Strengthening employee share ownership in the UK

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Scott was voted one of the top three forecasters of UK GDP by Focus Economics in 2016.

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EXECUTIVE SUMMARY

This report analyses the scope to promote wider individual employee share ownership in the UK, and the potential benefits of doing so. The report assesses the potential for employee share ownership to reduce inequality, tackle the UK economy's productivity crisis, improve financial resilience and increase employee voice within companies.

The importance of employee share ownership

There is a growing literature in support of the view that that employee ownership often enhances long-term productivity and performance within companies; improves employee engagement and commitment; incentivises investment in staff and acts as a tool to retain workers; and could contribute to the financial resilience of employees. Financial inequality and sluggish UK-wide productivity growth are two of the most-discussed economic issues of our age, and employee share ownership offers potential to help tackle both of these.

Furthermore, evidence suggests that employee ownership is viewed positively by the wider public and politicians alike. A survey of 1,000 listed company employees, commissioned as part of this research, found that:

- 68% said that they like the idea of holding shares in the company that they work for.
- 60% believe that employee shares/options would incentivise them to stay with their employer for longer than originally intended.
- 58% agreed that share ownership would/does make them "more motivated to do well in my job". This suggests that employee share ownership could improve workforce productivity.
- 56% said that employee share ownership would make them more interested in other types of investment – suggesting that it can encourage individuals to engage more with savings and investment products.
- 46% of those surveyed that held employee shares/options said that they did so because they expect shares to increase in value in the future. 42% said they did so as another way to save/earn money, and 36% said they held shares to benefit from dividend payments.

Expanding employee share ownership could generate significant financial returns to UK households, especially given the context of individuals currently holding excessive savings in current accounts and low-return instant access savings accounts. SMF research from 2017 showed that savers effectively lost around £8 billion in savings over the past five years due to holding savings in accounts where returns trailed behind inflation.[1]

In contrast, share ownership over the long-term has offered inflation-beating returns. The FTSE All Share Index has increased by on average of 3.6% per annum since 1997 (according to London Stock Exchange statistics). In addition to these capital gains, shareholders receive dividend income; data from the end of 2018 show a dividend yield of 4.5% for the FTSE All-Share.[2]

Suppose a UK employee held a relatively modest £1,000 worth of employee shares[i], and these increased in value by 3.6% per annum (as per the average of the FTSE All Share since 1997), with

[i] The current median value of employee shares held is £5,000. We use a lower figure here to provide some conservative estimates of the benefits of broader employee share ownership.

a dividend yield of 4.5%. This would generate a gross return of about 50% (£500) over a five-year period, if dividend income is reinvested in shares. Even after taking into account inflation of 2% per annum, this still leaves a healthy real return of 34% - that is 6% per year. Further, employee gains might be magnified if higher levels of engagement and productivity (through increase sense of involvement in the company) translate into higher rates of base pay.

Low rates of employee share ownership despite benefits

Despite these benefits and positive opinions, employee share ownership rates across the country are low. In the period 2014 – 2016, just 3.6% of the UK adult population (or approximately 1.9 million people aged 16 and over) held some form of employee shares. In part, this reflects the limited number of companies currently offering employee share ownership schemes at present; just over 13,000 companies in the UK operate some form of tax-incentivised employee share ownership plan. This is out of a total of 1.4 million private sector enterprises with at least one employee.

People who were of working age were more likely to have employee shares than individuals who were over the State Pension threshold (4.2% versus 1.8%, respectively).

Cost appears to be a significant barrier to wider rates of employee share ownership among UK households. According to the survey commissioned as part of this study, 38% of listed company employees that had been offered shares/options declined them because of a lack of spare income to purchase shares. This was the most commonly-cited reason for not holding shares, followed by concerns about shares declining in value (31%) and not being interested in participating (24%).

Research by Oxera found that larger companies (by employees, turnover and capital) are more likely to offer employee share ownership – with access more limited among small-and-medium-sized enterprises (SMEs). Further, share ownership schemes are concentrated heavily in certain segments of the economy; 80% of tax-advantaged employee share schemes are concentrated in four sectors: 1) manufacturing; 2) real estate, renting, and business activities; 3) wholesale and retail trade; 4) financial intermediation.[3] It is difficult to establish fully why some companies offer share ownership opportunities while others do not; suggesting a multi-pronged policy approach might be most appropriate.

What to do

While the three major political parties have either implemented or proposed policies related to employee share ownership, no party has introduced or proposed a game-changer policy which would dramatically increase ownership across the economy. Most recently, the Labour Party proposed the creation of Inclusive Ownership Funds (IOFs) which would own 10% of large companies – we have analysed this policy in the greatest detail in the main body of the report, as it is the most comprehensive proposal put forward recently. We find that IOFs would lead to lower levels of household wealth directly held in shares, including existing employee share schemes, as this wealth is diluted following the rollout of IOFs. We estimate that the order of magnitude of such wealth expropriation is likely to be significant: share dilution would cost all investors about £340bn if 10% IOFs were rolled out with immediate effect. This includes £26bn in lost UK pension scheme wealth and £28bn knocked off the value of shares (including employee shares) held by UK households. Clifford Chance has estimated that local government pension schemes account for about a quarter (26%) of the lost pension wealth due to IOFs.

We estimate that £5bn of this £26bn lost pension wealth relates to households in the bottom half of the income distribution. On a per-household basis, share dilution under the IOF policy would amount to £900. For those in the bottom half of the income distribution, the per household loss is about £360. Of the £28bn knocked off the value of household-held shares, about £2.8bn of this relates to shares held by those in the bottom half of the income distribution. About 1.2 million households in the bottom half of the income distribution hold shares, including employee shares.

In the final chapter of the report, we put forward the following set of proposals which could incentivise the take-up of employee shares. In particular, we focus on promoting individual employee share ownership via non-discretionary schemes, open to all employees at a workplace.

Recommendations

The most important intervention that policymakers should make in this area is to provide a clear sense of leadership, direction and priority. Government should put the onus on employers to promote employee share ownership to their staff, in recognition of the scope for higher rates of employee share ownership, done right, to bolster productivity in the economy and potentially reduce income and wealth inequality.

Drawing on the lessons of the Davies Review and the Hampton-Alexander Review, we recommend establishing a new norm around employee ownership and the expectation of a firm to promote it. A clear public target for employee ownership should be established and companies' performance towards meeting it should be monitored and reported.

Recommendation

The Government should set a target for the percentage of employees in public companies who own shares/share options in their employer, and deploy public scrutiny and pressure to encourage firms to take action to ensure that target is met. Setting a target and expectations would lead business managers to think about barriers within their firm to increasing employee share ownership – and respond appropriately.

The target, which could be set by an independent review, should then be overseen by an independent body modelled on the Hampton-Alexander Review, and supported by stronger public advocacy from politicians – of all parties – who seek broader ownership of the economy.

Promote employee share ownership

Employee share ownership is viewed favourably by consumers and prospective workers, but there is some room to promote employee ownership as a viable business structure to more employers (and investors).

The Employee Share Ownership Index, which used to be independently calculated to track the performance of publicly listed companies in the UK with substantial employee ownership, showed that firms in the index performed better in the long term than the FTSE All Share. The

Index is a useful tool to highlight the long-term advantages associated with employee ownership. However, it has not been updated since 2016.

Recommendation

The Government should update regularly the Employee Share Ownership Index, which tracks the performance of listed firms with employee owners against the movements of the wider FTSE All Share.

Allow employee shares of a different class which carry more voting rights

Employee shares issued under a Share Incentive Plan must be ordinary shares in the company, but certain restrictions could apply, such as limited or no voting rights. A key condition for the success of employee ownership is granting workers a voice within a company and providing a means to exercise this voice.

Recommendation

The Government should abandon the legislation which allows employers to restrict the voting rights of employee shares. Moreover, the Government should explore the possibilities of reclassifying employee shares in order to give participating workers more voting rights than external shareholders. This could include enhanced rights to nominate board directors.

In making this recommendation, we are mindful that this is a complex and contested topic. The principle of "one share one vote" has significant defenders, who argue that control over a company should be allocated in direct proportion to an owners' economic interest in that company. There are also legitimate questions to answer about how rules allowing differential ownership might diminish board accountability to minority shareholders. Such questions should be answered carefully in any exploration of enhanced voting rights for employee-owners. To be successful and sustainable, any such enhanced-rights regime would have to be designed so as to preserve board accountability in particular.

Transparency requirements

Disclosure of headline data on the offer and take-up of employee share ownership schemes in companies' annual reports could simultaneously promote the practices of employers themselves and apply pressure on competitors to also consider awarding or selling employee shares to their workers. This also provides shareholders with more information to engage with the company on their overall approach to human capital management. Greater transparency of employee share ownership schemes might also help companies to attract talent, by making it easier for prospective employees to identify firms adopting good practice.

In particular, the Financial Reporting Council should require that the following aspects should be included in annual reports, through amendments to the UK Corporate Governance Code:

- The type of employee share scheme(s) on offer to workers (SIP, SAYE, CSOP, EMI, other);

- The proportion of eligible employees who participate in share ownership, per scheme offered;
- The average value of employee shares per participating worker.

Evaluation of a similar policy, the disclosure of the extent of the gender pay gap within an employer's workforce, indicates that compulsory reporting is likely to influence the behaviour of businesses, as 84% of firms surveyed by charity Close the Gap in 2017 were worried about the potential impact of reporting their gender pay disparities on their reputation.[4] Reporting on employee ownership and involvement could similarly nudge employer behaviour.

Recommendation

The Financial Reporting Council should require firms to include information on what type of employee share ownership schemes are operated, the extent to which each scheme is taken up by eligible workers and the average value of employee shares in annual reports.

Reduce the SIP holding period

Workers currently need to keep their employee shares in a Share Incentive Plan (SIP) for five years in order to benefit from the exemption on income tax and national insurance contributions on any increases in the value of their investment.

This period of time outstrips the holding period of SAYE and CSOP schemes and the three-year cap on contributions under and EMI scheme. Additionally, with estimates suggesting that workers in the UK move roles every five years on average, a holding period of equal length might be acting as a disincentive for participation.

Recommendation

The Government should decrease the holding period of Share Incentive Plans from five years to three years.

In addition, the Government should carry out a regular Statutory Review every five years in order to evaluate the holding period of SIP schemes as labour market dynamics continue to evolve.

Ensuring employee ownership schemes are structured in the right way, and are not considered in isolation

One finding from the Opinium survey was that employees expressed a strong preference for having access to share options rather than buying shares from their employer; 55% preferred share options versus 26% preferring buying shares. Conceivably this reflects the fact that share options limit the downside financial risks of share ownership, with individuals not having to exercise an option if doing so would lead to a financial loss. This should be a consideration in deciding how employee share ownership schemes should be constructed – especially given our previous finding that affordability and concerns about declining share value are the biggest barriers to workers wanting employee shares.

Recommendation

Employee share schemes should reflect the affordability constraints and risk appetites of workers. This might favour share option schemes over simply letting workers buy company shares.

Another consideration is how employee share ownership compares with other worker concerns and policy tools for improving employee outcomes. While this report has highlighted that share ownership can bring with it numerous benefits, and that employees like the idea of owning shares within their company, it is not a silver-bullet solution. Indeed, a majority of those we surveyed said that they would prefer profit-related pay or performance-related pay to employee share ownership.

A risk from widespread employee ownership, and dividend payments, is that the pay gap between those working in the best-performing and worst-performing companies could widen rather than narrow. Those in best-performing companies could receive, on average, much more dividend income than those in poorly performing companies. If politicians aim to reduce inequality using employee share ownership, it should be noted that this might not be the best way of achieving that goal.

Given this, other approaches to improving the financial outcomes of workers might be a higher priority and should be considered in addition to employee share ownership.

Recommendation

That employee share ownership is seen as part of a broader package of initiatives aimed at improving employee pay, motivation and "voice". Policymakers should also consider the case for encouraging other forms of non-regular remuneration, such as profit-related and performance-related pay.

CHAPTER 1: INTRODUCTION

A widespread narrative suggests that the market economy is failing to deliver greater wealth for everybody. Many are concerned that wealth-owners benefit disproportionately, whereas individuals with low income and limited assets gain little or nothing. The World Economic Forum finds that, over the past five years, wealth inequality in the UK has been increasing, whereas income inequality has slightly declined on average.[5] IFS research has shown that the highest-income 1% of adults in the UK receive around 14% of national income; this share has increased since the 1980s.[6]

Addressing these concerns requires new thinking from government, including around employee share ownership – the topic of this report. As we discuss, giving workers a stake in their employer could boost their wealth and pay, and also increase employee voice in the economy.

From a broader macroeconomic perspective, poor productivity growth in the UK has contributed to weak wage growth. Employee share ownership has the potential to contribute to improvements in productivity across the country; studies have shown that employee ownership is associated with a productivity premium. In 2016, the Employee Ownership Index highlighted that listed companies which have at least 3 per cent of their share capital held by employees (or on employees' behalf) outperformed firms in the FTSE All Share in ten out of the previous thirteen years by an average annual margin of 13.9%.[7]

Employee share ownership could also be *politically* beneficial, and has been promoted by the three major political parties in the UK. Policies implemented by the Conservative-led Coalition Government such as 'shares for rights' saw the creation of a new type of employee ownership arrangement, with Employee Shareholder Status. Most recently, the Labour Party put forward a proposal for the creation of Inclusive Ownership Funds, whereas the Liberal Democrats have campaigned for the introduction of a right to request employee shares.

Wider distribution of ownership would enable employees to participate in the economy not only as consumers and suppliers of labour but also as owners of capital. This would tackle criticism that, regardless of their relative efforts, employers enjoy benefits which are unavailable to workers. Employee share ownership could also be a mechanism to increase employee say in the running of a company, which would give workers a stake in future decision-making.

Additionally, increases in income and wealth associated with employee share ownership could act as a gateway to more workers being interested in the wider financial system, regardless of their skill or education level.

Successive governments have sought to expand the number of organisations which are majorly employee-owned. However, to date, such measures have had a limited impact.

There are four main tax-advantaged schemes in the UK which incentivise individual employee share ownership:

- Save As You Earn (SAYE) and Share Incentive Plans (SIPs), both of which are open to all eligible employees in a workplace;
- Company Share Options (CSOPs) and Enterprise Management Incentives (EMIs), which are discretionary schemes, usually aimed at managerial and senior staff (although this is not a formal criterion).

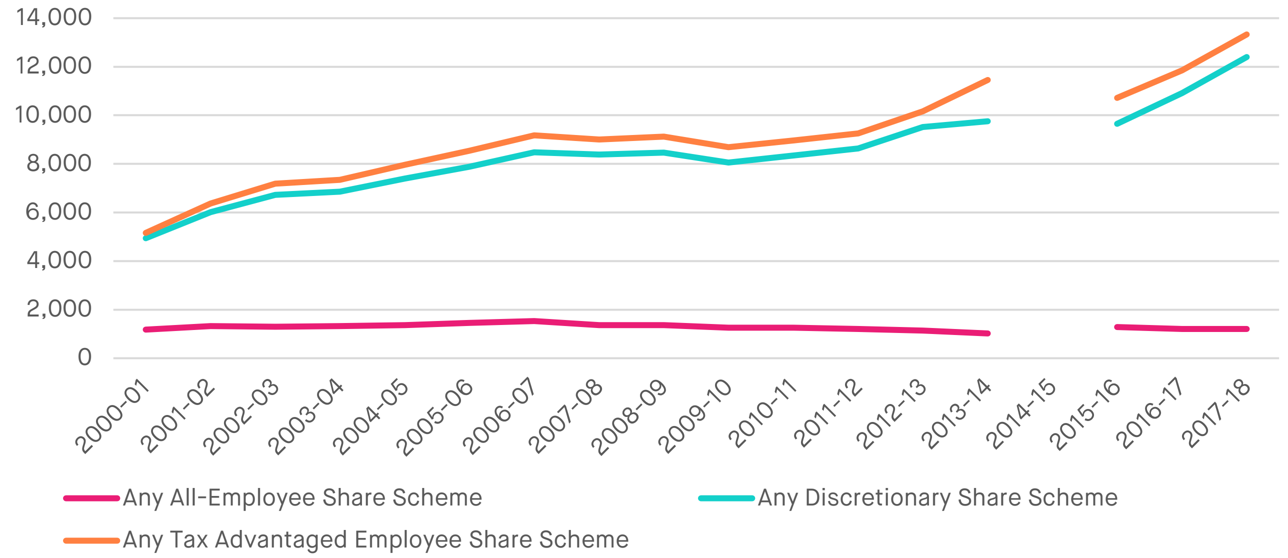
The table below summarises the key characteristics of each scheme:

Table 1: Employee share ownership schemes in the UK

Scheme	Type	Coverage	Limit	Holding Period	Tax Advantage
Save As You Earn (SAYE)	Options	All employees	£500 per month	3 – 5 years	No Income Tax No National Insurance Contributions Interest and bonus tax free
Share Incentive Plans (SIPs)	Shares	All employees	Free: £3,600 Partnership: £1,800 or 10% of income, whichever is lower Matching: Up to 2 per partnership share bought	5 years	No Income Tax No National Insurance Contributions
Company Share Option Plans (CSOPs)	Options	Discretionary	£30,000 per employee	3 – 10 years	No Income Tax No National Insurance Contributions
Enterprise Management Incentives (EMIs)	Options	Discretionary Firms with assets of £30m or less	£250,000 per employee in a 3-year period	Maximum 10 years	If bought at market value at the time of issue: No Income Tax No National Insurance Contributions

Currently, over 13,000 companies in the UK operate some form of employee share ownership plan which attracts tax relief from the government.[8] However, productivity improvements associated with employee ownership only arise when employee ownership is widespread across the employer's workforce.[9] As illustrated in Figure 1 below, official statistics show that the number of firms operating a tax-advantaged share scheme open to all employees has remained relatively stable since the turn of the century, whereas the use of discretionary share schemes, often targeted at more senior workers, has expanded drastically.

