EsopCentre

Enterprise Management Incentives:

Powerful Lessons From Five Practical Case Studies

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and Investment Education

Enterprise Management Incentives: Case Studies

An Overview of the Statutory Requirements

- The highly tax-efficient and highly-commercially flexible EMI was first introduced through Finance Act 2000 and has the potential to benefit any company that meets the criteria for a **Qualifying Company** and whose employee participants meet the criteria for an **Eligible Employee**.
- To be a **Qualifying Company**, the company: (1) must be independent throughout the life of the options, (2) must have gross assets that do not exceed £30 million at the date of grant and (3) must not have its trading involved in certain trades for 20% or more of its activities for the life of the options.
- To be an **Eligible Employee**, an individual: (1) must be an employee within the company or the company's group, (2) must give "committed time" to the company that amounts to at least 25 hours a week or, if less, for at least 75% of his/her "working time" and (3) must not at the date of grant have a material interest (more than 30%) in the company.
- The maximum initial market value of shares over which an employee may hold unexercised EMI options is £250,000 and the total market value limit for the company to grant options is £3,000,000.
- The company must have fewer than 250 employees to grant options under EMI.

Enterprise Management Incentives: Case Studies

Case Study 1:
For Motivation Towards A Sale

Case Study 2:
For Long-Term Incentive Plan (“LTIP”) Requirements

Case Study 3:
For An Employee-Controlled Company In Perpetuity

Case Study 4:
For Succession And Shareholder Investment Diversification

Case Study 5:
For The Growth Shares Model

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Case Study 1:

For Motivation Towards A Sale

- **Private company currently worth £300,000 has a projected value in 5 years time of £7 to £10 million.**

- **Fast growth business marketing software technologies to premium clients.**

- **Corporate objective to exit in 5 years time and in order to realize this ambition needs high calibre engineers that are difficult to recruit in the marketplace and even more difficult to retain.**

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Case Study 1:

The Solution

- **Focus the scheme on the corporate objective of realising value after a limited company life with the key employees sharing in the capital sale.**
- **Option price is set at nominal value only in order to maximise the benefit to the employees.**
- **Lower level of share options for the support staff, recognising that team performance from all levels is required for the achievement of the corporate objective.**
- **Exercisable events restricted to exit positions of takeover share sale, management buy-out, flotation on a recognised stock exchange and sale of trade and assets.**
- **Options lapse for employees who leave for any reason whatsoever, a feature that concentrates the attention on the focus for selling out in 5 years time.**

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Case Study 1:

Interesting Scheme Features

- **The accumulating right to exercise for one-off grants rather than a series of annual staggered grants at different option prices.**

- **This feature establishes the option price when the market value of the shares is low.**

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Case Study 2:

For Long-Term Incentive Plan ("LTIP") Requirements

- **Company quoted on the Alternative Investment Market with a value of £18 million.**
- **High level reputation in the business of passenger and freight rail transport.**
- **Already has Share Incentive Plan and a ShareSave Scheme on an all-employee basis.**
- **Requires a tax-efficient LTIP for its director and executive team to meet retention needs.**

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Case Study 2:

The Solution

- **Establishes an EMI scheme with options granted as "nil cost" options, i.e. 100% discount on the market value at the date of grant.**

- **Settles monies into an employee share trust to enable the trustees to purchase shares off the AIM market.**

- **Agrees performance conditions linked to Total Shareholder Return that must be achieved for the exercise of options in 3 years time.**

- **Options granted on an annual basis so that option lives overlap with up to three live options at any point in time, each with a different outstanding period remaining.**

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Case Study 2:

Interesting Scheme Features

- **The combination of the 100% discount EMI options and the employee share trust replicates the LTIP arrangement with an absolute guarantee of no tax or NICs at the inception of the scheme.**
- **The staggered option arrangement based on overlapping options assists retention by ensuring that if a director or executive left the company then he/she would be walking away from value.**

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Case Study 3:

