



# Consultation on Employee Share Ownership





## Foreword by the Chancellor of the Exchequer

In the November 1998 Pre-Budget Report, I announced that the Government would publish a consultation document on employee share ownership. Share ownership offers employees a real stake in their company with shareholders, managers and employees working towards common goals. Today only a fraction of British employees and an even smaller minority of those outside senior management own shares in the companies that they work in. Yet the evidence is that employee commitment is a vital strength for companies competing and succeeding in the global economy.

I want, through targeted reform, to reward long term commitment by employees. I want to encourage the new enterprise culture of team work in which everyone contributes and everyone benefits from success. And I want to double the number of companies in which all employees have the opportunity to hold shares.

This consultation process asks for views of employees and employers on how to spread employee share ownership more widely. Please help us achieve this by giving us your views on the best way forward.

A handwritten signature in black ink that reads "Gordon Brown". The signature is written in a cursive, slightly slanted style.

GORDON BROWN MP

## Why employee share ownership?

The Government supports employee share ownership schemes which involve the widest range of employees for two reasons:

- **Productivity.** Employee share ownership has a contribution to make towards increasing Britain's productivity. Britain's productivity lags behind that of our main competitors and discussions with business have confirmed that we could do more to remove the barriers to opportunity and ambition. Sustained employee share ownership has a part to play, by harnessing the ambition of employees to see the company in which they work succeed. Research evidence indicates that employee share ownership has a positive effect on employee productivity.
- **Fairness.** The all-employee tax-advantaged schemes promote enterprise for the whole workforce and not just a few senior staff. They help all employees to share in the success of the company.

## Consultation

This consultation document asks employees, companies and other interested parties for their views on how the Government might best promote employee share ownership. It sets out objectives and assesses the current schemes in the light of these objectives. Given that companies have considerable experience of the current schemes in practice, the Government would prefer to seek a wide range of views from interested parties at this stage, before coming forward with detailed proposals.

## What employee share ownership means for you

### *What do employee share schemes mean for companies?*

Shareholders have a direct interest in improved company performance. However, few employees have such direct incentives. Offering employees the opportunity to participate in share schemes directly links the interests of owners and companies to make the company successful and grow. Share schemes can be used to help recruitment and retention of staff, by encouraging a long-term commitment to the company.

## What companies say about employee share ownership



### *Senior Manager, FI Group:*

*“The directors recognise that the quality and motivation of its workforce is crucially important to the future success of the group and, consequently, much effort has been made to encourage share ownership within the workforce and to promote a participative management style. Substantial workforce share ownership arose from the 1991 workforce buy-out and has continued to increase. Directors believe that this cornerstone of workforce share ownership has been a key feature in developing a culture of shared success in the group, helping to foster a high level of workforce commitment and loyalty.”*

### *Managing Director, Burall PlasTec*

*“Employee share ownership means that all our staff are deeply involved in the business, come rain or shine. So the communication within the organisation has to achieve a common understanding of business objectives and challenges. This gives us great strength in our ability to change and react to the challenges with the support of all our staff. And in today’s environment, where the impact of technology, IT and globalisation brings change and challenge ever more rapidly and frequently, our ability to react is key to sustaining competitive advantage. So success becomes more likely, and if we are successful then we all get an extra benefit for our hard work.”*



### *What does employee share ownership mean for employees?*

Employee share schemes can have important benefits for employees. These benefits mean that employees are often very keen to participate in employee share schemes. They become more aware of their company’s aims and objectives, more committed to their company and aware of its overall performance. On a personal level, employees feel that share schemes help them to save for the future and also help to introduce them to holding shares more generally.

## What employees have to say about employee ownership

*“I took a risk when I invested in FI shares ten years ago, but the gamble has really paid off. I have been buying shares right from the first opportunity because I sensed they would be a good investment. Based on today’s share price, I should make a substantial profit – so I am thinking about updating my car. But I will be using the rest to supplement my pension in years to come.”*

*“Ownership of the organisation in which one works has meant a totally new view of the employee/employer relationship. One genuinely cares about the company’s performance and the way it interacts with the outside world.”*

*“Good for morale, it makes us feel part of the company and that we are worth something.”*

*“It helps to break down barriers and build up trust.”*

*“Sharesave offers me the opportunity to put aside £250 a month out of my salary to buy Allied Domecq shares. The benefits financially are that I get company shares at a discount in a tax efficient manner. Sharesave makes me feel part of the company as a whole and gives me the ability to invest for the future.”*



## Employee share ownership and productivity

Employee share ownership offers the prospect of bridging the gap between employees and shareholders, to the long term benefit of employees, managers and outside investors. By aligning more closely the interests of the workforce and the owners of the company, employee ownership can help increase cooperation. Over time, employees with a stake in the business have an incentive to contribute more actively to the development of the business by raising productivity. If the majority of employees have such an ownership stake, then individual efforts may become mutually reinforcing, and employees have an interest in the work of their colleagues. Once they have become shareholders, employees are more likely to feel greater commitment to the company for which they work. This in turn can help companies in their recruitment and retention, and enable them to obtain a better return from their investment in employee training. Finally, employees who are also shareholders may better understand the risks faced by the company and its investors, which in turn can encourage recognition of the case for pay responsibility.