Figure 1: Number of companies with tax-advantaged employee share schemes



Source: SMF analysis of HMRC Employee Share Schemes statistics
Note: Data for 2014-15 not available from source
Note 2: Firms can operate more than one share scheme at a time

Employee share ownership does come with financial risks which must be managed by policymakers. Owning an increasing share in one's own employer could act against investment diversification, especially among workers who tend to stay in the same industry for a long time. If an employee's company fails, they risk not only losing their income but also wealth tied up in firm shares. It is for this reason that there are established protocols which prevent people from saving into their company for retirement purposes. Any attempts to increase employee share ownership need to address this 'eggs in one basket' problem.

It is also crucial that efforts to increase employee share ownership boost ownership among those on lower as well as middling and higher incomes. Employee shares could be unaffordable for workers at the lower end of the income distribution. As such, incentives to roll out share ownership schemes risk exacerbating already sizeable income and wealth inequalities.

The rest of this report is structured as follows:

- *Chapter 2* weighs the potential benefits and drawbacks of employee share ownership;
- *Chapter 3* explores the state of employee share ownership in the UK;
- *Chapter 4* describes employee share ownership initiatives abroad;
- *Chapter 5* evaluates recent policy proposals in regard to employee share ownership;
- *Chapter 6* outlines our policy suggestions to incentivise the wider use of employee share ownership.

Research methods

This report is based on the following analysis:

- Quantitative analysis of the Wealth and Assets Survey (Wave 5, 2014 – 2016).[10]
- Findings from a survey of 1,000 employees of publicly listed companies carried out by Opinium between 22nd November 2019 and 2nd December 2019.

- An expert roundtable which brought together senior officials from businesses, business groups, and local and national policymakers to test out our preliminary findings and ideas. The discussion was held under Chatham House rule.

CHAPTER 2: EVALUATING THE POTENTIAL OF EMPLOYEE SHARE OWNERSHIP

Employee share ownership requires workers to have a significant and meaningful stake in their employer. As defined by the Nuttall Review, employee ownership expands beyond financial participation and promotes worker engagement.[11]

Employee ownership takes three forms:

- *Direct employee ownership* or *individual share ownership* - employees participate in one or more share plans (which attract tax relief from the government) and become individual shareholders in their company;
- *Indirect employee ownership* or *collective share ownership* - shares are held collectively on the behalf of workers, normally using an employee trust;
- *Combined direct and indirect ownership* – a combination of individual and collective share ownership.

Each of these three types has its own merits. However, in this research, we primarily focus on incentivising higher participation in individual employee ownership schemes, given that this is the most tangible, concrete form of employee ownership – giving individuals a stake in a company which they can purchase and sell.

The evidence on employee share ownership

Pure economic theory would dispute the potential impact that employee share ownership could have on workers' motivation and productivity.

Although it is in individual employees' interest for their firm to prosper, their personal incentive in ensuring this happens reflects only the individual difference which the worker himself/herself believes that they can make on the performance of their employer. This could therefore lead to a subdued effect on productivity, as workers would not take into account the contributions of their co-workers.

Whilst the theoretical concerns outlined above should not be dismissed lightly, analysis of firm and employee behaviour has found a number of channels through which employee ownership can have a positive impact on productivity, employee engagement and well-being.

Benefits of increased rates of employee share ownership

There are multiple reasons why benefits may arise from employee share ownership. In part, at least, employee share ownership aligns the interests of workers and owners. This alignment in turn means that companies may be less vertically structured and more open to innovation.[12] Research indicates that the sharing of profits amongst employees, for instance through employee ownership, creates a collective positive peer pressure and a commonality of interest, which in turns boosts engagement and performance. In addition, there may be other less immediately-tangible benefits such as higher levels of training and investment in skills because of better employee retention.

Productivity and performance

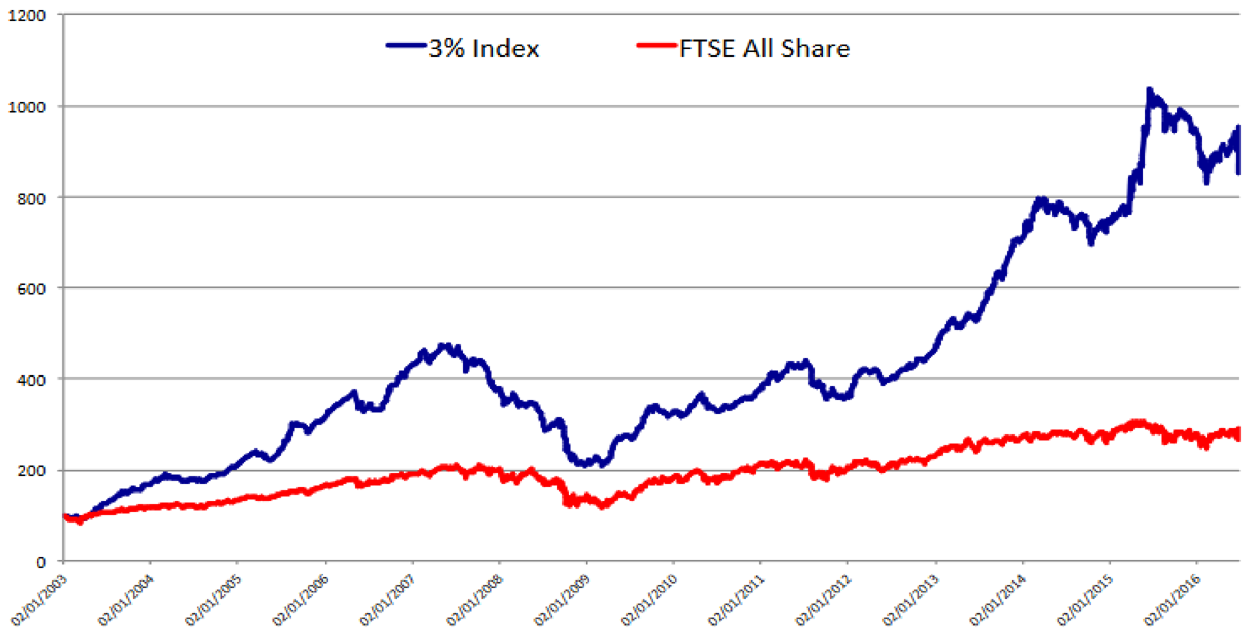
There is a growing literature in support of the view that that employee ownership often enhances long-term productivity and performance within companies.

Bryson and Freeman found that companies with pay linked to company performance, particularly share ownership schemes, have higher worker productivity than firms without such pay arrangements.[13] In 2019, the UK's fifty largest employee-owned businesses reported a 7.7% increase in mean productivity and a 2.5% median rise in operating profits.[14]

Oxera estimates that the effect of tax-advantaged employee share schemes (or individual share ownership) on company performance is significant and productivity increases by 2.5% in the long run.[15] Listed companies exhibit improvements in productivity on a larger scale (4.9% in the long run) as a result of operating a tax-advantaged employee share scheme; unlisted firms show no significant productivity premium, although this may be due to unobservable issues related to employee participation.[16]

The UK Employee Ownership Index, which tracks the performance of companies which have at least 3 per cent of their share capital held by employees (or on employees' behalf), shows that such firms have consistently outperformed the FTSE All Share index. Between 2003 and 2015, the average annual margin of performance of firms in the 3% index was 13.9% higher than the FTSE All Share.[17]

Figure 2: UK Employee Ownership Index, 2003 - 2016



Source: UK Employee Ownership Index

Academic research has established that employee-owned businesses in the UK (defined as firms where employees own a stake both individually and collectively) are more resilient, display less sales variability, and deliver more stable performance over business cycles.[18] The same study also showed that the profitability of these companies correlates with giving employees greater autonomy in decision-making.[19] Firms with employee owners, which adapt their organisational structure and empower their front-end employees, are more likely to sustain their performance as their size increases.[20]

However, improvements in productivity and performance could be dependent on employee share ownership schemes being designed and implemented effectively and at a wide scale, often in conjunction with other workplace initiatives. The Cass Business School estimates that employee representation at board level between 30% and 60% improves the performance of employee-owned businesses (representation of over 60% was found not to deliver any additional benefits and representation of less than 30% makes no impact on performance).[21] Additionally, the impacts might be larger when more than one employee share scheme is used[22] or when employee ownership schemes are used in combination with profit-sharing arrangements.[23]

Despite the evidence that employee ownership is associated with higher productivity, the Office for Tax Simplification found that increased productivity was not a primary target among companies which offered employee share schemes in 2012.[24] Some of the employers who responded to the Review of Tax Advantaged Employee Share Schemes did agree that improvements in productivity could be a by-product of participation in an employee share plan, however employee shares were mainly offered as a means to drive interest and commitment among workers as well as to open up share ownership across employee levels.[25]

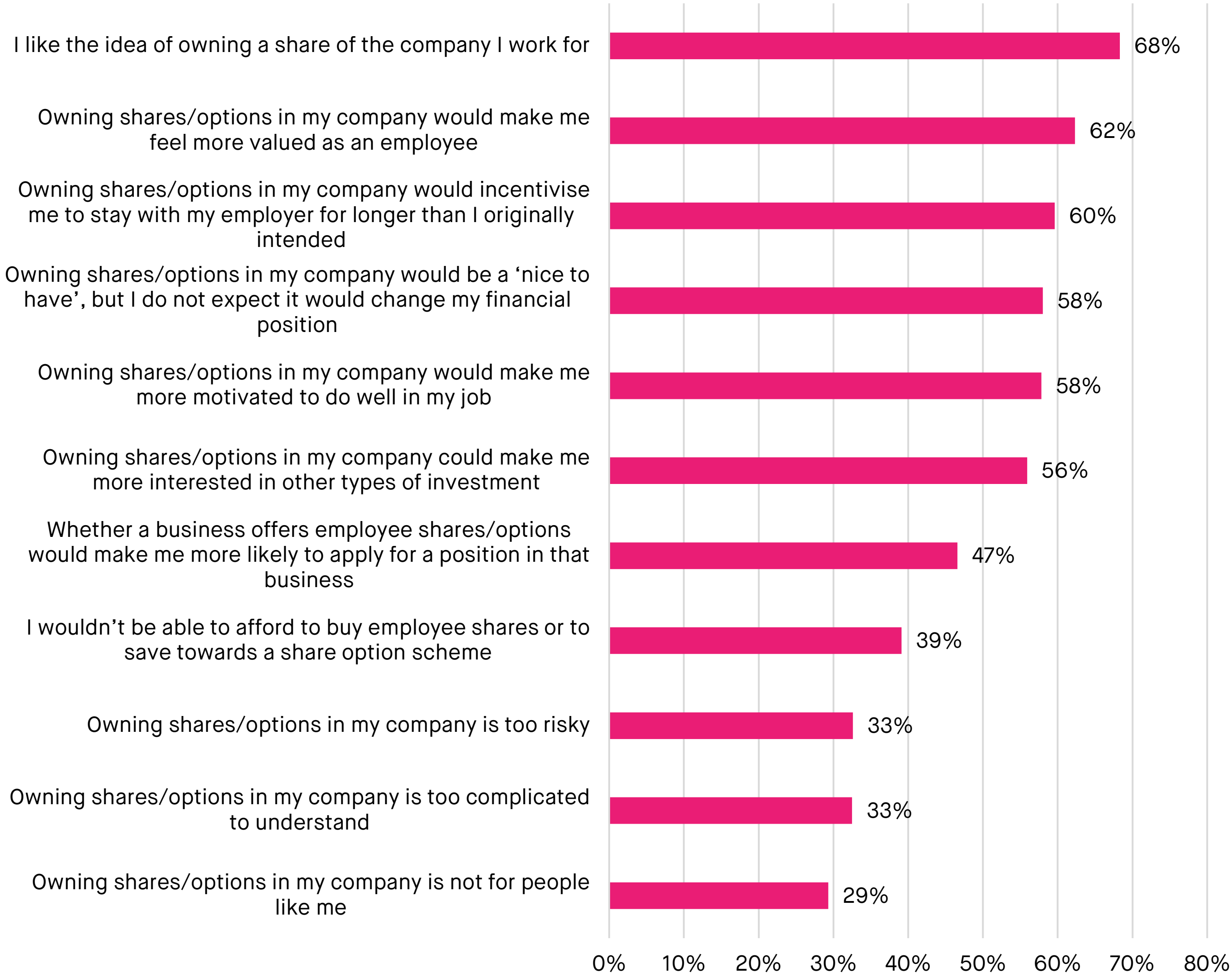
Employee engagement and commitment

Evidence supports the notion that giving workers a stake in their employer enhances their commitment and motivation. For instance, the MacLeod Review of employee engagement named employee ownership as a ‘profound and distinctive enabler of high engagement’.[26] A survey from 2006 reported that the top-rated advantage arising from employee ownership was increased staff commitment, cited among 91% of surveyed employee-owned businesses.[27]

However, as the Nuttall Review notes, employee ownership and employee engagement are mutually reinforcing – the benefits arising from employee ownership are often as a result of employee engagement, whilst simultaneously, employee ownership as a business structure incentivises employee engagement.[28]

Among the 1,000 employees of listed companies surveyed as part of this research, 58% agreed that share ownership would/does make them “more motivated to do well in my job”. This positive motivational effect can in turn help bolster company productivity.

Figure 3: % of employees agreeing with the following statements



Source: Opinium Survey of listed company employees

Investment in staff and retaining workers

Employee share ownership can be a tool to retain workers as tax-advantaged schemes have a minimum holding period of between 3 to 5 years before employees can benefit from their shares or options. Over half (52%) of employee-owned companies in 2006 reported experiences of easier recruitment and retainment of talented staff.[29]

This could be one of the reasons why research by the Cass Business School finds evidence that employee-owned businesses favour actions which have a long-term payback horizon, and, therefore, invest more in human capital than non-employee-owned firms.[30]

The Opinium survey results, graphed above, show that 60% of listed company employees believe that employee shares/options would incentivise them to stay with their employer for longer than originally intended.