For An Employee-Controlled Company In Perpetuity

- **Private company currently worth £5 million with no plans for sale in either the short-term, the medium-term or the long-term.**
- **Very fast growth company in the business of software testing and recognises the opportunities in the U.K. and throughout the world for its continuing growth.**
- **Belief in the employee share ownership ethic for growth and development and wishes to see its shares recycled in perpetuity between its employees.**
- **Sets option prices equal to the market value of the shares at the date of grant with employees buying their shares primarily through bonus monies.**

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Case Study 3:

The Solution

- **Exercises are made on an all-employee basis with all employees offered shares on the basis of a tiered structure prepared on the basis of objective and fair criteria linked to seniority.**

- **Encourages early share purchase by restricting the opportunity for exercise to the period of three years from the date of grant.**

- **Encourages some retention by not allowing sale of the shares until two years after purchase.**

- **Exercises are satisfied through the employee share trust purchasing shares from the existing shareholders and then dispensing them to employees on exercise.**

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<u>Case Study 3:</u>

<u>Interesting Scheme Features</u>

- **The employee share trust operates as a surrogate market for the shares in the absence of a recognised stock exchange.**
- **Recognised share valuation methodologies are used to establish a surrogate value for the shares on a six-monthly basis.**
- **The same 20% of the share capital is recycled through the employee share trust adopting a commercial persona and acting as both provider <u>and</u> purchaser of the shares.**

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Case Study 4:

For Succession And Shareholder Investment Diversification

(Note: Employee Share Schemes for Management Buy-Outs)

- **Company has grown steadily over many years and existing shareholders in their late 50s are contemplating retirement.**
- **Engineering business with a long history but with strong potential for new product development and the capture of new markets.**
- **Existing shareholder/directors have identified successors who as responsible individuals will be able to lead the workforce of some 220 individuals into this new era for the business.**
- **Existing shareholders want to retain some interest but also want to realise some value for their shares with a view to diversifying their investment portfolio.**

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Case Study 4:

The Solution

- **Company establishes an employee share trust to enable the shareholder/directors initially to sell 24% of their combined shareholding and realise cash for investment elsewhere.**

- **Company grants EMI share options to key management team members with top-up tax-unapproved share options to take the combined new management shareholding to 40% in five years time and to 75% in 7 years time.**

- **Company has taken deliberate steps to train and to develop its new management team to the level of management that is required to run the company.**

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Case Study 4:

Interesting Scheme Features

- **Existing shareholder/directors realise cash through a capital gains tax transaction with the employee share trust at the CGT rates.**

- **Existing shareholder/directors have in the short-term retained control of the company, even control of special resolutions, whilst at the same time ensuring that their investment portfolio is not restricted to shares in their own company.**

- **The statutory corporation tax deduction is an attraction with the company benefiting from relief within its corporation tax computation based on the gain realised by the employees at exercise.**

- **The new management team can envisage a future with their shareholding escalating over time and their own opportunity in time for a realisation of value through selling to the same employee share trust.**

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Case Study 5:

For The Growth Shares Model

- **Private company currently worth £10 million with five shareholders who are resolved to drive the company forward towards high growth in order to realise the company's potential.**
- **Operating in a specialised management consultancy field with a dynamic set of products and services that have unlimited potential in the UK and worldwide.**
- **Existing shareholders want to preserve for themselves the existing Whole Company Value at the date of the commencement of the employee share scheme AND going forward.**
- **Resolved to involve the whole workforce of 140 employees in a growth shares model as the impetus for the company to grow in the UK and overseas.**

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Case Study 5:
The Solution

- **Reclassify the existing ordinary share capital into a new preference share capital to replace the existing ordinary share capital.**

- **Value the company at the £10 million Whole Company Value and freeze the £10 million Whole Company Value into the new preference shares.**

- **Create new ordinary shares as the Growth Shares, allocated 80% to the existing shareholders and 20% to the new employee shareholders. so that all (existing shareholders and new shareholders) benefit from the growth.**

- **On a sale of the company, say for £50 million, the first £10 million is paid to the preference shareholders while the remaining £40 million is paid to the ordinary shareholders (the Growth Shareholders).**

