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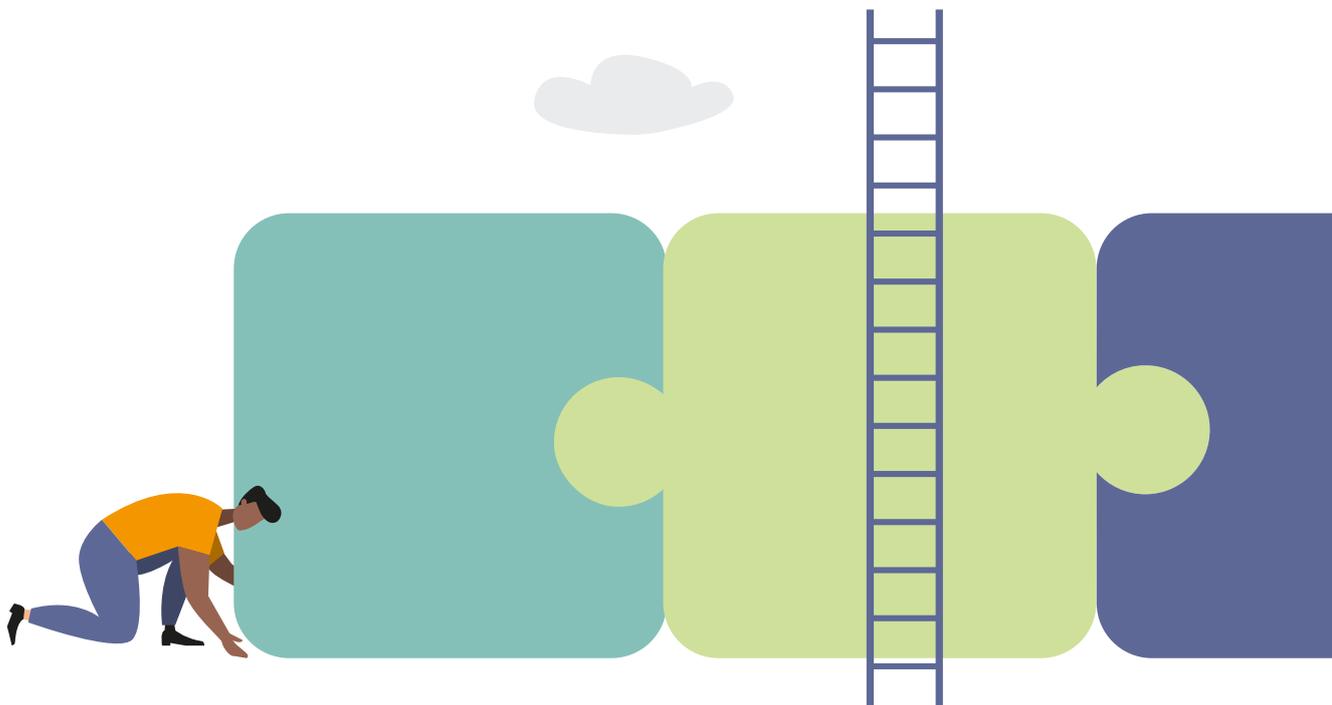
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What next for Employee Ownership policy in Wales?

Introduction

There is strong evidence that transitioning to employee ownership, which is when a business is totally or significantly owned by its employees, can be hugely beneficial to business owners, employees, the economy, and our communities. According to the Employee Ownership Association, co-owned companies tend to be more successful, competitive, profitable and sustainable. In Wales, we already have many examples of employee-owned businesses that are leading the way, across the country and across different sectors.

In this document, we want to look at what Wales needs to do to promote this form of business ownership, and how we can double the number of employee-owned businesses in the country. The White Rose

Centre's 2019 Survey of Employee Ownership in the UK showed that Wales had a relatively low number of employee-owned businesses compared to Scotland. This suggests that there is considerable potential for this sector to grow in Wales.

By looking at examples of best practice in other countries, showcasing the case studies of employee-owned businesses in Wales, and looking at the economic and policy context, this document sets out clear policy recommendations for the next Welsh Government. But this objective will require a joint-effort from the Government, the business community and the wider public, and we look forward to this conversation being started in a co-operative spirit.



What is Employee Ownership?

Employee ownership is where a business is totally or significantly owned by its employees.