Financial resilience of employees

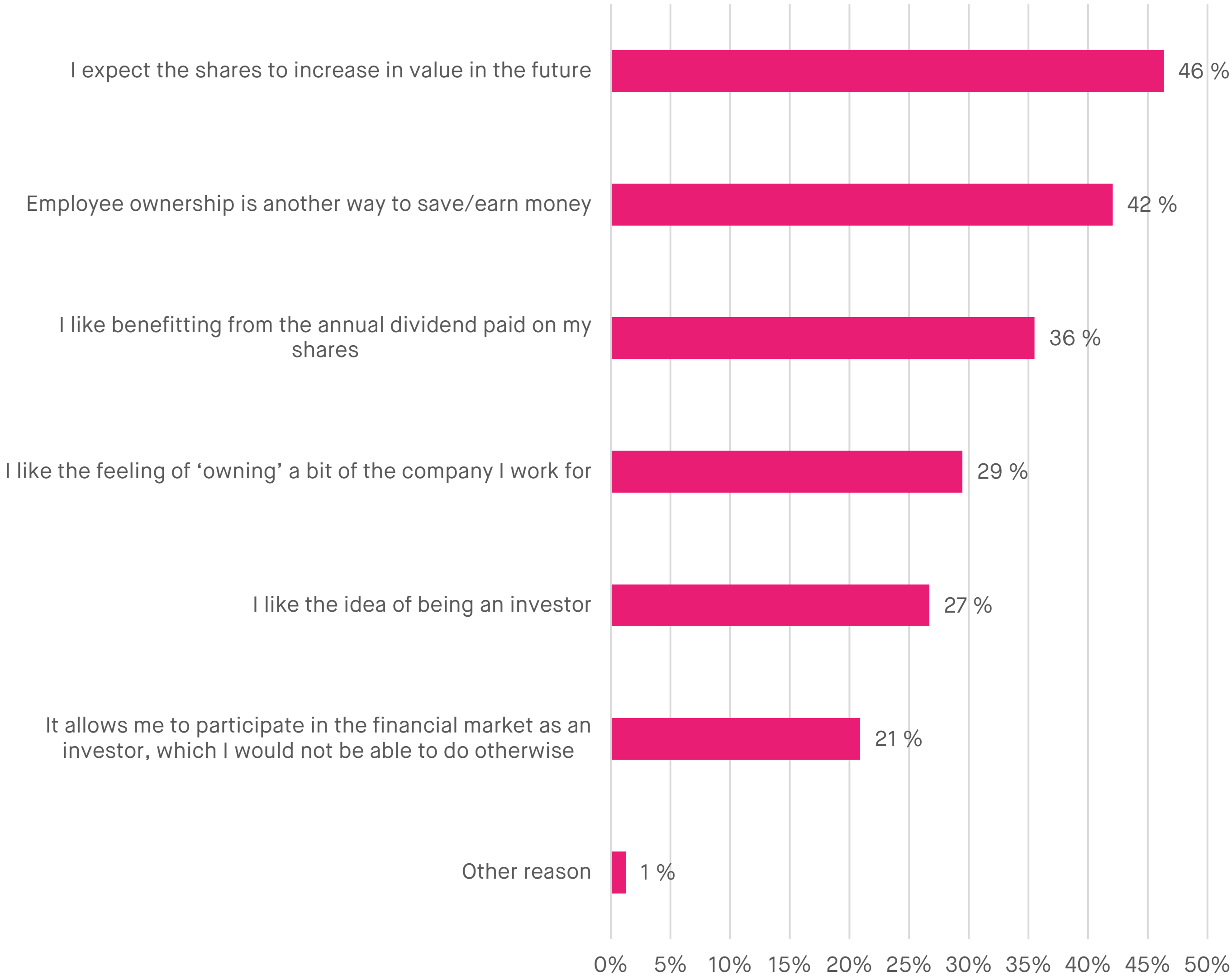
From a financial perspective, employee share ownership provides individuals with an additional asset, which can increase their financial resilience.

Survey results from ProShare find that, among respondents who are participating in a Save As You Earn (SAYE) employee share scheme, eight in ten report that this provides them with a convenient way to save.[31] Similarly, 77% of participants in Share Incentive Plans (SIPs) said that the scheme was a convenient way to invest.[32]

56% of the listed company employees surveyed by Opinium said that employee share ownership would make them more interested in other types of investment – suggesting that it can encourage individuals to engage more with savings and investment products.

46% of those surveyed that held employee shares/options said that they did so because they expect shares to increase in value in the future. 42% said they did so as another way to save/earn money, and 36% said they held shares to benefit from dividend payments.

Figure 4: Reasons for holding shares, %



Source: Opinium Survey of listed company employees

Expanding employee share ownership could generate significant financial returns to UK households, especially given the context of individuals currently holding excessive savings in current accounts and low-return instant access savings accounts. SMF research from 2017 showed that savers effectively lost around £8 billion in savings over the past five years due to holding savings in accounts where returns trailed behind inflation.[33]

In contrast, share ownership over the long-term has offered inflation-beating returns. The FTSE All Share Index has increased by on average of 3.6% per annum since 1997 (according to London Stock Exchange statistics). In addition to these capital gains, shareholders also receive dividend income; data from the end of 2018 show a dividend yield of 4.5% for the FTSE All-Share.[34]

Suppose a UK employee held a relatively modest £1,000 worth of employee shares[ii], and these increased in value by 3.6% per annum (as per the average of the FTSE All Share since 1997), with a dividend yield of 4.5%. This would generate a gross return of about 50% (£500) over a five year period, if dividend income is reinvested in shares. Even after taking into account inflation of 2% per annum, this still leaves a healthy real return of 34% - that is 6% per year. Further, employee gains might be magnified if higher levels of engagement and productivity (through increased sense of involvement in the company) translate into higher rates of base pay.

Encouraging wider access to employee share ownership schemes across the economy could also help to reduce substantial gender divides in income and wealth. The Opinium survey of listed company employees suggests that at present there is a divide in access to share ownership schemes. While 54% of males surveyed said that their employee operated a share scheme, this stood at 47% for females surveyed. This is likely to be a reflection of men being more likely to work in sectors such as manufacturing and engineering, where employee share ownership is more prevalent. Policy to encourage employee share ownership should recognise this gender divide and ensure efforts to encourage wider rates of share ownership narrow, rather than exacerbate this divide.

Drawbacks of employee share ownership

There are a number of reasons which could disincentivise firms from offering employee shares, such as establishment and administrative costs, lack of means to finance share schemes, or the risk that the board of directors might lose the controlling stake of the firm, which would make it susceptible to takeovers.

Below, we focus on the two main channels through which workers themselves might be dissuaded from participating in share ownership: exposure to risk and affordability.

Risk

One of the biggest concerns about employee ownership is that it could incentivise workers to invest too much of their wealth in their employer, which goes against the principle of diversification and could result in shares becoming too risky. Employee shares account for 61% of the gross financial wealth of employee owners in lower supervisory and technical occupations, making the financial wellbeing of this group overly dependent on the value and performance of their employee shares.

[ii] The current median value of employee shares held is £5,000. We use a lower figure here to provide some conservative estimates of the benefits of broader employee share ownership.

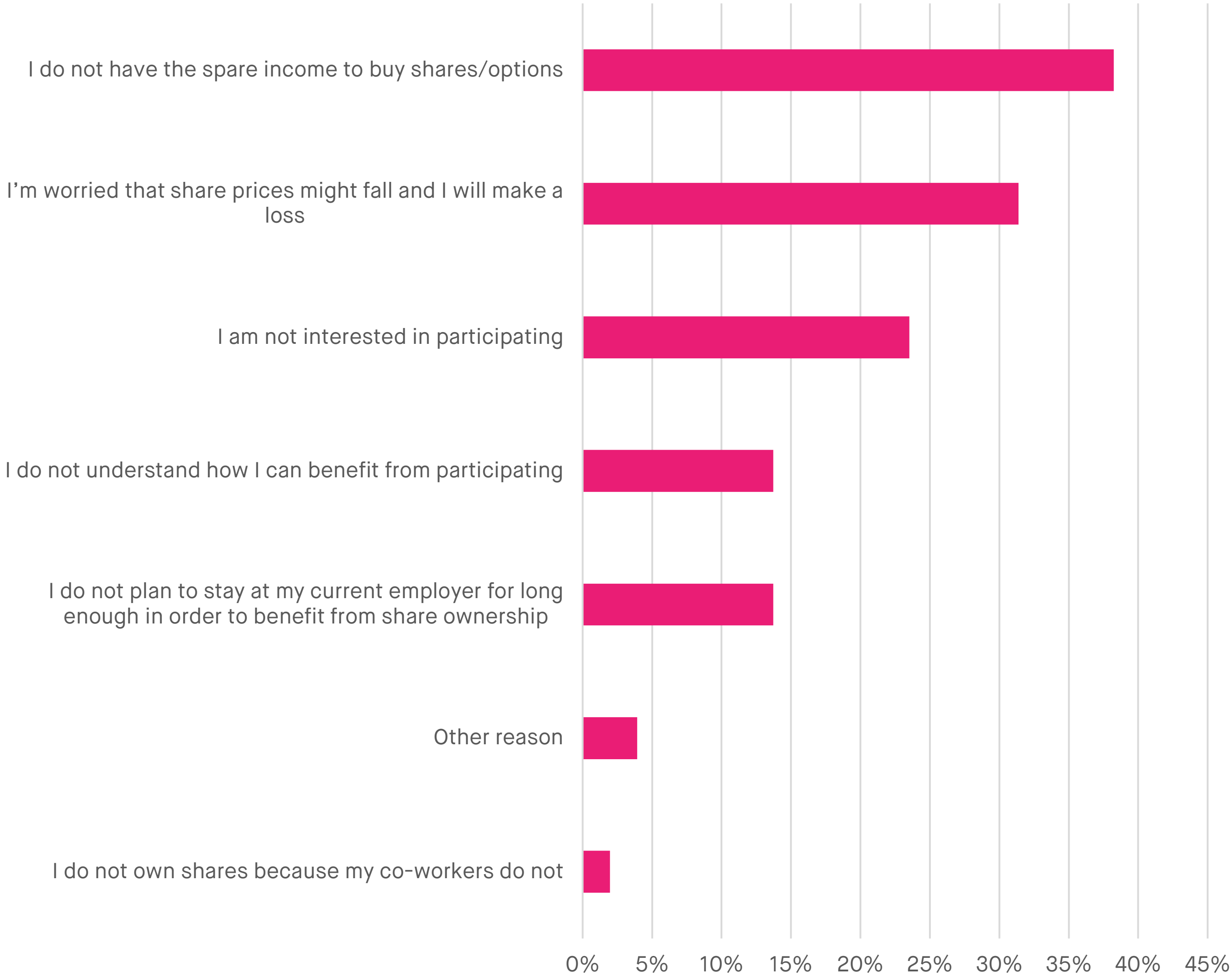
Protection against severe market movements, such as that applied to current and savings accounts and cash ISAs in the UK, does not cover the value of employee shares, which could increase the risk associated with this type of investment even further.

Affordability

With interest rates in the UK at a historic low, households are borrowing more and saving less.[35] As low productivity growth has resulted in low wage growth, some workers might be priced out of owning a share in their employer, unless shares are given out for free.

ProShare report that the key reason for non-participation in an employee share scheme was unaffordability, cited among 40% in regard to SAYE and 32% in regard to SIP.[36] The Opinium survey commissioned as part of this research showed a similar finding: 38% of listed company employees that had been offered shares/share options declined them because of a lack of spare income to purchase shares. This was the most commonly cited reason for not holding shares, followed by concerns about shares declining in value.

Figure 5: Reasons for not holding shares, % among those offered shares/options but had declined the offer



Source: Opinium Survey of listed company employees

Public attitudes towards employee share ownership

A growing stock of evidence suggests that employee ownership is viewed positively by the wider public and politicians alike.

In 2017, a YouGov poll commissioned by the Employee Ownership Association found that the public were generally supportive of the idea of employee ownership: more than half of respondents viewed employee-owned firms as more trustworthy than non-employee owned firms (58%) or expressed the view that it would be better for the UK economy if there were more employee-owned companies (53%).[37]

This favourability extended to consumers and prospective workers, with four in ten of respondents reporting that they were more likely to buy products and services from employee-owned business or apply for a job at such an employer (41% and 44%, respectively).[38]

As Figure 3 shows, 68% of listed company employees said that they like the idea of holding shares in the company that they work for.

Employee ownership is a prominent issue across political party lines and features in the latest Labour and Liberal Democrat policy manifestos. We evaluate the details of current proposals and recent developments in the policy landscape in Chapter 5.

CHAPTER 3: THE STATE OF EMPLOYEE SHARE OWNERSHIP

This chapter outlines the four main types of direct employee share ownership schemes which attract tax advantages both for employees and for employers in the UK and analyses their take-up over time. We also explore the characteristics of firms offering employee share ownership to their workers and the characteristics of workers who hold employee shares.

Typology of direct employee share ownership schemes in the UK

Employee share ownership in the UK has been steadily increasing since 2000, with latest estimates showing that more than 13,000 companies operated at least one employee share ownership scheme in 2017-18, up 12% from the previous year and up around 160% from the turn of the century.[39]

We have seen growth in the proportion of firms operating share ownership schemes, but such firms are a very small proportion of the total business population. As a share of private sector employers, the proportion of firms offering employee share ownership via a tax-advantaged scheme has increased from 0.47% in 2000 to 0.98% in 2017.

Employee share schemes can be grouped into two categories: all-employee (open to all employees in a firm) and discretionary (which are usually aimed at managerial and senior staff, although this is not a formal criterion).

As discussed in Chapter 1, the growth in employee share ownership has been driven by an increasing number of firms offering discretionary share schemes; all-employee share schemes experienced modest fluctuations but have overall remained relatively flat over time.

All-employee share schemes

All-employee share schemes in the UK take two main forms: Save As You Earn schemes (which offer a share option i.e. the opportunity to buy shares at a prespecified price) and Share Incentive Plans (which award and/or sell actual shares to employees).

Although the schemes are open to all employees in a company, an eligibility period might apply, specifying how long individuals need to have worked for the firm in order to qualify to participate in employee ownership.

Save As You Earn (SAYE)

Save as You Earn (SAYE) schemes, also referred to as Sharesave schemes, were introduced in 1980 in order to provide workers in listed companies with a way of buying employee shares at a discount.

SAYE schemes consist of two parts: a savings agreement and a share option.

The savings agreement specifies the amount an employee has agreed to pay into the scheme, up to a limit of £500 per month; this is deducted automatically from net pay and deposited into a savings account. The length of the contract, usually either 3 or 5 years, and the interest rate to be earned are set at the beginning of the scheme. Employees might also be eligible for a bonus at the end of the savings contract.

At the end of the savings period, participants have a choice of whether to take their savings out in cash or to buy shares in their employer. Most options quote a buying price at a discount of up to 20% of the market value of the shares at the time of option issue.

Interest and bonuses earned on savings are tax-free. Additionally, employees do not pay income tax or National Insurance Contributions on any increases in the market value of the shares between the dates of option issue and exercise.

Capital Gains tax might be applicable if the shares bought under a SAYE scheme are sold or disposed at a later period in time.

Share Incentive Plans (SIPs)

Share Incentive Plans were legislated in 2000 to further encourage employee share ownership. Unlike SAYE schemes and discretionary schemes, SIPs distribute actual shares to employees rather than options.

There are four types of shares which can be issued under a SIP scheme:

1. **Free shares**: employees can receive up to £3,600 of free shares per tax year from their employer;
2. **Partnership shares**: which can be bought with pre-tax salary. Employees can buy shares worth up to £1,800 or up to 10% of their income per tax year (whichever is lower);
3. **Matching shares**: employers can give up to 2 free matching shares for each partnership share bought by employees;
4. **Dividend shares**: which can be bought with the dividends from free, partnership, or matching shares, dependent on whether an employer offers these.

Employees who keep their free, partnership, or matching shares in the plan for 5 years are exempt from paying income tax or National Insurance on the value of their shares. Dividend shares are exempt from income tax if they are kept for at least 3 years.

Shares are also exempt from Capital Gains tax if they have been kept in the plan until the point at which they were sold. Employees who take their shares out of the plan and sell them at a later point in time might have to pay Capital Gains tax if the value of their shares has increased.

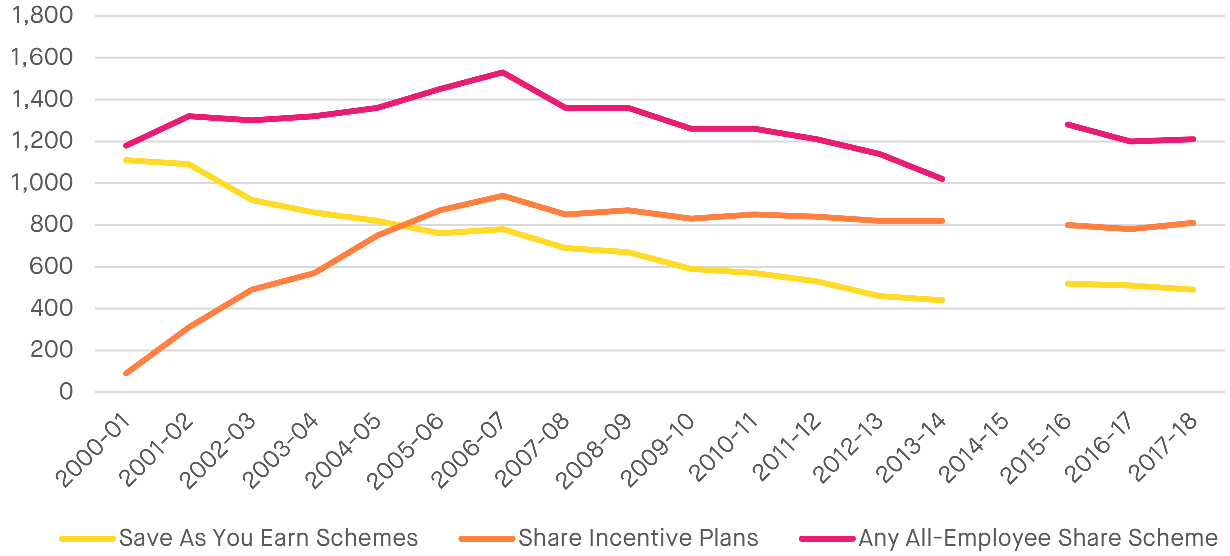
All-employee share schemes over time

The overall number of companies offering at least one share scheme which covers all employees in the business grew by 2.5% since the turn of the century.

