

Mutuals, Employee Ownership, and Workplace Democracy

Policy Paper 106



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Executive Summary

- Liberal Democrats have always believed in helping individuals to take and use power, enabling them to be involved in the decisions which affect their lives. We believe that employee participation in the workplace, together with wider employee ownership, is important for diffusing economic power; promoting enterprise; increasing job satisfaction; and improving service to customers.
- We believe that every individual has the right to play a meaningful role in society regardless of their occupation, wealth, gender, age, role, or position. Part of this meaningful role is tied up in the rebalancing of power, economic and otherwise – providing citizens with a stake in their own economy – an involvement in their own future. And part of it is ensuring that every person involved in the economy has a sense of self-worth about what they contribute – about the work that they do and the skills that they use. In this way, and in this way only, can a system of ethical, fair, and collaborative capitalism prosper.
- Liberal Democrats believe that choice and competition have an important role in empowering individuals and driving economic efficiency. But our tradition also recognises the importance of, in John Stuart Mill's words, the "*civilising and improving influences*" of association and participation. In seeking to reshape our economy, this fundamental aspect of our liberal values and tradition must be reasserted.
- Despite the evidence of the strong economic performance and resilience, and greater equality of distribution of the benefits of economic growth, there is still a tendency in government and the business community to see all forms of employee ownership as a fringe concern. This must change. The current economic crisis, and declining real incomes for most low- and middle-income earners, has led to many questions being raised as to the way the UK economy is currently structured.
 - What can be done to restart economic growth by improving the supply side of the economy?
 - How can the economy be rebalanced and made more resilient to economic shocks?
 - How can we ensure that banks and other financial institutions serve the needs of the whole economy, not just their own sector?
 - Can the benefits of economic growth be spread more equitably, so that it is not just top executives and bankers who benefit, through changing the ownership and power structures of the economy rather than simply through tax and benefit policies?
 - Can the distribution of economic and political power be more widely spread so that individual citizens have greater control over the decisions which affect their lives?
- The Party believes that the long-standing liberal vision of the benefits of mutuals, employee ownership and share ownership, and workplace democracy is of more relevance now than ever before. In a time when the weaknesses of the current system are abundantly clear – be this via public bailouts, excessive bonuses for executives, or a

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lack of engagement by citizens across all aspects of the political and economic spectrum – we have the opportunity to use long-held Liberal beliefs about the power of collaboration to correct many of these inadequacies to the benefit of both employees and employers.

- We argue, therefore, that government should be seen to be treating these sectors on an equal basis with more traditional economic structures. As a result of the history of neglect there is a need in the short- to medium- term not just to level the playing field but in some cases to provide additional incentives to promote these sectors. The business, financial services and education communities, and the associated professions need to improve their knowledge of the benefits that mutualisation, employee ownership and share ownership, and workplace democracy can bring to the economy and society. The mutual, co-operative, and employee ownership sectors and practices need to be viewed as mainstream in the economy, not a fringe activity.
- We have a number of proposals, which are explained more fully in this paper. Perhaps most importantly, we propose that:
 - Workers' rights to participation in organisations with over 250 employees should be **enshrined** in legislation.
 - Employee participation should mean having a say on such issues as:
 - The **remuneration** policies of the company (including at board level).
 - The **terms and conditions** of employment of the company.
 - The **strategic direction** of the company.
 - Provisions for dealing with **employee suggestions and concerns**.
 - Companies Act legislation should be amended to allow the option of a **two-tier board structure** along German lines where companies and employees wish to adopt it.
 - That in companies where 5% or more of the shares are owned by employees (either individually or in trust), employees have the right to **elect a member to the Board** of the company
 - There be a **Minister** in BIS with particular responsibility for the sector. This will encourage a consistent approach in legislation, a reduction in 'unintended consequences' of business law, and ongoing support for and championing of this important sector.
 - There be a **'Right to Request'** in the following circumstances:
 - Employees of publicly-listed firms with over 250 employees have the right to request 5% of the shares.
 - Employees of all companies limited by shares with over 250 employees have the right to request an employee share scheme in which all employees can participate.
 - At the point of transfer of any business, employees have the right to put in a bid for the firm that employs them.

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- Employee Share Ownership be encouraged in a similar manner to the US, for example through a discount on capital gains tax when businesses, or significant shares in a business are transferred to employees.
- Employees in firms where ownership is held collectively should be permitted to receive a 'profit share' tax free, which would be related to the maximum which they would have been able to receive under an all employee share scheme.
- Work is undertaken by the new Minister and the Department for Communities and Local Government on community-based initiatives for mutualisation.

Introduction

1.1 Overview

“...the civilising and improving influences of association, and the efficiency and economy of production on a large scale, may be obtained without dividing the producers into two parties with hostile interests and feelings...the relation of masters and work-people will be gradually superseded by partnership, in one of two forms: in some cases, association of the labourers with the capitalist; in others, and perhaps finally in all, association of labourers among themselves” - John Stuart Mill, ‘Principles of Political Economy’.

“We want to see democracy, participation and the co-operative principle in industry and commerce within a competitive environment in which the state allows the market to operate freely where possible but intervenes where necessary” - Preamble to the Liberal Democrat Federal Constitution.

1.1.1. Liberal Democrats have always believed in helping individuals to take and use power, enabling them to be involved in the decisions which affect their lives. We believe that employee participation in the workplace together with wider employee ownership is important for diffusing economic power, promoting enterprise, increasing job satisfaction, and improving service to customers.

1.1.2. We believe that every individual has the right to play a meaningful role in society regardless of their occupation, wealth, gender, role, or position. Part of this meaningful role is tied up in the rebalancing of power, economic and otherwise – providing citizens with a stake in their own economy – an involvement in their own future. And part of it is ensuring that every person involved in the economy has a sense of self-worth about what they contribute – about the work that they do and the skills that they use. In this way, and in this way only, can a system of ethical, fair, and collaborative capitalism prosper.

1.1.3. Liberal Democrats believe that choice and competition have an important role in enabling and empowering individuals and driving economic efficiency. But our tradition also recognises the importance of the “civilising and improving influences” of association and participation. In seeking to reshape our economy, this aspect of our liberal values and tradition needs to be reasserted.

1.1.4. For these reasons, we believe that not only would a step change in the number of associations, partnerships, retail and worker co-operatives, friendly societies, mutual insurers, and credit unions have an intrinsic benefit for both workers and businesses – it would also have a positive effect on the resilience and sustainability of our economy as a whole. Furthermore, the hoarding of economic power is not only problematic for the economy, but also has the potential to be socially destabilising.

1.1.5. Recent economic history has given rise to a renewed interest in a variety of proposals in this field, and it is our opinion that our strong, liberal traditions put us in a unique position to produce policy in this area. It is our belief that the encouragement of, and support for, varied methods of commercial organisation, such as mutualisation, employee ownership, and participation will give us the opportunity as Liberal Democrats to have a fundamental, and

beneficial, effect on the way our economy operates and how the benefits of its successful operation are distributed.