With research showing that employee-owned businesses are stronger performing than other SMEs, employee ownership is also becoming increasingly popular with entrepreneurs creating new businesses, to help attract and reward talented employees and drive business growth.

Being an owner does not make every employee a manager: like any successful company, one owned by employees still needs a professional and effective management team. But its managers are far more likely to be supported by staff who are committed to their company's success because they have an ownership stake in it.

Employee ownership can take a number of forms:

Direct Employee Ownership

Using one or more tax advantaged Employee Share Schemes, employees become registered individual shareholders of a majority of the shares in their company.

Indirect Employee Ownership

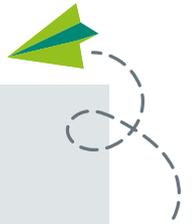
Shares are held collectively on behalf of employees, normally through an Employee Ownership Trust.

Combined Direct and Indirect Ownership

A combination of individual and collective share ownership.

A Management Buyout

A Management Buyout is a purchase by employees but not an all-employee approach.



What are the benefits of Employee Ownership?

Independent research has found that the benefits of employee ownership are multi-faceted.

In 2018, the Ownership Effect Inquiry chaired by Baroness Bowles produced a report titled *The Ownership Dividend: The Economic Case for Employee Ownership*, which found that there was an economic dividend to employee ownership that pays off at three levels; for workers, businesses, and the wider economy.

Workers

At the individual worker level, they found that:

“By aligning the interests of owners, managers and workers, employee-owned businesses (EOBs) unite people behind a shared goal and ensure that employees can:

- *Enjoy higher engagement, motivation and wellbeing*
- *Top up their salaries by sharing in the capital value they create*
- *Work within transparent governance regimes that lock in benefits for the long-term”*

Businesses

The Inquiry spoke to another 100 employee-owned businesses and found an irrefutable consistency in outcomes reported, including that they:

- *Typically achieve greater levels of productivity and efficiency than non-EOBs*

- *Have stronger workforce retention/find it easier to recruit*
- *Encourage employees at every level to drive innovation*
- *Approach decision-making and planning based on long-term stewardship of value, which enables resilience (data shows that EOBs are more sustainable during economic downturns)*

Wider economy

The Inquiry also found that employee-owned businesses make a vital contribution to the wider economy, specifically at a local and regional level, making them essential to a place-based approach to economic development. They found that:

“EO has ever more important, positive impacts on local and regional economies: the values, outlooks and approaches of EOBs ensure that they are more likely to create and retain jobs that are rooted to local areas, and less likely to relocate or create offshore jobs. As a result, EOBs directly drive economic resilience at a regional level. Capital distributed to staff in the form of dividends is often spent or invested locally, and the majority of EOBs make explicit commitments to contribute directly to their local communities.”

Wales, as a part of the United Kingdom with one of the weakest economies in terms of traditional measurements like GVA per capita, stands to gain significantly from an increased number of employee-owned businesses strengthening its economic resilience. Rooting companies in Wales through growing employee ownership would also go some way towards solving the problem of Welsh businesses closing or relocating jobs.

It is also important to note the positive impact that employee ownership has for equality, both in terms of the economy and decision-making. In the United Kingdom, the top 10% of the country has almost 70% of its financial wealth – an unacceptable disparity, especially given the high levels of poverty in Wales. Promoting worker and citizen-engagement through employee ownership has the potential to create a fairer and more equitable society – an objective that has become even more important during the Covid-19 pandemic and the associated economic and humanitarian crisis.

Owners

A fourth, and crucial, benefit to employee ownership is the benefit to business owners themselves. Employee ownership can be particularly attractive if you are:

- Looking to retire from a business you own.
- Looking to retire from a family business and other family members are not interested.

- Starting a new business and want to attract top talent.
- Keen to give your employees a stake in the business to ensure long-term growth.
- Wanting to ensure your business can stay independent long-term.

On the Employee Ownership Wales website, the benefits of EO for owners and start-ups are made clear:

Exiting owners

“You’ve built up your business and have a great team, but it’s now time to move on. Selling to a competitor or getting bought out by the highest bidder can be unpalatable and might mean saying goodbye to your brand, seeing your workforce dismantled or product line changed. Selling to your employees benefits both you, and them. They know your business best. They don’t need the funds upfront; you can be bought out against future profitability to a schedule that suits you, including blending this with some immediate borrowing or using surplus cash so your short-term needs are met as well as having long-term security. By selling to your employees, you can also negotiate your future involvement. Be an adviser, be on the board, pop in for a cup of tea every Friday or say goodbye altogether.”