Figure 6, below, explores the composition of all-employee share schemes offered over time. SAYE schemes, although popular in the early 2000s, have steadily fallen over time. Latest estimates show that only 490 employers currently distribute employee shares through a SAYE scheme.

In comparison, the number of SIPs rose rapidly until 2006/07 and has remained relatively flat since. Offered by just over 800 companies, SIPs accounted for the majority of all-employee share schemes in use in 2017-18.

Figure 6: Number of companies with tax-advantaged all-employee share schemes



Source: SMF analysis of HMRC Employee Share Schemes statistics
Note: Data for 2014-15 not available from source
Note 2: Firms can operate more than one share scheme at a time

Discretionary share schemes

Discretionary share schemes issue share options to a selection of employees. There are two types of discretionary schemes which offer tax advantages: Company Share Option Plans (CSOPs) and Enterprise Management Incentives (EMIs).

Company Share Option Plans (CSOPs)

Company Share Option Plans (CSOPs) have existed in their current form since 1996, when tax relief for Executive Share Option Schemes was reduced.

Under a Company Share Option Plan (CSOP), employees can buy up to £30,000 worth of shares at a fixed price, which cannot be less than the market value at the time of option issue.

Participating employees do not pay income tax or National Insurance contributions on the difference between the price at which they purchase the shares and their market value, given that they exercise the option between three to ten years of issue. Capital Gains tax might be applicable if the shares are sold at a later date.

Enterprise Management Incentives (EMIs)

Legislated in 2000 alongside SIPs, Enterprise Management Incentives (EMIs) are aimed at smaller trading companies (with up to £30m worth of assets and fewer than 250 full-time employees) in order to attract and retain staff.

Companies in certain sectors, such as banking, farming, property development, ship building, and provision of legal services cannot offer an EMI scheme as these trades are not covered by EMI legislation.[40]

Capped at a total value of £250,000 per employee in a three-year period, EMIs offer more attractive means of renumeration than SAYE, SIPs, and CSOPs, which could explain their predominant popularity.[41]

Similar to CSOPs, the fixed price of the shares at the time of the issue of the option cannot be lower than the market value. Participating employees do not pay income tax or National Insurance Contributions at the point of exercise, given that they purchase the shares within ten years from the day of the option grant. Capital Gains Tax might be applicable if the shares are sold at a later date.

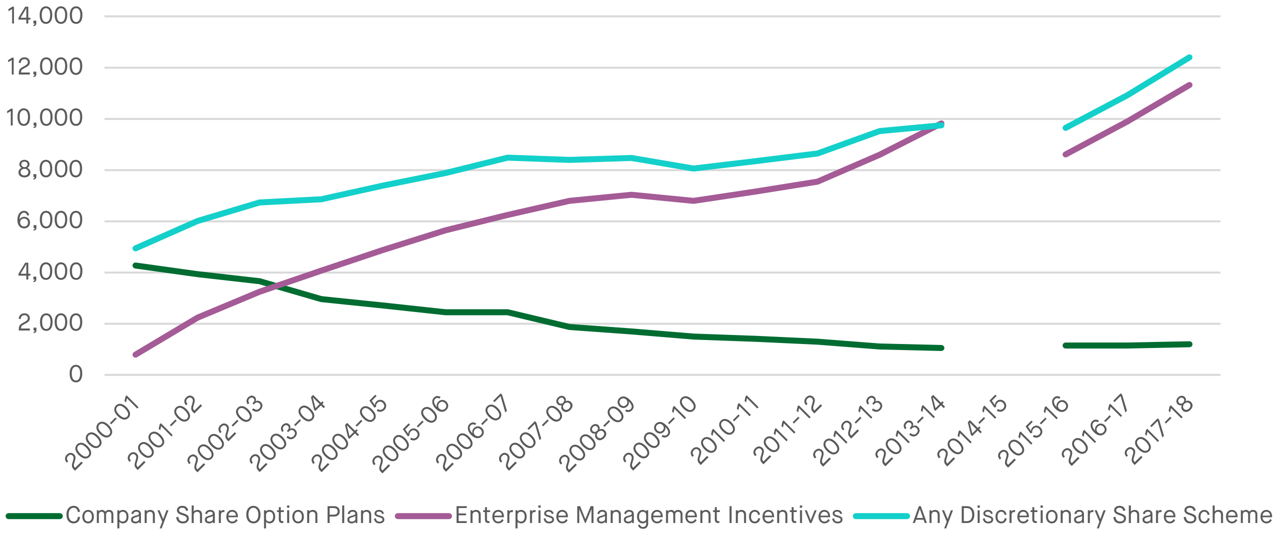
Discretionary share schemes over time

The number of companies offering any type of discretionary share scheme in 2017/18 amounted to 12,400, representing an increase of over 150% since 2000/01. This growth has driven the headline increases in employee share ownership over time.

As shown in the figure below, EMI schemes have become the main type of discretionary share scheme on offer, with 11,320 firms distributing shares to their employees through such a scheme.

The use of CSOPs has plummeted over time in comparison to EMIs. However, the total number employers using a CSOP scheme in 2017/18 (1,200) was just under the number of firms which operated any all-employee scheme (1,210), adding further weight to the observation that companies predominantly favour discretionary share schemes over share schemes open to all employees. This could be due to companies not understanding or anticipating the benefits of offering employee ownership to more junior staff or focusing retention efforts on senior and managerial staff.

Figure 7: Number of companies with tax-advantaged discretionary share schemes



Source: SMF analysis of HMRC Employee Share Schemes statistics
Note: Data for 2014-15 not available from source
Note 2: Firms can operate more than one share scheme at a time

Summary of employee share ownership schemes in the UK

The table below provides a quick summary of the main characteristics of the four main types of employee share ownership schemes in the UK.

Table 1: Employee share ownership schemes in the UK

Scheme	Type	Coverage	Limit	Holding Period	Tax Advantage
Save As You Earn (SAYE)	Options	All employees	£500 per month	3 – 5 years	No Income Tax No National Insurance Contributions Interest and bonus tax free
Share Incentive Plans (SIPs)	Shares	All employees	Free: £3,600 Partnership: £1,800 or 10% of income, whichever is lower Matching: Up to 2 per partnership share bough	5 years	No Income Tax No National Insurance Contributions
Company Share Option Plans (CSOPs)	Options	Discretionary	£30,000 per employee	3 – 10 years	No Income Tax No National Insurance Contributions
Enterprise Management Incentives (EMIs)	Options	Discretionary Firms with assets of £30m or less	£250,000 per employee in a 3 year period	Maximum 10 years	If bought at market value at the time of issue: No Income Tax No National Insurance Contributions

The prevalence of employee share ownership in the UK

Who offers employee share ownership?

Research by Oxera in 2007 found larger companies (by employees, turnover and capital) are more likely to offer employee share ownership. 80% of tax-advantaged employee share schemes are concentrated in four sectors: manufacturing; real estate, renting, and business activities; wholesale and retail trade; and financial intermediation.[42]

There could be a gap between opportunity to participate in an employee share scheme and take-up by workers. Anecdotally, we heard that this gap could be driven by the role of employers – by law, firms can offer a range of financial products to their workers, however they cannot give advice to whether and how these products could benefit participating individuals. Only firms authorised by the FCA and registered on the Financial Services Register can formally offer financial advice on investments, including employee shares, at a fee payable by the individual.[43] Previous SMF research has found that only 24% of adults were willing to pay for financial advice in 2017,[44] suggesting that a range of barriers, independent of employee ownership itself, could be preventing workers from participating in share schemes.

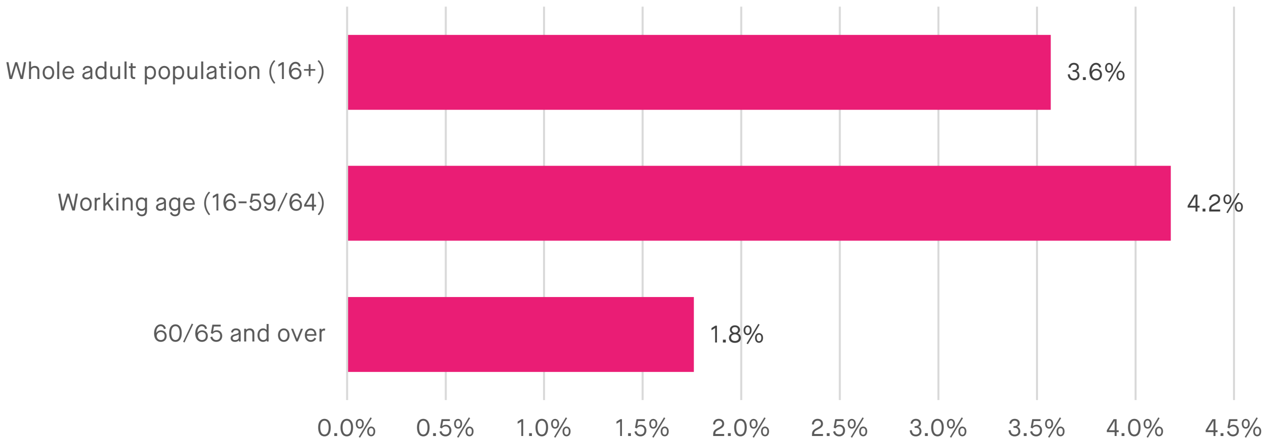
Who has employee shares?

In the period 2014 – 2016, 3.6% of the UK adult population (or approximately 1.9 million people aged 16 and over)[iii] held some form of employee shares. In part this reflects the limited number of companies currently offering employee share ownership schemes at present; as discussed earlier, currently just over 13,000 companies in the UK operate some form of an employee share ownership plan. This is out of a total of 1.4 million private sector enterprises with at least one employee[45]

People who were of working age (16-59 for women and 16-64 for men) were more likely to have employee shares than individuals who were over the State Pension threshold (4.2% versus 1.8%, respectively). For the remainder of this chapter, the analysis focuses on working-age individuals only, as they are the group who would be impacted by future changes in the policy landscape.

Looking at the age breakdown of employee share ownership more granularly, those aged 45-64 were most likely to hold employee shares – with 5.4% of those in this group reporting this to be the case.

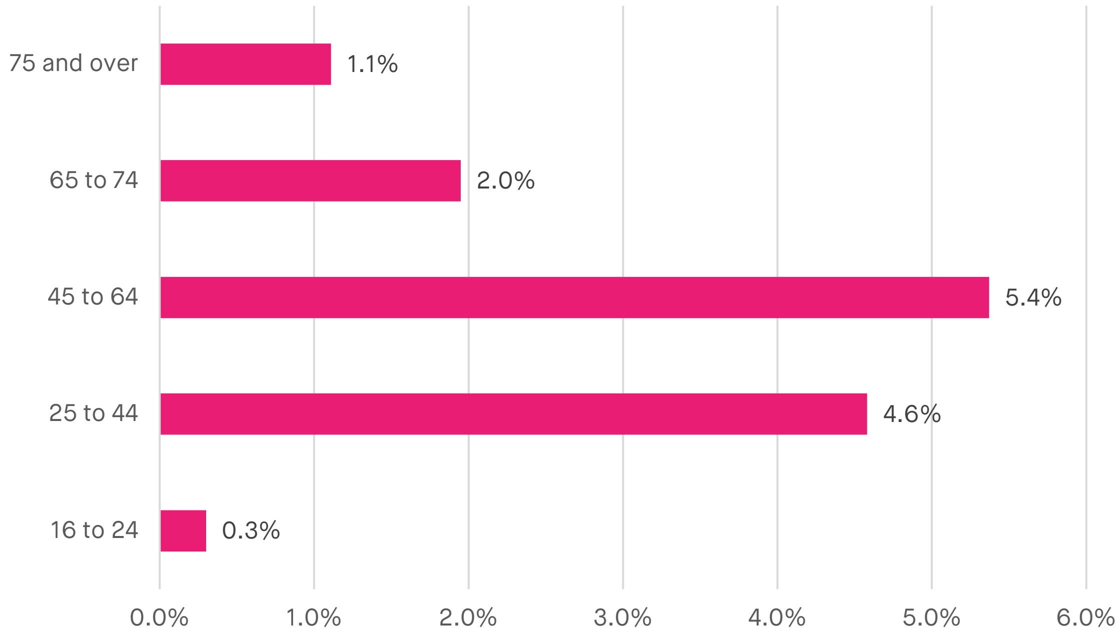
Figure 8: Holders of employee shares, by age group



Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)

[iii] As our analysis focuses on the aggregated period 2014-2016, we use the population estimates for 2015 (source: ONS *Estimates of the population for the UK, England and Wales, Scotland and Northern Ireland* (2015))

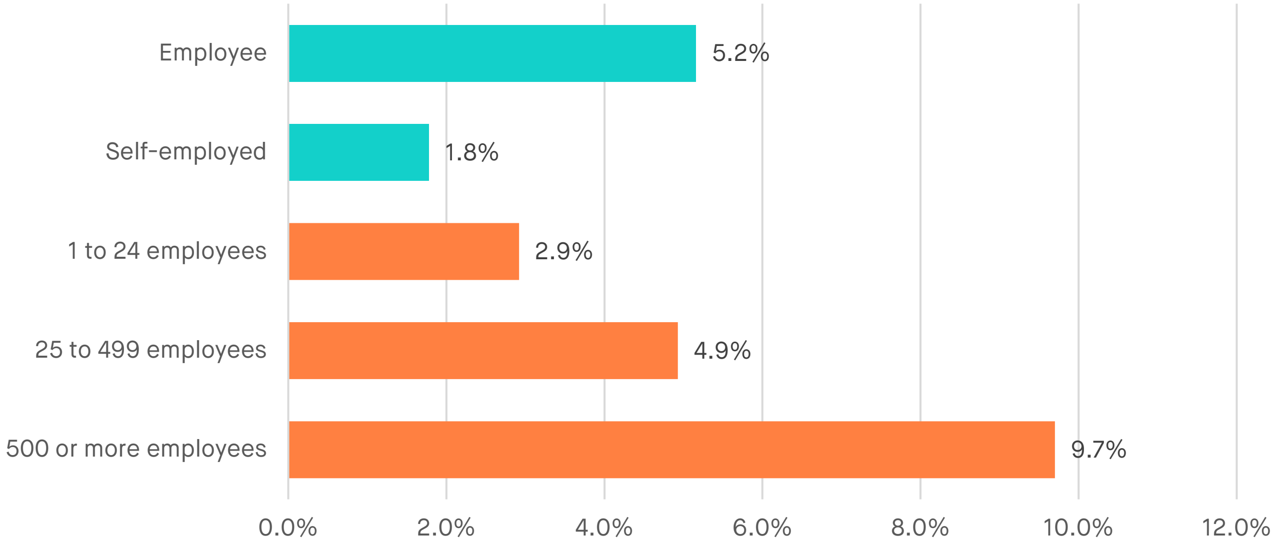
Figure 9: Holders of employee shares, by age group



Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)

Employee shares are more common among employees of larger companies. Amongst the largest employers, hiring 500 or more staff, 9.7% of workers had some type of employee shares, whereas only 2.9% of individuals working in small companies (with 1 to 24 employees) reported that they were owners of employee shares. This finding supports previously reported analysis that larger employers were more likely to offer employee shares to their workers than smaller employers.