1.1.6. In addition to this belief, the *Facing the Future* paper as passed by Autumn Conference 2011 provided us with a clear framework for our work – to encourage the growth of these business models in the private sector, and to recognise the benefits to individuals and businesses of increasing and improving employee participation in corporate governance and decision-making.

1.2 The Current Economic and Political Context

1.2.1 The current economic crisis, and declining real incomes for most low and middle income earners, has led to many questions being raised as to the way the UK economy is currently structured:

- i) What can be done to restart economic growth by improving the supply side of the economy?
- ii) How can the economy be rebalanced and made more resilient to economic shocks?
- iii) What is the role of financial services in the economy and how can we ensure that banks and other financial institutions serve the needs of the whole economy not just their own sector?
- iv) Can the benefits of economic growth be spread more equitably, so that it is not just top executives and bankers who benefit, through changing the ownership and power structures of the economy rather than simply through tax and benefit policies?
- v) Can the distribution of economic and political power be more widely spread so that individual citizens have greater control over the decisions which affect their lives?

1.2.2 Political concern about these issues has become apparent with cross-party forays into the area, including David Cameron's plea for 'moral capitalism', and Ed Miliband's 'predator companies'. Our concerns were put best by Nick Clegg earlier this year, when he said "We also need to put much more power in the hands of the other stakeholders in the economy – shareholders and employees – when it comes to setting top pay. Trusting not the unfettered market, nor the interventionist state, but trusting people. That is the core of the more responsible capitalism: power in the hands of people. Strong economic citizens able to keep vested interests in check." ¹

1.2.3 The proposals pioneered by Stephen Williams MP to distribute shares in the banks to all citizens is one example where Liberal Democrats are seeking to spread ownership more widely. This paper seeks to set out other ways in which this can be done

1.2.3 Liberal Democrats have a critical role to play in this debate, drawing on the liberal principles of association and partnership set out by John Stuart Mill, in a way that the Conservative and Labour Party cannot, captured as they are by the interests of capital and the unions.

1.2.4 Participation can have two elements – democratic and economic. Democratic participation is, in our view, a fundamental right, and economic (or ownership) participation is something that should be encouraged.

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1.2.5 Economic participation does not occur only through our role as employees, it can also be through our role as consumers (very broadly defined) which can encompass retail co-operatives, purchasing co-operatives, as well as financial mutuals and friendly societies.

1.2.6 There is also an intermediate form of participation where some might argue it is democratic (and hence a fundamental right) and others where it is economic (and therefore to be encouraged but not a right). Examples would include housing or education where there have been moves towards housing co-operatives and co-operative schools. A distinguishing characteristic here is the extent to which there is a reality of individual choice and the potential of switching. In the case of much social housing there is little alternative to exercise an individual choice to move if service is inadequate. Likewise in education it is likely to be much more difficult to choose a different school than it is to choose a new electricity supplier.

1.2.7 Some of the issues raised as to whether participation should be treated as a fundamental right in education and housing are beyond the scope of this paper and more appropriately dealt with by specific policy papers on these topics. We shall treat them therefore for the purpose of this paper only as to be encouraged in the same way as other forms of economic participation.

1.2.8 Concentration of capital can cause ownership to become complacent in the oversight of management and for the interests of the few to outweigh the wellbeing of the many. Therefore, a significant part of overhauling this form of economy is to redistribute power more widely, particularly to employees.

1.2.9 Whilst in employee-owned companies employee participation is more likely to occur naturally, as a result of ownership rights, it is conceptually distinct. As was rightly pointed out in the last policy paper on this issue, *Citizens at Work*, "if there is one belief which Liberal Democrats hold above all others, it is in the rights of individuals to take part in the affairs of the community to which they belong ... In few places is this less realised in Britain today than in the workplace". Employees of retail co-operatives, friendly societies, credit unions or indeed public sector institutions have as much right to influence decisions affecting their lives as others in the private sector.

1.2.10 Of course, the type of changes we desire will not necessarily result directly from a change from a traditional share-holder or private ownership structure. However, what does seem clear to us is that governance and culture move forward together – and that greater employee participation is likely to bring with it the improvements outlined here.

1.2.11 This paper sets out to explore how the principles of mutualisation, employee ownership, and participation might be applied to the UK; the barriers which are faced in creating a more diverse, co-operative, democratic liberal economy; and makes policy recommendations for achieving such an economy.

¹ Nick Clegg, Mansion House Speech, 16th January 2012

Benefits of the Liberal Economy

2.1 What is Mutualisation, Employee Ownership, and Employee Share Ownership?

2.1.1 It is important to distinguish between **employee-owned firms, co-owned firms** and **employee share ownership**. By employee-owned firms we mean those firms with majority employee share ownership. Co-owned firms are those with significant employee ownership. For convenience we adopt the Employee Ownership Association test for co-owned firms as those with employee ownership in excess of 30%. Ownership can be held collectively, as with the John Lewis Partnership and employee co-operatives, or shares can be held individually by employees.

2.1.2 By contrast many firms have employee share schemes to reward and motivate employees but collectively these may amount to a relatively small shareholding in the company. They may nevertheless enable individual shareholders to accumulate considerable assets and share in the growth in value of a firm, as well as accumulating assets which may make a significant difference to their later life.

2.1.3 The Cabinet Office's *Mutual Benefit* paper defines two forms of mutuals, as "organisations [that are] either owned by and run in the interests of existing members, as is the case in building societies, co-operatives, and friendly societies, or... owned on behalf of the wider community and run in the interests of the wider community".

2.1.4 **Co-operatives** are member groupings which can encompass a range of memberships such as consumers (eg. the Co-operative retail group and collective purchasing groups), workers (eg. the Mondragon worker co-operative in Spain or the Suma food co-operative in the UK), or more hybrid multi-stakeholder forms (eg. co-operative schools), where parents, teachers and members of the local community are members.

2.1.5 There is also a long tradition of **financial mutuals** in the UK. A financial mutual is an organisation that supplies financial services products, and which is owned by its customers, or members. That means there are no shareholders to either pay dividends or account to, and a mutual can concentrate entirely on delivering products and services that best meet the needs of its customers. These range from building societies (eg. Nationwide), to insurance companies (eg. Royal London), to friendly societies (eg. Benenden Healthcare Society). We also include **credit unions** within this general category.

2.1.6 Throughout this paper, to avoid lengthy descriptions or incomplete umbrella terms, we will refer to mutuals, employee-owned, and employee share owned businesses (including financial mutuals) as MEEOs. In employee share owned businesses, we include traditional firms who have share schemes for all employees, even if the percentage share ownership by employees is low. MEEOs are our primary focus, and we do not prescribe (or indeed, proscribe) any one form of business as the 'right' type of MEEO.

2.2 Mutuals, Employee Ownership, and Employee Participation in the UK Economy

2.2.1 It is a matter of concern that the UK economy has, with some exceptions, become generally less diverse in its ownership structure since the 1980s. In the past 15 years alone, mutual insurers have gone from 50% of the market to just 5%, despite evidence showing that consumer trust and satisfaction with mutual organisations remain high. Since the act permitting demutualisation of the building societies in 1986 there has been a similar decline. This is attributed by some as a reason for the unsustainable boom in lending to the housing market in the period leading up to the financial crisis.