From employeeownershipwales.co.uk

For business owners, four of the key benefits of employee ownership as a succession plan are:



Start-ups

“Many dynamic start-ups are choosing this model because it cements an engaged culture from the off and gives them a competitive edge in attracting and retaining talented employees. Businesses in need of a boost can look to employee ownership as a way to galvanise and refocus. And not-for-profit organisations and charities can use employee ownership to make their team feel more valued and give employees a voice.”

From employeeownershipwales.co.uk

The Welsh context

Employee Ownership in the UK and in Wales

As mentioned in the introduction, Wales has many examples of employee-owned businesses that are making a positive difference to their communities, employees, and wider economy. With the support of the Social Business Wales service, more and more businesses are considering employee ownership as an option.

Research from the White Rose Employee Ownership Centre found that up to June 2019, there were 368 employee-owned businesses in the United Kingdom. This number had been increasing year on year, with over 60% of these businesses having become employee-owned in the previous five years. The graphic below shows the wide variety of sectors with employee-owned businesses in 2019, with most populous sectors including manufacturing, wholesale and retail, and health and social care.

Sectoral Distribution of Employee-Owned Business in the UK, 2019

Graph taken from White Rose Employee Ownership Centre



The report also displays the variation in the number and proportion of employee-owned businesses in the regions and nations across the United Kingdom in 2019. Areas with the highest percentage of employee-owned businesses are in economically prosperous areas such as London and the South East of England, although Scotland also has a high number. Wales, on the other hand, along with regions of England that are less-economically prosperous such as the North East and the East Midlands, have the lowest proportion of employee-owned businesses.

This means that there is a lot of potential for growth for the employee-owned sector in Wales. In order to see Wales move up the table and become one of the best places to become an employee-owned business in the UK, we need to understand what the barriers to transition are, what support is available, and what the Welsh Government can do to intervene and boost this crucial sector of the economy.

What is Wales doing well?

Despite Wales having a lower proportion of employee-owned enterprises than some other parts of the UK, there is reason to be confident about the performance and potential of the sector. The number of employee-owned businesses is growing, and high profile firms such as Cwmni Da and Tregroes Waffles are calling for more of their fellow Welsh businesses to take the step towards employee ownership.

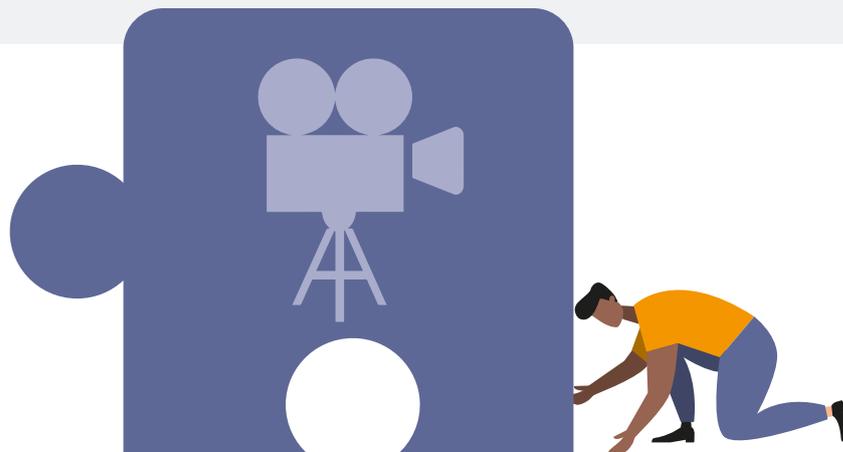
The Wales Co-operative Centre employs specialist business transition advisors that focus on employee ownership and employee share schemes. Their work is part of the Social Business Wales service, funded by the European Regional Development Fund through Welsh Government. This means that the cost of specialist advice is fully covered, offering businesses free guidance and support every step of the way.

Over 50 Welsh companies have received advice about ownership transition from the Wales Co-operative Centre, which completed its first assignment in 1994 with the £9million purchase of Tower Colliery by its employees. Since then many businesses have been helped to make the transition to employee ownership including engineering companies, health firms, retail businesses, film and TV companies, architecture firms, IT organisations and print companies. The specialist business advisors provide several services to businesses considering transitioning to employee ownership, including business evaluation, staff and board engagement, valuation, leadership development, financial advice, tax advice, and ongoing advice.

