White Rose Employee
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EMPLOYEE OWNERSHIP IN BRITAIN

Findings from the WREOC Employee Ownership Survey

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June 2017

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Introduction

Employee ownership is an increasingly important form of business ownership and organisation in Britain. Employee-owned firms operate in a range of sectors, including retail, wholesale, health services, social care, business consultancy, and manufacturing. Although some firms have been employee-owned for many years, employee ownership started to become more prevalent from the mid-1980s. A wave of conversions took place in the late 1980s and early 1990s, often using an ESOP-type structure. After a lull in the late 1990s, conversions to employee ownership picked-up in the 2000s, with the pace escalating from around 2010. Following recent policy initiatives, there is currently considerable interest in employee ownership within the business community.

There is considerable heterogeneity across the employee-owned sector in Britain. Traditionally, workers' co-operatives were the most common form of employee ownership, but since the late 1980s new ownership forms and structures have developed. Some firms have indirect employee ownership, with shares held collectively in an Employee Benefits or Employee Ownership Trust, whilst others have direct employee ownership whereby individual employees own shares. It is also common for ownership to take a hybrid form, combining direct and indirect ownership.

In this report we consider the influences on the development of employee ownership since the 1980s, and highlight the factors contributing to the current rise in employee ownership conversions. Political support for employee ownership is found to be the strongest but not the only influence on levels of employee ownership activity. We then outline the main features of employee ownership in Britain. Finally, the chapter identifies and discusses groupings of employee-owned firms, based on the circumstances of their conversion. Four main groups are identified: ownership conversions arising from privatisation, business succession, sharing ownership, and business start-ups.

The report draws on the findings of a major research project conducted from 2014 onwards in collaboration with the Employee Ownership Association (EOA) (the main employee ownership trade association and lobby group in the UK). Currently, 162 firms have responded: which represents well over a half of the companies in Britain that are substantially employee-owned.

The development of employee ownership

The traditional form of employee ownership in Britain is the workers' co-operative, where ownership is equally shared between all or most employees. Although the co-operative movement is said to have begun in Britain, this form of worker ownership has ebbed and flowed in popularity. Attempts were made to promote co-operatives in the 1970s but the high profile failures of some key ownership conversions at this time set back the cause of worker co-operatives. In their place a new form of employee ownership emerged in the 1980s based loosely on the Employee Stock Ownership Plan (ESOP) model widely found in the United States. In this form, ownership is passed to a trust with a remit to benefit employees. This is said to be an indirect model of employee ownership. In some cases ownership is retained within the trust but in others shares are subsequently distributed to employees. Share distributions may be based on individual subscriptions or financed by company profits. Trust ownership provides the basis for employee participation in profits and corporate governance. An alternative form of ownership dispenses with the trust model: instead employees own shares directly, which they typically acquire by subscription. A variant of this model mimics the co-operative form by offering single shares to each employees utilising a membership model.

A wave of employee ownership conversions took place in the late 1980s and early 1990s, often using an ESOP-type structure (see Pendleton 2001). Most of these were short-lived and there was a lull in new conversions later in the 1990s. Conversions to employee ownership picked-up in the early 2000s, with the pace escalating from 2010. New legislation in 2014 has further stimulated interest in employee ownership and has led to an increase in the number of companies becoming employee-owned. There are now about four times as many employee-owned firms as in the late 1980s.

As will be discussed later, there are a variety of contexts for ownership conversion. A sizeable proportion of employee-owned firms convert when an owner wishes to exit ('business succession'), taking advantage of recent legislation to promote this. Others become employee-owned during privatisation. In the 1980s and 1990s a substantial proportion of publicly-owned transport companies became employee-owned: in the twenty-first century health service, central and local government activities have been privatised into employee ownership. Other contexts for employee ownership are start-ups and divestments, and cases where owner-managers want to widen ownership. There are very few cases where employee ownership arises from company distress. In most cases conversion to employee ownership is initiated and implemented by owners and managers rather than employees.

The survey concentrates on British employee-owned firms, where employee ownership is defined as a minimum of 25 per cent of the company broadly held, either directly or indirectly, by 70 per cent of more of the employees, with the balance held by senior managers. However, the typical employee component of ownership is much higher than this, and a large proportion are 100 per cent employee-owned. In addition, to these firms there is a periphery of firms with employee ownership of between 10 and 24.99 per cent, much higher than the typical levels of worker share ownership in large stock-market listed companies with employee share ownership or financial participation schemes. There are also worker co-operatives, most of whom have just a handful of employees. Currently, the number of active co-operatives is not known but is unlikely to number more than 2-300. Overall, our estimate is that the employee-owned sector accounts for around 1 per cent of employment in Britain.

