy, including how proposed tax reforms can be pursued optimally and into the future.

CHAPTER 2: PLC WORLD – THE STATUS QUO AND ITS FLAWS

WHAT WE MEAN BY BUSINESS OWNERSHIP

Business ownership can take a number of forms, which are described in Box 2.1 below. It should be noted that this sets out the range of possible ownership models rather than legal forms for businesses.[16]

Box 2.1 Business ownership models

Type of ownership	Description	Examples
Public Limited Company	A listed PLC sells shares to the public under UK company law.	GlaxoSmithKline UK Tesco
Private equity	An investor seeks a medium-term return by buying out an equity stake in a business, before cashing out the investment.	CVC Capital Partners
Partnerships	Two or more people share the risks in a business.	PwC Kennedys
Family ownership	A firm is majority owned by members of the founder's family; family members are also involved in the governance of the firm.	Laing O'Rourke Swire
State-owned businesses	A business is owned by national or local government.	Ordnance Survey

16 Businesses can either be unincorporated (i.e. have no legal personality separate from their owner(s)) or incorporated (i.e. where a company has a separate legal personality). See BIS, *A guide to legal forms for business* (2011).

Mutuals , co-operatives and employee-owned firms	A mutual is a business owned by its customers or its employees, or a combination of the two.	Nationwide
	Co-operatives are owned and run by and in the interests of their members, whether they are customers, employees or residents. Co-operatives also promote co-operation through their business activity.	Co-operative Group
	Employee-ownership refers either to 'direct employee-ownership' (through share ownership) or 'indirect employee-ownership' (through a trust).	John Lewis Partnership
	Firms can be hybrids of these different forms.	

THE MAKEUP OF THE UK ECONOMY

Despite the plurality of options, the dominant ownership model in the UK is the PLC. For instance, at the turn of the century the UK was the only country in a sample of 27 major economies where ownership of the top 20 firms (by capitalisation) was held widely.[17] In contrast, while the UK has a similar proportion of family-owned firms to its European comparators, they employ a significantly lower proportion of the private sector workforce than the average.[18] Other principal EU economies have a higher proportion of family firms among their largest 1,000 businesses, and UK family firms are predominantly SMEs compared to larger family-owned firms in countries such as Germany. A recent analysis showed that while family firms in the UK tend to follow a life-cycle and evolve into widely held companies, Continental European ones do not.[19]

17 Rafael LaPorta, Florencio Lopez-de-Silanes, and Andrei Shleifer, 'Corporate Ownership Around the World', *Journal of Finance*, Vol. LIV, No. 4, (April 1999), 492

18 http://ec.europa.eu/enterprise/policies/sme/files/craft/family_business/doc/familybusiness_study_en.pdf

19 Julian Franks, Colin Mayer, Paolo Volpin and Hannes F. Wagner, 'Evolution of Family Capitalism: A Comparative Study of France, Germany, Italy and the UK' (2008)

Similarly, while there are 6,169 co-operatives in the UK, they constitute only approximately 3 percent of UK GDP.[20]

OWNERSHIP OF FIRMS BY EMPLOYEES

More specifically, the level of employee ownership in the UK is modest at present. Employee ownership can take two forms: direct ownership (where an employee owns shares in a PLC) or indirect ownership (where the shares are held in a trust on behalf of the employees). In addition, firms can have hybrid structures where they mix these models.[21]

The proportion of a firm that is owned by employees can vary markedly. 'Employee-owned' companies typically refer to firms where employees own 50 percent or more of the business; 'co-owned' firms are those where employees own between 25 percent and 50 percent of the organisation; many firms have some shares owned by employees.

A high proportion of large listed firms run a direct employee share scheme in the UK. This translates to about one in three of the workforce in these firms owning shares in their firm. However, several points should be noted. First, HMRC data shows that the total number of companies with tax-advantaged employee share schemes (9,260 in 2011–12) has plateaued since 2006–07 (9,170).[22] Of perhaps more significance, the number of firms operating a tax-advantaged share scheme open to all employees has declined by 17 percent since its peak, representing a substantial fall.[23] As will be discussed later, this is important, given that firms where share schemes are limited to specific parts of the workforce (typically

20 Co-operatives UK, *Co-operative economy* (2013)

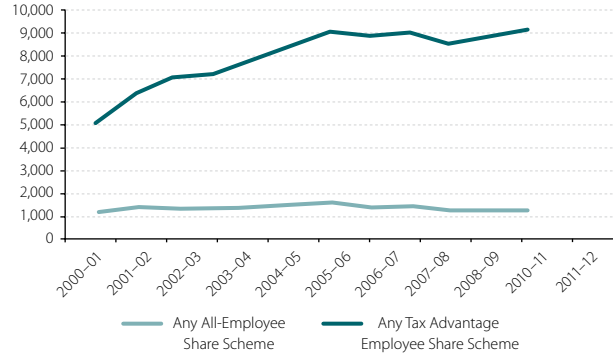
21 BIS, *The Nuttall Review of Employee Ownership: One Year On Report* (November 2013)

22 HMRC, *Employee Share Schemes Statistics for 2011–12* (2013), Table 6.2.

23 www.hmrc.gov.uk/statistics/share-schemes/ess.pdf

senior management) tend not to see the productivity gains that can stem from broader and deeper employee ownership.

Chart 2.1: Companies With Tax-Advantaged Employee Share Schemes[24]



HMRC data

Second, the most recent Workplace Employment Relations Study shows that the percentage of private sector workplaces using share schemes has halved from 20 percent to 10 percent.[25] Third, recent figures shows that only 20 companies of the 350 listed on the FTSE 100 and the FTSE250 are 3 percent or more employee-owned.[26]

Finally, the size of the sector that is categorised officially as 'employee owned' (i.e. firms where the majority of the company is owned by employees) is comparatively small. The turnover of all employee-owned businesses is estimated at £30bn.[27]

24 www.hmrc.gov.uk/statistics/share-schemes.htm#3

25 Brigid van Wanrooy, Helen Bewley, Alex Bryson, John Forth, Stephanie Freeth, Lucy Stokes and Stephen Wood, *The 2011 Workplace Employment Relations Study: First findings* (2013), 25.

26 The definition used by the UK Employee Ownership Index is the percentage of their issued share capital held by or for the benefit of employees other than main board directors. Data provided by Capital Strategies. For more detail on the initiative see www.employeeownershipindex.co.uk/wiki/index.php5?title=Welcome_to_the_UK_Employee_Ownership_Index

27 Mutuo, *Mutuals Yearbook 2012* (2012)

Box 2.2: The growth of the PLC in the UK

Although characteristics of the PLC can be traced back to the first joint stock company, the East India Company, the PLC grew in the last quarter of the nineteenth century in the UK as the family-owned business model receded. Between 1750 and 1850 dominant firms tended to remain sole-proprietorships or small-scale partnerships, and families resisted ceding control of their enterprises to external investors.[28] However, tax laws boosted share activity after the First World War, and the London Stock Exchange tripled in size in the inter-war period. More generally, there were major waves of takeover activity in 1900, 1920 and 1930. Drawing on a sample of firms, Franks, Mayer and Rossi report that ownership of UK firms dispersed rapidly in the first half of the twentieth century.[29] In the 1940s and 1950s there was growth in protection for minority investors, and institutional investors grew. To protect their interests, companies issued dual class shares and strategic block voting became the norm (as is currently the case in much of Europe). However, the growth of institutional investors and financial funds put pressure on regulators to open up the corporate sector to the capital markets.[30]

Recent research has also explained why family ownership declined in the UK. It was less because families sold out and more because their holdings were diluted in the process of issuing shares to finance growth. More often than not this was pursued so as to enable acquisition.[31]

This concentration of ownership in the form of PLCs led the Ownership Commission to conclude that the shareholder model has become the 'default corporate organisational form [in the

28 Rohit Lekhi and Ricardo Blaug, Ownership and good work (*Work Foundation, 2010)*

29 Julian Franks, Colin Mayer and Stefano Rossi, 'Ownership: Evolution and Regulation' (CEPR, 2005)

30 Rohit Lekhi and Ricardo Blaug, Ownership and good work (*Work Foundation, 2010)*

31 Julian Franks, Colin Mayer and Stefano Rossi, 'Spending less Time with the Family: the decline of Family Ownership in the United Kingdom' in Randall K. Morck, A History of Corporate Govern*ance around the World: Family Business Groups to Professional Managers* (NBER Books, 2005), 581–83.

UK]… to an extent that reduces opportunities for other ownership forms to grow and prosper'.[32]

PROBLEMS WITH THE STATUS QUO: THE PLC MODEL

Traditional consensus has held that firms with publicly tradable shares provide unrivalled advantages at a market and firm level. Firms are subject to the discipline of the capital market such that failure will result in share prices dropping and a different firm acquiring and improving the business. At a firm level, the PLC structure enables companies to access capital in large quantities.[33] The model also provides a method of matching those seeking investment to investors and savers.