Employee share ownership is widespread in the United States, and most of the research evidence on the practical impact of employee ownership relates to the US.

The key conclusion of this research is that employee share ownership, especially when combined with other means of active employee participation, does have a positive impact on employee motivation, productivity and corporate performance. The benefits are enhanced when share ownership operates in parallel with modern management methods, so that financial incentives are reinforced by other practical measures.

So, the economic case that employee share ownership can play a part in enhancing company performance is borne out by research evidence. Many UK companies have already recognised the potential of employee share ownership by setting up such schemes.

## Employee share schemes: A country comparison

There are three tax-advantaged schemes designed to promote employee share ownership in the UK. These are the Approved Profit Sharing scheme (APS), the Save As You Earn Sharesave scheme (SAYE) and the Company Share Option Plan (CSOP). The schemes are more fully described in the Annex at the back of this consultation document. Both the APS and the SAYE scheme must be offered to all employees. The CSOP can be made available by companies to a limited number of employees, although some companies (including a few very large companies) do allow a range of employees to participate. Currently around one million employees are given shares and a similar number are granted share options each year through these schemes. About 7% of the workforce currently participates. The UK is still behind other countries in the extensive use of employee share schemes and it may be that there are lessons which the UK can learn from their experience. Both the USA and France, in particular, achieve considerable participation in employee share schemes.

### *USA*

Employee share ownership has long been a part of the business culture of the United States. The most widespread employee share ownership schemes are Employee Share Ownership Plans. ESOPs are similar to UK employee share ownership trusts, but are used much more widely, driven in part by their use as retirement savings vehicles. There are around 11,000 ESOPs involving about 10 million employees or 10% of the workforce. Partly for tax reasons, many ESOPs own 30% or more of the company and so play a more integral role in the company's activities. ESOPs can borrow money to buy company shares and repay the loan from dividend income, employer contributions (for which the company gets tax relief) or other investment income. Alternatively, the company can contribute cash or shares to the ESOP. The ESOP allocates shares to employees which are distributed to the employees on retirement. In quoted companies, an ESOP contribution is often used as part or all of a top-up to employee contributions to a 401(k) plan, which is another form of retirement plan. Several million US employees hold shares through 401(k) plans, which allow employees to contribute part of their pre-tax pay into an investment fund set up by the company. Employee contributions are often topped-up by companies and both the employee contributions and company top-ups can be in the form of company shares. When benefits are paid out of a 401(k) they receive favorable tax treatment.

### *France*

France has around six million employee participants (around 23% of the workforce) in company share schemes. France is the only European country where all companies, including unquoted companies, with at least 50 employees are legally obliged to set up a company savings scheme (although employee participation remains optional). Companies with fewer than 50 workers can also apply the scheme on a voluntary basis. The employees have no access to accumulated contributions for 5 years, which are then exempt from income tax and (partially) from social security contributions. Schemes can take the form of employee savings plans (with bigger tax incentives for investment in shares) or employee shareholding plans (which involves purchases of shares in the employing company) and must be open to all employees. By 1994, there were almost 16,000 such agreements covering over 19,000 companies.

## Extending employee share opportunities

The Government wants to increase the number of companies making employee share schemes available to all employees. The table below shows the current distribution of take up of the approved schemes by company size:

### Participation in Approved Share Schemes by market sector, November 1998

Number of UK listed companies: 1992

Smaller listed companies (ie outside FTSE 350): 1642

Number of unlisted companies admitted to trading on AIM\*: 276

Number of companies with schemes:

	APS	SAYE	CSOP
FTSE 100	65 (65%)	93 (93%)	94 (94%)
FTSE 250	64 (26%)	175 (70%)	215 (86%)
Smaller listed	185 (11%)	554 (34%)	974 (59%)
Total Listed	314	822	1283
Unlisted on AIM	3 (1%)	29 (11%)	137 (50%)
Unlisted outside AIM	542	350	2349
Total (Listed and Unlisted)	859	1201	3769

Source: Inland Revenue

\*AIM is the unlisted securities market operated by the London Stock Exchange

As the table indicates, most of the very largest companies already have at least one approved all-employee share scheme. Therefore in order to increase the number of companies in which all employees have the opportunity to own shares, ways must be found to increase the attractiveness of employee share schemes to smaller and unquoted companies. The current design of schemes, together with the costs and administrative burdens of setting up and running the schemes, may not favour participation by smaller companies. Smaller companies may also lack the information and advice to set up schemes easily, which might be remedied by more vigorous promotion of the schemes. The Government would particularly welcome views on the costs and other barriers to setting up and running schemes and whether there are improvements which could be made in this area.