Why did these new forms develop, and what explains the subsequent patterns of growth in employee ownership conversions? We argue that there are several contextual factors that have increased the relevance of employee ownership. More decisive, however, in accounting for short-term fluctuations in employee ownership conversions is governmental action, though the increasing interest of governments in employee ownership can be attributed to the broader economic and social context.

Contextual factors favouring employee ownership

Several long-run developments provide a favourable context for the development of employee ownership. One is the shift from manufacturing to services in advanced industrial economies. This has favoured the development of firms that are rich in human capital and less dependent on physical assets for the generation of value. Firms that are dependent on human capital clearly need to attract, retain, and develop high quality human resources to achieve competitive advantage (Rousseau and Shperling 2003). As value generation by the firm resides in employee skills and knowledge, it is appropriate to provide employees with rights to control and to the returns to human capital. It is notable that employee ownership is spreading fast amongst ‘human capital’ firms providing business consultancy, architecture, and engineering design services, with some world-leading firms such as Arup owned by or on behalf of their employees.

A second development is increasing economic and employment insecurity. Globalisation, competition, and deregulation have made it increasingly difficult for firms to offer the implicit guarantees of long-term employment, career progression, and social benefits that became common in large firms post-Second World War. But how can firms achieve employee commitment, especially when they are increasingly dependent on human capital, when they can commit less in terms of careers and job security in return? Margaret Blair (1995) has argued that employee ownership provides a means to break out of this 'hold-up' situation by giving employees control and return rights commensurate with those of other shareholders (see Pendleton and Robinson 2011). The adoption of employee ownership in the American airline industry and the British bus industry in the 1980s and 1990s can be viewed as a way of securing employee support for changes to traditional wage and employment structures in response to increased competition, deregulation, and new entry (Gordon 2000)

Finally, the financial crisis of 2007-8 and its aftermath have heightened interest in alternative forms of corporate organisation. It has been argued that the dominant forms of corporate ownership and organisation, most notably public limited companies (PLCs), tend to be characterised by short-termism and limited engagement by owners (Ownership Commission 2012). Employee ownership can ameliorate both problems. It can also reduce inequalities by passing greater control to workers, as argued in the influential book on inequality *The Spirit Level* (Wilkinson and Pickett 2010). However, very few firms become employee-owned as a result of economic distress.

Government action and policy development

Developments in government policy towards employee ownership have had a major influence on the growth of employee ownership. There are two elements to this: regulatory initiatives and privatisation

i) Regulatory and legislative initiatives.

Regulatory initiatives comprise the establishment of legal identities for share plans and the provision of tax concessions. Since the late 1970s successive UK governments 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 employees.

Recently, a series of initiatives by the 2010-2015 Conservative-Liberal coalition has given a major filip to employee ownership. Drawing on a major review of employee ownership by employee ownership expert Graeme Nuttall, a series of measures were implemented in 2014 to encourage trust-based employee ownership (Nuttall 2012). Owners selling 50 per cent or more of their company to an Employee Ownership Trust (EOT) were exempted from capital gains tax on the growth in value, whilst firms with at least 50 per cent ownership by a trust became able to award profit shares to employees that are exempt from income tax up to a value of £3,600 each year. These changes have stimulated wider interest in employee ownership, and there has been a wave of conversions using the EOT form. Some existing employee-owned firms have changed their ownership structure to incorporate an EOT.

These kinds of initiatives provide incentives and signals to firms and their owners to convert to employee ownership. The justification for them is that they counter-balance obstacles to employee ownership, such as the expense of establishing trust structures (where used), a lack of awareness and knowledge of employee ownership amongst professional advisors such as lawyers and accountants, as well as amongst business owners, and a perceived unwillingness of financial institutions to provide support for employee ownership conversions (see All Party Parliamentary Group on Employee Ownership 2008).

ii) Privatisation

Privatisation is the other main government activity that has stimulated employee ownership. Waves of employee ownership conversions correspond with privatisation programmes in Britain. Two main phases can be discerned: the first is the privatisation programme of the Thatcher-Major Governments in the 1980s and first half of the 1990s; and the second is the current privatisation programme mainly implemented by the Conservative-Liberal Coalition Government from 2010-2015 but initiated by the Labour Government preceding it.