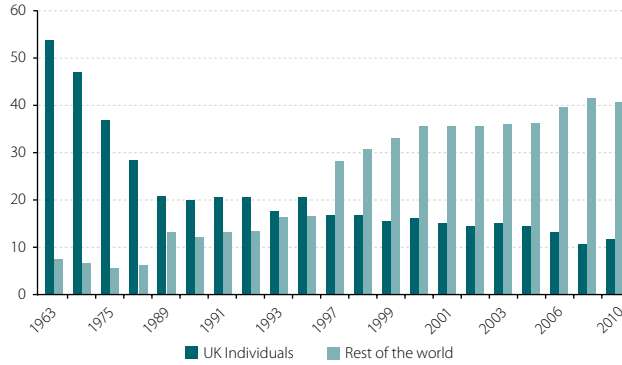
However, the reviews of Sir George Cox and Professor John Kay highlighted major flaws in the current PLC form.[34] Underlying both critiques is the concept of an 'ownerless corporation' where individual and institutional shareholders often do not fulfil their role as long-term stewards of the firm and its assets. PLCs therefore can fail to deliver long-term sustainable value creation resulting in short-term decision-making. This problem derives from two overriding factors. First, although the actual investors in a firm may have a long-term view, they are often represented by intermediaries whose performance is typically measured against recent share price performance. The cumulative behaviour of intermediaries favours short-term rather than long-term business success. This line of accountability matters: ownership has become more fragmented and more distant with foreign owners growing markedly as a proportion of investment alongside a decline in individual share-ownership (see Chart 2.2); institutional investors remain a major owner of shares (about a third).

32 Ownership Commission, *Plurality, Stewardship and Engagement* (2012)

33 David Erdal, *Beyond the Corporation: Humanity Working* (Bodley Head, 2011), 8.

34 John Kay, *The Kay Review of UK Equity Markets and long-term decision making – final report* (BIS, 2012); Sir George Cox, *Overcoming Short-termism within British Business: The key to sustained economic growth* (2013).

Chart 2.2: Percentage of the UK stock market owned by value: UK individuals vs Rest of World[35]



ONS data: Share Register Survey

Second, the owners of a PLC rely on agents (managers) to pursue the optimal objectives for the firm, but the objectives of managers and of owners are not always aligned. For instance, short-term profits may boost the performance outcomes (immediate share price) against which managers are rewarded but act as poor proxies for long-term performance. This factor, among others, has meant that performance rewards directed at senior managers have not had the desired effect on company performance.[36]

Others also question whether the PLC remains as efficient a model as it once was. As Will Davies has argued, the theory of the PLC is based among other things on the assumption that 'corporate assets are worthless unless they are tradable'. However, intangible assets within firms constitute an increasingly important part of the assets of the economy. Assets such as intellectual property and human capital are less straightforward, measurable and tradable than traditional assets held by firms. The growth in these less

35 www.ons.gov.uk/ons/rel/pnfc1/share-ownership---share-register-survey-report/2010/stb-share-ownership-2010.html#tab-UK-individuals-holdings-of-UK-shares

36 Kayte Lawton and Tess Lanning, *Sharing profits and power* (IPPR, 2013),19.

tangible assets thus may render the PLC structure a less suitable form of ownership structure.[37]

Finally, shareholder capitalism has come under criticism for being too narrow in terms of the interests it seeks to serve and to pursue. Alternative frameworks have emerged. Will Hutton has spoken of 'stakeholder capitalism', and of the interest that the firm should have in pursuing the interests also of creditors, debtors, employees, suppliers, customers and wider society. Michael Porter's concept of 'shared value' includes promoting economic value in a way that also creates value for society by addressing its needs and challenges.[38]

CONCLUSIONS

The reviews of George Cox, John Kay and the Ownership Commission have put forward a clear case for reforming the lines of accountability in UK firms. Part of this can be achieved by reforming the PLC model, for instance: empowering and engaging the shareholder; giving incentives for long-term investment; and dispersing ownership across employees. However, as the Nuttall Review of Employee Ownership and others have argued, there are also strong arguments for diversifying the economy more generally. Chapter 3 goes on to explore the economic case for greater diversity of business ownership and for more employee ownership.

37 Will Davies, *Reinventing the firm* (Demos, 2009)

38 Michael Porter and Mark Kramer, 'Creating Shared Value: how to reinvent capitalism and unleash a wave of innovation and growth', *Harvard Business Review*, January / February 2011.

CHAPTER 3: MARKET-LEVEL BENEFITS OF DIVERSITY OF OWNERSHIP

A core purpose of industrial policy should be to help create market conditions that encourage firms to compete, to innovate and to grow sustainably across the economic cycle. In theoretical terms, greater diversity of ownership structures brings advantages at an economy-wide level and helps policymakers achieve these objectives.

1. Diversity and resilience

In the aftermath of the financial crisis, the Government recognised the importance of diversity in the financial sector as a route to boost competitiveness, resilience and accountability. Wider resilience in the economy is fundamentally important: crises cannot be foreseen with any confidence, and the ability of the economy to withstand an economic shock or to re-bound effectively from an economic shock provides the system with greater stability and makes it less prone to major recessions.

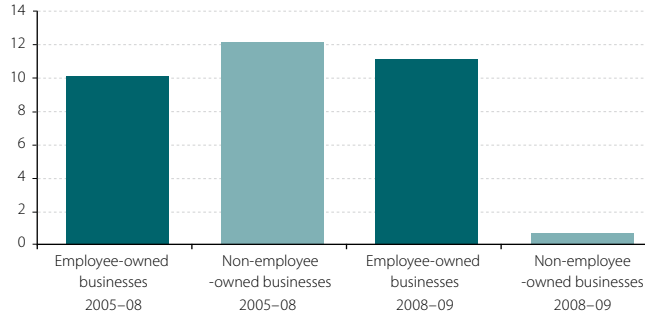
Due to a wider range of financing patterns and risk profiles across different firms, an economy with greater diversity of ownership is likely to display a less uniform response to economic booms, financial crises and recessions. At its broadest level, a market economy benefits from plurality in the same way as a natural ecosystem benefits from biodiversity. As Nicholas Taleb's work exemplifies, unpredictable events can have a severe impact on the economy, and instilling resilience to such events is therefore imperative. Different types of firms manage risk in different ways and have different risk profiles and appetites for risk.

Box 3.1: Concentration of risk

The banking sector in the financial crash illustrated clearly the dangers of a concentration of business form. As Andrew Haldane argued, PLC banks each sought to manage risk through diversity in the years preceding the crash. But they all did so in the same way. Whilst rational at an institution-level, this merely acted to concentrate the risks at a system level.[39] Therefore, as the expert on mutuals and employee-ownership Professor Jonathan Mitchie has argued, 'what one wants is a diversity of appetite for risk within the system. Mutuals will tend to have less appetite for risk than will shareholder owned banks'.[40]

Evidence suggests that alternative structures such as financial mutuals, employee-owned businesses and the Mittelstand in Germany have shown more reslience in the recession. In particular, research from Cass Business School has shown that employee-owned businesses (EOBs) have proved themselves to be considerably more resilient through the economic downturn than non-employee-owned businesses (NEOBs). The figures from Cass Business School are quite startling (see Chart 3.1 below).

Chart 3.1 Percentage increase in sales turnover (mean) across different types of business



Data from Lampel 2010

39 Andrew Haldane, *Rethinking the Financial Network (2009)*

40 Jonathan Mitchie, *Promoting corporate diversity in the financial services sector* (Kellogg College, 2010)

The table indicates that while employee-owned businesses (in red) performed at only marginally lower performance levels than non-employee-owned businesses (in blue) in the boom (2005–08), they out-performed the latter by a factor of about ten in the downturn that followed (2008–09). Other evidence suggests that employee-owned businesses (EOBs) display less sales variability across the business cycle.[41]

This pattern appears to stem from a range of factors: risk tolerance and investment horizons; and availability of finance. First, when weighing up an investment proposition, EOBs tend to put greater emphasis on the downside risks than the upside risks; the case is opposite for managers in PLCs who typically put a higher value on the upside risk. Arguably, this is partly because managers in PLCs are motivated more strongly by the upside than the downside. Therefore, EOBs are more likely to have greater stability through crises than PLCs, potentially alongside less growth in the good times.

The second factor is, in part, the cause of the first: namely that, even if they did wish to expand, EOBs are less able to source the finance necessary for rapid growth than PLCs. As will be discussed in more depth in Chapter 5 this stems from their inability to use equity finance and the unavailability of suitable alternative forms of finance. Therefore, subsequent to the financial crash and in the downturn, highly-indebted PLC firms sought to deleverage and many were forced to contract. Conversely, EOBs, with much lower levels of debt, were able to maintain their size or expand. Therefore, a firm's risk tolerance is determined in part by the access (or lack of it) to finance.