## Promoting long-term share holdings

The current schemes do not promote long-term holding of shares by employees effectively. The option based schemes (SAYE and CSOP) do not require any holding of shares for the period of participation and employees can exercise the options and sell the shares immediately. Research by ProShare in 1997 confirms informal findings that the majority of employees dispose of their shares as soon as they are able to. Only around a third of SAYE participants appear to hold on to their company shares. Retention under the APS scheme seems to be higher. This may be because, unlike SAYE, participating employees are shareholders from the outset and have shareholder rights, including receipt of dividends and voting rights. The Government wants to promote longer term shareholding by employees and seeks views on how employees might have greater incentives to hold onto their shares.

## Consultation

This document seeks views on the current tax-advantaged share schemes for all employees. The Government would welcome comments on these schemes or proposals for new schemes which would be in line with the Government's stated objectives and in particular:

- How can the Government encourage more companies, particularly smaller and unquoted companies, to offer all-employee share schemes? What are the existing barriers to participation?
- How can the Government encourage longer term holding of shares by employees?

Comments should be sent as soon as possible, and no later than the end of January 1999 to  
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Parliament Street  
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Telephone (fax): 0171 270 6332 (0171 451 7524)

Additional copies of the consultation document can be obtained from the Treasury Public Enquiry Unit on 0171 270 4558.

Respondents should give details of any organisation whose views they represent. Unless respondents indicate to the contrary, it will be assumed that they have no objection to their response being made public.

The conclusions of this review of employee share ownership will be announced in the 1999 Budget.

## Details of UK Share schemes

There are currently three different Inland Revenue approved Employee Share Schemes:

- The Approved Profit Sharing scheme (a free/matching share scheme);
- The Save As You Earn Sharesave scheme (a share option scheme linked to a savings contract); and
- The Company Share Option Plan (a share option scheme)

There is no necessary connection between the schemes which have developed separately over the years.

The following pages set out the tax treatment of the current approved schemes (see box opposite) and outline how companies and employees participate in them. For unapproved schemes, i.e. normal tax on shares and options, employees face income tax on the full value of any shares less the price (if any) paid for them. Employees pay no tax on the value of unapproved share options when granted, but at exercise pay income tax on the difference between the then value of the shares and the price paid.

Some assessment of current approved schemes is also provided in line with the Government's objectives.

More detailed information for both employees and practitioners on setting up or participating in each of the approved share schemes is available from the Inland Revenue Public Information Office 0171 438 6420 or on the Internet at [www.open.gov.uk/inrev/irhome.htm](http://www.open.gov.uk/inrev/irhome.htm).

## Current UK employee share schemes

### *Approved Profit Sharing (APS)*

The company makes tax deductible payments to a trust which buys shares in the company and appropriates them to scheme participants. All employees (including part timers) with 5 years' service must be eligible to participate on similar terms, but most companies accept those with much shorter service. The shares must be left in trust for at least 2 years, and are free of income tax if left in trust for a further year. The employee pays CGT (if relevant, given the annual exemption) on the difference between the sale price and the value of the shares when first awarded.

1m participants. 859 companies.

Average value of shares per employee £680. Tax cost: £150m

### *Save As You Earn Sharesave (SAYE)*

Employees enter into a 3 or 5 year savings contract to save a fixed monthly sum of between £5 and £250, receiving a tax free bonus at end (with additional bonus if 5 year savings are held on deposit for further 2 years). Bonuses, equivalent to fixed rate interest, are set by HM Treasury. Proceeds of savings and interest may be (but do not have to be) used to exercise, free of income tax, share options granted at start of contract. Options can be granted at a discount of up to 20% of the market value. As with the APS scheme, all employees (including part timers) with at least 5 years service must be entitled to participate on similar terms. Most schemes accept those with much shorter service. The employee does not pay income tax on any increase in the shares' value over the life of the option, but pays CGT (if relevant, given the annual exemption) when the shares are sold.

1¼m participants. 1,201 companies.

Average grant per employee £2,700. Average savings £59pm. Tax cost: £380m.

### *Company Share Option Plan (CSOP)*

The company grants employees options to purchase shares at a future date at the market price of the shares at the time of grant. Each participant may be granted options over shares worth up to £30,000 at any one time. No income tax is charged on the increase in value of the shares between grant and exercise provided the two main rules are observed: options must be held for at least 3 years; and there must be a gap of at least 3 years between each tax-relieved exercise. Employees are liable for CGT on gains, but the annual CGT exemption means that the effective tax rate is less than if income tax were paid. The scheme is discretionary: companies can select those employees or directors to whom they wish to grant options.