In the first phase of privatisation, notable conversions to employee ownership included the National Freight Consortium, and many state and local authority-owned bus passenger companies in England and Scotland. At its peak, most of the major bus operators in most of the largest English and Scottish cities were employee-owned. Privatisation into employee ownership was encouraged by governmental offers of preferential pricing. Whilst many local authorities were ideologically opposed to privatisation, they viewed employee ownership as preferable to acquisition by companies based elsewhere with consequent loss of local control of bus services. Although national trade unions were generally hostile to privatisation, local union organisations often preferred employee ownership to acquisition by new entrants to the bus industry with reputations for changing wage and employment structures. However, none of these bus companies survive as employee-owned entities, and employee ownership appears to have been a transitional stage in the re-concentration of the industry (see Pendleton 2001: 193-195).

The second phase of privatisation has involved the divestment of local authority, national government, and National Health Service activities into 'public service mutuals'. This is a continuation of contracting-out measures initiated in the first phase of privatisation. Divestments from the Health Service were introduced by the 2005-2010 Labour Government whereby primary care trust staff were given the 'right to request' the formation of social enterprises to deliver community health services (see Ellis and Ham 2009). The Coalition Government continued this policy with its 'right to provide' policy for NHS trusts and adult social care. Support has also been given for the creation of public service 'spin-outs' from national and local government services by the Mutuals Support Programme.

By mid-2014 100 'mutuals' had been 'spun-out'. Examples include children's social care, youth services, and libraries, as well as healthcare. Some members of the government have been ardent advocates of the mutual form as a way of empowering workforces and improving services, but others have probably viewed employee ownership as a relatively less contentious means of privatising services, especially in the politically sensitive health service.

The support for employee ownership by the 2010-2015 Conservative-Liberal Coalition was unprecedented in Britain. It is perhaps best explained by competition between the two government parties (cf. Carter and Jacobs 2013), with the Liberal Party in particular keen to introduce policies that would give it a distinct identity within a government in which it was a minority member. Policy experts, lobbyists, and 'flagship' employee-owned firms, aided by ‘policy entrepreneurs’ in the employee ownership community, were able to exploit this competition to push employee ownership further onto the political agenda (cf. Kingdon 1995).

The Employee Ownership Research Project

Our research aims to identify the size and distribution of the employee ownership sector in Britain. Within firms we aim to identify the ownership and governance characteristics of employee-owned firms, and to identify the nature and causes of variation between employee-owned firms. To collect data on employee-owned firms, we have conducted a series of internet-based searches from 2014 using keywords such as ‘employee ownership’. Other sources of information included the employee ownership sector and their representative bodies, alongside employee ownership advisors and experts. This generated a substantial pool of firms describing themselves as ‘employee-owned’. To screen this initial sample we conducted further intensive web investigations of each company supplemented by scrutiny of company ownership information held at Companies House.

After removing firms that clearly did not meet our definition of employee ownership, we were left with a pool of around 350 firms that were possibly employee-owned. These companies were sent a screening letter to establish whether they had broad-based employee ownership and to invite them to complete an in-depth company survey. Those who responded in the affirmative to both questions were sent a link to a web-based survey. This questionnaire asked a series of questions about ownership structure, governance, and market context. Around 200 firms offered to complete the survey, of which 180 actually did so. After elimination of some double entries and those firms which on closer scrutiny did not meet our criteria for employee ownership (and a couple of firms which had ceased trading during the survey period), we were left with a final useable group of 162 companies representing well over a half of employ-owned companies in Britain. This is the largest study of employee ownership yet conducted in Britain.

We draw on our survey data to provide a profile of employee ownership in Britain in the next section.

Forms of employee ownership in Britain

In the analysis that follows we provide an outline of the main characteristics of the employee sector, based on our survey data, before exploring the variations in employee ownership in more depth. Initially, we distinguish between indirect or trust-based employee ownership, direct ownership, a membership-based version of direct ownership, and a hybrid model that combines indirect and direct ownership.

Table 1 provides details of the distribution of the main ownership types in our sample. 72 per cent of the sample have an Employee Benefit or Employee Ownership Trust, whilst 55 per cent have direct ownership of some form. 27 per cent combine both forms of ownership, leaving 45 per cent using a trust alone and 28 per cent using direct ownership exclusively. 90 per cent of those companies using a trust envisage that at least some of the equity will be held permanently in trust.