41 Joseph Lampel, Dr Ajay Bhalla, Dr Pushkar Jha, *Model Growth: Do employee-owned businesses deliver sustainable performance?* (Cass Business School, 2010)

Box 3.2 International comparisons: what diversity can do for you

Along with its beneficial exchange rate under the Euro, the resilience of the German economy in the current downturn is often attributed to the strength of its Mittelstand or mid-sized family-owned firms. These firms employ a majority of private sector workers and are export-driven. Many are highly focused on specific products in the supply chain.

The Mittelstand features some of the positive characteristics that have been identified with EOBs above. They often display a comparative aversion to debt and a lower appetite for short-term risk-taking. During the years 2001 to 2011, Mittelstand firms built up their equity, boosting their overall equity ratio.[42] Therefore, as with the EOBs cited in the research, they sacrificed a margin of profits in the boom time for growth and stability in the medium- to longer-term.

However, it is questionable how far these lessons can be replicated in the UK, which has been termed an 'outsider-dominated economy' because of its relatively widely-dispersed share ownership. For instance, the Mittelstand has very specific cultural, economic and social roots. Family-owned firms in the UK operate in very different financial and legal frameworks. For instance, research has pointed 'to a life cycle of family control in outsider- but not insider-dominated countries. This life cycle stems from both external financing and corporate control requirements and is reflected in a higher level of profitability of family firms in insider but not outsider systems.'[43]

An economy made up of different types of firms with differing risk appetites and access to finance, imbues the market with greater resilience. For instance, if credit is constrained in one part of the economy then not all firms are impeded by this constraint.

42 http://uk.reuters.com/article/2012/11/14/us-germany-mittelstand-idUSBRE8AD0KV20121114

43 http://faculty.london.edu/pvolpin/evolution.pdf

Box 3.3 Diversity in finance

If the lesson of plurality should be heeded across the economy, there are also particular lessons for the financial services sector. Variety can feed through into a more resilient economy of lenders. This may stem simply from diversity in the financial sector, where variety of structures across the banking sector tends to support a broader range of corporate forms in the rest of the economy.[44] For these reasons the Coalition Agreement set out a commitment to 'foster diversity in financial services, promote mutuals and create a more competitive banking industry'.[45]

2. Longer-term horizons

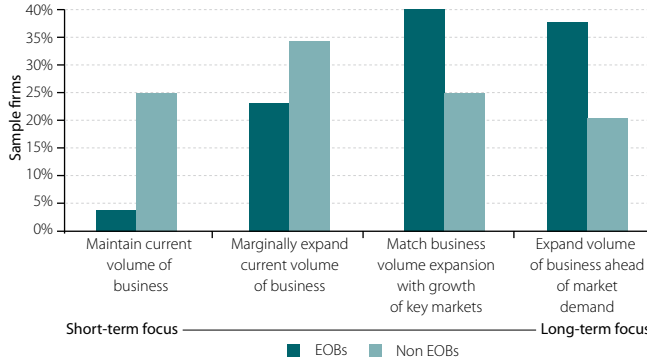
If one of the failings of the dominant PLC model is that it favours short-term priorities, alternative structures can offer countervailing forces with longer horizons. Research by Lampel et al has shown that 'EOBs are more conservative when it comes to balancing short- against long-term response to changing demand conditions'.[46] This is a feature shared with the Mittelstand in Germany. In part, this stems from the fact that ownership and management are aligned rather than separate (under PLCs) and, in addition, the absence of short-term priorities established by the equity markets.

44 Jonathan Michie, Promoting Corporate Diversity in the Financial Services Sector (Kellogg College, 2010); Rym Ayadi David T. Llewellyn *Reinhard H. Schmidt Emrah Arbak Willem Pieter De Groen, Investigating diversity in the banking sector in Europe: key developments, performance and role of cooperative banks (CEPS, 2010)*

45 HMG, Coalition *Agreement* (2010)

46 Lampel et al, *The Employee Ownership Advantage* (BIS, 2012)

Chart 3.2: How companies would respond to increasing demand



Data from Lampel 2012

3. Investment in skills

Some alternative structures such as EOBs (in the UK) and family firms (in Germany) invest more in human capital than comparators. This investment in skills can benefit the whole economy. On the whole, EOBs invest more in human capital than NEOBs. This investment in skills benefits the firm, but it also benefits the wider economy.[47] Research by Professor Andrew Pendleton shows that, where firms have employee share ownership schemes and where there is employee participation in these schemes, this is associated with high levels of employee training. This may stem from greater employee commitment within employee owned firms and a consequent confidence from employers that the investment in training will not be lost by employees leaving the firm.[48]

4. Competition

Theoretically, plural markets are also likely to offer a more competitive environment than one in which competitors adopt

47 Lampel et al, *The Employee Ownership Advantage* (BIS, 2012)

48 Andrew Pendleton, 'Employee share ownership and human capital development: Complementarity in theory and practice', http://eid.sagepub.com/content/32/3/439.abstract

similar business structures and risk strategies. For instance, in the nineteenth century, the life insurance industry was locked in competition with a vibrant mutual sector focussed on sickness and death insurance with positive repercussions for the consumer.[49] As Professor John Kay has argued in relation to the financial service sector: 'Implied in the promotion of competition is the promotion of diversity, because for me the essence of competition is not just that several people do things. It is that people do things differently. If they do them well, then these things get imitated. If they do them badly then they bear the consequences.'[50] Greater diversity would also benefit consumers through a wider variety of products from which to choose.

5. Efficient business transfer and succession

It is economically efficient for poor firms to fail. However, it is inefficient for good firms to do likewise. Previous research from the (then) Department for Trade and Industry suggested that 30 percent of closures were transfer failures rather than simple 'business failures' (i.e. viable firms that could have survived had succession been managed better).[51] Intuitively, a plurality of options at succession stage is likely to mean that firms can find the appropriate succession strategy. More particularly, the dominant routes for SME succession are trade sales (to competitors) or family ownership (leaving equity in the business).[52] However, both have their disadvantages: family ownership can be difficult to sustain; and trade sales offer no continuity or security for the other stakeholders in the business.[53] Employee ownership may be an attractive alternative option offering sustainability, realisation for the owner of some or all of the firm's assets and preservation of the

49 Simon Cordery, *British Friendly Societies, 1750–1914* (2003)

50 Cited in www.cefims.ac.uk/documents/research-109.pdf

51 DTI, *Passing the baton* (2004) [n.b. the survey was from 2001]

52 Will Davies and Jonathan Michie, *Employee ownership: defusing the business succession time-bomb in Wales*

53 For a wider discussion of the trade-offs in choosing the succession method see EOA and Co-operatives UK, *Simply Buyout* (2013).

firm's distinctive purpose. Employee ownership will be the most appropriate succession method for some firms and ensuring that it is available as an option is likely to reduce the number of business transfer failures.

CONCLUSIONS

There are a range of important reasons why at the market level diversity of business ownership is desirable. Perhaps most telling, diversity can boost the resilience of the economy by varying the risk profiles and lending patterns of firms across the economy. However, beyond this, an economy with greater diversity of business ownership can be imbued with greater competitiveness, and can benefit from higher levels of investment in human capital.

CHAPTER 4: FIRM-LEVEL BENEFITS OF EMPLOYEE OWNERSHIP

The previous chapter demonstrated that there are clear benefits at the market-level to having a plurality of ownership types. This section explores whether different ownership forms carry a performance premium. Evidence suggests that, at a firm level, alternative structures can boost productivity and resilience. Over-reliance on the PLC structure therefore limits the productivity-enhancement that could come with other business structures.

PERFORMANCE OF EMPLOYEE-OWNED BUSINESSES

No one type of ownership or business structure is right for all firms and form must follow function. However, domestic and international evidence indicates that different business ownership types carry different benefits, although the evidence is stronger for some types rather than others. Evidence on the impact of private equity ownership is mixed and inconclusive. Freedom from demands of shareholders or from the stock-markets can alleviate short-term pressure. But, investment in skills, in employee practices and job security can all suffer.[54] International evidence suggests that family ownership can provide a positive alternative to PLCs – although it is not clear how far these lessons can be translated from the continent to the shores of the UK given very different cultures and forms of industrial organisation. Indeed, family ownership can perpetuate poor management where leadership is handed down to the eldest son or daughter.[55]

Evidence suggests that in certain conditions and circumstances, employee ownership can confer advantages on a firm. Mutuals, co-

54 Rohit Lekhi and Ricardo Blaug, *Ownership and good work* (Work Foundation, 2010)

55 http://cep.lse.ac.uk/pubs/download/pa004.pdf; Nicholas Bloom, Christos Genakos, Raffaella Sadun and John Van Reenen, 'Management Practices across firms and countries', National Bureau of Economic Research, Working Paper 17850, February 2012, www.nber.org/papers/w17850

operatives and employee-owned firms are not, of course, immune to failure and employee-ownership does not predicate against bad business decisions being made. The widely-reported failure of the Co-operative Bank demonstrated this vividly. Lehman Brothers was approximately a quarter-owned by employees (through direct employee share ownership) before its collapse.[56]

A comprehensive review of the research conducted by Matrix concluded that employee-owned businesses (EOBs) 'perform at least as well' as other firms, finding more evidence supporting productivity enhancement among EOBs than not.[57] Specific studies bear this out:

- A meta-evaluation of studies of the effect of employee ownership in the USA showed that, when ownership is distributed to employees (through Employee Stock Ownership Plan), productivity improves by an average of 4.4 percent in that year, and that this higher productivity is maintained subsequently.[58]
- Research in the USA and the UK has matched EOBs and NEOBs with important and robust conclusions. Using a sample of 300 firms, Kramer showed that sales per employee in EOBs (stock-owned) are significantly higher than in non-EOBs. This advantage strengthens as the firm decreases in size and as the level of employee stake increases.[59] This high level finding corroborates research by Blasi and Kruse that found that the adoption of ESOP boosted annual sales growth, annual employment and annual growth in sales per employee by

56 'The feeling is mutual', Economist, 21 January 2012.