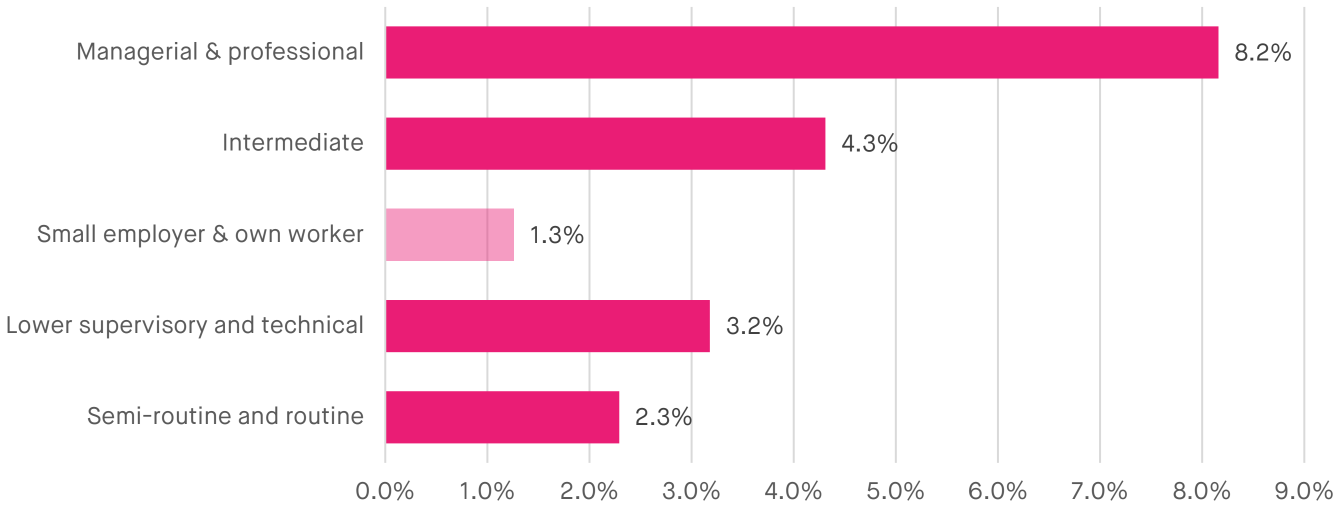
Figure 10: Holders of employee shares, by employment mode and employer size



Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)
Base: Working age population

Looking at the prevalence of employee share ownership across the occupational distribution shows that individuals were more likely to be holders of employee shares the higher the skill level of their job. 8.2% of people in managerial and professional occupations had some type of employee shares. This proportion decreases across the occupational ladder, to 2.3% of workers in semi-routine and routine jobs.

Figure 11: Holders of employee shares, by occupation

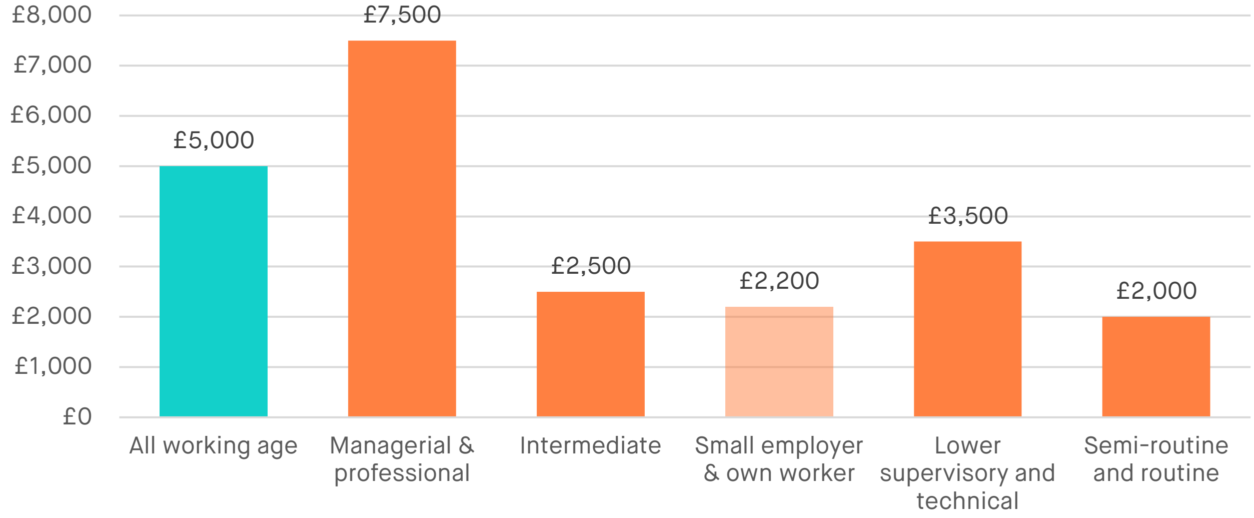


Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)
Base: Working age population

Value of employee shares and options

Having explored the take-up and distribution of employee shares, we now look at the value of these shares across key characteristics. On average, the total amount held in employee shares by a working age shareholder was £5,000 in the period 2014 – 2016.

Figure 12: Median value of employee shares and options

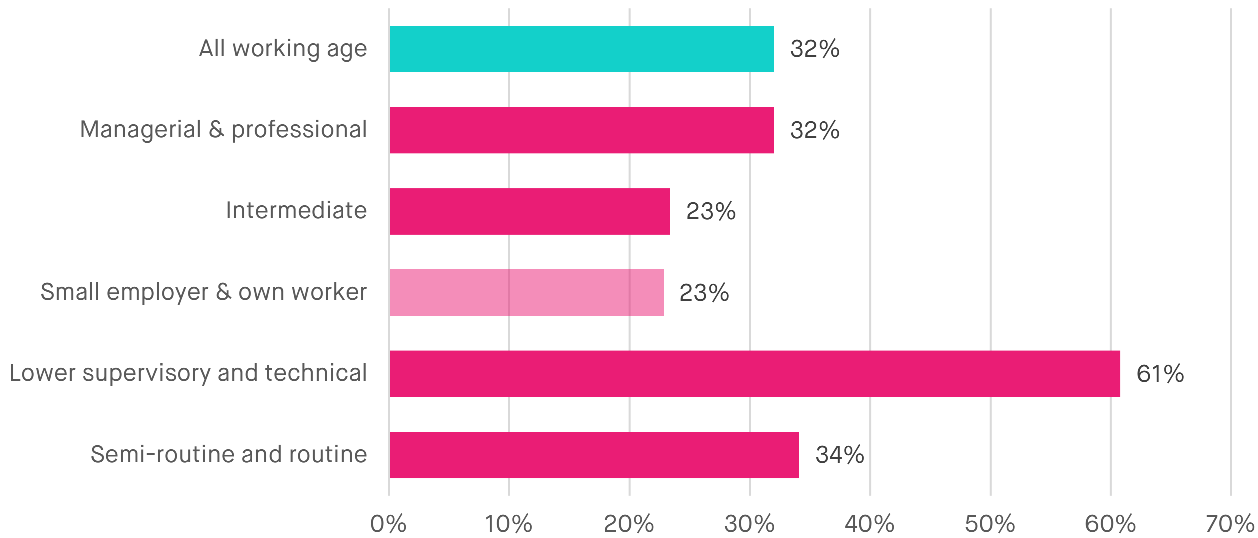


Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)
Base: Working age holders of employee shares and/or options

Employee owners in managerial and professional occupations, who were most likely to hold employee shares, were the only group to have more money in these shares than the average, at £7500.The pot of employee shareholders from lower supervisory and technical occupations was the second highest, at £3,500.

As a proportion of individuals' gross financial wealth, employee shares account for 32% on average. This proportion varies between 23% and 34% for all occupational groups other than lower supervisory and technical; for employee shareholders in the latter group, employee shares make up 61% of their gross financial wealth. This finding indicates that individuals in lower supervisory and technical jobs might be at higher risk of under-diversification and might lose out the most if the value of their employer falls.

Figure 13: Value of employee shares and options, as a proportion of gross financial wealth



Source: SMF analysis of Wealth and Assets Survey (2014 – 2016)
Base: Working age holders of employee shares and/or options

CHAPTER 4: INTERNATIONAL EMPLOYEE SHARE OWNERSHIP PRACTICES

This chapter provides a brief overview of the legislative differences in regard to employee share ownership in the United States and a selection of countries in Europe.

Europe

Employee share ownership is becoming more popular and more widely used throughout Europe. In 1990, 10% of all European listed companies had employee share plans; this proportion rose to 50% in 2000 and 86.6% in 2017.[46]

In many EU countries, the tax breaks which incentivise employee share ownership are focused on high-growth start-ups which might not yet be able to pay high salaries; stock options are therefore used to attract and retain workers.[47]

Employee ownership among low-wage workers has only risen on a significant scale as the intended result of legislative changes. Such policies vary from coercive (such as in Sweden or Germany, where employees have sufficient power to negotiate for pay with a component linked to company performance) to incentive-based (such as in the United States, where it is up to firms themselves to decide whether to tie worker renumeration to performance).[48]

Two thirds of stock options are allocated to executives, with the remaining third being distributed to workers below executive level; in the US it is the other way around. [49] Across Europe, France, the UK and Estonia are most supportive on employee ownership.[50]

France

In France, profit sharing schemes are mandatory for companies with 50 or more workers; profit sharing, therefore, is the main channel for employees' financial participation. Share ownership coverage, albeit higher than the European average of 3%, was just 7% in 2012.[51]

Focusing on reducing public spending post-financial crisis, France scrapped some of the incentives focused on employee share ownership and long-term savings in favour promoting household consumption instead.[52] Following the Macron Law (2015), democratization rates have increased, which highlights the high responsiveness of employee share ownership to changes in fiscal incentives.[53]

There are currently two types of schemes: free shares (allocations gratuites) and business creator share warrants (bons de souscriptions de parts de créateurs d'entreprise).[54] According to a survey of 45 major French corporations in 2012, free shares are offered in around 50% of companies and employee shares were sold in 72% of companies.[55]

The Macron Law implemented some major changes to for free shares. For example, the vesting period was reduced, and the retention period made optional. Moreover, the employer's specific contributions were reduced to 20% of the value of the shares at vesting date (instead of 30%), and the obligation to make such contributions will be eliminated for certain small and medium-sized companies. The employee's specific contribution is expected to simply disappear.[56]

Share warrants in France are similar to stock options – shares can be acquired over a period of time at a price set at the time of allocation. They have a favourable tax regime but are only available to certain companies.

France took the decision to double its employee share ownership by 2030 and the new PACTE law (Action plan for business growth and transformation) will organise the first steps in this direction in 2019.[57]

Sweden

The European Company Survey estimates that 11% of Swedish private-sector companies offer employee share ownership schemes (which is more than double the European average of 5%).[58]

Since the beginning of 2018, Sweden has offered tax advantages to small and early stage firms which wish to issue employee shares in order to help recruit and retain staff. The new rules aim reduce the tax burden on employers and employees. This legislation is not too dissimilar from the way EMIs operate in the UK.[59]

In order to be eligible, the following criteria apply:

- The company must have no more than 50 employees; revenue of no more than SEK 80 million; and must have operated its business for less than ten years. Certain types of companies are excluded from the scope of the rules, such as banks and financial companies, insurance companies, and real estate companies.
- To attract the beneficial tax treatment, the options must not be exercised prior to the third anniversary of the option grant date and must be exercised within ten years from date of the option issue date.
- The total value of all options granted by the company must not exceed SEK 75 million and the value of each employee's options must not exceed SEK 3 million.
- The option holder must be employed by the issuing company during the initial three years of the vesting period and the option holder's working hours must on average be at least 30 hours per week. In addition, the option holder must receive a salary from the company amounting to minimum 13 income base amounts (SEK 812,500, based on the 2018 income base amount) during the three-year period and the option holder (and their connected persons) must not hold a material interest (broadly, 5% of the votes and share capital) in the company.[60]

Germany

Due to a lack of tax incentives in the past, employee shares were not common in Germany. Where they were present, they were more common in public limited companies. As minority shareholders have significant rights in Germany, many companies use virtual stock options to mimic the growth of company shares. These are subject to income tax.

In response to the widening gap between growth in corporate profits and employee wages, the German government is now promoting employee share schemes, giving workers a larger proportion of their company's profits. Tax concessions are used to encourage firms to sell their shares to workers below the market price. The stock must be held in trust for some years before it can be sold.[61]

Ireland

The Key Employee Engagement Programme (KEEP) was introduced in Ireland by the Finance Act of 2017. KEEP is a new tax-advantaged share scheme for small- and medium-sized enterprises.

The scheme is designed to allow for the tax efficient granting of share options by SMEs in order to retain key employees.

Under the KEEP scheme, income tax is not chargeable on the grant/exercise of a qualifying share option. However, Capital Gains Tax (CGT) will arise on the gains realised on the sale of shares obtained by the exercise of qualifying KEEP share option. The lower CGT rate of 33% applies to the employee on the disposal of the shares compared with the income tax / PRSI / USC combined rate of 52%.[62]

Currently, there is little evidence on the coverage of employee share ownership in Ireland, potentially due to the relative newness of the change in policy.

United States

In 2014, 19.5% of all private sector employees reported owning stock or stock options in their companies.[63] The proportion increases to 34.9% of all employees in firms which have stock (excluding nonprofits, law and accounting firms, many very small companies, etc). This accounts to approximately 30m Americans.[64]

One stark difference between practices in the US and Europe is that the US has a much larger employee share ownership culture within small- and medium-sized firms, whilst similar initiatives are ‘virtually non-existent’ in Europe.[65] This is largely due to the fact that Employee Stock Ownership Plans (ESOPs) were implemented in 1974 in order to aid the passing of SMEs from older owners to younger workers.

Figure 14: Number of employee shareholders and value of assets held in employee shares

Employee shareholders (in million persons)		
	EUROPE	USA
LISTED	8	20
SMEs	1	14
TOTAL	9	34

Assets held (in billion Euro and US$)		
	EUROPE	USA
LISTED	375	2500
SMEs	13	1300
TOTAL	388	3800

Source: European Federation of Employee Share Ownership

ESOPs are currently the most common type of employee share scheme in America. All full-time employees who work 1,000 hours or more per year become participants and receive shares in their accounts from contributions made by the company and, very rarely, by their own purchases. Employers can deduct the value of stock contributions to the ESOP trust, but employees pay tax only after they receive and sell their shares. Share allocations are made on the basis of relative pay.

Summary

The selection of international practices discussed above highlights the growing popularity of employee share ownership among foreign policymakers.

In a manner not too dissimilar to discretionary schemes in the UK, employee ownership in Europe tends to be perceived as a means to retain and reward higher-earning workers, particularly in small- and medium-sized businesses.

Domestic policymakers should keep a close eye on developments around the changing nature of the way free shares are awarded to workers in France, in order to circumvent the problems with affordability of employee shares among staff at the bottom end of the income distribution. The UK should also consider the practices in the US which have established a wider culture around employee share ownership, especially in small- and medium-sized businesses.

CHAPTER 5: THE EMPLOYEE SHARE OWNERSHIP POLICY LANDSCAPE IN THE UK

Since the 1970s, successive UK government have initiated several employee share schemes, such as the Share Incentive Plan and Enterprise Management Incentives in 2000. Although these schemes were not designed with substantial employee ownership as a primary objective, they have nevertheless provided mechanisms for employee-owned firms to distribute equity to workers.[66]

Employee share ownership has been promoted by main political parties in the UK in recent years, reflected in both policies implemented by government, and proposed in party manifestos. This chapter explores the current and recent policy stance of the Conservatives, Labour and Liberal Democrats with respect to employee share ownership, considering the strengths and drawbacks of their approaches.

Conservatives

Unlike Labour and the Liberal Democrats, measures to encourage employee share ownership have not been a strong feature of Conservative policymaking in the past couple of years. This includes in the 2019 general election manifesto. However, the party has implemented a couple of changes in this area in the recent past.

During the Coalition Government of 2010-2015, the Conservative-led administration tried to push employee share ownership through what was widely referred to as a 'shares for rights' policy. The policy, announced in the 2012 Autumn Statement, allowed for the creation of Employee Shareholder contracts. Staff who opted for Employee Shareholder Status (ESS) could receive company shares worth at least £2,000. Up to £50,000 of shares were exempt from capital gains tax on disposal.

The drawback of holding Employer Shareholder status was that it entailed a loss of employee rights, including rights related to unfair dismissal, redundancy and the right to request flexible working and time off for training.