Case studies

Cwmni Da

- Award-winning TV company based in Caernarfon, employing 50, with a £5 million turnover. Cwmni Da is known for making factual, drama and children's programmes, primarily Welsh-language.
- Transitioned to employee ownership in 2018 with the support of Social Business Wales.
- The process saw the company valued, funds raised from banks to buy the shares, and 100 percent of the shares were transferred into an Employee Ownership Trust.
- The shareholding is held in the Trust on behalf of the workforce. The Trust is overseen by a Corporate Trustee and a board which includes a solicitor, accountant, the Managing Director, and a staff member. The Trust looks after the interests of the employees and decides annually how much is re-invested and how much is paid to staff.
- Smooth business succession, keeping the company locally-rooted, workforce empowerment, buy-in and engagement, and the ability to manage ongoing culture change were the key incentives to EO for the Managing Director.
- A profit share at the end of the year, and the possibility of a tax-free lump sum of up to £3,600 for employee shareholders has been a major plus for staff.
- Learnings: a successful transition relies upon a strong team, expert external advisors, open and honest communication between the company hierarchies and a realistic timetable.



Tregroes Waffles

- Tregroes Waffles is a small, family run bakery based in the Teifi Valley in South-West Wales. It started life in 1983 when Kees Huysmans came to Wales and set up a market stall selling his version of traditional Dutch stroop.
- Recruiting locally, the business employs 15 people and remains strongly embedded in the community – a local institution.
- The owner began to explore the concept of employee ownership about five years before the transition started, inspired by the John Lewis Partnership model.
- In 2016, Kees sold 10% of his shares to the Trust using company profits to pay for them. As part of the agreement, the owner will sell a further 10% to the Trust each year provided the company is able to pay for them.
- The employee ownership model has enabled Tregroes Waffles to maintain and build upon its success in the area.
- Benefits: smooth business succession, keeping the company locally-rooted, workforce empowerment, buy-in and engagement, and the ability to manage ongoing culture change.
- Learnings: a successful transition relies upon careful planning, a strong team, expert external advisors, and a realistic timetable and a shared belief in the ongoing viability and strength of the brand.



What are the barriers to growing Employee Ownership?

The 2012 Nuttall Review into the barriers to employee ownership in the UK, launched by the UK Government, found several obstacles to developing the sector. Many of the Review's conclusions are still relevant to the situation in Wales.

Lack of awareness and understanding in the business community

The Review found that:

"... Awareness of employee ownership is extremely low among all involved in business. Lack of awareness was cited repeatedly as a fundamental obstacle."

As well as this lack of awareness, the Review found that there were misconceptions about the definition of the employee-owned model:

- It can be confused with related but different concepts such as social enterprise, not for profit organisations and co-operatives. The Review states that it is best understood as a business model in its own right, which can be effective in achieving growth and profit maximisation.

- Employee share ownership is often associated with executive remuneration rather than being available to all employees. Even when the connection is made to share ownership by all employees this is very much from the point of view of financial participation rather than employee ownership involving employee engagement.
- That employee ownership can detract from profit-making – it is crucial that there is wider understanding that companies could have employee ownership and operate on a not for profit basis, but most are typical commercial businesses.
- Employee ownership means less effective decision making
- That it means a company has to be a worker co-operative
- That employee ownership is not compatible with trades unions

The Review also found that there was also a lack of awareness among business advisors, and a lack of specialist support available for businesses seeking advice on transitioning to an employee ownership model. Clearly in Wales there is a small specialist support team in place and the priority for raising awareness of this team, and Employee Ownership as a whole, is being prioritised.

These cultural barriers to Employee Ownership were also perceived to have caused a problem through difficulties in accessing bank funding because of a lack of awareness of this business model. This was also noted to be the case in academia and education when teaching leadership and business studies, as well as in other professional advice services.

In order to overcome these barriers, Government must step in and take responsibility for the development of awareness of the benefits and potential of Employee Ownership in the business community and for other stakeholders. Employee Ownership must be prioritized and taken to the mainstream of business support and engagement. This will require a continuity of focus, with resources directed specifically to the necessity of raising awareness and inducing the potential demand within the market. This requires Government leadership and facilitation, but showcasing examples of best practice and giving a platform to successful examples of Employee Ownership is crucial.