57 Matrix, *The employee ownership effect: a review of the evidence* (Employee Ownership Association, 2010).

58 'Employee Ownership, Employee Attitudes, and Firm Performance: A Review of the Evidence,' in Daniel J.B. Mitchell, David Lewin, and Mahmood Zaidi (eds.), *Handbook of Human Resource Management* (Greenwich, 1997). 113–151. Also available at www.nber.org/papers/w5277.pdf?new_window=1

59 Brent Kramer, 'Employee ownership and participation effects on outcomes in firms majority employee-owned through employee stock ownership plans in the US', *Economic and Industrial Democracy*, 31(4) 449–476.

between 2.3 and 2.4 percent.[60]

- In the UK, the Cass Business School found that employee numbers grew quicker in EOBs than in comparator NEOBs both during the boom and during the recession.[61]
- A recent analysis in Scotland matching the performance of EOBs to NEOB comparators found that the performance of EOBs was 'generally superior', with EOBs employing more staff, exhibiting higher turnover growth and demonstrating higher value added.[62]

However, the productivity premium is affected by which employees within the firm are owners and the proportion of the firm they hold. Employee share ownership delivers stronger productivity improvements if a firm is employee-owned (50 percent or more) or co-owned (25 percent or more).[63] Kramer's research shows that the advantage was stronger as the average employee's stake in the firm stock increased.[64] In part, this is a simple dilution effect: the less of the firm that employees own, the less their financial interests will be aligned with the performance of the business.

In addition, however, most of the research indicates that not only the depth but also the breadth of employee ownership within a firm matters. Bryson and Freeman's study of shared capitalism assesses shared ownership and performance related pay against ratings of labour force productivity; gross output per worker and GVA per worker. It finds, among other things, that the largest gains from employee ownership come from participation in all-

60 www.nceo.org/articles/research-employee-ownership-corporate-performance

61 Joseph Lampel, Dr Ajay Bhalla, Dr Pushkar Jha, *Model Growth: Do employee-owned businesses deliver sustainable performance?* (Cass Business School, 2010)

62 Employment Research Institute, *The growth of employee owned businesses in Scotland* (Scottish Enterprise, 2013)

63 Brione and Nicholson, *Employee ownership: unlocking growth in the UK economy* (Centre Forum, 2012)

64 Brent Kramer, 'Employee ownership and participation effects on outcomes in firms majority employee-owned through employee stock ownership plans in the US', *Economic and Industrial Democracy*, 31(4) 449–476.

employee schemes rather than schemes limited to managers.[65] This finding was underscored by a large study comparing US firms with narrow (options granted to less than 10 percent of employees) versus broad (bottom 90 percent of employees) share schemes. The research concluded that those firms with broad-based options witnessed a statistically significant positive effect on cost- and industry-adjusted return on assets; for firms with narrow schemes, the effect was negative.[66] UK evidence is rather more equivocal: an Oxera study (commissioned by HMRC) explored the effect of tax-advantaged share schemes on firm performance. It found that adopting an SAYE (an all-employee scheme) had a statistically significant positive effect on both long run company performance and the GVA of a firm. However, the other schemes – including the other all-employee scheme, the Share Incentive Plan – had no statistically significant effect.[67]

Overall, the evidence suggests that there are limitations to the advantages of direct employee share ownership as currently envisaged because schemes are often targeted on senior managers, whilst often excluding those who cannot afford to purchase a stake or are not permitted to be part of the scheme.[68] Evidence suggests that the UK's total capitalisation of employee owned shares tends to be skewed more strongly towards executives rather than non-executive employees than in many European countries.[69] It should be noted also that direct employee share ownership rarely results in significant reform to governance.

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65 Alex Bryson and Richard B. Freeman, 'How does shared capitalism affect economic performance in the United Kingdom?'

66 Yael V. Hochberg and Laura Lindsey, 'Incentives, Targeting, and Firm Performance: An Analysis of Non-executive Stock Options' (2009), available at http://bschool.nus.edu.sg/Portals/0/images/SAW/docs/HL_Feb09b.pdf

67 Oxera, *Tax-advantaged employee share schemes: analysis of productivity effects – Productivity measured using turnover Report 1* (HMRC, 2007); Oxera, *Tax-advantaged employee share schemes: analysis of productivity effects – Productivity measured using GVA Report 2* (HMRC, 2007). See also, Jane Kerr and Clare Tait , *Evaluation of Tax-Advantaged All-Employee Share Schemes* (HMRC, 2008).

68 Will Davies, *All of Our Business: Why Britain needs more private sector employee ownership* (EOA, 2012)

69 Rohit Lekhi and Ricardo Blaug, *Ownership and good work* (Work Foundation, 2010)

THE ASPECTS OF COMPETITIVE ADVANTAGE

A number of factors explain the productivity premium that comes with employee ownership. Understanding how, when and why this premium emerges is a necessary step towards designing policy that can promote a more diverse economy.

Elimination of agency problem

Employee ownership and family ownership align the interests of managers and owners. In addition, employee ownership removes the agency costs by aligning compensation of all employees to firm performance and 'engendering a commonality of interest'. Meanwhile, the incentives can reward cooperation and dis-incentivise unhelpful conflict.

Collective endeavour and rewards

Sidney Webb's initial economic theory was that making an employee a shareholder in the business would 'stimulate his zeal and careful working and, as part owner of the capital, with which he works,' he will share responsibility in the business.[70] However, the theoretical benefits are not all intuitive. First, although co-ownership means that the individual employee has an incentive for the firm to prosper, classical economics would suggest that this incentive would equate only to the marginal difference that the individual could make to the performance of the firm. In a one-person business, the employee would reap all the rewards from good performance and the incentive would be very large; in a multi-national, a single employee could make a minimal difference single-handedly and the incentive would be extremely small.[71] Second, in a large firm, not only would the direct performance incentive be weak, but theoretically there would be a risk of 'free-

70 Cited in P.R. Knyght, 'Auditing Employee Ownership in a Neo-Liberal World', *Management Decision*, Volume 48, Number 8, 2010,1304–1323.

71 Meade cited in Brione and Nicholson, *Employee ownership: unlocking growth in the UK economy* (Centre Forum, 2012)

riding'. This risk would arise because under employee ownership the reward would be felt collectively across all employees and would not discriminate on the basis of individual contribution to overall performance. So, why not just sit back whilst your colleagues exert themselves and then reap the rewards?

Instead, the positive effect originates from group behaviours and norms. Laboratory experiments into performance related pay have shown that individual financial rewards often do not act as efficient methods of encouraging good performance because these extrinsic rewards can crowd out intrinsic motivation. Conversely, 'pro-social' rewards – when an individual's performance affects the reward of others – have been shown to be more effective.[72] Employee-ownership harnesses this dynamic, with the sharing of profits amongst employees creating a collective positive peer pressure and a commonality of interest.[73] This manifests itself partly through co-monitoring where workers monitor each other's performance and effort.[74] In addition, other disicplines indicate that there are non-monetary rewards for the employees – friendship and mutual regard – which may have a positive effect on collective action. A social psychological perspective would predict that employee ownership can be an effective way of cultivating social bonds between employees, who feel a sense of interdependency. These bonds build up the firm's stock of 'social capital', enhancing trust and promoting cooperation without the need for formal monitoring.[75] These social bonds cultivate trust and promote higher levels of happiness among the workforce.

72 Ye Li and Margaret S. Lee, 'Incentivizing Workers Using Prosocial Motivations', Columbia University, Center for Decision Sciences

73 Estrin cited in Brione and Nicholson, *Employee ownership: unlocking growth in the UK economy* (Centre Forum, 2012); P.R. Knyght, 'Auditing Employee Ownership in a Neo-Liberal World', *Management Decision*, Volume 48, Number 8, 2010,1304–1323.

