

EMPLOYEE OWNERSHIP



ESOP's fables

Australia trails the rest of the developed world when it comes to employees holding a stake in their own company. The moral of the story is that an employee share ownership plan translates to motivated workers, writes **Craig West**.

THE NEWLY RELEASED information kits on employee share ownership plans (ESOPs) have again focused our attention on the issue of employees owning shares in their employer. The Government is working on improving the rates of ESO in Australia as we lag behind many developed economies.

Although ESOPs have been around in Australia for over 30 years, they are one of the least utilised mechanisms for raising capital, even though they have the added advantage of motivating and retaining key staff. In the US and countries in the EU, the schemes are widely used and very popular.

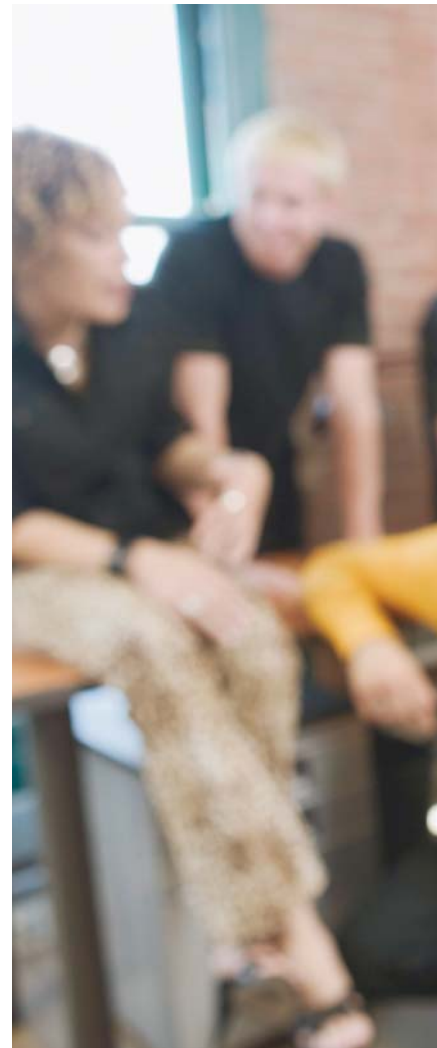
In Australia, employee share ownership plans are far less common. For example, in 1999 only 5.4 per cent of employees participated in any kind of share scheme. As recently as 1986, this figure was just 1.4 per cent*. The Federal Government has indicated strongly that it wants this to change. In July 2003, Tony Abbott announced the launch of an employee share ownership focus, saying: "Employee share schemes have many benefits. They encourage saving, boost wealth, promote a sense of ownership, but as much as anything they can help turn wage earners into stakeholders, proletarians into capitalists and antagonists into collaborators."

In the May 2003 budget, the Federal Government established an employee share ownership development within the Employment portfolio with funding of \$1.7 million.

The unit was designed to alert workers and managers to the opportunities of ESO and provide information on the types of schemes available. The unit will work with the Australian Securities & Investments Commission and the Tax Office to make standard share schemes easier to establish.

For workers, employee share bonuses give them another chance to get ahead in the business. It's a means to motivate the workforce. It's a way of empowering people who might otherwise feel disenfranchised and alienated. Over the years, a surprisingly wide range of people have lent support to the cause. In one of his first political speeches, Winston Churchill declared in 1897: "Ultimately, I hope that the labourer will become, as it were, a shareholder in the business in which he works." Forty-nine years later he announced his commitment to "make the status of the wage earner that of partner rather than an irresponsible employee".

The percentage of Australians owning shares in their own workplace has risen from 2.4 per cent in 1984 to 3.9 per cent in 1994 to 6 per cent (or nearly half a million people) today. About 90 per cent of Australian listed companies have share schemes of some sort, although often these are geared more towards managers, who are two-and-a-half times more likely to hold employee shares than other workers. Just 3 per cent of unlisted companies have employee share schemes at all,





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probably because they assume, wrongly, that workers can't have shares in private businesses.

Privatisation has boosted share ownership generally, while targeted tax concessions have boosted employee share schemes. In 1974, the Whitlam Government first introduced employee share tax concessions. In 1994, the Keating Government introduced Division 13a of the Income Tax Assessment Act, providing a \$500 a year tax concession for benefits given as employee shares, or alternatively deferral of tax for up to 10 years for shares and options issued to employees at a discount. In 1996, the Howard Government doubled this tax concession to \$1000 a year.

According to a large-scale American study – which the Nelson report into ESO in Australia calls “encouraging” – 66 per cent of businesses report improved morale as a result of employee share ownership, 36 per cent report higher productivity, 33 per cent have reduced labour turnover, and

23 per cent report improved profitability (although only 57 per cent reported no disadvantages, such as dilution of stock value and less control of the business).

Industry trends

Around 400,000 employees have employee shares as a benefit of employment. The total pool of wage and salary earners that could have access to employee shares is estimated to be around 6 million. The industries with the highest raw numbers of employees with employee shares are finance and insurance (86,600), manufacturing (75,800) and retail trade (53,700). These industries with high levels tend to reflect the influence of a small number of very large companies in those industries (*1999 ABS Survey of Employee Benefits and Earnings*).

