A stake in success

Employee share ownership and
the post-COVID economy

Executive summary

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SMF Social Market Foundation

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EXECUTIVE SUMMARY

This report sets out the case for an expansion of employee share ownership in the UK, and for the share ownership agenda to form a key part of a "fair and strong economic recovery" narrative as we emerge from the Coronavirus crisis. The report argues that the case for wider rates of employee share ownership is compelling.

The UK economy has a persistent problem of low productivity growth, which is suppressing employee pay and living standards. UK workers produce less per hour than their peers in France, Germany, the United States and Italy. Furthermore, Office for Budget Responsibility forecasts predict that the Coronavirus pandemic will have a long-lasting "scarring" effect on productivity.

Evidence presented in this report suggests that employee share ownership could play a role in tackling the UK's productivity crisis, improving economic growth, innovation and outcomes for employees such as higher wages. Some of the evidence cited in this report includes:

- An Oxera study commissioned by HM Treasury on tax-advantaged share schemes which found that broad-based employee share ownership was linked to improved company performance measures, such as turnover and profitability.[1] The study found that, on average, the effect of tax-advantaged employee share plans is significant and increases company productivity by 2.5% in the long-run.
- Research by HM Revenue and Customs into Share Incentive Plans (SIPs) and Save As You Earn (SAYE) plans which showed 81% of 984 organisations surveyed citing increasing employee commitment as a major reason for setting up SAYE schemes; 87% said there had been a positive impact on relations between the organisation and its employees (the equivalent figures for SIP are 79% and 82% respectively).[2]
- A cross-country meta-analysis of 129 studies on employee ownership in general (i.e. not just via share ownership) which found that two thirds of the studies identified favourable effects related to employee ownership.[3]
- An analysis of 102 studies covering 56,984 firms which found that employee ownership has a modest but statistically significant positive relationship with firm performance. [4]
- Qualitative research on tax-advantaged share plans in the UK, which show that businesses see share plans as important tools for recruiting and retaining talented and key staff. [5]
- UK and US indices tracking the stock market performance of companies with a relatively high proportion of employee shareholders. These show such companies significantly outperforming broader stock market indices.

Furthermore, we argue that employee share plans could be an important tool for bolstering the financial resilience of UK households:

- New analysis of the ONS Wealth and Assets Survey, presented in this report, shows an "employee share ownership" premium, with employee shareholder households having much higher levels of median financial wealth.

- This finding holds true across income groups and age groups. Employee shareholders in the lowest income quartile ("the poorest 25%") have median net financial wealth £10,900 greater than those that are not employee shareholders.
- Evidence from the US also shows a wealth premium for employee stockholders. An analysis by the National Center for Employee Ownership of workers aged 28-34 found that employees holding stock in the companies where they work had 92% higher median household wealth. The study found that this "wealth premium" held true even once the analysis is segmented by income group.

Despite these benefits, we argue that there are a number of barriers to wider rates of employee share ownership in the UK. At present less than 5% of working age individuals are employee shareholders, reflecting lack of access to share plans, as well as lack of participation where they are available.

Barriers to share plan participation and rollout include:

- **Lack of awareness of – or scepticism towards – the benefits of employee share ownership.** Companies may be sceptical of the ability of share plans to improve corporate performance, while employees may lack an awareness of the potential financial benefits of share plan participation.
- **Cost of plan implementation and administration.** To implement a share plan, companies must be willing to devote considerable time and financial resources to the design, preparation, communication and ongoing operation of plans.
- **One particular cost issue that arose in our discussions with stakeholders was the way share plans are treated for accounting purposes.** Amendments to accounting standards, under International Financial Reporting Standards 2 (IFRS 2), have seen harsh accounting treatment of SAYE option plans.
- **Employee finances.** Even where share plans are offered by an employer, employee participation is not guaranteed. Share plan participation is lower in low-wage industries such as hospitality and retail, suggesting lack of financial means is likely to be a key barrier to participation in share plans. Higher rates of staff churn may also be an issue driving lower participation in these industries.
- **Even where an individual on a lower income is able to set aside some money for saving, risk aversion may discourage participation in a share plan**, particularly as such an individual may not have sufficient earnings or savings to be able to diversify and set aside money elsewhere.
- **The changing labour market.** The rise of the gig economy and individuals expecting to change jobs more frequently limit both the number of individuals able to participate in share plans, and interest in participation. For example, the five year holding period for Share Incentive Plans may undermine interest in employee participation. Evidence suggests on average people now expect to stay in a job for less than five years.
- **Lack of institutional support and leadership from government.** For the employee share ownership agenda to have a real impact over the long term, it requires substantial institutional effort, involving improved access to advice, training and other support on a continuing basis.