74 Richard B. Freeman, *When Workers Share in Profits: Effort and Responses to Shirking* (LSE, 2008)

75 E. Ostrom et al., 'Covenants with and without swords: Self Governance is possible', *American Political Science Review*, 86, no 2, (1992)

Participation effects

Employee ownership is often accompanied by greater participation in decision-making by employees (as manifested, for example, by co-monitoring) and stronger collective employee voice. A recent survey showed that employees in EOBs were far more likely to be very satisfied or satisfied with their involvement in decision-making in their workplace (58 percent) than were employees who responded to the Workplace Employee Relations Survey (40 percent). Nearly twice as many in EOBs thought that 'management allow employees or employee representatives to influence final decisions'.[76]

The performance premium to a firm only appears when co-ownership is combined with employee engagement and participation. Evidence from the USA indicates that 'ownership alone, and participation alone, however, have, at best, spotty or short-lived results.'[77] Therefore, as Centre Forum has argued, 'ownership both relies on and reinforces the positive effects of participation'.[78] Employee ownership can facilitate better employee engagement, which, in turn, can lead to more innovation, less industrial action and better information sharing.[79] Employees are more favourable to their employer, reducing absenteeism and boosting staff retention.[80]

Innovation

The evidence is mixed on whether the longer-term perspective associated with employee-owned businesses facilitates greater

76 Professor Ronald McQuaid, Dr Emma Hollywood, Sue Bond, Dr Jesus Canduela, Alec Richard and Gemma Blackledge, *Fit for work? Health and Wellbeing of Employees in Employee Owned Business* (Employee Ownership Association, 2012), 11.

77 NCEO cited in APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008)

78 Brione and Nicholson, *Employee ownership: unlocking growth in the UK economy* (Centre Forum, 2012)

79 Matrix, *The employee ownership effect: a review of the evidence* (Employee Ownership Association, 2010); Kramer 2010.

80 Employment Research Institute, *The growth of employee owned businesses in Scotland* (Scottish Enterprise, 2013), 21.

innovation. Surveys and qualitative studies are equivocal: employee-ownership can act as both a facilitator for, and a drag on, change.[81] However, evidence from the USA suggests that employee stock ownership is the most consistently positive compensation variable in 'predicting both the presence of an innovative culture in a work site of a multinational corporation, and the willingness of workers to engage in innovative activity in their work.'[82] Employee ownership can secure a 'commitment dividend' from employees. This leads to better sharing of practices and information.[83] The ambivalent nature of some of the evidence on innovation may stem from the fact that whilst employee-owned firms may provide cultures within which employees feel ready and encouraged to innovate, they also tend to be less well-placed to make capital intensive innovations. In addition, theoretically at least, investment in technology may result in redundancies which may be obstructed by workers seeking to preserve their position.

Customer satisfaction

Evidence suggests that co-owned businesses have a 'very consistent record in generating high levels of customer satisfaction'. This may be attributable to various factors: exemplary customer services; the ability of EOBs to adapt more effectively than other firms to changing aspirations of customers; and reputational benefits. Evidence here is subjective – EOBs themselves consider themselves more attractive to customers. Meanwhile, customers think a co-owned company will be more ethical, which may provide it with a premium.[84]

81 Employment Research Institute, *The growth of employee owned businesses in Scotland* (Scottish Enterprise, 2013).

82 APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008) citing Blasi evidence; P.R. Knyght, 'Auditing Employee Ownership in a Neo-Liberal World', *Management Decision*, Volume 48, Number 8, 2010,1304–1323.

83 APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008) citing evidence from Jonathan Michie unpublished.

84 APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008), 18.

Sector and size

Employee ownership is comparatively concentrated in a number of sectors including retail, business services and agriculture. For instance, 71 percent of the turnover of the cooperative sector is from the retail sector; 11 percent from agriculture and 6 percent from financial services.[85] Certain factors are likely to affect the spread of employee-owned firms: employee ownership reaps particularly strong advantages where a highly-committed workforce is viewed as a competitive advantage (hence retail). Indirect employee ownership is well-suited to knowledge-intensive industries.[86] Conversely, it is hard to envisage how large capital-intensive firms could become majority employee-owned, because of the constraints on capital inherent to employee ownership (see below). Further, the productivity-enhancing qualities of employee-ownership dip significantly as the firm gets larger. This is not to deny that some major firms – such as Arup and John Lewis Partnership – have succeeded in matching scale with productivity. But, the evidence suggests clearly that the comparative performance benefits at a firm level are much stronger when the business is small. The effect weakens as the firm grows in size.[87] It might be noted that 87.5 percent of co-operative firms in the UK have a turnover of £1,000,000 or less.[88]

CONCLUSIONS

Alternative business forms can generate a productivity premium at the firm level. This premium is most clearly evident for employee-owned businesses, where employee ownership is significant, where

85 Co-operatives UK, *The UK co-operative economy 2012: alternatives to austerity* (2012)

86 P.R. Knyght, 'Auditing Employee Ownership in a Neo-Liberal World', *Management Decision*, Volume 48, Number 8, 2010,1304–1323; Joseph Lampel, Dr Ajay Bhalla, Dr Pushkar Jha, *Model Growth: Do employee-owned businesses deliver sustainable performance?* (Cass Business School, 2010).

87 Kramer, 2010, 452, 468; Joseph Lampel, Dr Ajay Bhalla, Dr Pushkar Jha, *Model Growth: Do employee-owned businesses deliver sustainable performance?* (Cass Business School, 2010); Blasi 1996.

88 Co-operatives UK, *The UK co-operative economy 2012: alternatives to austerity* (2012)

the firm is small and where employee ownership is accompanied by employee participation and voice.

The research also shows that within employee owned firms who owns the stake and how much they own matters to the productivity effects. The premium emerges more strongly as ownership is more dispersed across the firm and where the stake owned by employees is significant.

These findings do not indicate that industrial policy should aim to convert all firms into employee-owned companies, but it does suggest that where this option might be appropriate that firms can adopt this structure.

CHAPTER 5: THE PATH TO DIVERSITY

The chapters above have demonstrated that the UK economy could benefit from greater diversity of business ownership structures. The evidence suggests that adopting alternative structures could in some cases also boost the productivity of firms. But, why do more organisations not opt for alternative business structures?

This chapter shows that altering the course of corporate governance and business ownership in the UK is a complex, but necessary, undertaking for effective industrial policy. The chapter goes on to establish how the agenda developed by the Coalition Government under the auspices of the Review by Graeme Nuttall could be pursued beyond the current wave of reforms.

PATH DEPENDENCY AND THE NEED TO OPEN UP OPTIONS

The evolution of business structures in the UK and policy development has led to path dependency. Growing competition in the business world does not result necessarily in organisations adopting optimal ownership structures.[89] Instead, external environmental factors also affect corporate structures. These factors include: the role and structure of the banking and financial sector; the history of industrialisation and institutionalisation; political forces, which may direct towards or away from concentration of ownership; and cultural norms. In the UK, 'historical accidents' and other environmental factors have steered the market to adopt methods that are not necessarily optimal. As experts have argued, 'fundamental changes cannot fully occur in a nation's system in the absence of changes of relevant traditions and complementary factors.'[90]

89 Moreover, there remain significant variations in corporate forms between different countries.

90 Shuangge Wen and Jingchen Zhao, 'Exploring the rationale of the enlightened shareholder value in the realm of UK company law – the path dependence perspective', *International Trade and Business Law Review*, 14, 2011. http://usir.salford.ac.uk/15818/2/Zhao_ITBLR.pdf

This path dependency subsequently becomes self-reinforcing as the dominant corporate entities lobby effectively for regulatory and legal reforms that benefit the PLC.[91]

This suggests that the market cannot be allowed to steer itself and that the impulses that converge to guide firms to develop in the way they do require serious attention. There are a number of specific barriers that prevent greater diversity of ownership structures from emerging (many of which are symptoms of path dependency). These are set out below.

1.Information and awareness

Path dependency and other factors – such as low awareness of alternative options and biased or ignorant advice from professional advisers – inhibit organisations that might advantageously adopt non-PLC status. As the Nuttall Review established persuasively, this problem is particularly acute in employee ownership. The Nuttall review concluded that 'a lack of awareness of the concept of employee ownership' underpins many of the barriers to the growth of the sector.[92] This conclusion echoed the findings of a 2008 study by the All Party Parliamentary Group for Employee Ownership.[93] Recommendations proposed by Nuttall and accepted by the Government fall into three bands:[94]

- **Increasing awareness,** including promotion of employee ownership through events; promotion of a voluntary 'Right to Request' employee ownership under which employees could nudge employers towards considering whether employee ownership would be appropriate for the firm; a guide as to how the 'right' should work.

91 Lucianne Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance', *Stanford Law Review* (Harvard, 1999), Vol 52, 127.