2.2.2 Whilst in the last few years there has been a welcome growth in the co-operative sector, this is still a relatively small share of the economy compared to other countries. In the UK, co-operatives are estimated to comprise 2% of the economy compared to 7% in Germany and 5% in the US. In the US, 40% of the population belong to credit unions compared to 2% in England and Wales.

2.2.3 Employee Owned firms (including co-owned firms where employees have a significant stake – usually over 30%) account for 2% of the UK economy according to the Employee Ownership Association. This translates to an annual turnover of £25 billion.

2.2.4 Companies with an element of employee share ownership are much more widespread. However, a recent study by Baker & McKenzie shows that take-up of HMRC tax-advantaged schemes remain comparatively low, with only 10 of 116 companies that have been in the FTSE100 since 2008/09 taking up Share Incentive Plans (SIPs), and 40 offering a Save As You Earn (SAYE) scheme. There are potentially many reasons for this, though it is worth noting that the same study shows that up to 42% of FTSE100 companies offer shares as a method of executive pay – which lends weight to the theory that employee share ownership alone may not be sufficiently broad-based to warrant praise.

2.2.5 Some would argue that employee participation in the workplace takes place through union representation and collective bargaining. However trade union membership has suffered a steep decline. In 1989, after 10 years of decline in trade union membership figures, trade union density was 38.6%. By 2011, this had fallen to 25.7%.² The lack of employee representation in the private sector is even more stark: whereas over half of public sector workers are members of a trade union only about one in six private sector workers are. Whilst many private sector employers (eg. BT and Tesco) have developed effective forums to enable employee participation, there are many organisations where there are few formal structures.

2.3 Participation and Competition at the Heart of a Liberal Economy

2.3.1 Rebalancing the economy by geography and sector and between long-term and short-term – in short, the sustainability of the existing economy – has become a prominent issue in political dialogue. We are not convinced that this sustainability should be our only concern. As our constitution says, we believe in free markets, appropriately restrained, with benefits distributed fairly throughout the economy. It is clear to us that currently this is not the way the economy works.

2.3.2 We therefore also see a need to rebalance the economy so that there is greater diversity of organisational and ownership form. Currently the economy has become overly dependent on just one type of ownership – the shareholder economy - with adverse consequences for wealth and income distribution, economic stability, economic growth and the distribution of economic and political power.

2.3.3 A liberal economy is where communities or groups of people are free to come together to meet their needs. Communities of consumers to meet their retail needs and to engage in collective purchasing; savers and borrowers to meet their financial needs; mutual insurers to meet insurance needs; residents to meet their local public service needs; parents to meet their childcare needs; older people to meet their social care needs; communities of workers to meet their employment and income needs; and also partnerships with capital to meet business or public service needs.

2.3.4 Income and wealth inequality have grown over the past few decades and taxation policies have been unable to counter this. Policies to enable workers to have more of an opportunity to benefit from the profits generated within a company would help to remedy this. A more equal distribution of profits would also go some way to reducing the effects of income inequality within and between firms.

2.3.5 In the same way, in a number of markets, such as energy and financial services, there is concern that increasing concentration amongst suppliers, combined with growing information asymmetries caused by complex products and services, leads to many consumers, particularly the most disadvantaged, suffering. Increased mutualisation and collective purchasing can lead to the empowerment of consumers against large corporations.

2.3.6 In a liberal economy we should not be prescriptive about which form of ownership is appropriate. A liberal economy welcomes the consumer-owned Co-op competing against the employee-owned Waitrose competing with the shareholder-owned Tesco competing with Asda and its significant employee share scheme generating substantial benefits for its employee shareholders. In a liberal economy, significant employee ownership may be more prevalent in some sectors, such as professional services or those relying on significant customer service contact, than others, such as a large, very capital-intensive steelworks.

2.3.7 There is also likely to be the development of various hybrid structures to meet the needs of the business and the community. Employee-owned companies may work in partnership with private equity to supply business needs. Ex-offenders, probation officers, and local residents may work together to reduce re-offending. We should aim for a tax structure to provide appropriate support for different types of organisation avoiding unfair competition. A liberal economy and society will balance the interest of participants, employees, managers, and the wider community directly as well as through democratically accountable parts of government.

2.3.8 Competition in markets should be at the core of a liberal economy. But so should participation. The two can and should go naturally together. We believe that this aspect of liberalism needs to be reasserted in our economic life, as we look to a substantial and permanent shift to greater economic and democratic participation for every citizen in the economy.

2.4 The Benefits of MEEOS and Participation for the Economy and Individuals

2.4.1 There is an unusual consensus across academic and economic studies that business performance is positively affected by a combination of employee ownership and participation. In terms of **job creation**, employee-owned businesses (EOBs) in recent years have increased employment annually at twice the level of non-employee owned businesses. During the first year of the recession (2008-09), EOBs increased employment by 12.9% to non-EOBs' 2.7%.³ When considering **sales growth**, despite marginally underperforming prior to 2008, in 2008-09, growth for EOBs outstripped non-EOBs by more than 10%.⁴ Similar figures appear when examining **profitability**. Essentially, EOBs are more stable across the business cycle, and buck commensurate trends during recessions.

2.4.2 There is also evidence that the rewards of ownership are more evenly spread in employee-owned firms. For example, the chief executive of John Lewis Partnership (JLP) took home just under £1.1m in 2010/11 – significantly less than CEOs of comparable retail companies. Perhaps most notably, the level of bonuses in JLP is standardised at a percentage of income – so every worker from shop floor to Chief Executive took home a 14% bonus at the end of the 2011-2012 financial year. At a time of concern about growing income inequality and spiralling boardroom pay, employee-owned firms would have an important role to play in spreading the benefits of economic growth more widely.

2.4.3 Recent research by Cass Business School has shown that employee-owned businesses have been more resilient to the economic downturn than non employee-owned businesses with their employment continuing to grow.⁵ When economic conditions are tough, a fully involved workforce can take decisions which help businesses and employment to be sustained.

2.4.4 Even in non-employee-owned businesses where there are good employee share schemes, there is evidence of improved performance and employees gaining a significant benefit from the success of the business. Employees of Sports Direct recently received on average a £44,000 bonus over two years from their share scheme because of the soaring share price, and Asda employees who saved £250 per month in their share scheme over three years received a payout of £16,000. There is, therefore, significant potential for workers to benefit with significant asset accumulation and to help foster a savings habit. Employee share ownership, even if it is a relatively small share of the total share capital of a company, can be very beneficial to worker and company.

What Employee Ownership and Workplace Democracy Mean For You

Employee ownership and workplace democracy sadly quite often seems detached from people's own experiences of work. But look at it this way – you are likely to spend over 80,000 hours of your life in work – wouldn't you want this time to be as rewarding as possible?