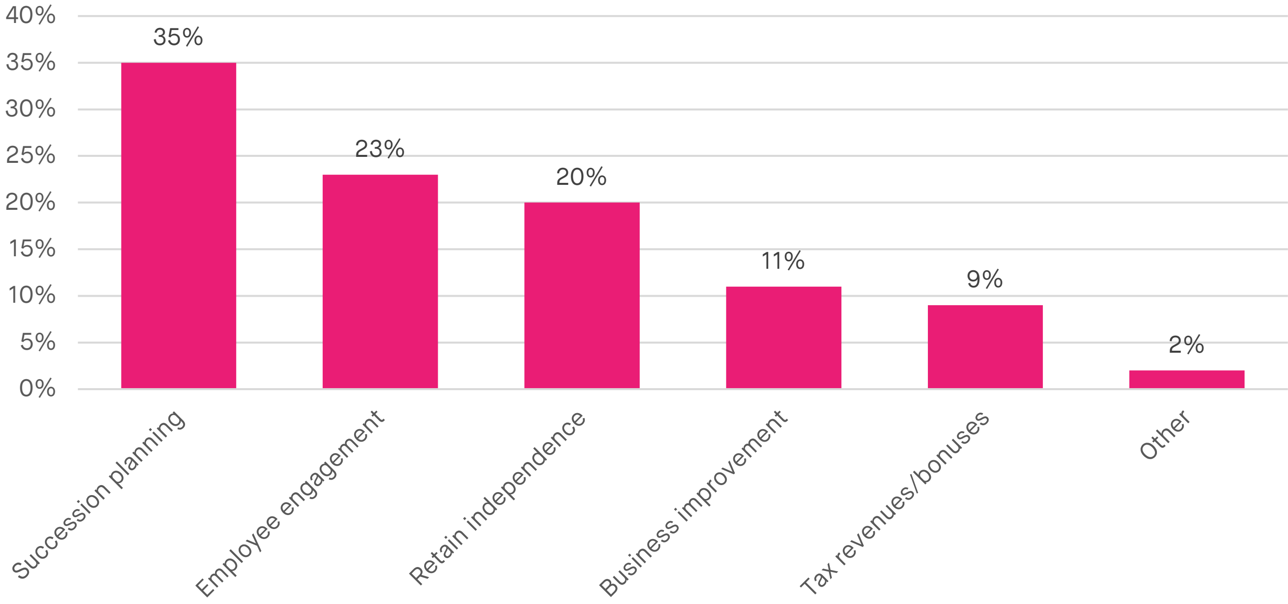
In the 2016 Autumn Statement, ESS was abolished for new entrants as it became clear that the policy was not having the desired effect of increasing employee share ownership significantly – particularly among those on low-to-middle incomes. Indeed, evidence suggested that ESS was mainly being used by higher earning employees as a method of avoiding income tax and capital gains tax. ESS attracted significant interest from private equity firms as it allowed participants in a management buy-out to avoid capital gains tax on their shareholdings when they exited the company.[67]

Ultimately, ESS was a poorly designed attempt to increase share ownership in the economy. Critically, linking employee share ownership to the removal of key worker rights limited the appeal of the policy – particularly to those on lower incomes who would be most financially vulnerable in the event of, for example, an unfair dismissal.

In addition to ESS, following the 2012 Nuttall Review of employee ownership, measures were introduced in 2014 to encourage trust-based employee ownership. Owners selling 50% or more of their company to an Employee Ownership Trust (EOT) were exempt from capital gains tax on the growth in the value; firms with at least 50% ownership in a trust became able to award profit shares to employees which are exempt from income tax up to a value of £3,600 per year. The

EOT must operate for the benefit of all employees on similar terms. According to the Employee Ownership Association, EOTs now represent about half of the wider employee ownership sector.[68] Survey data from the Association show that succession planning was the most widely-cited reason for establishing an EOT, followed by employee engagement.

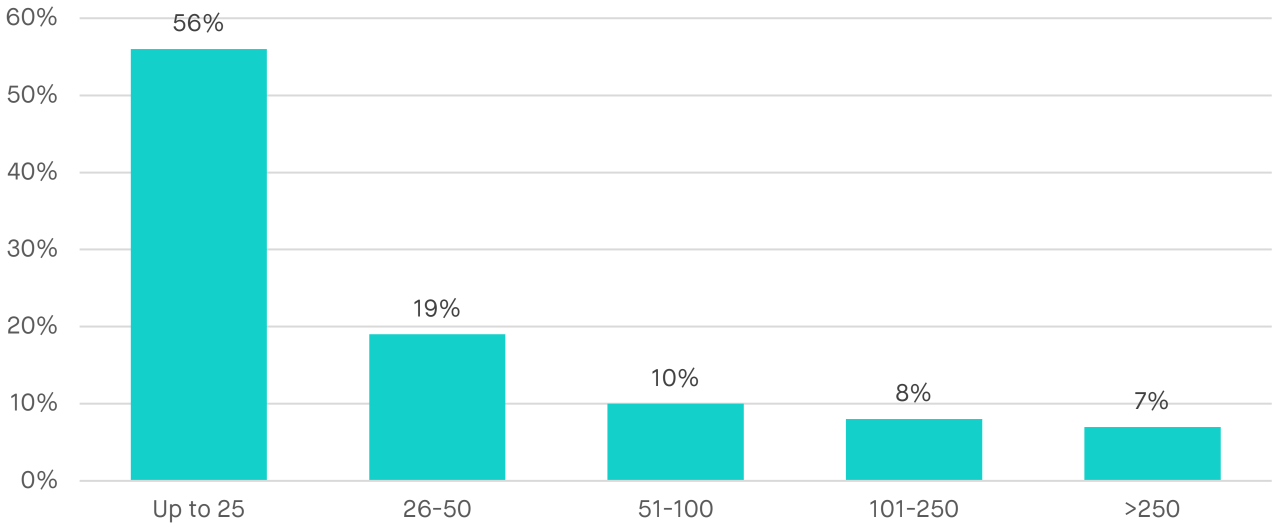
Figure 15: Reasons for establishing EOT



Source: Employee Ownership Association 2017 sector update

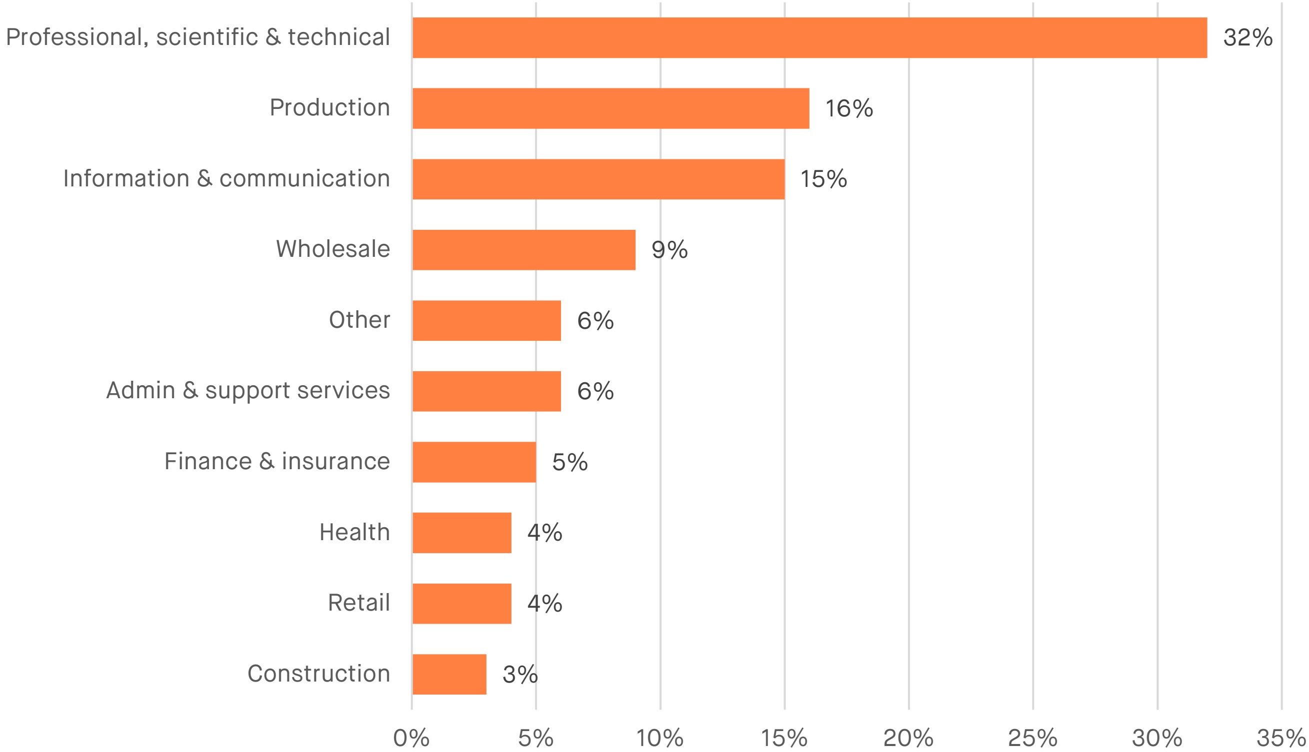
While Employee Ownership Association survey data suggest that EOT companies tend to be smaller businesses, we note that the data also suggest they are heavily concentrated in certain sectors – namely professional services, production and information & communication. Just 4% of EOT companies are in the retail sector, where average staff pay is relatively low. If employee ownership is relatively concentrated in better-paying sectors of the economy, it may lead to widening rather than narrowing income divides between employees.

Figure 16: Business size of EOT companies, by number of employees



Source: Employee Ownership Association 2017 sector update

Figure 17: Sectors of EOT companies



Source: Employee Ownership Association 2017 sector update

Labour

Compared with the Conservatives, the Labour Party has been more active in the debate around employee ownership over the past couple of years. Notably, during the 2018 Labour Conference, the party announced plans for the creation of Inclusive Ownership Funds (IOFs) – a policy that also made its way into Labour's 2019 general election manifesto.

With the Labour leadership party leadership currently up for grabs, it remains to be seen whether the IOF policy, or some variant of it, will remain a feature of party policy going forward. Nevertheless, we provide an assessment of the IOF policy, as set out at the 2018 Party Conference and 2019 manifesto, to provide insights into the merits and drawbacks of such an approach.

Under Labour's IOF proposals, private sector companies with 250 or more employees would need to transfer at least 1% of their ownership into an IOF each year, up to a maximum of 10%. Smaller companies would be able to set up an IOF on a voluntary basis.

Following the rollout of IOFs, staff would be entitled to dividend payments of up to a cap of £500 per year. Any returns eligible for the IOF above that level would go to the government. Labour estimates that total payments from IOFs would reach £4bn per year by the fifth year of the policy, with about £2bn going to the government and the rest going to employees. Given this, the IOF proposal should be seen as a tax in addition to a means of increasing employee ownership.

Building on the 2018 Labour Conference announcement, the 2019 Labour election manifesto set out further information on how the policy would operate, with Labour stating that government revenue generated through IOFs would be used to top up its proposed Climate Apprenticeship

Fund. The purpose of the Climate Apprenticeship Fund is to support the training of employees to work in "clean technologies".

While Labour's policy proposal could support employee incomes (by as much as the capped amount of £500 per annum), raise additional government revenue and provide incentives for employees to be more productive (in order to receive greater dividend income), we note a number of issues with the proposed policy. We discuss these below.

Implementational issues

There would be a number of substantial challenges in translating Labour's IOF proposal into reality.

Firstly, if the proposal were to apply to all businesses with 250 or more employees, as has been stated, some 7,500 businesses in the UK would need to set up IOFs.[iv] About 10.7 million employees would be eligible for dividends from IOFs.

One implementational barrier is that many large unlisted companies do not routinely pay dividends - and Labour has admitted that it might not be possible to force such companies to start issuing dividends.[69] If this is the case, there would be incentives for companies to delist from the London Stock Exchange in order to avoid the costs associated with IOFs, if it is not possible to extend the IOF policy in full to unlisted companies.

Labour has also suggested that foreign-owned companies would not have to set up IOFs for their whole business; however, the party's quoted estimates of the number of companies affected suggest that UK subsidiaries of foreign businesses would be included.[70] Depending on the specifics, this could create an environment in which UK-owned businesses are relatively more handicapped by the policy, which in-part amounts to a tax as government receives dividend income beyond the £500 capped amount to employees. Foreign-owned companies would then have a competitive advantage over UK-owned companies, with associated implications for jobs in the latter.

As well as subsidiaries of foreign companies, there is currently a lack of clarity around how multinational companies, with overseas profits and workers, would be treated under the plans.

It is also unclear how IOFs would work within companies which already have significant employee share ownership schemes – including those firms where workers already own more than 10% of the company, and where employees receive average annual dividends in excess of £500. In such instances, workers could be left worse-off if an IOF replaced an existing employee share scheme or trust arrangement. It is also unclear if partnerships, such as the John Lewis Partnership, would have to establish an IOF.

Another lack of clarity within the Labour Party's plans is how IOF dividends would interact with employee tenure within a company. Other employee ownership schemes, such as EMIs, attempt to improve staff retention rates by linking payouts to a certain amount of time spent within a company. Labour's proposal appears to pay out dividends to workers on an equal basis, implying that incentives to remain with an employer are more limited. Conceivably, this could be

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[iv] Number of businesses based on business population estimates published by the Department for Business, Energy & Industrial Strategy

addressed by linking the dividends cap to employee tenure; however, this is not a feature of the Labour policy as set out in 2018 and 2019.

The prospect of legal challenges is also a significant implementational barrier to mandatory IOFs for large companies. As the law firm Clifford Chance has noted, there are important constraints on the ability of any government to reduce the value of private property (in this case, shares) and there are several approaches that aggrieved shareholders and foreign governments could take if the IOF policy is rolled out. [71]

Clifford Chance has argued that there is potential conflict between Labour's proposal and World Trade Organisation's (WTO) General Agreement on Trade in Services (GATS) rules. Article XVI:2 of GATS contains rules on market access barriers; proposed IOF plans might be contrary to this, given that the policy would limit the participation of foreign capital in UK services companies to 90%, in the instance where an IOF is required to hold 10% of the shares.

Clifford Chance has also argued that the IOF policy might be contrary to the European Convention on Human Rights (ECHR). Article 1 of Protocol 1 to the ECHR guarantees the right to peaceful enjoyment of property. Given that the IOF proposal could be seen as expropriation of up to 10% of a company, it could be argued that it is in breach of the ECHR (which was directly incorporated into UK law by the Human Rights Act 1998).

Further, the IOF plans are likely to be contrary to existing bilateral investment treaties (BITs) between the UK and other nations. BITs provide guarantees to overseas investors that they will not be discriminated against nor will investments be expropriated. The UK currently has around 100 BITs with foreign states; as such the IOF plans risk giving rise to a substantial number of BIT claims, given that it could be argued that the plans amount to expropriation. In addition to BIT claims, IOF plans also risk undermining Free Trade Agreements. Post-Brexit trade deals between the UK and other nations could see guarantees for investors as a key part of negotiations; the IOF proposal, as it stands, could therefore undermine the ability of trade deals to be agreed in the future, given the expropriation risks faced by investors.

Limited productivity incentives

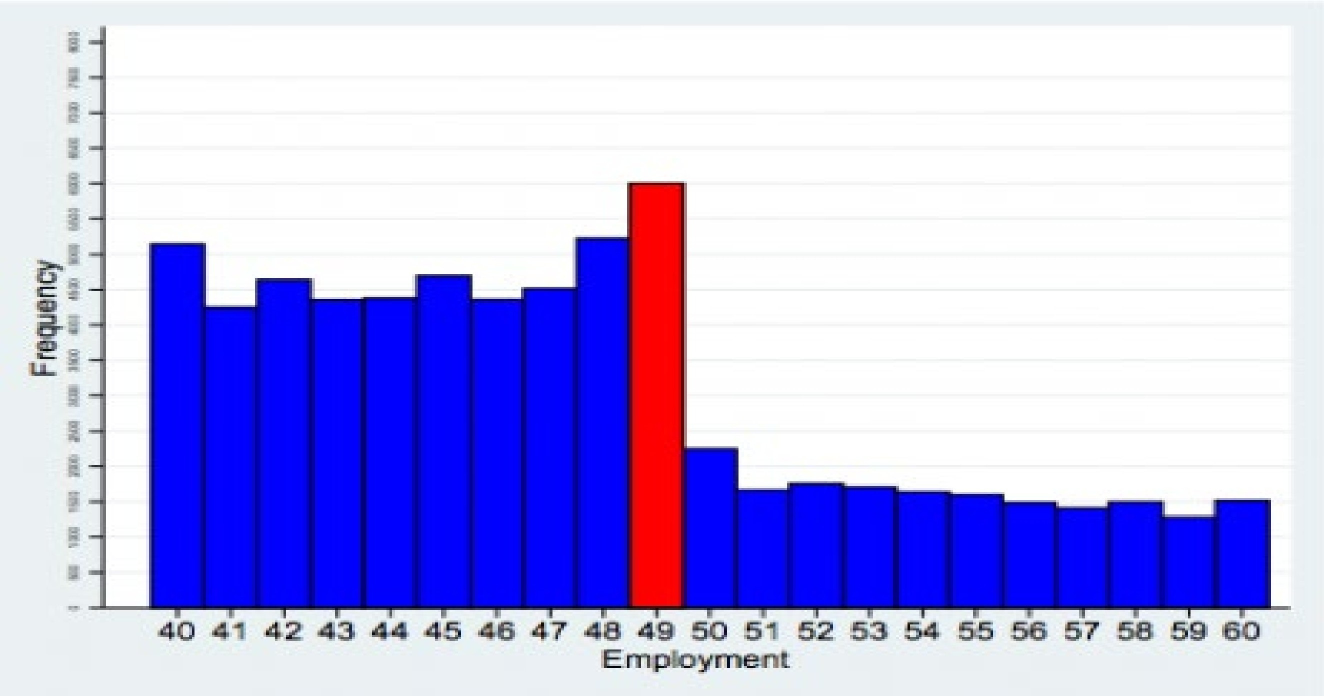
One worry we have with the proposed IOF policy is the capping of annual dividend payments at £500. Once the cap has been reached, workers will have more limited incentives to improve their productivity and the performance of the company they work for. A policy with no cap in dividends would provide stronger incentives to be more productive. Further, if IOFs replaced, fully or partially, existing employee share ownership schemes in some companies, then the associated benefits of employee ownership, such as worker motivation and commitment, could also be hindered.