Financial Barriers to Employee Ownership

The Employee Ownership Association has urged that without incentivised support for entrepreneurs and their employees to pursue co-ownership, few would be willing to take the financial risk of drastically changing their company structures and practices.

The Nuttall Review found that a lack of finance was referenced repeatedly as an obstacle to employee ownership. It said that:

“Employee-Owned Companies are associated more often with debt finance, insofar as the employee owners are reluctant to have their ownership interest diluted by seeking out equity capital.”

It has also been noted that smaller firms seeking to transition to employee ownership can struggle to access traditional lending from banks, as a result of a lack of awareness of this as a business model that was discussed in the previous section. This can also be a problem for employee-owned businesses seeking to expand.



The economic context

Covid-19

It would be impossible to produce a report on an aspect of the Welsh economy without discussing the Covid-19 crisis and the associated economic difficulties that Wales, like much of the world, finds itself in. The lockdown brought much of the Welsh economy to a halt, and the winter of this year will be one of the most challenging any of us can remember.

Evidence of the perilous situation many Welsh businesses found themselves in over the summer is that 20% of Welsh businesses had temporarily closed or paused for trading by the end of May 2020, the highest percentage of any of the UK nations. 65% of Welsh businesses had experienced a decrease in turnover from what they would normally expect at this time of year, similar to the picture across the UK. 23% of businesses reported that their turnover has decreased by more than half. 46% of Welsh businesses had six months or less cash reserves, the highest percentage of the UK nations.

The statistics highlighting the extent of the economic downturn are endless. The Government interventions through the furlough scheme and the Welsh Economic Resilience Fund were essential to the survival of the Welsh economy. The impact of the crisis on specific sectors appeared to put Wales particularly at risk - Wales employs more people in 'shutdown sectors' than many other parts of the UK.

The Learning and Work Institute Cymru showed that Wales has a greater reliance on employment in the 'shutdown sector' than other parts of the UK, and the Centre for Towns found that Wales employs a higher than average percentage of people in these sectors. It found that small coastal towns were the most affected areas in Wales and the UK, particularly impacting Aberystwyth, Porthcawl and Llandudno and other, similar places.

The challenges that our communities face, on top of the pre-existing and long-term problems of persistent poverty and the climate crisis, means that there has been a united call in Welsh policymaking and on the community level for a greater focus on well-being, sustainability and resilience. The potential benefits of employee ownership highlighted in this report are, therefore, even more important than ever.