92 BIS, *Sharing Success: the Nuttall review of employee ownership* (2012)

93 APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008)

94 BIS, *Government response to the Nuttall Review* (2012)

- **Increasing resources,** including through establishing a new Institute to provide evidence and support to mutuals.
- **Reducing complexity,** by developing model documentation and 'off-the-shelf' toolkits to help firms understand the steps needed to move to employee ownership;[95] simplifying share buyback procedures.

However, there are two further areas where the Government should also act.

Awareness

Anecdotal evidence suggests that business schools teach very little on employee ownership, thus inculcating the next generation of business leaders with a narrow perspective on corporate forms and management practices. The Government's taskforce on business schools has focused on how they can be marshalled to act as hubs for advice and support to businesses. There has been less consideration of their syllabuses and their implication for business ownership and governance.

Nudges

The Government wishes to limit the regulatory burden that accompanies any nudges towards employee ownership. This explains its adoption of a voluntary 'right to request employee ownership' rather than a compulsory one. There are some reasonable grounds for seeking to limit the consequences of a full and unconstrained 'right': firms may spend a significant amount of time and resources responding to repeated requests; recurrent requests may undermine business planning and even put off investors by injecting uncertainty. However, the result is that the 'right' is not a 'right' at all because firms would not even have to respond to the request by assessing its implications.

95 BIS, *Moving to employee ownership: guidance on model documentation* (July 2013)

In this context, the aim should be to stimulate a meaningful nudge, whilst limiting the burden of regulation. One option would be to bolster the voluntary 'right' with a duty imposed on firms at specific trigger points to consider such a 'right' were a request from employees to be made. The most important trigger point at which such a duty would be applicable would be at the succession stage. However, consideration should also be given to applying this duty at other points such as when a firm is expanding, when a merger or acquisition is being pursued or if significant ownership is changing hands.

2. Taxation

There have been persistent criticisms – from the Ownership Commission and others – that tax policy disincentivises the creation of employee-owned businesses. Attention has focused on the withdrawal in 2003 of the corporation tax relief for companies contributing funds to an Employee Benefit Trust (an independent trust that holds shares on behalf of employees), although other aspects of the tax system arguably also discourage employee ownership. Pan-European studies have shown that although financial participation can exist without tax incentives, tax incentives significantly increase financial participation.[96] Below, the report sets out how the Government should design its reforms in tax policy to remove existing barriers.

Relief on Capital Gains Tax and on Profit related payments made to employee owners

Since the 1990s, UK governments have relied heavily on tax incentives to increase direct employee share ownership. Current schemes include the Share Incentive Plan (SIP), Save As You Earn (SAYE), the Company Share Option Plans (CSOP), and Enterprise Management Incentive scheme (EMI). In Britain, about 20 percent of

96 *The PEPPER IV Report: Benchmarking of Employee Participation in Profits and Enterprise Results in the Member and Candidate Countries of the European Union* (2008)

firms have some form of employee share ownership, covering almost a third of the UK workforce.[97] However, as noted above, the number of firms offering share ownership to all employees has actually decreased in recent years (see Chapter 2). There are no plans to increase these reliefs currently, although the Cox Review advocated expanding the allowance in the SIP scheme from £3,000 worth of shares per employee to £5,000 or 10 percent of the employee's salary (whichever is the lower). Following a recommendation from the Office for Tax Simplification, the Government is considering whether CSOP should be discontinued.[98]

However, following an announcement in the 2013 Budget, the Government is consulting on two new tax reliefs: a Capital Gains Tax Relief on the sale of a controlling interest in a business into an employee ownership structure; and, an income tax and National Insurance Contribution exemption for employees of employee-owned firms.[99] Employee Benefit Trusts were able previously to get corporation tax relief on money put into an EBT. But in 2003, the Government restricted this because the relief was being abused as a tax avoidance measure. From 2003, the relief was only applicable where shares were then transferred to employees.

How these proposed reforms operate in practice, what types of firm are eligible and how they are designed with the future in mind will go a long way to determining their success in encouraging a more plural economy. There are compelling reasons to limit the eligibility of firms and the distribution of the tax relief so as to extract the most public benefit from the incentive.

97 Alex Bryson and Richard B. Freeman, 'How does shared capitalism affect economic performance in the United Kingdom?'

98 HMRC, *Consultation: Office of Tax Simplification's report on tax advantaged employee share schemes* (2012)

99 HMT, *Supporting the employee-ownership sector* (2013)

Box 5.1 Recommendations for eligibility and distribution of the Government's proposed tax relief

1. Qualification criteria

Current direct employee share schemes operate at times – such as in the case of the EMI – as a reward for risk taking. However, there are a number of reasons why the Government should limit new tax concessions to indirectly-owned employee ownership. Trust-based models avoid the risks associated with employees having both their capital and their employment in the same business. It may be undesirable from an employee's perspective to hold too many of their assets in the firm for which they work because if their firm goes bankrupt they risk losing not only their job but also their savings. This dilemma – manifested in the collapse of Enron – suggests that there may be limits to which direct ownership of shares by employees is desirable. Significant tax reliefs are also already aimed at directly-owned shares. Trust-based models also possess an inherent lock on the assets ensuring that they remain with employees over time (rather than being sold).

Second, there is a strong case to limit eligibility to the scheme to majority-employee owned businesses. This would have a number of important advantages. First, the performance premium is stronger when employees own a higher proportion of the business. Second, it would make tax avoidance more difficult. Third, given that the Government wishes to limit expenditure on the scheme, there is a case to target tax relief at firms where the productivity improvement will be the most significant. Firms should not be allowed to dilute the level of employee ownership below 50 percent subsequent to receiving the relief without forfeiting past reliefs.

Finally, the Government could utilise this as an opportunity to promote participatory and appropriate governance structures. In the light of the failure of the Co-operative Bank, the Government could use this tax lever to encourage effective corporate governance. Eligibility to the relief could be contingent on meeting certain standards for employee voting rights, employee participation in decision-making and governance.

2. Maximising the relief on Capital Gains Tax (CGT)

A CGT tax relief will at least partly resolve the problem at succession stage. First, it may act as a simple incentive for owners to consider selling into employee ownership. Second, the amount saved in tax relief would allow an owner to sell into employee-ownership at what would otherwise be below the market rate. Third, it is likely to raise awareness of employee-ownership in the professional advice sector and put a responsibility on advisors to discuss the option of employee ownership with their clients. The policy should also reduce the number of undesirable business failures. This policy could be important as there are 2.9 million family-owned firms with nine or fewer employees, and, on average, 172,000 firms are expected to leave the control of a generation each year.[100] As indicated earlier, research suggests that there are a significant number of business failures, a large proportion of which are unnecessary.

3. 3.National Insurance Contributions (NIC) and income tax relief

In introducing the new NIC, the Government should have an eye to other agendas. Given that the overall intention is to remove distortions from the tax system, the relief should be set at the level enjoyed by direct ownership. Under the Share Incentive Plan, employees can receive up to £3,000 in shares per year free of income tax and NIC, and there is a strong case for the new relief for indirect owners to be set at the same level.

As the Employee Ownership Association has proposed, there is also a rationale for limiting the relief to the 20 percent Income Tax band so that the money can be spread wider and does not benefit a narrow pool of employee owners. Any proposal will have to be seen in the context that the employee-ownership sector employs approximately 150,000 employees.[101]

Beyond this, the Government should look at how this new tax relief scheme can be designed for the future. In 2011–12, the

100 www.ifb.org.uk/media/44219/theukfamilybusinesssectorreportnov2011_final.pdf

101 Mutuo, Mutuals *Yearbook – The Definitive Guide to the Mutual Sector* (2013)

Government spent £610m on tax-advantaged employee share schemes.[102] Relative to this expenditure, the £50m allocated for the CGT tax relief and relief on income tax and NIC (described above) appears very modest. In fact, the Employee Ownership Association has previously estimated that the cost of re-introducing the tax advantage to EBTs would be £51m per year.[103] This would leave no room for the CGT relief. While the Government may be unready to increase this sum in 2014, consideration should be given now as to how the scheme can expand and keep up with demand in the future. Otherwise, a risk lurks: if the policy of promoting employee ownership is successful, the value of the relief – and therefore the level of the incentive – will decline over time as the number of organisations and employees claiming from the fixed pot expands. Therefore, the scheme could become a victim of its own success.

One potential response to both these problems is by tracking forward the growth in employee ownership and committing additional Exchequer resources to the scheme in line with growth in the sector. Data on employee ownership is extremely thin at present. What evidence does exist does not break the numbers down in terms of business size or level of employee ownership. In this light, tracking the uptake of the scheme and prevalence of employee ownership could both provide a more accurate evidence base for policymaking along with the data needed to flex the sums available for the tax relief in the future.