In the finance sector, the inclusion of employee share ownership provisions in enterprise bargaining agreements in the major banks has been a very strong influence. These were initially introduced as a trade-off for conditions, but were regarded as a win-win provision.

An estimated 6.8 per cent of employees covered by current federal private enterprise bargaining agreements have provisions for employee shares as part of their agreement. However, the number of agreements with such provisions is very low (73 out of 9074) and concentrated in just a few industries (manufacturing, finance and transport). Employee coverage is greatest in communications, finance, transport and business services (the disparity to the industries with high numbers of agreements arises because of relative agreement size) (*Workplace Agreements Database, Department of Employment and Workplace Relations*).

Listed and unlisted companies

A very high proportion of listed companies have employee share ownership plans (estimated to be around 90 per cent of listed companies and 56 per cent of subsidiaries of overseas listed companies having at least one employee share ownership plan, although some of these are executive-only plans (*Mercer, 2002*)).

A number of reasons are given for this high level, including developing an ownership culture, attraction and retention, and long-term incentives. A much lower number of unlisted companies have employee share plans (data on this is not reliable, but estimates range from negligible, through to 3 per cent to about 20 per cent).

According to a House of Representatives inquiry, the main reasons for employers not putting plans in place are cumbersome administration, cost implications, difficulties with approval, and having a corporate structure not considered to be appropriate (*Shared Endeavours: an Inquiry into Employee Share Ownership in Australia*).

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Demographic trends

In 2003, 51 per cent of Australians owned shares (this figure includes both direct and indirect share ownership, and covers both employee as well as non-employee share types). At this time, 39 per cent of Australians owned shares directly, with a further 12 per cent owning them indirectly through superannuation.

ESO value

The value of employee share ownership is unknown, but was estimated by the Nelson Committee to be worth between \$9 billion and \$12 billion in 2000, with an annual increase in value running into the billions of dollars.

Of the total, it was estimated that between \$6 billion and \$8 billion was held in equities in listed companies and between \$3 billion and \$4 billion in unlisted companies. About \$1.5 billion of the total was estimated to be holdings in executive-only plans. A significant proportion of the total comes from a small number of large corporations (*Shared Endeavours: an Inquiry into Employee Share Ownership in Australia*).

Australian and international trends

Australian incidence of employee share ownership is low compared to a number of other countries, such as the US, the UK, France and Japan. However, employee share ownership in Australia is similar to that of Germany.

It also appears that employee share ownership is more concentrated among managerial occupations than in some other countries.

ESOPs for small-to-medium business are an efficient way to solve the issue of staff retention – good people are looking for incentives outside income to stay with their employer and many of the schemes include vesting periods and qualifying periods so that staff have to ‘stick around’ to reap the benefits.

Companies that have introduced them report positive results. While they are expensive to set up (\$10,000-\$50,000) the benefits of attracting, retaining and motivating key staff – while not easily quantified – is of great value to most businesses. ●

**Figures come from Tony Abbott (Member for Warringah) cited in his Employee Share Ownership launch speech, Humanising Capitalism (16 July, 2003). All other figures are from ABS data unless otherwise attributed.*

Case study 1: JOL

“Companies who are employee owned, or who have large and significant employee ownership stakes, now account for around £14 billion (\$33 billion) in total annual turnover in the UK alone.” So says the website of JOL, a British association of employee-owned and trust-owned businesses.

“The sector is growing because employee ownership is proving to be a durable, successful business model that’s extremely well suited to the challenges of 21st century management.

“Contrary to outdated notions about employee ownership, JOL member companies and other employee-owned businesses tend to:

- Have highly professional management, with strong decision-making authority recognisable to any successful company – and don’t operate on a hyper-democratic ‘co-op’ model.
- Aim to make, and do make, profits, but distribute them differently to non-employee-owned businesses.
- Are quite capable of generating growth by raising funds internally or externally.
- Operate successfully in highly competitive markets, including international markets.
- Are exceptionally well equipped to handle innovation.
- Can deliver higher productivity than comparable non-employee-owned companies.”

For more information, see www.jol.org.uk.

Case study 2: Eircom

“Eircom employees left smiling.”

This was the headline that the UK *Financial Times* ran upon the flotation of the Irish fixed-line company Eircom, which was 30 per cent owned by its employees through an employee share ownership trust. The employees of Eircom had every reason to be smiling, thanks to the prescience of Irish trade union leaders. When Eircom floated in early 2004, the employee share ownership trust’s holding had risen from €127 million (\$204 million) in 1996 when the company was privatised to €700 million (\$1.126 billion) at the time of the float.

The UK ESOP Centre reports that while more than half the beneficiaries will be ex-employees, this shows how employee ownership can contribute to their retirement savings, while also flagging the success of this new approach towards remunerating and rewarding existing employees.

Maoiliosa O’Culachain, managing director of Active Capital Strategies, writes: “The ESOP is doing very well. It will maintain its stake at or about current levels – it is minimising dilution in the new issue by taking up a rights issue – and will increase representation on the board again. It will be making a distribution of shares worth €66 million (\$106 million) immediately afterwards, bringing the total distributed to date to €276 million (\$444 million).”