300,000 participants. 3,769 companies.

Average grant per participant £5,700. Tax cost: £100m.

## Approved Profit Sharing scheme (APS)

### *I am a company – how do I set up an Approved Profit Sharing scheme?*

You will need to set up a trust to administer the scheme and allocate funds to the trust to buy company shares. The trustees are responsible for purchasing the shares, holding them for the employees for at least two years and thereafter making them available to the employees. In order to be approved by the Inland Revenue, the scheme will need to be open to all employees to participate on similar terms and give employees the same rights as other shareholders. The Inland Revenue Employee Share Schemes Unit (0171 438 6626) can provide advice and specimen rules and documents.

### *I am an employee – how do I participate in an Approved Profit Sharing scheme?*

The company will set up a trust and allocate it funds to purchase company shares. The trustees will set aside your shares in the trust. You will not pay income tax when the shares are set aside for you or if you sell them after at least three years. You will have the same rights (for example to dividends and voting rights) as other shareholders during those three years.

### *Approved Profit Sharing and the Government's objectives*

Compared with the other approved all-employee scheme, the APS scheme is more likely to be taken up by smaller, unlisted companies. However, the APS scheme appears to be less popular with quoted companies than the other schemes. The Government would welcome comments on how the scheme design could make it more attractive for large and small companies. In addition, while the APS scheme does involve on-going shareholding by participants for (usually) three years, it does not encourage employees to continue holding shares to build up a larger stake in the company over the long term.

## **SAYE (Save As You Earn) Sharesave**

### *I am a company – how do I set up an Approved SAYE Sharesave scheme?*

You will need to set up an arrangement with a savings carrier (a Bank, Building Society or European equivalent) which has been approved to operate SAYE Sharesave contracts for the employees taking part in the scheme. The savings carrier will administer the scheme on the company's behalf, collecting the employees' savings. You need to offer participation to all employees of the company and grant options (which can be at a discount of up to 20%) to participating employees to buy shares with the proceeds of the matured contracts. The Inland Revenue Employee Share Schemes Unit (0171 438 7783) can provide advice and specimen rules and documents.

### *I am an employee – how do I participate in a SAYE Sharesave scheme?*

To participate, you need to agree to save a fixed amount per month (£5-£250) for three or five years. You will be given an option to buy a fixed number of shares at a fixed price (set at the time the option is given). At the end of the savings contract you will receive a tax free bonus, and you will be able to use your savings and bonus to buy up to the set number of shares in your option. You will not be taxed when you receive your option or when you use your savings related option to buy shares.

### *SAYE Sharesave and the Government's objectives*

SAYE is very popular with the largest listed companies. Even compared to the other approved share schemes, SAYE is disproportionately offered by the largest firms. Therefore it may be possible that the current scheme design and bonus rates structure are not particularly suitable for smaller businesses. The SAYE scheme does not require any holding of shares for the period of the savings contract and participants often sell their newly acquired shares for cash immediately after exercising their options. Therefore there is little on-going participation as a shareholder in the company.

## Company Share Option Plan

### *I am a company – how do I set up a CSOP?*

You need to give options to selected employees to buy shares in the company at a fixed price (which cannot be less than market value at the time the option is given) during a set period of time. The Inland Revenue Employee Share Schemes Unit (0171 438 7201) can provide advice and specimen rules and documents.

### *I am an employee – how do I participate in a CSOP?*

If your employer includes you in the scheme, the company will give you an option to buy a set number of shares at a fixed price during a set period of time. If the value of the company's shares goes up, you can use the option to buy shares at a fixed price, during that time. You will not normally be taxed when you receive an option under a CSOP. You will not normally be taxed on the increase in value of the shares when you exercise your option to buy shares as long as the option has been held for at least three years and at least three years have passed since you last exercised an option under the scheme.

### *CSOP and the Government's objectives*

The CSOP is a discretionary scheme and is often used to offer considerable rewards to managers and senior executives. However, several large companies do use CSOPs as a way to offer incentives to their workforce as a whole and one third of CSOP participants are in CSOP schemes which are effectively available to all employees. But the distribution of benefits does appear relatively uneven. About half of the employees granted options in 1996/97, involving a tenth of the total number of schemes, were granted options worth less than £3,000. Whereas less than a tenth of the employees, but involving about two fifths of the total number of schemes, were granted options worth more than £20,000. So while the large majority of participants in the scheme receive relatively modest grants, a large number of schemes offer sizeable rewards for a much smaller number.