There are three key benefits:

- 1. JUST REWARDS** – employee ownership makes sure that the people who do the work are rewarded for the benefits they bring to their company. It's not about bonuses for bosses – it's about putting the money that you work for back in your pocket.
- 2. YOU KNOW BEST** – workplace democracy is about getting workers to talk about how they should be working. You spend your time doing a job that management might not understand as well as they think – getting involved means that they listen to you about how things work best.
- 3. GIVING YOU A STAKE** – money in the economy doesn't usually make its way down to workers at the bottom. Giving you ownership in a business means that as well as sharing in your company's success, you can build up savings and invest in your future.

2.4.5 There is also emerging evidence from both the UK and overseas that collective action by consumers through collective purchasing can also lead to significant benefits for consumers. For example, Which's 'The Big Switch' for collective energy purchasing carried out in the first half of 2012 has led to average savings of £123 per year and for the 30,000 switching who are on the worst deals in the market savings are generally over £200. In Europe, organisations such as iChoosr have also extended this concept to products and services such as financial services and mobile phones.

2.4.6 Mutual financial institutions also offer significant benefits. Evidence from the Association of British Credit Unions asserts that credit unions, for example, offer higher rates on deposits than most banks, and lower interest rates on loans to low and middle income earners than, for example, the payday loan companies, although the customer base can be different. At a time when there is considerable concern about the mis-selling of insurance and other financial services products, proponents of financial mutuals argue that consumers generally feel that this is less likely to occur when the organisation is mutually-owned compared to being owned by a third party.

2.4.7 In the absence of external shareholders to satisfy there is evidence that mutuals and employee-owned companies are better able to pursue a long-term purpose, rather than simply maximising dividend payouts and share price.

2.4.8 There can be disadvantages of such structures. More limited access to external risk capital can make rapid expansion more difficult and a lack of participation by members can lead to weaker governance of management than a more traditional shareholder model – though governance can also be weak there. One long-standing concern is that if an employee's wealth and pension are tied up in a company, they risk losing not only their job but also much of their

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wealth and pension provision should the company fail. Nonetheless, we were impressed by the arguments that some organisations gave in evidence-giving sessions regarding the diversification of wealth arising from employee share ownership, particularly towards the end of their working life, and the range of pension protection mechanisms that apply both in this country and others.

2.4.9 Given the benefits noted above, the case for the encouragement of MEESOs, particularly in the private sector where there has not been any significant recent growth, would seem to be relatively clear: they maintain high levels of trust; the rewards of ownership are more evenly spread, meaning a reduction in overcompensation for those at the top; they lessen employee stress and thus improve worker performance/output, they reduce the inequality inherent in many private sector firms and they can introduce greater competition in various markets through collective purchasing and retail co-operatives so benefitting consumers. It is quite clear that these benefits are not only internal, but are likely also to have an important effect on the performance of the economy as a whole.

2.4.10 There is evidence that distinct from the benefits of employee ownership and share ownership, employee participation in decision-making has a positive impact on an organisation's performance. There is also emerging strong evidence that employee wellbeing is positively affected by employee participation. Stress now accounts for more days lost to sickness than any other ailment and stress is reduced where employees have more autonomy and the ability to influence the decisions which affect their lives.

² Labour Force Survey; <http://www.bis.gov.uk/policies/employment-matters/research/trade-union-stats>

³ *Model Growth: Do employee-owned businesses deliver sustainable performance?*, JLP and EOA, 2010

⁴ Ibid.

⁵ Ibid.

Building the Liberal Economy

3.1 Current Government Policies to Promote the MEESO Sector and Employee Participation

3.1.1 There are two main areas where government currently seeks to promote the MEESO sector and employee participation.

3.1.2 **Promotion of mutual and employee-owned spin-outs from the public sector.** This has been most evident in the work of the Cabinet Office mutuals taskforce. This has been embodied in a 'Right to Provide' for public sector workers to spin out of the public sector. Examples of spin-outs include Central Surrey Healthcare (initiated under the last government) and Anglian Community Enterprise. There are also hybrid models such as MyCSP (the part 'mutualisation' of the administration of the civil service pension scheme) and the involvement of the workforce in Circle Healthcare's takeover of Hinchingsbrooke Hospital. In addition, the work of Liberal Democrat Ministers in BIS has secured agreement to a significant employee ownership stake in Royal Mail and the examination of the mutualisation of the Post Office.

3.1.3 Liberal Democrats generally welcome this initiative and the fact that the 'Right to Provide' places the onus on the workforce to seek a spin-out. As a result it is done with the agreement of the workforce. Where the public sector has taken a decision that it should no longer directly provide a function, every opportunity should be taken to involve the workforce to take an ownership stake in the business, as has been done with Royal Mail.

3.1.4 **Tax incentives to promote employee share ownership.** The UK currently has two main all-employee systems that enjoy favourable tax treatment: Save As You Earn (SAYE) and the Share Incentive Plan (SIP), plus two other more selective schemes – Company Share Option Plan (CSOP) and Enterprise Management Incentives (EMI) – which can be expanded to more employees when firms wish to do so. Appendix 1 summarises these schemes.

3.1.5 Apart from these measures, government has done relatively little to promote mutuals and employee ownership. In relation to employee participation there has been even less. The only measure has been the 'Information and Consultation of Employees regulations', part of the Employment Relations Act 2004 as a response to the EU Information and Consultation Directive. However this has done little to change fundamentally the attitude of most employers on this issue.

3.1.6 It is also worth noting that CSOPs and EMIs are often schemes used by companies to incentivise and reward executives, as opposed to widening the share ownership base in a given company.

3.1.7 For these tax-favourable schemes to promote employee share ownership, they must be all-employee schemes. Allowing companies discretion as to who deserves to be incentivised often favours those at the top end of the pay scale. However, we recognise that the EMI scheme serves to encourage entrepreneurship. We therefore propose that for all firms with over 250 employees, to receive favourable tax treatment on any shares in government scheme, the scheme must be open to all employees.

3.1.8 In our view, the benefits of participation, both economic and political, are such that government should take a much more active role in promoting it throughout the economy. This should form an integral part of Government policy to promote democratic and economic reform as part of Liberal Democrat pro-growth and fairness policies.

3.2 Barriers to MEESO Development

3.2.1 There are several barriers to a greater role for mutuals, employee-owned businesses, and employee share ownership including:

- i) Difficulty with access to risk capital because the inability to sell equity creates obstacles to establishing new mutuals and growing existing ones.
- ii) Legislation and regulation that is often focused primarily on conventional forms and structures. For example, financial mutuals consider that financial services regulation takes inadequate account of their particular position and is biased towards the conventional plc model. Similarly, some aspects of energy market regulation can be a deterrent to collective energy purchasing.
- iii) Lack of understanding and awareness amongst policy makers, professional advisers and business owners of these alternative corporate forms.