Perverse hiring incentives

The proposed IOF policy imposes substantial additional administrative requirements on businesses once they reach 250 employees, as well as a higher tax burden. This would create disincentives to taking on extra staff, as well as encourage attempts to avert the IOF policy. For example, companies might decide to split their business operations into separate entities, each with less than 250 employees, as a way of avoiding having to set up an IOF.

International evidence suggests that linking regulatory and tax burdens to the number of employees a company can discourage business expansion. In France, a disproportionate number of businesses have 49 employees, reflecting the fact that businesses with 50 or more workers are subject to a range of additional requirements, including having to create worker councils, introduce profit-sharing arrangements and submit restructuring plans to worker councils if the company decides to fire workers for economic reasons.[72]

Figure 18: Firm size distribution by number of employees, firms with 40-60 employees in France



Source: National Bureau of Economic Research, Working Paper 18657, Size-Dependent Regulations, Firm Size Distribution, and Reallocation

Risk of lower wages

Unless IOFs are accompanied with amplified employee say in how companies are run, a clear risk of the policy is that employers could cut wages, or curb wage growth, to compensate for the costs associated with establishing an IOF. This includes the tax element of IOFs, the need to pay out dividends and administrative costs.

Curtailed wages risk creating a state where employees' incomes are left broadly unchanged from the IOF policy, but the *volatility* of their income becomes greater as dividends replace regular pay.

Lack of genuine employee ownership

Although the Labour IOF policy has been marketed as an employee share ownership policy, we note that the measure, much like the EOTs introduced by the Conservatives, does not give employees a direct ownership stake in the company they work for. Individual workers would not hold shares which they could sell and make a financial return from. This is in contrast to existing schemes such as SAYE and SIPs.

Share dilution and impacts on investors, savers and pensions

A consequence of IOFs could be widespread share dilution: the more shares that are issued by a company (e.g. as a result of setting up an IOF), the more earnings and dividend income per share diminish. This would have a negative impact on existing shareholders, including UK households and pension funds.

Data from the Office of National Statistics provide insights into who these existing shareholders are. The ONS estimates that, as on the end of 2016, UK-based individuals directly held 9.5% of FTSE 100 company shares; 5% were owned by UK insurance companies and 3% held directly by UK pension funds. Pension funds also hold UK equities indirectly, through collective investment vehicles such as unit trusts, investment trusts and ETFs. Charities, churches and other parts of the third sector held 1.1% of shares.[73]

All of these parties would stand to lose from an IOF policy which trigged share dilution, which raises questions around the scale of the benefits to UK workers. Even if an employee benefits from IOF dividends, they might lose out in other ways from the policy - for example, if there is an impact on future pension income. Establishing the *net* impact of the policy on workers is difficult, given limitations in publicly available data and the fact that those benefiting and losing out from the policy would be different groups of individuals.

Savers and investors would also be impacted by a likely decline in foreign direct investment, which would result from a policy perceived by many as expropriation. Decreased overseas demand for UK-listed shares, for example, would translate into lower share prices and a loss of wealth for shareholders such as households and pension funds.

Under the IOF policy, a significant amount of wealth would be expropriated from investors through share dilution. To give an estimate of the scale of this dilution, we examined data in the ONS Blue Book on total corporate profits in the UK. We then applied a price-earnings multiple of 15 to this to produce an estimated value of UK corporations, in line with that seen for the FTSE All-Share Index.[74] The Annual Business Survey tells us that large companies with 250 or more employees account for about half of non-financial sector Gross Value Added (GVA) in the economy, and on this basis, we assume that large businesses also account for about half of the value of corporations in the UK. This gives a total market value of £3.43 trillion for large companies. Therefore, a policy of expropriating 10% of company value into IOFs would, under this estimate, cost investors £343bn. We note that this is similar to the £340bn cost estimated by Clifford Chance in its analysis of the impact of the IOF policy.[75]

We stress that, given uncertainties around Labour's policy (such as around the treatment of subsidiaries and multinationals), this is very much an "order of magnitude" estimate.

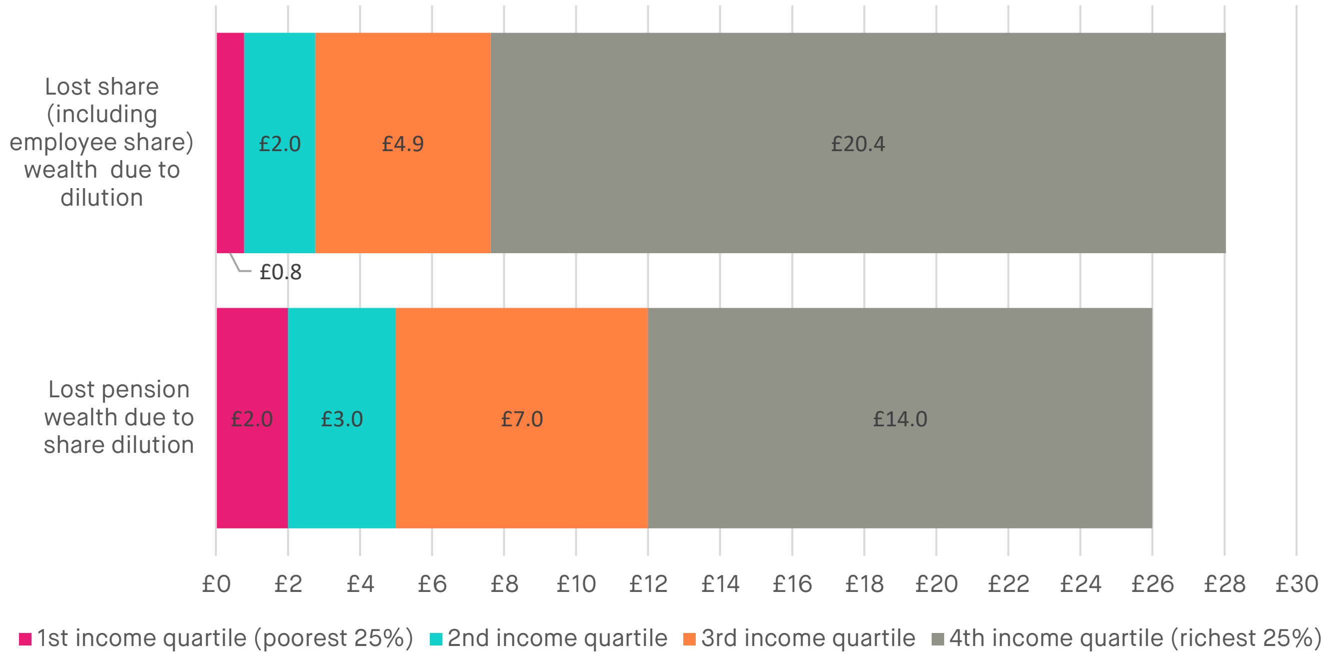
We have produced similar order of magnitude estimates around the extent to which UK households would lose out from expropriation of pension wealth as well as shares owned by households (including existing employee shares).

According to the Towers Watson Global Pension Assets Survey, UK pension assets amount to about 102% of UK GDP. Some 32% of this is held in equities, of which 36% are domestic equities. Based on this, we estimate that UK pension assets held in domestic equities amount to £259bn in 2019, with £26bn expropriated if 10% IOFs were to be rolled out with immediate effect. We estimate that £5bn of this £26bn relates to households in the bottom half of the income distribution. On a per household basis, share dilution under the IOF policy would amount to £900. For those in the bottom half of the income distribution, the per household loss is about £360.

Clifford Chance has estimated that local government pension schemes account for about a quarter (26%) of the lost pension wealth due to IOFs.

Households would also lose out if they hold shares in companies as a form of investment, including shares in the company in which they work. SMF analysis of the Wealth and Assets Survey suggests that about 15% of households hold UK-listed shares/employee shares. We estimate that share dilution, if 10% IOFs were imposed with immediate effect, would water down household wealth held in shares by £28bn. About £2.8bn of this relates to shares held by those in the bottom half of the income distribution, as shown in the chart below. About 1.2 million households in the bottom half of the income distribution hold shares, including employee shares.

Figure 19: Estimated loss of household wealth due to share dilution, with a 10% IOF, in £bn



Source: SMF analysis of the Wealth and Assets Survey and Towers Watson Global Pension Assets Survey

Liberal Democrats

The Liberal Democrats, in their 2019 General Election manifesto, mentioned encouraging "employers to promote employee ownership by giving staff in listed companies with over 250 employees a right to request shares, to be held in trust for the benefit of employees".

If introduced, this policy would be unlikely to have a significant effect on levels of employee share ownership in the economy. Conceivably, a right to request could be denied by an employer for a number of reasons, including administrative costs and lack of interest among other members of staff. Further, the employer could require workers to make a financial contribution to benefit from the employee ownership trust; this could be a barrier to employees, particularly those on lower incomes.

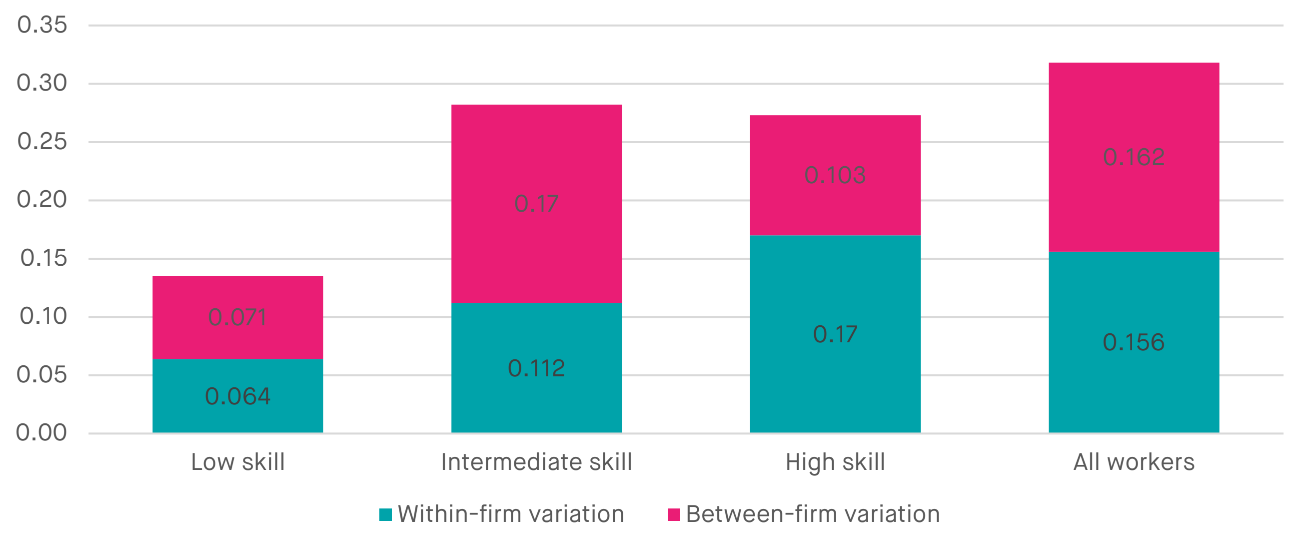
We note that, as with Conservatives' EOTs and Labour's proposed IOFs, the Liberal Democrat policy focuses on indirect ownership in the form of trusts, rather than direct ownership in the form of shares held by individual employees.

Distributional concerns with current and proposed employee ownership policies

A concern with current employee ownership policies, as well as those proposed by Labour and the Liberal Democrats, is that they might widen rather than narrow income inequality in the economy.

One reason this might occur is that a significant proportion of wage inequality in the economy reflects *between-firm* differences in pay rather than *within-firm* differences. That is to say, a significant share of wage inequality is due to a high proportion of workers employed in relatively poorly performing companies (which are unable to offer higher rates of pay, given their profitability). Aghion et al (2017) found that, for those on low and intermediate skill levels, the majority of wage variation is explained by between-firm differences rather than within-firm differences.[76]

Figure 20: Variance decomposition of UK wages, 2004-2014



Source: Aghion et. Al (2017)

Therefore, a risk from widespread employee ownership, and dividend payments, is that the pay gap between those working in the best-performing and worst-performing companies could widen rather than narrow. Those in best-performing companies could receive, on average, much more dividend income than those in poorly performing companies. If politicians aim to reduce inequality using employee share ownership, it should be noted that this might not be the best way of achieving that goal.

Summary

While major UK-wide political parties have either implemented or proposed policies related to employee share ownership, no party has introduced or proposed a game changer policy which would dramatically increase ownership across the economy. Liberal Democrat proposals for a right to request shares are likely to see limited impact, and the Conservatives are currently devoid of new policy in this space. While Labour's IOF proposals at first glance could bring a higher rate of employee inclusion, there are substantial questions surrounding the potential implementation of the policy. The IOF proposal also risks undermining incentives to hire staff and invest in the UK. Share dilution from the policy would have a negative impact on UK savers and pension funds.

The issues with the current policy landscape highlight the strong case for new policy proposals in this space.

CHAPTER 6: INCENTIVISING EMPLOYEE SHARE OWNERSHIP

The chapter outlines channels which could encourage the take-up of direct employee share ownership, with a main focus on all-employee schemes. Low rates of employee ownership and issues with existing and proposed policies in this space mean there is a need for new ideas to promote a widespread employee ownership economy.

Set a public target for and promoting employee ownership

Following the Nuttall Review, awareness of employee share ownership has been rising, aided by more Government involvement.[77] Yet, the majority of the effort to incentivise employee share ownership has been focused on the worker side, rather than on employers.

By definition, the central relationship involved in employee ownership is between worker and employer. Successful policy interventions here are therefore likely those that involve employers directly. How can policy change employers' behaviour so they do more to promote and expend employee ownership?

Elsewhere, the SMF has explored the role that taxation and legislation can play in encouraging a different approach among employers to the pay and training of their staff. Most recently, we have recommended an expanded understanding of Section 172 of the Companies Act to encompass a broader duty on directors to promote the interests of employees.[78] We believe that such an understanding could well lead to a greater effort from public companies to promote employee ownership.

However, we do not consider that such an expanded duty alone would create a necessary additional incentive on firms to offer more opportunities for their workers to own employee shares. Hence, we have looked elsewhere to other examples of interventions that have demonstrably affected change.

Our review suggests that the Davies Review and the Hampton-Alexander Review process, which seeks to increase the proportion of women on the boards of public companies, are a useful template for increasing employee share ownership. At the heart of the Hampton-Alexander process is a target, clearly set out in 2016, and widely understood: 33% representation of women on FTSE 350 Boards and FTSE 350 Executive Committee and the Direct Reports to Executive Committee by the end of 2020.[79]

The Hampton-Alexander Review, a body independent of but backed by Government, is now driving progress towards that target. It does so by the use of public benchmarking and social pressure: it publishes regular reports and league tables and makes other public comments by which the public and investors can judge companies' progress towards the targets. It is important to note that the 33% target has no statutory basis: there is no legal or regulatory requirement on companies to meet it, or even to try to meet it. Yet firms do so.

