Employee Ownership Wales

Guide to **Share Ownership** within an Employee Owned Company

www.employeeownershipwales.co.uk

Contents **Page**

Published by the Wales Co-operative Centre, 20 December 2012

Copies of this guide are available from www.walescooperative.org

Also available in Welsh.

Also available in large print format.

1. The role of shares in an employee owned share based company

A large number of employee owned companies operate a structure whereby their employees are also direct shareholders in the business and beneficiaries of a trust that may also hold shares in the company on behalf of all employees.

This guide aims to provide a practical overview of shares in a private limited company to help employee owners understand the general role of shares and some of their rights as an individual shareholder.

2. What are Shares?

When a company is formed the founders will typically invest a sum of money to start the business and provide it with money to fund its operations. The money invested at this time is referred to as the capital of the company.

Simply put a share is part ownership of a business. This part ownership entitles the owner to a share of the profits assuming the company is profitable, or a chance to have a say on important decisions relating to the company such as appointing which directors sit on the Board. This part ownership could also be sold to someone else for a higher amount than originally paid assuming that the company has been more profitable since the share was originally owned.

A single individual, a group of family members, or indeed hundreds and thousands of different people might own the issued shares of a particular company.

People who own shares are normally referred to as shareholders or members of the company.

3. Why would people want to own shares?

People normally decide to buy shares for two reasons: (1) in the expectation that the value of those shares will increase over a medium to long period of time; (2) in the expectation that the company will make sufficient yearly profits to be able to pay dividends to shareholders.

In an employee owned setting employees might decide to buy shares for the purposes above, but also in order to have a right to have a say on important matters relating to what the business does and how it does it.

4. Who owns shares in employee owned companies?

In an established employee owned company it is likely that all of the issued shares of the company will be owned by one or a mix of employees, employee benefit trust, or share incentive plan.

Where an employee buyout is likely to take place the existing owner(s) agree to sell all of their shares to one or a mix of employees, employee benefit trust, or share incentive plan. This transfer of ownership might take place over a protracted period of time if the value of shares being bought is too high to fund as a one off purchase.

Having all of the shares of a company owned by the employees, either directly or indirectly through a trust, ensures that all of the profit generated by the employees endeavours and contribution will be theirs rather than distributed to outside investors.

5. What types of shares do companies use?

A commercial share based company must have at least one issued share, but typically they have many issued shares.

There are two types of shares that a company may issue. These are Preference shares and Ordinary (equity) shares and a company may have both types in issue:

- Preference shares – enjoy preferential rights over ordinary shares in relation to dividends and repayment of capital in the event of a winding up of the company. The holders of Preference shares receive a fixed rate of dividend. Preference shares may take one of the following forms:
    - Cumulative Preference share - If a company doesn’t earn an adequate profit in any year, dividends on preference shares may not be paid for that year. If the preference shares are cumulative any unpaid dividends on these shares go on accumulating and become payable out of the profits of the company in subsequent years. Only after such arrears have been paid off can any dividend be paid to the holder of ordinary shares. Thus a cumulative preference shareholder is sure to receive dividends on his shares for all the years out of the earnings of the company.
    - Non-cumulative Preference share – The fixed dividend is paid to these holders before any dividend can be paid to ordinary shareholders. However, if in a particular year there is no profit to distribute among the shareholders the non-cumulative preference shareholders will not get any dividend for that year and they cannot claim it in the next year during which period there might be profits.
    - Redeemable Preference share - Capital raised by issuing shares is not repaid to the shareholders (except through a buy back of shares in certain conditions). However, capital can be raised through the issue of redeemable preference shares. Shareholders invest by way of the redeemable preference share, receiving a fixed dividend rate, knowing that the company will redeem (buys back) these shares after the expiry of a stipulated period.

- Participating or non-participating Preference shares – Preference shares which in addition to paying a specified dividend, entitle preference shareholders to participate in receiving an additional dividend if ordinary shareholders are paid a dividend above a stated amount. Thus participating preference shareholders obtain return on their capital in two forms (i) fixed dividend (ii) share in excess of profits. Preference shares which do not carry the right to share in excess profits are known as non-participating preference shares.

- Ordinary (equity) shares - Ordinary shares will get dividend and repayment of capital after the claims of preference shareholders have been met. There will be no fixed rate of dividend to be paid to the ordinary shareholders and this rate may vary form year to year. This rate of dividend is determined by directors and in case of larger profits, it may even be more than the rate attached to preference shares. Such shareholders may go without any dividend if no profit is made.

It is highly unlikely that employees will hold anything other than Ordinary shares within an employee ownership setting. However, it is possible that financial institutions may have taken preference shares in return for finance to allow an employee buyout to proceed.