Although we set the definition for employee ownership at 25 per cent of total ownership, the average level of employee ownership is much higher than this in all forms of employee ownership (and the median is 100 per cent except in companies with a hybrid of direct and indirect ownership.

Table 1 The main structures of employee ownership

Percentages of respondent companies

	Employee trust is present	**Employee trust only**	**Direct ownership is present**	**Direct ownership only**	**Hybrid of trust ownership and direct ownership**
Proportion of total sample (%)	72	45	55	28	27
Mean ownership (median) %	82 (100)	86 (100)	84 (100)	93 (100)	75 (75)

N = 162

Table 2 shows the date of conversion to employee ownership amongst the companies in our sample. The figures suggest a steep rise in conversions especially since 2010. Of course, care must be taken in interpreting these figures because they do not take account of attrition (conversions away from employee ownership and company liquidations) in earlier years. Nevertheless, the rise is genuine in that the typical level of attrition we have observed is typically under 5 companies per year. There was a big rise in conversions in the late 1980s and early 1990s but in total these did not number more than 60 (see Pendleton 2001). Overall, the steep rise in conversions since 2010 can be attributed to government legislation and promotion (as can the earlier conversions in the 1980s/1990s). Over half of the conversions occurring since 2010 took place in 2014 and after.

Table 2 Dates of conversion to employee ownership

Percentage of respondent companies

Date of ownership conversion	Proportion of respondent companies (%)
1950s	2.5
1960s	1.3
1970s	3.7
1980s	5.6
1990s	9.4
2000s	18.8
2010 to date	58.7

N = 160

The sectoral distribution of employee ownership is of interest because this provides an indication of the appeal of employee ownership to various types of firm, bearing in mind that these figures are not adjusted for the role of each sector in the economy. We noted earlier that the shift from physical to human capital-based production in advanced economies could stimulate employee ownership, and the figures in Table 3 are consistent with this. The largest single group of employee-owned firms can be found in the Professional, technical, and scientific sector: a third of our respondents are found in this sector alone. Activities in this sector include engineering and design consultancies, architects, and management consultancies. When other similar activities are included such as information and communications, real estate, and finance and insurance, it can be seen that over 50 per cent of employee-owned companies are in activities where the mode of production is primarily human-capital based. Other substantial areas of activity include manufacturing. The role of privatisation is shown by the proportion of employee-owned firms that are found in education, health and social work, and public administration – all typically public sector activities in the past. Finally, it is notable that there are none of the employee-owned companies in our sample are in the transport sector: in the earlier phase of employee ownership in the 1980s and 1990s most conversions were local transport companies.

Table 3 Sectoral distribution of employee-owned companies between business sectors

Percentage of responding companies

Business Sector (SIC categories)	**Proportion of sample (%)**
Mining and quarrying	1
Electricity and gas	1
Manufacturing	19
Construction	5
Wholesale and retail	6
Transport and storage	0
Hotels and restaurants	1
Information and communications	7
Real estate	2
Financial and insurance	7
Professional, technical, and scientific	33
Administration and support activities	3
Public administration	1
Education	4
Health and social services	11
Arts, entertainment, and recreation	1

N = 156

The nature of the employee ownership sector

Closer scrutiny of the sample indicates that there are four main contexts in which employee ownership is typically created: business succession, privatisation, sharing ownership, and start-ups. The proportions of each type, along with key ownership and governance characteristics, are shown in Table 4.

As Table 4 shows, business succession is the most common context for employee ownership, followed by 'sharing ownership'. Start-ups and privatisation cases are similar proportions of the sample. The table excludes a very small mixed category, mainly comprising cases of firms that have been divested from larger firms. There are just two cases of rescues. Levels of employee ownership are similar between the four main categories but there are greater differences in governance characteristics. In terms of median size privatisation firms are the largest with 650 employees. There is not much difference between the other groups of firms, with the median ranging between 30 and 52. However, the sharing ownership group has a high mean because of the presence of a small number of very large consultancy firms within this group.