3.2.2 There are also various technical issues which currently deter expansion of the sector. These include:

- i) The tax treatment of employee benefit trusts – measures introduced in the Finance Act 2003 – in effect leads to double taxation of transfers of shares to employee benefit trusts.
- ii) Private equity-owned firms cannot currently have HMRC tax advantaged employee share schemes.
- iii) The limited nature and lack of flexibility of HMRC-approved share schemes.
- iv) The current legislation concerning co-operatives, which deters expansion of the sector.

3.3 Policies to Promote Employee Ownership, Employee Share Ownership and Mutuals

3.3.1 We consider that the benefits of encouraging MEESOs and employee participation are significant and that existing policies are inadequate to secure the step change in economic and democratic participation that we wish to see. Barriers to entry are significant and pose diverse threats to the efforts of even the most enthusiastic business owners who may wish to explore these options. As such, we see it is as likely that government will need to lead the way in helping companies to overcome these barriers. We recommend a three pronged approach:

- Encouragement and promotion of alternative forms of ownership.
- Removing barriers to greater mutualisation, employee ownership and share ownership.
- Legislation and taxation changes to incentivise mutuals, employee ownership and employee share ownership.

3.3.2 **Encouragement and promotion of alternative forms of ownership.** We Liberal Democrats believe that there is currently insufficient diversity in ownership forms in the UK

economy. Many voices in the sector say that much could be achieved by a coherent, consistent publicly-voiced support coming from policy makers. There is a need to ensure that business schools, professional advisers and others are more aware of the potential of the sector. The potential of collective purchasing has already been shown by the 'Big Switch' campaign, and there is much that central and local government can do to promote this, as shown by the joint BIS/Co-ops UK competition for collective purchasing. At a time when public sector resources are severely constrained and there is a desire to ensure that unnecessary regulations are not introduced, government must rely more on its facilitation and promotional role. Collective purchasing initiatives such as that being undertaken by Cornwall County Council, alongside the NHS, the Eden Project and local businesses in relation to energy and the Green Deal for energy efficiency show what can be done by galvanising local communities.

3.3.3 Stressing the role that government can play in encouraging and promoting alternative forms of ownership is not an easy policy option. Incentives, legislation, and regulation may have a role to play but government has a critical role to play in changing the balance of presumption. We are looking to achieve a situation where government has 'mainstreamed' the role of MEESOs and employee participation in the economy.

3.3.4 We propose:

- i) A Minister be given specific responsibility for promoting the MEESO sector and employee participation, most likely in the Department of Business, Innovation and Skills (BIS). They would be responsible for championing the sector and critically reviewing all legislation and regulation to ensure that the needs of the sector are adequately taken into account.
- ii) DCLG, working with the Local Government Association and local authorities collectively and individually, should examine whether there are any changes to local authority powers required to enable greater mutualisation, employee ownership and participation.
- iii) Liberal Democrat local authorities and DCLG look actively at how they can facilitate local authority-wide and community initiatives working with community groups, other public sector bodies, registered social landlords credit unions and local businesses to promote a) collective purchasing initiatives in their local communities and b) Co-operatives' (including worker, retail and multi stakeholder cooperatives) contribution to local social and economic regeneration.

3.3.5 **Removing barriers to greater mutualisation, employee ownership and share ownership.** We noted in a previous section various legislative, tax and regulatory barriers. We propose:

- i) Change in the tax legislation so that employees of companies, taken over during the first three years of a SIP by an unlisted company for cash are not subject to a tax charge.
- ii) Change in the law to enable private equity-owned companies to have HMRC tax-advantaged employee share schemes. Currently this means that three million employees are unable to benefit from tax advantaged schemes and indeed when companies with share schemes are taken over by private equity eg Boots, they have to cancel their schemes.
- iii) Making it easier to transfer funds from employee shareholding into a pension fund at retirement. In the case of employee owned or co-owned firms where shares are individually held, there will often be requirements that employees sell their shares back to the employee benefit trust at retirement.

Mutuals, Employee Ownership, and Workplace Democracy

- iv) A reduction in the time period during which SIPs have to be held from five to three years to make them consistent with other HMRC schemes.
- v) Action to remove the adverse tax consequences for companies that wish to transfer shares to Employee Benefit Trusts, caused by the provisions in the Finance Act 2003 which, whilst introduced to stop the use of Employee Benefit Trusts (EBTs) to avoid tax had the unintended consequence of introducing what is arguably a double taxation charge on transfers to EBTs by companies seeking to become employee owned or co-owned. This issue was considered in some detail by the All Party Parliamentary Group on Employee Ownership in 2008 and we support the suggestions made, detailing them in Appendix 2.
- vi) A Co-operatives and Societies Consolidation Act to simplify and bring together current legislation (a proposal along these lines was announced by the government in January 2012 and has been a key demand by those active in promoting the sector).
- vii) A formal legal structure should be established for the holding of employee shares. Currently they are generally held in an employee benefit trust, but this can be costly to establish in terms of legal structure. We are struck by the success of the Community Interest Company Status in helping to facilitate the spread of social enterprises and believe a similar simple 'off the shelf' structure would be helpful.
- viii) The UK Government should ensure that financial mutuals and co-operative banks' particular capital structures are understood and treated fairly by financial services regulators.

3.3.6 The MEESO sector is also notable for the number of problems in raising finance faced by those seeking to set up and expand employee owned companies as well as by the mutual sector more generally. This is a subset of a wider problem faced by small and medium sized firms in obtaining finance but the problems of employee owned firms and mutuals in raising finance are more acute as they may not have access to external equity capital. There are several financial products in the market such as the 'social loan' raised by Hackney Community Transport which have risk bearing characteristics. However they tend to be relatively small scale and there is limited awareness of their existence.

3.3.7 There are also proposals from bodies such as the Association of Financial Mutuals as to how access to external capital might be improved. A major role for the government minister responsible for mutuals and employee ownership would be to work with banks and financial institutions, perhaps with some cornerstone financing from government to make available an array of financial products suited to this sector.

3.3.8 Legislation and taxation changes to incentivise mutuals, employee ownership and employee share ownership. There are four important questions when it comes to legislation:

- i) What can be done for employee ownership and co-ownership models to be considered more actively by business owners?
- ii) What can be done to boost employee share ownership and employee influence within companies where there is currently a low proportion of equity held by employees?
- iii) What can be done to get more firms to have all employee share schemes?
- iv) What can be done to promote and maintain mutuals?

3.3.9 The Deputy Prime Minister Nick Clegg in his Mansion House speech raised the idea of introducing a 'right to request' as a nudge measure to boost the prevalence of employee ownership and share ownership. For a 'right to request' to be meaningful there should be a

corresponding 'obligation to respond' on the business owner. We propose that employers should be required to consider the request reasonably, in addition to meeting with employees, and being asked to provide reasons for their refusal, or grounds upon which they would accede to the request. There should be the right of appeal if the reasons for turning down the request are not seen as reasonable. We suggest a trigger for the request of 10% of employees might be used, although this should be subject to consultation.

3.3.10 We consider that there is more which can be done to incentivise business owners to consider significant transfers of shares in their business to employees. In the US it is at the point of business ownership change that Employee Share Ownership Plans have played a significant role by providing a fiscal incentive for owners to transfer shares to an ESOP.