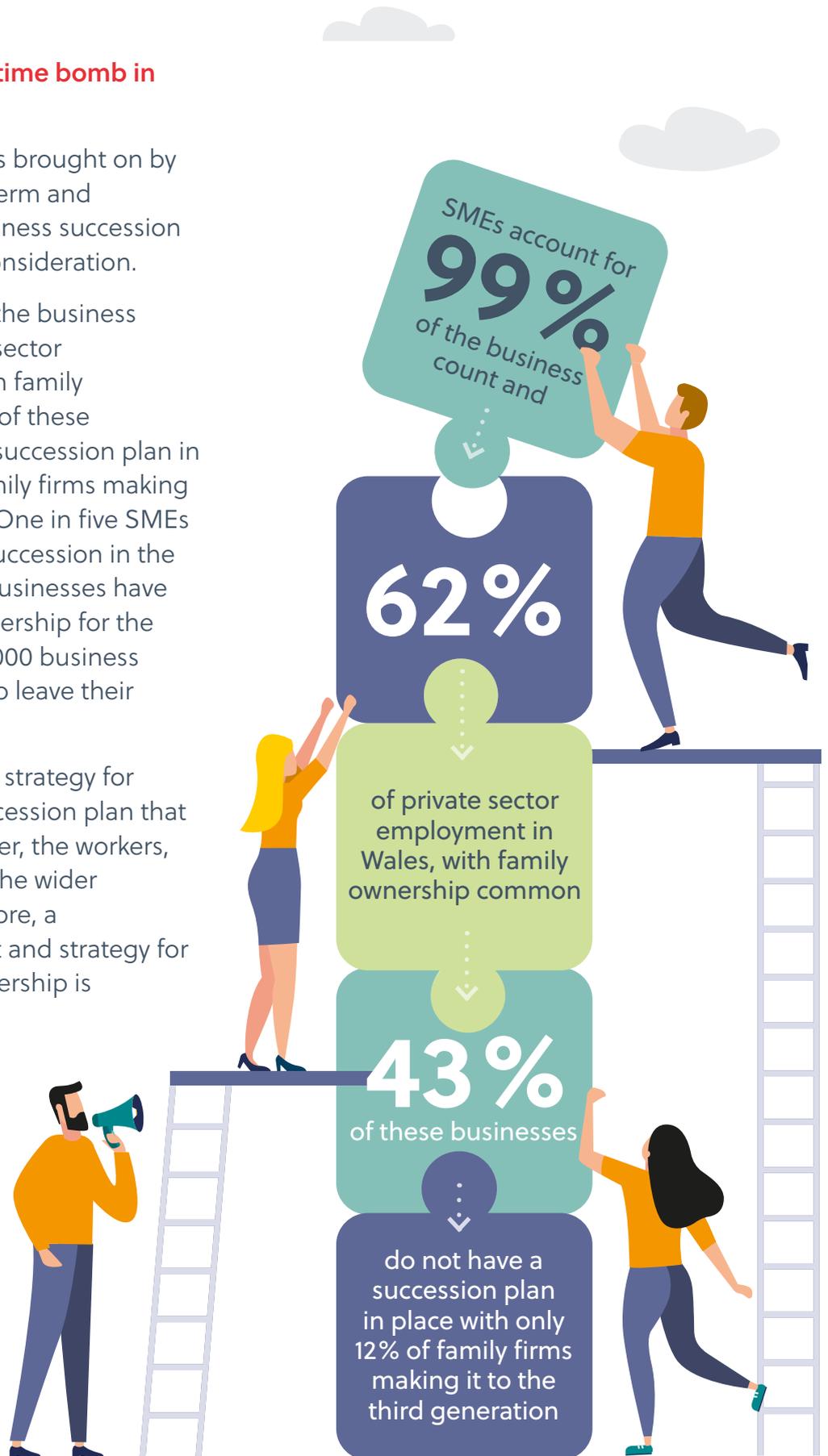


The business succession time bomb in Wales

As well as the sudden crisis brought on by Covid-19, the more long-term and persistent problem of business succession in Wales is also a crucial consideration.

SMEs account for 99% of the business count and 62% of private sector employment in Wales, with family ownership common. 43% of these businesses do not have a succession plan in place, with only 12% of family firms making it to the third generation. One in five SMEs face planning closure or succession in the next 5 years, and 29% of businesses have been under the same ownership for the past 21 years, meaning 15,000 business owners could be looking to leave their businesses.

Given this “time bomb”, a strategy for promoting a business succession plan that protects the business owner, the workers, the local community and the wider economy is crucial. Therefore, a Government commitment and strategy for promoting employee ownership is necessary.



What are the next steps and what can we learn from?

This paper has outlined the situation we are in: the benefits of employee ownership, the sector in Wales as it is now, and the barriers to growing the sector. This section will outline what Wales and the Welsh Government can do to remove those barriers and support Welsh businesses to becoming employee-owned.

Scotland

The best example of a success story within the UK can be found in Scotland. Research by the White Rose Employee Ownership Centre in 2019 found that Scotland had the second-highest proportion of employee-owned businesses of all the nations and regions of the UK, behind only London. This broke the trend of higher levels of employee-owned businesses generally being found in more prosperous areas such as London and the South East of England.

In 2018, the Scottish Government announced an ambitious target of raising the number of employee-owned businesses in Scotland from around 100 to 500 by 2030. Accompanying this target was the establishment of 'Scotland for EO', an industry leadership Group backed with £75k of Scottish Government funding. Scotland for EO is a leadership group led by industry working in partnership with the public sector. Its purpose is to have a championing, influencing and facilitating role with the aim of building a stronger, larger and more confident employee ownership community in Scotland. The number of EO businesses was already rising

at this point in Scotland, a feat which had been achieved with the support of Co-operative Development Scotland (CDS), a dedicated team within Scottish Enterprise whose remit it is to promote awareness of EO and other co-operative models and provide advice to businesses considering adopting these models.

The purpose of this Leadership Group was clearly to overcome the cultural barriers to employee ownership that were identified in the Nuttall Review. It allows for the business community to take the lead and promote the option of employee ownership to people, and points towards the specialist support available through CDS. Perhaps as important as this intervention is the fact that the Scottish Government has given itself a specific target to work towards, necessitating an employee ownership strategy and proactive action. This responsibility on the Government to produce the demand, that is then able to access specialist support, means that employee ownership is firmly on the economic development policy agenda.