Table 4 **Employee ownership: ownership characteristics of employee-owned firms**

Percentage of firms in each category

	Business succession	***Privatisation***	***Sharing ownership***	***Start-ups***
Proportion in the total sample (%)	39	13	28	16
Average level of employee ownership (%) (median)	85 (100)	87 (100)	81 (100)	93 (100)
Proportion using indirect employee ownership i.e. a trust	95	14	82	36
Proportion using direct employee ownership	63	86	52	80
Proportion of group in manufacturing (%)	26	0	20	12
Proportion of group in human capital-rich production (%)	57	11	51	64
Mean number of employees (n) (median)	166 (52)	1022 (650)	2999 (49)	96 (30)

N = 159

Business succession

Employee ownership of this sort arises when business owners want to exit the business but do not want to sell the company to a competitor or to pass the company to a family member. Employee ownership is a way of protecting the company and the interests of the company's workforce as the owner exits. There has been a steady expansion of these cases in recent years: whereas they accounted for 16 per cent of the population of employee-owned firms in the late 1990s they are now more than double this at 39 per cent.

Ownership conversion in these cases is nearly always instigated by the business owner, and employees often have little direct involvement in the conversion. In nearly all cases (95 per cent) the owner sells the ownership share to a trust but there are cases where owners gift the company and in some instances owners either defer the payment or provide a loan to the trust to purchase the shares off them. In others, the trust secures an external loan to purchase shares from the owner, backed by future income streams. The advantage of a trust in these circumstances is that lack of worker expertise, and employee wealth and liquidity constraints, do not prevent the conversion from taking place. Owner instigation of the conversion also sidesteps the coordination problem that would arise if workers themselves were to organise the buy-out.

Privatisation

Privatisation was an important backdrop to many conversions to employee ownership in the late 1980s/early 1990s, accounting for over 50 per cent of conversions at the time. It then declined in importance until very recently. The Conservative-Liberal Coalition Government of 2010-2015 reinvigorated privatisation, primarily by spinning-off parts of public services out of the private sector.

Although the mean level of employee ownership is very similar, public service 'spin-outs' differ from business succession conversions in several ways. Because many of these organisations provide public services at nil cost to the service user, they have typically registered as either Community Benefit Societies or Community Interest Companies (CICs). In the health service spin-outs, ownership is usually offered directly to the workforces, typically in the form of £1 shares. Subscription by employees, along with users, gives them membership rights. The typical subscription level within these organisations is around 80 per cent of the workforce.

Unlike business succession and sharing ownership conversions, these conversions are typically instigated by managers and employees, often with substantial trade union involvement. As a result, there tends to be extensive employee involvement in governance. As might be anticipated, given the public sector background, collective bargaining over pay and conditions is widespread in this group (whilst near absent in the other types of employee-owned firm).

Sharing ownership

The sharing ownership group is comprised of cases where, prior to employee ownership, the company is typically owned by a group of owner-managers, not necessarily linked by family ties, serving as company directors. Unlike many business succession cases, owner-managers typically continue to work in the firm though the conversion may form part of a longer-term succession plan. The average level of employee ownership (81 per cent) is slightly lower than in other types of employee-owned company.

Start-ups

In the past, employee ownership does not seem to have been that well-suited to business start-ups. There have been significant barriers to the supply of capital and the assumption of risk by employees, except in the case of the smallest companies. For this reason, there were no business start-ups in our survey of employee-owned companies in the late 1990s. However, with the continuing shift to services, and the importance of human capital in some service industries (such as business consulting) these barriers to employee ownership are much less significant. Employee ownership can be a form of ‘glue’ that links together members of an otherwise fairly loose network of consultants or creative employees. 64 per cent of companies in this group are human capital-rich firms, higher than any of the other groups. However, as in the other types of firm, the average level of employee ownership is high (93 per cent).

Several features flow from these circumstances of employee ownership creation. One, ownership tends to take the form of direct ownership: employees may be required to subscribe to shares to supply working capital and to show their commitment to the emergent organisation. There is a trust in 36 per cent of cases but these hold on average lower levels of equity than business succession and sharing conversions. The value of EOTs and EBTs as instruments of conversion are less relevant to recent start-ups, though they may become more so as these firms develop.

Conclusions

This chapter has reviewed the development of employee ownership in Britain. The role of political support for employee ownership emerges as critical to the development of employee ownership, with the extent of conversion activity broadly correlating with levels of policy activity and innovation. The current level of support for employee ownership is unprecedented, and this is reflected in a vibrant and growing employee ownership sector. This review has also highlighted the variety of ownership forms and contexts within the employee ownership sector. Our current research suggests there are distinct constellations of employee-owned firms, created in distinct sets of circumstances. The findings provide a detailed portrait of the growing employee-owned sector: as the research develops further we hope to portray in greater depth the richness of employee ownership in Britain today.

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