3.3.11 We do not support a uniform 'right to request' a majority or 100% stake in a business, however we propose that at the point of transfer of any business, employees have the right to put in a bid for the firm that employs them. In order to maximise these types of sales, there should be a Capital Gains Tax cut for owners selling to employees. There will be no obligation for proprietors to accept the bids of employees in this provision if they get a better offer elsewhere.

3.3.12 Whilst over 80% of FTSE 100 listed companies have tax-advantaged employee share schemes, fewer than 50% have all-employee schemes and far fewer smaller listed companies have such schemes. We propose, therefore, that employees in all companies limited by shares employing more than 250 employees should have the right to request an employee share scheme in which all employees can participate.

3.3.13 We are also keen to boost employee share ownership and employee influence within firms where there is currently a low proportion of equity held by employees.

3.3.14 We therefore propose that employees in all publicly-listed companies should have the 'right to request' a 5% stake in the business which under company law gives certain additional rights. In France, for example, if employees have a 3% shareholding in a company they have a legal right to a seat on the board.

3.3.15 Although we support and aim to pursue employee ownership in all companies, we accept that there are those where the workforce are primarily based abroad, often in a number of places, who would be unable to comply with proposals over elections to boards. Whilst it would be ideal to propose a policy whereby foreign workers could send a representative to the UK, and where all workers wherever they are based have a right to participation, we recognise that this will not always be possible. As such, we propose that for all companies where employees own 5% of the shares, and where more than 250 employees are based in the UK, employees have a right to elect a member to the board.

3.3.16 Currently, where shares are collectively, rather than individually, held by employees, they do not receive the tax benefit that employees receiving shares under an HMRV tax-advantaged scheme benefit from.

3.3.17 We propose therefore that employees, where ownership is held collectively rather than individually, should be permitted to receive a 'profit share' tax free which would be related to the maximum which they would have been able to receive under an all employee share scheme. It should not be at as high a level as such a profit share is arguable less risky.

3.3.18 We consider that there is a strong case for giving a further boost to employee share ownership and so propose that there should be a requirement that any IPOs or further share offers on the London Stock Exchange should offer shares to employees on a first refusal basis, possibly with a predetermined discount. For a limited period (as public finances allow) firms with significant employee ownership (50% plus) should have a discounted employers NI rate.

3.3.19 The government could encourage the mutual sector through legislative measures preventing further demutualisation of building societies, financial mutuals etc and use of asset locks to prevent employee-owned and mutuals from transferring assets to non-mutuals. We see disadvantages in ossifying a mutual structure when in the future such a structure may not be appropriate.

3.3.20 However we propose that legislation be introduced to ensure that if there is to be demutualisation that individual members do not benefit themselves financially in order that there is not the individual financial motive for demutualisation which led to the demutualising of many financial services companies in the 1980s and 1990s.

Prioritising Participation

4.1 What is Employee Participation?

4.1.1 Employee participation is a somewhat nebulous term and is often used interchangeably to cover concepts such as **employee empowerment, industrial democracy, workplace democracy** and **employee voice**. Participation is a necessary but insufficient condition for workplace democracy which exists when employees have some real control over organisational goal setting and strategic planning.

4.1.2 Some formal structures of **employee participation** (eg works councils), can be little more than tools for managers to inform their employees of pre-made decisions and enlist their help in implementing them. In other, more usefully-implemented, forms, they can provide important opportunities to share views and influence policy and practice. A key factor is whether employee representation is through direct election or union appointment, or a combination of the two.

4.1.3 Currently in the UK the only legal provisions are under the Information and Consultation Regulations of the Employment Relations Act 2004 which gives employees the right to request (triggered by a request from 10% of employees) that their employer set up a procedure to consult with them over:

- i) The recent and probable development of the undertaking's activities and economic situation.
- ii) The situation, structure and probable development of employment within the undertaking and on any anticipatory measures envisaged where there is a threat to employment.
- iii) Decisions likely to lead to substantial changes in work organisation or in contractual relations.

4.1.4 Most other West European countries already have more extensive national regulations on workplace democracy, most commonly defined by statute or regulation. In the UK, voluntary take-up has been low. In Germany there are two-tier boards with representation of workers, shareholders, and senior managers; this was a legacy of the post-war occupying powers, who wanted to avoid undue concentrations of power – whether industrial or political. In other countries such as the Netherlands and France, there are statutory systems of works councils.

4.2 Barriers to Workplace Democracy

4.2.1 It seems apparent there is no great enthusiasm amongst employers or most unions to promote greater employee participation in the workplace. Employers see it as a curtailment of their ownership rights whilst many unions have traditionally seen it as a threat to their role as the main representative of workers to management and ownership. This is in contrast to other countries such as the United States and Italy where unions have been at the forefront of promoting establishment of worker co-operatives.

4.2.2 The idea that employees have rights to participate because they are employees rather than through their union membership is a threat to traditional union mind-sets, and this tension has been a major contributor to the Labour Party consistently failing to come to terms with workplace participation and industrial democracy. Partly as a result of these tensions, the only significant measure introduced by the last Labour Government in this field, the Information and Consultation Regulation 2004, has seen limited take-up.

4.3 Policies to Promote Employee Participation and Workplace Democracy

4.3.1 Similar considerations arise in relation to the government's role in boosting employee participation. The government could merely seek to act as a champion of employee participation with information and awareness-raising campaigns. It could go further by establishing reporting standards of practices of employee involvement and encouraging the Financial Reporting Council to help to enforce this. One way of achieving this would be to amend the UK Corporate Governance Code so that listed companies are required to establish a policy concerning employee participation, as well as perhaps employee share ownership. Whilst such measures would be a substantial step forward and should be pursued we do not believe they are sufficient.

4.3.2 In view of the importance of encouraging democratic and voluntary participation, employee participation is, in our view, critical. The average, full-time, working person will spend approximately 80,000 hours⁶ of their life at work, and so they should have the right to have significant input into this environment. Despite the operation of various trade unions in a number of sectors, there remains a fundamental lack of participation for a great number of workers.

4.3.3 We therefore endorse previous party policy that an employee's right to participation should be seen as a fundamental right and hence should be enshrined in law.

4.3.4 Previous party policy did not advocate setting out a specific form of participation, such as the German supervisory board structure or works councils. A German Supervisory Board approach would not be possible under current UK companies act legislation. Instead it proposed a more principles-based approach with an Industrial Participation Agency or a strengthened Advisory, Conciliation and Arbitration Service (ACAS) as the body which approved participation arrangements and acted as a promotional body for employee engagement.

4.3.5 An alternative approach would be one similar to the European Company legislation which implements three standard models of employee participation. Workers can either be represented at board level alongside employers, in a separate works council of employee-only representatives, or by a third option negotiated by common consent of employees and management.

4.3.6 We are of the view that the Government should not be prescriptive as to the specific form of participation and are attracted to the flexibility enshrined in the European Company legislation. Our proposed approach would lay out the minimum requirements for participation by employees, but would allow firms and individuals to be creative about the precise form of involvement.