More generally, the Government should look to consolidate the four existing tax-advantaged share schemes. If designed correctly this could help achieve the aims of tax simplification and provide productivity benefits. The evidence suggests that share schemes that cover the wider workforce are more likely to

102 HMRC, *Employee Share Schemes Statistics for 2011–12* (June 2013)

103 Will Davies, *All of Our Business: Why Britain needs more private sector employee ownership* (EOA, 2012).

boost the productivity of a firm than narrow-based schemes, but approximately £165m is spent on a combination of the EMI and CSOP which are not all-employee schemes.

3. Access to capital

An inherent conundrum

Access to capital is a fundamental barrier to the expansion of the employee-owned sector, with many alternative business structures – especially smaller firms – struggling to access the necessary capital at the succession stage and as they grow.

It is rarely commented on that the problem of access to capital can never be resolved entirely. For many firms, capital constraints are an inherent consequence of the ownership structure. Family firms and mutuals are often reluctant – and in some cases unable – to surrender equity in their businesses. This conundrum from a firm perspective has been summed up well: co-operative capital needs to offer 'a financial proposition which provides a return, but without destroying co-operative identity; and which enables people to access their funds when they need them. It also means exploring wider options for access to capital outside traditional membership, but without compromising on member control.'[104]

In fact, inability to access finance from the capital markets is arguably an intrinsic feature of the long-term approach and cautious assessment of downside risks displayed by employee-owned businesses. The irony, therefore, is that one of the principal attractions of the employee-owned sector to public policy makers (their conservative approach to risk) is predicated in part on their difficulty in accessing capital, yet it is the latter that holds back the sector.

When firms are unable or disinclined to surrender equity, they are reliant on lending from banks, bonds (in the case of larger firms)

104 Mark Hayes, *The Capital Finance of Co-operative and Community Benefit Societies* (Co-operatives UK, 2013)

or other forms of finance such as social finance and patient capital. Alternatively, they can use their profits to help them expand.

These difficulties may explain in part the relative lack of success that policy makers have had in this area.

The problem

The APPG concluded in its 2008 report that it was difficult 'to determine whether the problem is an absence of finance per se, or rather the absence of sympathetic finance and funding.'[105] The problem appears to stem in part from information blockages. A recent survey of mutuals has found that a quarter did not consider access to finance when they decided their legal constitution.[106] As the Nuttall Review has suggested, lack of awareness on the demand side should be tackled through the provision of better information on financing options.

However, the evidence also suggests that there is an absence of appropriate finance. The Nuttall Review concluded that not only was awareness a problem but that there is 'a more fundamental problem of a lack of finance was regularly cited.'[107] Other evidence corroborates this:

- Of the 96 employee-owned businesses responding to a 2006 survey, four in ten of respondents reported that it was hard to generate investment and that this was a disadvantage of their firm structure. In addition, 37 percent cited a 'lack of understanding by banks and other financial institutions' and 37 percent also cited 'Difficulty generating/accessing finance for investment' as barriers they faced.[108]
- A survey comparing the institutional barriers faced by

105 APPG on Employee Ownership, *Share Value: How employee ownership is changing the face of business* (2008)

106 http://mutuals.cabinetoffice.gov.uk/sites/default/files/documents/Soft%20Finance%20Hard%20Choices.pdf

107 BIS, *Sharing Success: the Nuttall review of employee ownership* (2012)

108 Patrick Burns, *Good Business The employee ownership experience* (2006)

employee-owned businesses and non-employee-owned firms shows that the former experience greater difficulty in obtaining capital from banks than the latter.[109]

The problems of finance arise predominantly at the succession and growth stage. At the succession stage, owners often discount the price of their firm in order to preserve aspects of the company that they believe would erode or disappear were the business to be owned by outsiders. Where the owner is unready to offer a significant discount, options include buying the firm over time out of profits. The introduction of a relief on CGT will offer a partial solution to the finance problem at succession stage. But, new finance options are also needed.

Growth capital is difficult to access for different reasons. Larger firms can use retail bonds or mini-bonds. But, options for other firms are more limited. These problems have been reiterated in a recent study of public service mutuals, which found that 'mutuals and finance providers alike mentioned two potential issues: providers often have a limited understanding of mutuals as such, and an unbalanced view of the relative value and risks in engaging with mutuals.'[110] A different study found that EOBs felt that the problem stemmed from potential investors' uncertainty as to the implications of investing in an EOB.[111]

In part, the lack of finance is probably attributable to the fact that many EOBs are small businesses and therefore face the difficulties accessing bank lending that characterises this sector of the economy. Employee-owned businesses are very reliant on well-functioning bank lending given that they tend to seek out debt

109 Joseph Lampel, Ajay Bhalla and Pushkar Jha, *The Employee Ownership Advantage: Benefits and consequences* (BIS, 2012)

110 http://mutuals.cabinetoffice.gov.uk/sites/default/files/documents/Soft%20Finance%20Hard%20Choices.pdf

111 Employment Research Institute, *The growth of employee owned businesses in Scotland* (Scottish Enterprise, 2013), 67.

finance and only the largest can utilise the corporate bond markets. However, a number of other sector specific problems in the market appear to be present:

- Limited understanding amongst finance providers of mutual organisations.
- Unbalanced views of the risks associated with mutuals.
- Specialisation of the product and the absence of market-scale.
- Short-termism of investors.

Intuitively, social investment could be a source of finance for many smaller organisations in the employee-ownership sector. However, as the Nuttall review notes neatly, many of the obstacles that prevent EOBs accessing capital are reflected in the social investment market: small market size, fragmented deal flows, lack of standardised deals, high transaction costs and low awareness.[112] In addition, there is a danger if the sector were to become overly reliant on 'soft money'. As the Boston Consulting Group has argued, the domination of 'soft money' (non-repayable grant) is not good for the public service mutual sector in the longer-term as it dilutes market discipline: 'the effect has been to lower the bar and allow some mutuals to spin out without developing the right capabilities and plans.'[113]

The available evidence suggests that there are problems on both the demand and supply side and that the Government should consider how it can assist in opening up additional sources of finance to allow more employee-owned firms to emerge and for existing companies to expand.

112 BIS, *Sharing Success: the Nuttall review of employee ownership* (2012), 52. Although it should be noted that intermediaries are seeking to develop local institutions that can finance social enterprises and public service mutuals. Social Investment Business Group, *Place based social investment* (2013)

113 Adrian Brown and Louis Watt, *Soft Finance, Hard Choices: A review of the finance market for public service mutuals* (2013)

Access to patient capital

Since the demise of the private finance initiative, the Government has made increasing efforts to woo institutional investors into infrastructure projects, citing the synergy between pension funds that typically seek long-term returns and the long-term stable returns realisable from infrastructure. Theoretically, the same commonality of interest applies between pension funds and employee-owned businesses, the latter who traditionally focus on long-term business growth and stable, steady growth across the economic cycle. Pension fund investors frequently lament the shortage of long-term investing opportunities.

However, left to its own devices pension fund investment is unlikely to flow to these businesses (many of them smaller firms) because transaction costs would be high as a proportion of the investment. Therefore, it is likely that an intermediary function would be needed to match EOBs with financing options from pension funds and to aggregate demand for finance from EOBs to achieve the necessary scale.

The Government should consider how pension fund investors could place their money in the EOB sector. Such a policy could have a positive reinforcing effect: pension fund investors may look positively on further distribution of shares and rights to employees as a route to greater stability and stronger performance within the companies in which they have an interest.

An employee-ownership lending bank

Given the apparent market failures that prevent EOBs from accessing capital, there is a strong case for establishing a business bank targeted at the employee-ownership sector. The principal source of lending for employee-owned firms is Baxendale Ownership, which has invested its own capital and manages a private capital fund. However, according to a recent BIS report, it believes that

much larger funds are needed to meet the financing requirements of the employee ownership sector.[114]

There are already specific lending banks aimed at the green sector (Green Investment Bank) and the SME sector (Business Bank). An 'Employee Ownership Lending Bank' (EOLB) could resolve several existing constraints, including boosting awareness of financing opportunities within the sector; increasing the amount of patient capital available to viable but under-served emoployee-owned businesses; and overcoming fragmentation by providing a platform for aggregating demand for finance (e.g. for pension funds). Not only would it help employee-owned firms expand where viable, but it would also nurture new employee-owned firms by offering finance to companies that are seeking to convert into majority employee-owned businesses. In addition, the EOLB could be used by government to pursue additional objectives, such as making requirements of employee ownership levels, corporate governance (such as voting rights) and employee participation. This would ensure that finance was provided to responsible as well as viable businesses, Such an institution would serve to kick-start the market, whilst developing institutional knowledge about lending to the sector. The purpose of the EOLB would be to complement rather than replace existing financial provision.