To address these barriers and encourage a shift towards greater rates of employee share ownership, we have set out a range of policy recommendations:

Report recommendations

New measures to nudge businesses to offer employee share plans

1. The Audit, Reporting and Governance Authority (ARGA) - the Financial Reporting Council's successor - should require firms to include information on what type of employee share ownership plans are operated, the extent to which each plan is taken up by eligible UK-based workers and the average value of employee shares in annual reports. This information should be reported regularly and in standardised form, for the use of investors pursuing an ESG agenda and seeking more information about companies' social and governance performance.
2. Government should explore the role that public sector procurement rules could play in encouraging wider rates of employee share ownership. Companies that are able to demonstrate how they share success with employees - such as through share plans - could be looked upon more favourably.
3. The ARGA should undertake a review of the accounting treatment of SAYE share plans, which currently disincentivises their implementation. In particular, consideration should be given to the current treatment of cancellations by plan participants, which sees expenses brought forward even though share options will never be exercised.

Modernising share plans to reflect the 21st Century labour market

4. The Government should decrease the holding period of Share Incentive Plans from five years to three years to reflect modern trends in job tenure
5. Those that voluntarily leave a company before the end of a share plan contract should be entitled to tapered tax benefits. They should not be treated as "bad leavers", as is the case at present.
6. Gig economy workers should be allowed to participate in tax-advantaged share plans.

Getting lower income workers on board

7. **Share Incentive Plan rules should be amended to allow preferential access to free shares for lower income workers.** For example, a company could be permitted to offer free shares exclusively to lower income workers, while having a match share arrangement with higher income workers. This would help widen participation in SIP while managing the company costs of such plans.
8. **Given the need to improve financial resilience among lower income households in the UK, government should consider the case for supporting a modest rate of interest or matching funding on SAYE savings**, or provide focused financial incentives to lower income employees. Lower income workers could also be offered greater SAYE option price discounts.

The SMF has argued elsewhere that government support for savers is currently poorly focused. For example, ISA tax reliefs disproportionately benefit higher earners. We have argued that financial support should be focused on lower earners and those of limited financial resilience. Government-provided match savings for lower earners participating in SAYE, and other corporate savings schemes, would be one way of doing this.

Strengthening rights and voice of employee shareholders

9. The Government should lift the caveat which allows employers to restrict the voting rights of employee shares. Moreover employee shareholders should have enhanced rights in the event of corporate failure, given that they face potential loss of wages as well as loss of savings tied up in company shares.
10. Companies offering employee share ownership should consider an Employee Advisory Panel to be a central element of such engagement with workers; those companies that offer employee share ownership but do not have such a panel should explain publicly why not. Where such a panel does exist, workers who own shares should be given additional representation. Companies could also consider establishing advisory panels composed solely of employees who own shares.

Introducing a new ownership model to encourage employee share ownership to form a key part of business succession planning

11. **The US Employment Stock Ownership Plan (ESOP) model should be brought to the UK, with Employee Ownership Trusts (EOTs) having an option to become ESOPs where stock is allocated to individual employees rather than held in a collective pool**. Embracing EOTs and ESOPs as part of entrepreneur succession planning could help widen employee ownership over time.

Supercharging entrepreneurship and innovation – with employee-owned start-ups and academic-owned university spinout companies

12. **The 25-hour working time requirement for Enterprise Management Incentive (EMI) share plans should be lifted for academic employees participating in university spinout companies**, to incentivise more academics to be involved in the creation of innovative, cutting edge, academic-owned start-ups. **Further, the Government should undertake a review of university spinouts in the UK**, exploring the extent to which British universities could learn from the relative success of US universities such as Stanford in developing a thriving culture of innovative spinout companies.
13. To help the UK's tech start-up scene to attract top global talent, companies with up to 499 employees should qualify for EMI plans (up from 249 at present). Given the difficulty of matching Silicon Valley salaries, widening access to share options could make it easier for fast-growing start-ups to attract talent.

Getting government to lead the charge

14. **The Government should establish an Employee Ownership Commission, tasked with developing the necessary institutional support needed to widen rates of employee ownership.** This includes reviewing business access to support and advice on employee ownership, financial support, marketing of employee ownership and identifying and removing barriers to employee ownership. The Commission should work closely with existing non-government organisations in the employee share ownership space.

ENDNOTES

[1] Oxera (2007), “Tax Advantaged Employee Share Schemes: Analysis of Productivity Effects”
[2] MacLeod and Clarke (2015), “Engaging for Success: enhancing performance through employee engagement”
[3] Kaarsemaker (2006), “Employee ownership and its consequences: synthesis-generated evidence for the effects of employee ownership and gaps in the research literature”
[4] Boyle et al (2016), “Employee ownership and firm performance: a meta-analysis”
[5] HMRC (2020), “Tax Advantaged Share Schemes 2019”