4.3.7 We propose that:

- i) Workers' rights to participation in organisations with over 250 employees should be enshrined in legislation. The way in which such participation should be enshrined should be flexible and the detail would be subject to consultation prior to implementation.
- ii) Government work with the Financial Reporting Council to amend the UK Corporate Governance Code so that companies are required to establish a policy concerning employee participation.
- iii) Companies Act legislation should be amended to enable a two tier board structure along German lines where companies and employees wish to adopt it.
- iv) Employee participation should be having a say on such issues as a) the remuneration policies of the company (including at board level); b) the terms and conditions of employment of the company; c) the strategic direction of the company; and d) provisions for dealing with employee suggestions and concerns.

4.3.8 Trade unions can continue to have a significant role to play in both employee owned firms and in employee participation processes, particularly in representing and protecting the rights of an individual worker. They may also have a formal role in employee forums/works councils, as they do in companies such as BT and Tesco. However they should not be the sole channel of employee voice and employees must have the ability to participate independently of the trade unions if they wish.

4.3.9 We have also considered how best to implement the principles of workplace democracy in the public and voluntary sectors. Privatisation in the public sector has increased the extent to which employees can have a say through structures established for the private sector. In the public sector, Liberal Democrats have no doubt that hearing the voices of employees and giving them more power to influence and advise is important and useful. The underlying question, however, is how to balance the interests of the wider public, expressed and managed through democratic elections, with the interests and contribution of employees.

4.3.10 In the voluntary sector, the legal definitions of charity since 1601 have precluded both employees and recipients from having a direct say in the management of their organisations – the concept of government by trusteeship is a key defining factor of the sector, not only in the UK. This has led to uncomfortable compromises in membership organisations such as the National Trust or the RSPB in relation to the status of members who are also beneficiaries and electors. The restrictions on employees are even greater. Although these structures have served well over time, there is a valid challenge about the potential role of employees and the human recipients of charitable help in defining and managing services for current and potential recipients.

4.3.11 We propose that employees have as much right to participate in the public and voluntary sector as they do in the private sector. Precisely how this is enshrined in law and practice should be the subject of consultation.

⁶ Average of 42.7 hours worked a week (ONS, December 2011), 47 weeks a year (24.6 days annual leave according to the European Foundation for the Improvement of Living and Working Conditions), retirement age of 63.5 according to ONS, with an expected working life of 40 years.

Proposals

5.1 Conclusions

5.1.1 The critical role that mutuals, employee ownership and workplace democracy have to play in a liberal society has been widely acknowledged by Liberal Democrats and their predecessor parties going as far back as the Yellow Book in the 1920s and to the philosophy of John Stuart Mill. The centrepiece of current political and economic debate is how we can get growth going again with a more responsible capitalism. At a time of rising inequality and the declining role of unions in representing employees, this longstanding liberal vision is particularly relevant today.

5.2.2 Existing party policy varies in how relevant it remains. Some longstanding Liberal Democrat policies, for example with respect to workplace democracy have largely survived the test of time and are as appropriate today as when they were last discussed twenty years ago. Others, in areas such as mutuals and employee ownership, need additional development.

5.2.3 What is very clear to us as Liberal Democrats, in line with Nick Clegg's Mansion House speech in January 2012, is that these policies are of critical relevance now and should be a central part of the Party's programme for government. From an economic standpoint, the encouragement of economic and democratic participation promises to right many of the wrongs of our current economy – from excessive boardroom pay to rising unemployment in economic downturns to slowing (even reversing) economic growth. From a party political standpoint, we have a much greater opportunity – to use our long history of participation and co-operation to build a stronger, fairer, more sustainable society.

5.2 Our Proposals in Full

Governmental

1. A Minister be given specific responsibility for promoting the MEESO sector and employee participation, most likely in the Department of Business, Innovation and Skills (BIS). They would be responsible for championing the sector and critically reviewing all legislation and regulation to ensure that the needs of the sector are adequately taken into account.
2. DCLG, working with the Local Government Association and local authorities collectively and individually, should examine whether there are any changes to local authority powers required to enable greater mutualisation, employee ownership and participation.
3. Liberal Democrat local authorities and DCLG look actively at how they can facilitate local authority-wide and community initiatives working with community groups, other public sector bodies, registered social landlords credit unions and local businesses to promote a) collective purchasing initiatives in their local communities and b) Co-operatives' (including worker, retail and multi stakeholder cooperatives) contribution to local social and economic regeneration.

Parliamentary

4. A Co-operatives and Societies Consolidation Act to simplify and bring together current legislation (a proposal along these lines was announced by the government in January 2012 and has been a key demand by those active in promoting the sector).
5. A formal legal structure should be established for the holding of employee shares. Currently they are generally held in an employee benefit trust, but this can be costly to establish in terms of legal structure. We are struck by the success of the Community Interest Company Status in helping to facilitate the spread of social enterprises and believe a similar simple 'off-the-shelf' structure would be helpful.
6. The UK Government should ensure that financial mutuals and co-operative banks' particular capital structures are understood and treated fairly by financial services regulators.
7. Legislation be introduced to ensure that if there is to be demutualisation that individual members do not benefit themselves financially in order that there is not the individual financial motive for demutualisation which led to the demutualising of many financial services companies in the 1980s and 1990s.

Taxation

8. Change in the tax legislation so that employees of companies taken over during the first three years of a SIP by an unlisted company for cash are not subject to a tax charge.
9. Change in the law to enable private equity-owned companies to have HMRC tax-advantaged employee share schemes. Currently this means that 3 million employees are unable to benefit from tax advantaged schemes and indeed when companies with share schemes are taken over by private equity eg Boots, they have to cancel their schemes.
10. Making it easier to transfer funds from employee shareholding into a pension fund at retirement. In the case of employee owned or co-owned firms where shares are individually held, there will often be requirements that employees sell their shares back to the employee benefit trust at retirement.
11. A reduction in the time period during which SIPs have to be held from five to three years to make them consistent with other HMRC schemes.
12. Action to remove the adverse tax consequences for companies that wish to transfer shares to Employee Benefit Trusts, caused by the provisions in the Finance Act 2003 which, whilst introduced to stop the use of Employee Benefit Trusts (EBTs) to avoid tax had the unintended consequence of introducing what is arguably a double taxation charge on transfers to EBTs by companies seeking to become employee owned or co-owned. This issue was considered in some detail by the All Party Parliamentary Group on Employee Ownership in 2008 and we support the suggestions made, detailing them in Appendix 2.
13. Employees, where ownership is held collectively rather than individually, should be permitted to receive a 'profit share' tax free which would be related to the maximum which they would have been able to receive under an all employee share scheme. It should not be at as high a level as such a profit share is arguable less risky.
14. For a limited period (as public finances allow) firms with significant employee ownership (50% plus) should have a discounted employers NI rate.