A proposed Employee Ownership Bank in the United States offers a potential framework. The Bank would provide loans and guarantees to firms that were at least 50 percent employee owned or to facilitate succession and majority employee ownership. As with the Business Bank, a principal objective would be to 'increase the provision of finance to viable but underserved businesses, in particular improving the provision of long term finance'.[115]

114 BIS, *The Nuttall Review of Employee Ownership: One Year On Report* (November 2013)

115 BIS, *Building the Business Bank: Strategy update* (2013)

There may be operation efficiencies in delivering this scheme as part of the Government's Business Bank.

Proposed duties for the Sanders Employee Ownership bank in the USA[116]

(b) Duties of Bank – The Bank is authorized to provide loans, on a direct or guaranteed basis, which may be subordinated to the interests of all other creditors —
(1) to purchase a company through an employee stock ownership plan or an eligible worker-owned cooperative, which shall be at least 51 percent employee owned, or will become at least 51 percent employee owned as a result of financial assistance from the Bank;
(2) to allow a company that is less than 51 percent employee owned to become at least 51 percent employee owned;
(3) to allow a company that is already at least 51 percent employee owned to increase the level of employee ownership at the company; and
(4) to allow a company that is already at least 51 percent employee owned to expand operations and increase or preserve employment.

More localised financial institutions

Compared with some comparators, the UK banking system is heavily centralised. Critics argue that this contributes to a dearth of local intelligence and low awareness of local businesses and their needs.[117] This inhibits lending to the SME sector. Given that many firms with alternative ownership structures (such as co-operatives, community-interest companies and employee-owned firms) are specific to a locality, a more localised financial function would be able to respond better to their needs. The Government is now forcing banks to be transparent about their lending in each

116 www.govtrack.us/congress/bills/111/s2914/text. Senator Bernie Sanders has recently pledged to re-introduce a bill into the Senate to legislate for a U.S. Employee Ownership Bank. 'Statement by Sen. Bernie Sanders at the Annual Vermont Employee Ownership Conference', 11 June 2013.

117 www.civitas.org.uk/economy/SimpsonSparkassen.pdf#sthash.iB8AYfgk.dpuf

locality across the country.[118] Arguably, there is a case for adopting more radical regulation of banks, such as by replicating the USA's Community Reinvestment Act.

Comparisons have been drawn with Germany's Sparkassen, which account for 40 percent of corporate lending in the country. The latter are savings banks whose constitutions require them to fulfil obligations to support the sustainable development of the economy within their defined locality.[119] Around three quarters of German SMEs have a relationship with a Sparkasse.[120] The Labour Party's Small Business Taskforce has proposed developing local lending institutions by importing aspects of the Sparkassen model, pointing to, among other strengths, their "relationship banking".[121] The institutions fulfilling this role could take a number of forms. One option would be for local authorities or Local Enterprise Partnerships to play a role as finance intermediaries. For instance, Humber Local Enterprise Partnership Business Loan Fund has established a fund to help specific business projects get off the ground; New Anglia LEP's Growing Business Fund seeks to support local SMEs; the North East LEP has developed a fund that re-cycles finance to support local businesses. Such organisations are positioned well to mix an interest in the local economy, with expertise about specific businesses and their risks. Questions to consider further in introducing such a scheme should include: first, what level of public equity or endowment would be needed upfront against which private investment could be leveraged? Second, to what extent is significant variation between these institutions beneficial or detrimental? For instance, common IT infrastructure would provide economies of scale, but shared lending requirements may impinge the local autonomy of each bank.

118 www.bbc.co.uk/news/business-23429237

119 www.civitas.org.uk/economy/SimpsonSparkassen.pdf#sthash.iB8AYfgk.dpuf

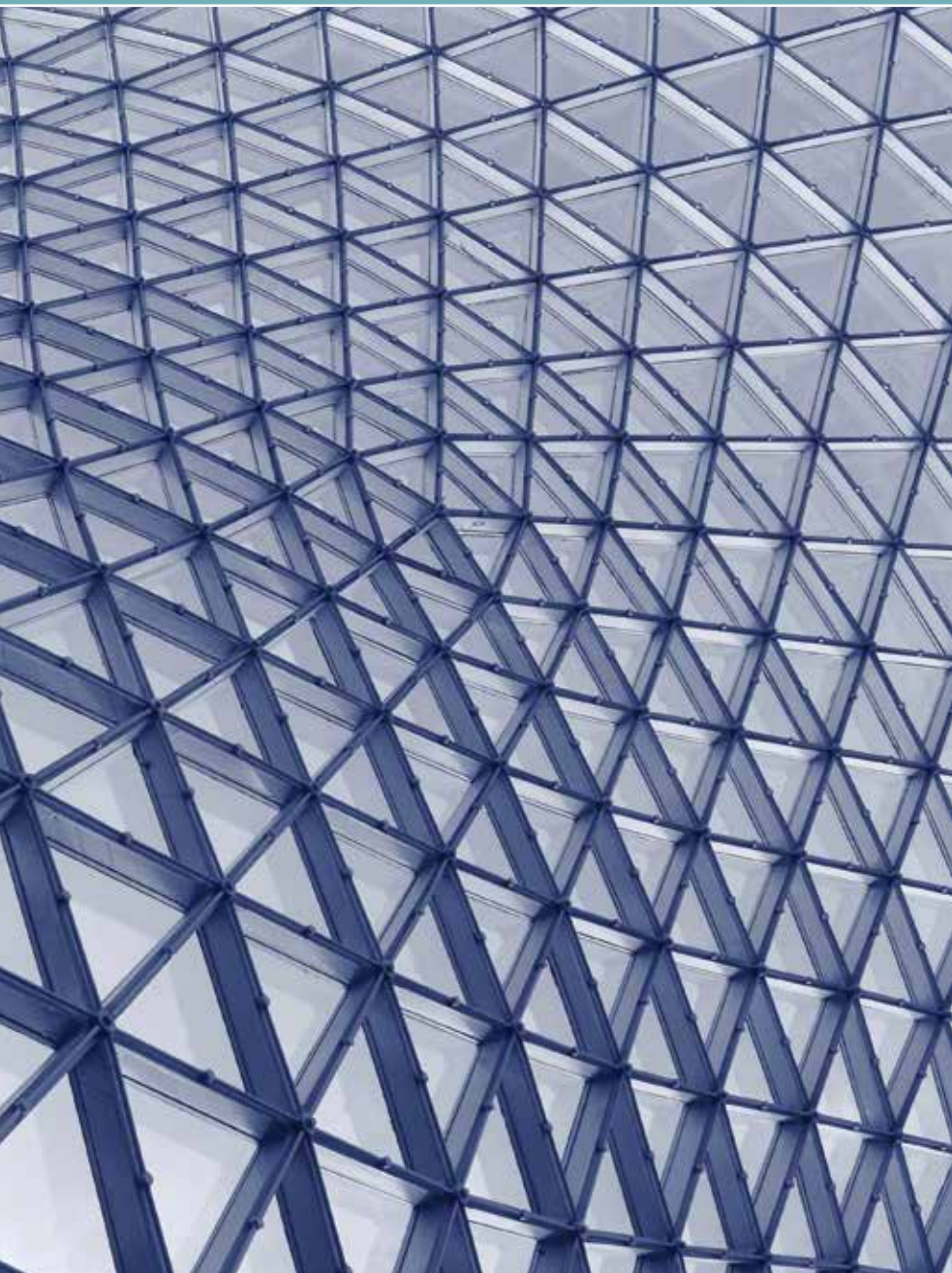
120 Stephen Clarke, Street Cred –*Local banks and strong local economies* (Civitas, 2012)

121 Labour Party Policy Review, *An Enterprising Nation: The final report of the Small Business Taskforce* (2013)

CONCLUSION

This report has argued that business ownership matters not only to the performance of the UK economy, but also to its resilience. Reforming business ownership is unlikely to be a short-term endeavour. Some of the constraints associated with growth of the employee ownership sector are intrinsic dilemmas. Employee-owned firms will always have fewer opportunities for raising finance than firms that are ready to surrender significant equity stakes to external investors. Neither should policymakers overlook the fact that some of the positive attributes associated with employee ownership – namely their longer-term outlook – partly stem from the factors that hold them back in the first place (such as access to finance).

However, there is also reason for optimism about the effect that policy interventions can have on the outcome. Just as history suggests that external influences can affect the decisions that business owners make at the point of succession and when seeking to grow, so policymakers have an important role to remove the imbalances that have emerged over time. So, removing tax disincentives, boosting awareness and nudging businesses to consider employee ownership and opening up wider sources of investment to finance growth in the sector should be part of industrial strategy.



In the wake of the financial crash there has been much soul-searching by politicians as to how failures in the market economy can be resolved. The PLC structure that dominates the UK economy has been criticised heavily for its short-termism and for excessive executive pay. This research sets out the economic case for promoting greater diversity of ownership structures and employee ownership in particular.

Despite the advantages revealed, the report identifies the barriers that inhibit companies from adopting alternative business structures, including tax disincentives and problems accessing investment. It recommends radical government action to overcome these and to promote a more diverse and resilient economy.

Kindly supported by

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