6. How else might shares differ?

Companies can issue different classes of shares which have different rights attached to them. This allows the company to benefit shareholders in different ways and achieve different aims. For instance a company could issue:

- 'A' ordinary shares with the rights to receive dividends, vote at general meetings, appreciate in value, and all other benefits associated with shares.
- 'B' ordinary shares with the rights to receive dividends, appreciate in value, but with no voting rights meaning that the shareholder couldn't vote at a general or extraordinary meeting of the members. In this instance the shareholder can benefit from the financial reward of being a shareholder, but has no control or say in how the business might be run.
- 'C' ordinary shares with the rights to receive dividends and vote at a general and extraordinary meeting, but no right to appreciate in value and must be redeemed at par if an employee leaves the company. A company might create such a class of shares so that employees can benefit from dividends and have a say in the business whilst they are employed, but as soon as they leave they have to sell the share for the amount they paid for it.
- 'A' Special Redeemable Preference share that doesn't attract a dividend and is redeemed at par, but entitles the holder to hold 26% of the vote on any matters that require a special resolution at a general or extraordinary meeting of the members.

The description of share classes above are purely to provide an example and your company could have A, B, C, or special shares with completely different rights attached to them.

An employee should refer to the company's Articles of Association in order to understand what rights are attached to a specific class of share.

7. How are shares controlled?

The Companies Act 2006 provides numerous protections for shareholders, but the Articles of Association are the first place to look for information about the rights of a particular company's shares.

Every company, whether they realise it or not, has 'Articles of Association' or 'Mem and Arts'. These are simply the basic internal rules of operation for a business that govern what tasks need to be done, what positions are required to perform the necessary functions, and how the processes in place are to be performed.

Often, articles of association deal with such operating issues as the calling of general meetings, the process for appointing and removing directors, the issuing of shares, transferring shares between shareholders, paying dividends to classes of shares and voting mechanism at general meetings.

As an employee the articles of association will contain important information relating to the process for buying and selling their shares, the method used to value the shares, the rights attaching to classes of shares, what voting rights they have and how they appoint or remove directors.

8. Does being a shareholder mean I get to vote on what the business does?

As a shareholder you have a right to attend general meetings and vote on any resolutions that are put to the members to be decided. However, being a shareholder doesn't mean that you will be involved in every strategic or operational decision the business will take. You are able to affect this by being able to vote on whether to appoint, re-appoint, or remove the Directors who are tasked with running the business for the benefit of members.

The types of resolution voted on at general meetings might include:

- Appointing and removing directors;
- Approving a joint venture;
- Approving capital expenditure over a certain monetary value;
- Approving changes to the company's Articles of Association;
- Approving the creation of a subsidiary;
- Approving the sale of a subsidiary or part of the business.

9. Do more shares ensure bigger dividends and a bigger voice?

Yes and no. In terms of dividends it is important to remember that any preference shareholders will need to be paid first. Assuming they have been paid Ordinary shareholders will then receive a dividend per share and as such more shares will mean more dividends.

Owning more shares than other shareholders might enable you to have more influence over the decisions a company makes, but this isn't always the case. A number of employee owned companies operate under a '1 person 1 vote' system. In effect this means that all members have an equal vote on resolutions that are to be determined at a general meeting regardless of how many shares an individual might own.

10. Do I automatically get a vote as a shareholder?

Not necessarily. It is possible for companies to issue 'non-voting' shares. This means that whilst the shares may attract a dividend and may go up or down in value the share doesn't entitle the holder to vote at general or extraordinary meetings of the member. The company's Articles of Association will detail what rights are attached to a specific class of shares.

It is also possible that when an employee leaves the business he or she becomes a 'restricted member' and is unable to attend or vote at a meeting of the company. The Articles of Association will contain any such rule.

11. How are my shares valued?

The method of valuing shares varies between companies. Some companies will set out a specific valuation method in their Articles of Association, whereas other companies will instead state that the fair value of shares is to be determined by the company's accountant or auditors.

If shares have been purchased by an employee through a Share Incentive Plan the value of the shares must be agreed by the Share and Asset Valuation department of HMRC.

12. What happens if I want to sell my shares?

The process for selling shares will vary from company to company and will be detailed in the company's Articles of Association. Most employee owned companies will stipulate that when an employee leaves he or she must offer to sell their entire shareholding to an employee benefit trust, another employee, or the company.

In a situation where an employee leaves the company there may be a process whereby the company funds the trustees of the EBT or SIP to buy the leavers shares at the time of leaving. However, it is also quite possible that the company may not be able or willing to fund the trustees and therefore the leaving employee might be forced to wait for the next dealing day.

Employee owned companies tend to operate an annual dealing day with the intention of matching people wanting to sell shares and people wanting to buy shares. Such a dealing day allows the shares to be offered to other employees for sale and the specific processes should be documented and available to shareholders.

It is quite possible that an employee may not be able to sell his or her shares. The company will not be under an obligation to buy ordinary shares, or 'gift' funds to an EBT or SIP to purchase the shares.

13. Further Information

This guide has been produced by Social Business Wales, which is funded by the European Regional Development Fund through Welsh Government and is delivered by the Wales Co-operative Centre.

Wales Co-operative Centre
Y Borth
13 Beddau Way
Caerphilly
CF83 2AX

Tel: 0300 111 5050
Email: info@wales.coop

The Wales Co-operative Development and Training Centre Limited (trading as the Wales Co-operative Centre) is a registered society under the Co-operative and Community Benefit Societies Act 2014, number 24287 R.

This publication is available in Welsh. Other formats, such as large print or braille, are available on request.

We welcome correspondence in English or Welsh and aim to provide an equal standard of service in both languages.