Part of the reason for this is direct commercial self-interest: some believe that widening the pool from which they draw board-level talent will improve leadership and, thus, company performance. But another part of the reason is that Davies-Hampton-Alexander have established a new *norm* for corporate conduct. Companies now operate under the expectation that they should meet the target, even though, strictly speaking, they have no obligation to do so.

Employee share ownership can be compared to increasing female representation on boards in the sense that it can deliver commercial benefits (as it increases productivity and reduces staff turnover, as discussed in Chapter 2). There are also broader social and political benefits, as employee share ownership increases the wealth of workers, increases public confidence in business and in the economic system as a whole, and reduces tensions between "the workers" and "the owners" by removing the distinction between the two.

Given that similarity, we recommend that a clear public target be set and promoted for public companies to meet for employee share ownership. As we discussed in Chapter 4, policymakers in France have already set a target for employee share ownership. We noted that the UK could benefit from adopting a similar approach.

We suggest that a UK employee share ownership target could take two possible forms. One would be for a proportion of outstanding equity to be in employee ownership. Another would be for a proportion of employees to hold an equity stake in the employee. We discuss each in turn below.

Targeting a *percentage of equity* appears superficially attractive, since it offers simplicity: seeking a situation where, for instance, 10% of a company owned by workers might capture public imagination and support. However, this approach has serious practical limitations, not least distributional ones: a firm could make progress towards the target through a more generous executive share ownership scheme that would do nothing to broaden ownership across the firm.

Targeting a *percentage of workers who own shares* is a more viable approach, and also one which directly relates to a broader objective of the policy intervention: wider ownership. The target could be an overall economy-wide target, rather than a uniform target applying to all companies. Such an approach might be preferred as it acknowledges that business circumstances vary by sector, size and so on – meaning it might be easier for some types of firm to reach a given level of employee share ownership than others. The downside of such an approach, however, might be a limited behavioural response from businesses – if firms for the most part see low rates of employee share ownership as an issue best tackled by other companies. Setting a common minimum expectation for employee ownership across larger firms would probably be more effective in getting companies to change behaviour. Once established, perhaps by way of an independent review, we recommend not just the creation of an independent body to monitor and report progress towards the target, but also clearer political leadership from any elected official committed to wider ownership of the UK economy. Politicians who say they want a more democratic and popular capitalism should raise their voices in support of mechanisms which allow and encourage employee share ownership.

In the context of the Hampton-Alexander Review, we also note the role that investors play in its efforts to encourage companies to meet the board membership target. We believe that investors could play a similar role in driving employee ownership.

Recommendation 1

The Government should set a target for the percentage of employees in public companies who should own shares/share options in their employer, and deploy public scrutiny and pressure to encourage firms to meet that target.

The target, which could be set by an independent review, should then be overseen by an independent body modelled on the Hampton-Alexander Review, and supported by stronger public advocacy from politicians – of all parties – who seek broader ownership of the economy.

Demonstrate the benefits of employee share ownership

The Employee Share Ownership Index, started in 1995 by corporate finance firm Capital Strategies, showed that publicly listed companies with substantial employee ownership (3% or 10% of capital) performed better in the long term than the FTSE All Share.[80] We view the Index as a useful tool to highlight the long-term advantages associated with employee ownership. However, the Index has not been updated since 2016.

Employee share ownership is already viewed favourably by consumers and prospective workers – as mentioned earlier, 68% of listed company employees surveyed as part of this research liked that idea of owning shares in the company they work for. Publicising the Employee Share Ownership Index more widely and updating it regularly could help apply additional pressure on businesses to offer employee share ownership from a third side: investors. Additionally, drawing attention ti the trend that companies which offer employee ownership perform well over time could further incentivise employers themselves to consider the business case for employee ownership, purely from a 'selfish' perspective.

Therefore, we recommend that the Government should commit to publishing either an updated version of the Employee Share Ownership Index or its own version which would track the performance of companies with employee ownership against firms without such arrangements.

Recommendation 2

In order to promote the benefits of employee share ownership to companies, the Government should regularly update (or publish its own version) of the Employee Share Ownership Index, which tracks the performance of listed firms with employee owners against the movements of the wider FTSE All Share.

Transparency requirements on employee share ownership

Throughout this research, we ran into the problem that precise and timely data on variety of offer of different employee ownership schemes and their take-up over time in firms of particular size, industry, and business structure was widely unavailable.

Requiring companies themselves to include a headline statistic on the type of employee share scheme(s) which are available to their workers and the proportion of eligible workers who participate in their annual reports would be a significant first step towards understanding the practical barriers which may disincentivise employees from owning shares in their employer.

We favour disclosure of this information to be included in the shareholder information section in annual reports, in a similar manner to preparing corporate governance statements. In particular, the Financial Reporting Council should require that the following aspects should be included in annual reports, through amendments to the UK Corporate Governance Code:

- The type of employee share scheme(s) on offer to workers (SIP, SAYE, CSOP, EMI, other);
- The proportion of eligible employees who participate in share ownership, per scheme offered;
- The average value of employee shares per participating worker.

It is important to note here that, if information is widely accessible and if enough firms of certain size in a certain industry operate employee share ownership schemes, this could apply pressure on competitors to also consider offering similar arrangements to their workers. This also provides shareholders with more information to engage with the company on their overall approach to human capital management.

Evaluation of a similar policy, the disclosure of the extent of the gender pay gap within an employer's workforce, indicates that compulsory reporting is likely to influence the behaviour of businesses. 84% of firms surveyed by charity Close the Gap in 2017 were worried about the potential impact of reporting their gender pay disparities on their reputation.[81] Reporting on employee ownership and involvement could similarly nudge employer behaviour.

Recommendation 3

The Financial Reporting Council should require firms to include information on what type of employee share ownership schemes are operated, the extent to which each scheme is taken up by eligible workers and the average value of employee shares in annual reports.

Issue employee shares of a different class which carry more voting rights

By law, the shares issued under a Share Incentive Plan must be ordinary shares in the company. However, employers are allowed to put certain restrictions on employee shares, such as limited or no voting rights.[82]

As the Nuttall Review highlights, the key condition for the success of employee ownership is allowing workers to exercise their voice internally.[83]

The Treasury's consultation on employee ownership highlighted that there was strong support for indirectly owned (collective) shares to carry voting rights. We recommend that the Government should lift the caveat which allows firms to restrict the voting rights of their employee owners or take those voting rights away completely, regardless of whether shares are held individually or collectively.

To further strengthen and incentivise employee engagement, the Government should explore the possibilities from reclassifying employee shares in order to give participating workers more voting rights than external shareholders who acquired their shares via the stock market. Policymakers might be justified in such an approach to employee voting rights if they believe that there are compelling benefits from elevating employee "voice" within a company and the economy more broadly – for example if this leads to productivity benefits, as some of the academic literature suggests.

As employee owners are likely to be numerous, companies should create a channel through which voting rights can be exercised; these can be left at the discretion of the employer in consultation with employees and can vary from surveys of the views of employee owners to nominating a worker representative (or some other candidate) to the board of directors.

In making this recommendation, we are mindful that this is a complex and contested topic. The principle of "one share one vote" has significant defenders, who argue that control over a company should be allocated in direct proportion to an owners' economic interest in that company. There are also legitimate questions to answer about how rules allowing differential ownership might diminish board accountability to minority shareholders. Such questions should be answered carefully in any exploration of enhanced voting rights for employee-owners. This is particularly important policy change leads to additional rights for a significant employee shareholder or senior manager.

To be successful and sustainable, any such enhanced rights regime would have be designed in so as to preserve board accountability in particular.

Recommendation 4

The Government should lift the caveat which allows employers to restrict the voting rights of employee shares. Moreover, the Government should explore the possibilities to reclassify employee shares in order to give participating workers more voting rights than external shareholders.

Reduce the SIP holding period

The number of Share Incentive Plans operated by companies grew rapidly since their legislation in 2000 until 2006-07. Although SIPs have become more popular than SAYE schemes, the number of active SIPs has remained relatively flat since 2006-07.

In our view, a fundamental flaw in the design of SIPs is their required holding period of five years, which could be a long time in the context of recent increases in labour force flexibility and the changing nature of work.

A global survey of millennials by Deloitte (those born between 1980 and 1995), who would soon make up the largest proportion of workers in the global economy, finds that almost half (49%) would quit their current job within the next two years, if they had the choice.[84] About a quarter of those respondents had left an employer in the past 24 months.[85] In the UK, research from LV= estimates that workers move roles every five years, on average.[86]

Therefore, the five-year holding period for SIPs could often outstrip the average time an employee spends at their current role, as new hires are unlikely to automatically qualify for an employee share ownership from their first day of work. Polling from ProShare reports that 24% of surveyed respondents do not participate in a Share Incentive Plan because they might not be with the company for long enough to benefit.[87]

Among listed company employees surveyed as part of the research, 57% said that they would be more likely to want to own employee shares if they were able to benefit from ownership more quickly.

We recommend that the SIP holding period should be decreased from five years to three years, in order to match the minimum holding period of SAYE and CSOP schemes and the three-year cap on contributions under an EMI scheme. We also noted in Chapter 4 that France has recently reduced the holding period for free shares; the UK would benefit from a similar approach with respect to its employee share ownership schemes.

In addition, a Statutory Review of the time frame of the holding period and its effects should be carried out regularly, for example every five years. This exercise would allow policymakers to amplify any positive outcomes associated with the proposed policy change and/or assess any negative effects which may arise with the lowering of the minimum time requirement, such as the possibility that a shorter holding time could lead to reduced retention/ higher staff turnover.

Recommendation 5

The Government should decrease the holding period of Share Incentive Plans from five years to three years.

In addition, the Government should carry out a regular Statutory Review every five years in order to evaluate the holding period of SIP schemes as labour market dynamics continue to evolve.

Ensuring employee ownership schemes are structured in the right way, and are not considered in isolation

Among the listed company employees surveyed as part of this research, a significant proportion thought that the policy recommendations described above would increase their likelihood of wanting to own employee shares – as shown in the chart below. Increased company transparency and being able to benefit from share ownership more quickly (such as through reducing the SIP holding period) were the recommendations with the greatest proportion of workers saying that this would make them more likely to want employee shares (57% of employees for both).

Figure 21: Which, if any, of the following proposals make you more or less likely to want to own employee shares?

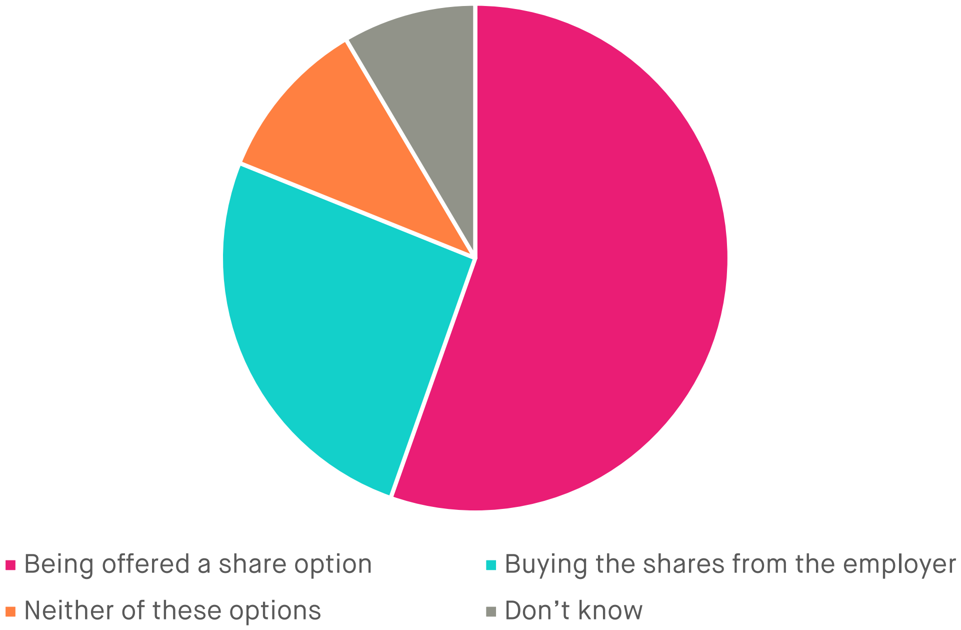
Source: Opinium Survey of listed company employees

One finding from the Opinium survey was that employees expressed a strong preference for having access to share options rather than buying shares from their employer; 55% preferred share options versus 26% preferring buying shares. Conceivably this reflects the fact that share options limit the downside financial risks of share ownership, with individuals not having to exercise an option if doing so would lead to a financial loss. This should be a consideration in deciding how employee share ownership schemes should be constructed – especially given our previous finding that affordability and concerns about declining share value are the biggest barriers to workers wanting employee shares.

Recommendation 6

Employee share schemes should reflect the affordability constraints and risk appetites of workers. This might favour share option schemes over simply letting workers buy company shares.

Figure 22: When thinking of employee ownership, which of the following is the most appealing?



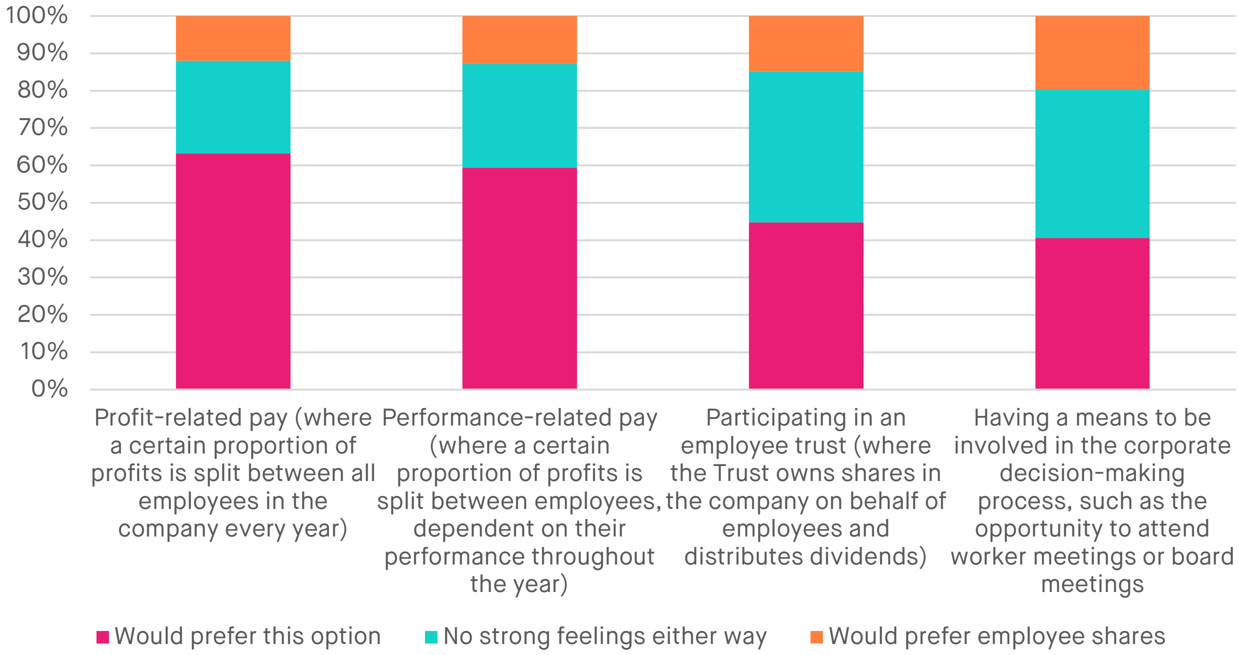
Source: Opinium Survey of listed company employees

Another consideration is how employee share ownership compares with other worker concerns and policy tools for improving employee outcomes. While this report has highlighted that share ownership can bring with it numerous benefits, and that employees like the idea of owning shares within their company, it is not a silver bullet solution. Indeed, a majority of those we surveyed said that they would prefer profit-related pay or performance-related pay to employee share ownership. Given this, other approaches to improving the financial outcomes of workers might be a higher priority and should be considered in addition to employee share ownership.

Recommendation 7

Employee share ownership should be seen as part of a broader package of initiatives aimed at improving employee pay, motivation and "voice". Policymakers should also consider the case for encouraging other forms of non-regular remuneration, such as profit-related and performance-related pay.

Figure 23: How would you rate having employee shares against the following other opportunities?



Source: Opinium Survey of listed company employees

ENDNOTES

[1] SMF, *Saving Better (2017)*

[2] http://siblisresearch.com/data/ftse-all-total-return-dividend/#:~:targetText=Dividend%20Yield%20of%20FTSE%20All%2DShare&targetText=Trailing%20twelve%20months%20yield%20(TTM,slightly%20higher%20than%20the%20average

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