Rights to Request

15. At the point of transfer of any business, employees have the right to put in a bid for the firm that employs them. In order to maximise these types of sales, there should be a Capital Gains Tax cut for owners selling to employees.
16. Employees in all companies limited by shares employing more than 250 employees should have the right to request an employee share scheme in which all employees can participate.
17. Employees in all publicly-listed companies should have the 'right to request' a 5% stake in the business which under company law gives certain additional rights.
18. For all companies where employees own 5% of the shares, and where more than 250 employees are based in the UK, employees have a right to elect a member to the board.
19. There should be a requirement that any IPOs or further share offers on the London Stock Exchange should offer shares to employees on a first refusal basis, possibly with a predetermined discount.

Workplace Democracy

20. We endorse previous party policy that an employee's right to participation should be seen as a fundamental right and hence should be enshrined in law.
21. To lay out the minimum requirements for participation by employees, but allow firms and individuals to be creative about the precise form of involvement.
22. Workers' rights to participation in organisations with over 250 employees should be enshrined in legislation. The way in which such participation should be enshrined should be flexible and the detail would be subject to consultation prior to implementation.
23. Government work with the Financial Reporting Council to amend the UK Corporate Governance Code so that companies are required to establish a policy concerning employee participation.
24. Companies Act legislation should be amended to enable a two tier board structure along German lines where companies and employees wish to adopt it.
25. Employee participation should be having a say on such issues as:
 - The remuneration policies of the company (including at board level).
 - The terms and conditions of employment of the company.
 - The strategic direction of the company.
 - Provisions for dealing with employee suggestions and concerns.
26. Employees have as much right to participate in the public and voluntary sector as they do in the private sector. Precisely how this is enshrined should be the subject of consultation.

Appendix 1: Current Tax Advantaged Employee Share Schemes

Save as you earn (SAYE) is an employee-contribution scheme that provides up to a 20 per cent discount on buying shares, which are then delivered after either three or five years. Employees have an option to buy the shares at the initial market price (less the discount) and if the share price has dropped since the share options were awarded the employee is under no obligation to buy the shares. This provides an effective way for employees both to save (up to £250 per month) and to have the possibility of a risk free gain if they choose to exercise the option and then sell the shares. When they sell the shares they will be subject to Capital Gains Tax (subject to the £10,100 annual exemption) on any gain. However in the short term it fosters less of a culture of ownership due to the delay in delivering the shares, after which point they can be quickly sold on – in effect it is similar to a share option plan rather than a share ownership scheme.

Share incentive Plan (SIP) has four modules for employees to acquire shares. The first consists of a share gifting module where firms give away shares to their employees (up to £3000 per employee per year without the employee having to pay income tax or National insurance on the shares value). The second is a partnership module where employees can contribute their own pre-tax income towards buying shares (up to £1500 per year, no time limits). Thirdly there is a matching shares module, for combined contributions. This is a more flexible model that also offers a route for employees to gain shares even when they could not afford to contribute much of their own income towards it. The final mechanism is that dividends paid on employee shares may be reinvested in so-called dividend shares. With all modules shares must be held in a trust for 5 years before being transferred into the employees ownership free of income tax and NICs

Company Share Option Plans allow UK employees to participate in share options and again they will pay Capital Gains Tax (subject to the £10100 annual exemption) only when they sell any shares, for which they have exercised the option to buy rather than being subject to income tax/national insurance. There is a limit of £30000 on the value of shares awarded. Unlike SAYE or SIP, CSOP does not have to be available to all employees and so can be awarded on a more discretionary basis. However some companies have found it to be particularly effective as a scheme for part time and low paid employees as it enables them to contribute to and share in the companies success without the low paid employee having to save or part with any money, as employees can use an advantageous loan arrangement to fund the purchase of the shares under option if they cannot afford them and repay through the proceeds.

The fourth scheme is the **Enterprise Management Incentive** scheme. This was devised for smaller companies and allows companies with gross assets of no more than £30 million and fewer than 250 employees to award options of up to £120,000 per employee and the total options over shares cannot have a market value of more than £3million. Once again this does not have to be awarded to all employees. Tax is only paid as Capital Gains Tax when the options are exercised and shares sold although even then this can be subject to generous entrepreneur's relief.

Appendix 2: Recommendations on Fiscal Changes of *Share Value: How Employee Ownership is Changing the Face of Business* by the All-Party Parliamentary Group on Employee Ownership

Tax Rules Affecting the Sector

The APPG have already noted the need for the broader regulatory framework to be reviewed under recommendation one and believe that recent CGT changes are also relevant to such a review.

Without wishing to pre-judge the issue, the instinct of the APPG is that there are a number of possible 'turn keys' which will satisfy both the Treasury's concerns about tax avoidance, and the co-owned sector's desire to offset intelligently the withdrawal of tax relief for companies contributing funds to an employee benefit trust.

- i) The APPG recommends that the Treasury and others explore whether the HM Revenue and Customs approved share incentive plan (SIP) trust could involve a permanent holding of shares, in addition to the already existing function of distributing shares to the employees as individuals. This is potentially an elegant and narrow reform of the current regime, building on the SIP trust which is already well-designed to avoid abuse, and therefore requiring no dilution of the Treasury's original objectives behind the 2003 reform.
- ii) The APPG encourages the Treasury to work with interested parties to draw sharper definitional and operational assumptions between employee trusts used for the purpose of achieving employee control structures in bona fide trading operation and contrived arrangements involving employee trusts used for the purpose of sheltering from income tax and national insurance contributions.
- iii) The APPG recommends that the Treasury explore how far new research evidence would support a more favourable tax treatment of SAYE over Company Share Option Plan [CSOP] schemes which are operated for selected employees only.
- iv) The APPG recommends that the Treasury consider making the annual allowances for employee share schemes index linked.
- v) The APPG suggests that the Treasury might also review options for fiscal concessions for investors and lenders supporting co-owned start-ups in areas of social and economic deprivation.

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This paper has been approved for debate by the Federal Conference by the Federal Policy Committee under the terms of Article 5.4 of the Federal Constitution. Within the policy-making procedure of the Liberal Democrats, the Federal Party determines the policy of the Party in those areas which might reasonably be expected to fall within the remit of the federal institutions in the context of a federal United Kingdom. The Party in England, the Scottish Liberal Democrats, the Welsh Liberal Democrats and the Northern Ireland Local Party determine the policy of the Party on all other issues, except that any or all of them may confer this power upon the Federal Party in any specified area or areas. The Party in England has chosen to pass up policy-making to the Federal level. If approved by Conference, this paper will therefore form the policy of the Federal Party on federal issues and the Party in England on English issues. In appropriate policy areas, Scottish, Welsh and Northern Ireland party policy would take precedence.

Many of the policy papers published by the Liberal Democrats imply modifications to existing government public expenditure priorities. We recognise that it may not be possible to achieve all these proposals in the lifetime of one Parliament. We intend to publish a costings programme, setting out our priorities across all policy areas, closer to the next general election.

Working Group on Mutuals, Employee Ownership and Workplace Democracy

Note: Membership of the Working Group should not be taken to indicate that every member necessarily agrees with every statement or every proposal in this Paper.

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