Germany

Germany's 'Mittelstand', its strong set of family-owned SMEs, is a subject of interest of economists around the world. It has been the focus of attention in Wales in recent years in response to the FSB's influential "Wales' Missing Middle" report, that identified the relative lack of medium-sized firms in Wales and the detrimental impact of this on the economy.

The work of Professor Friederike Welter has identified that culture plays a crucial role in the production and reproduction of the Mittelstand. According to Welter, the Mittelstand is a “mindset”, combining aspects of ownership, leadership, and organizational characteristics - Berghoff (2006) suggests that Mittelstand firms are family-controlled, have a patriarchal culture with flat hierarchies and informality, with trust playing a key role within internal and external relations. The leadership continuation is limited within the family, and as a result a long-term focus is held.

This suggests that for the concept of employee ownership to grow in Wales, and for a new business tradition and “way of doing things” to be encouraged, developing a culture of employee participation, partnership and ultimately ownership is crucial. As with the Leadership Group seen in Scotland, promoting and showcasing successful examples of employee-owned businesses that already exist in Wales, and allowing them to lead the way on this agenda, is an important part of this.

United Kingdom – Partnership Fund

Ownership at Work, the new think tank for the employee-owned sector which works in partnership with the Employee Ownership Association, has proposed the development of a wage-for-equity scheme on a large scale, that they have termed the Partnership Fund. The Partnership Fund is put forward as a way of mitigating the likely brutal effect on jobs when the furlough scheme ends and the expiry of other subsidies.

We believe that the Partnership Fund, as well as going some way to meet Welsh firms’ need for new investment at a time of economic uncertainty, is an opportunity to strengthen employee investment and ownership in Wales, and result in considerable benefits for productivity, resilience, and equality. Nigel Mason, the author of the report, outlined these potential benefits:

- New money is introduced into the company from the Partnership Fund in the form of subordinated convertible debt that ranks behind all secured debt, strengthening the company’s balance sheet.
- Company cashflow is further improved by the wage concessions offered by employees.
- The use of an EBT ensures fair play and eases the administration; employee equity is pooled.
- Employees who can afford to accept a reduced income for a finite period save their jobs, the jobs of others and potentially the whole company in return for a potential equity return.
- The financial interests of the EBT trustees and the government are aligned because both want to see the value of the business increased. Rather than the British Business Bank holding hundreds of minority equity stakes in disparate SMEs, responsibility for those stakes is effectively delegated to those with the best knowledge and the strongest incentive to make the arrangements succeed: the EBT trustees.

Recommendations

Based on the information in this report; the benefits of employee ownership, the challenging economic context Wales finds itself in, and the steps that other countries are taking to encourage the development of employee ownership, the Wales Co-operative Centre is recommending the following policy actions for the next Welsh Government:

1

Set a target of doubling the number of employee-owned businesses in Wales by 2026. This explicit target would ensure that the Government takes responsibility for the target being met and ensure that it takes a leadership role in developing the sector in Wales and ensure a continuity of focus.

2

Establish a Leadership Group, led by the business community themselves, with the purpose of promoting and celebrating employee-ownership in Wales. The Government should provide the funding and infrastructure needed for the business community, as well as other stakeholders, to promote this business model in the country.

3

Continue to fund specialist business support for businesses considering their succession options, with specific expertise in the employee ownership model. Social Business Wales has gained considerable experience in this area and has the potential to help many more businesses on their employee ownership journey.

4

Embed employee ownership as a mainstream business model in all business settings, including business and entrepreneurship studies within schools, FE and HE institutions, especially Business Schools. Engagement with business stakeholders in all settings is needed and could be an objective of the Leadership Group.

5

Develop a robust framework for implementing a wage-for-equity scheme on a large scale, or a "Partnership Fund". This follows the proposal from the Employee Ownership Association, and is based on the Futures Fund launched by the UK Government in May 2020.

We believe that these specific policy proposals have the potential to make a considerable difference to the employee-owned sector in Wales. We know that this would help to build a fairer, more resilient and stronger Welsh economy.

We welcome any comments on this report and encourage this debate to continue. If you would like to get in touch, please email our Policy and Research Officer, Daniel Roberts, via dan.roberts@wales.coop.





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