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Case Study 5:

Interesting Scheme Features

- **The Growth Shares, i.e. the ordinary shares, grow from zero value, to attract all future growth following the reclassification, with ALL gain as capital gain.**

- **The employee share scheme is Enterprise Management Incentives which has the special form of Entrepreneurs Relief that was specifically created by statute for Enterprise Management Incentives.**

- **For all Enterprise Management Incentives, the special form of Entrepreneurs Relief delivers a 10% capital gains tax rate on the capital gain, provided a period of at least two years has elapsed from the date of grant to the date of sale. However, when linked to the Growth Shares Model, the 10% capital gains tax rate applies to virtually all the sale proceeds as the base cost of the shares is no more than a very low nominal value, say £0.0001 per share.**

Enterprise Management Incentives

All Best Wishes For Your Business Initiative From David Craddock
Consultant, Lecturer, Author
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Management Buyouts, Share Valuation and Investment Education

We are very pleased to help you so please do not hesitate to make contact by telephone or e-mail.

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The Esop Centre’s *newspad*, edited by Fred Hackworth, is a monthly publication providing in-depth coverage of the main international news in the employee share ownership field.

May 2020

In this month’s edition:

- The State is back: Covid-19 is game-changer
- How Centre members are coping with the restrictions
- BT honours promise to give free shares to 100,000 employees
- Jersey: share schemes for trustees – register now
- London: Ocorian sponsored share plans symposium, October 15
- Share plan tax benefits threatened by mass furloughs
- Some agms are more virtual than others……
- Regulators gang up to stop dividend and bonus pay-outs
- Company Covid-19 news
- Employer NOT liable for employee’s deliberate leak of personal data


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newspad of the Employee Share Ownership Centre

Tidal wave of MBOs engulfs C.I. trust companies

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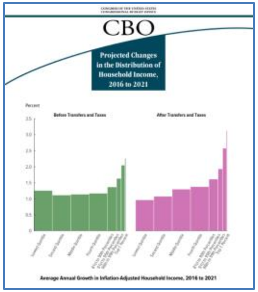
Resources - Bulletins



From 43,000 curated sources, you get a machine summary of the key point(s) from forward-looking articles, not just article titles:

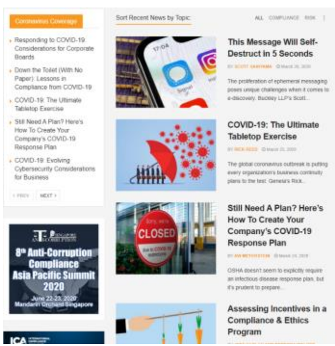
(LF.10) Reduced Inequalities

In September 2015, 193 world leaders agreed to 17 Global Goals for Sustainable Development. If these Goals are completed, it would mean an end to extreme poverty, inequality and climate change by 2030.
Goal 10: Reduce inequality within and among countries.

- If the distributions of **income**, means-tested transfers, and federal taxes follow CBO's projections, **income inequality** will be greater in 2021 than it was in 2016.
- **High growth** over the **past decade** has been based on unsustainable resource exploitation; addressing the **resulting growth** in **inequality** and environmental cost will be critical to ensure social stability and to ensure **strong sustainable growth** in the coming decade.
- The increase in **inequality** observed in the last 30 years is a serious threat to France's social contract.
- America's pluto-populist president is peddling a tax plan that will further increase **economic inequality** at a time when **income** and wealth gaps are already widening.
- A failure to give the **world's poorest women control** over their bodies could widen **inequality** in **developing countries** and thwart progress towards global goals aimed at ending poverty by 2030.
- Under French leadership the G7 group of the 7 largest advanced economies plus the European Union will focus in 2019 on fighting **inequality**, including **poverty** induced by **climate change**.
- Leadership might require companies to take positions and advocate for **change** on **global inequality** - including **in-work poverty**.
- Achieving the 17 **Sustainable Development Goals** - which include clean water, clean energy, sustainable cities, climate action, responsible consumption, **reduced inequality** and more - could open a market opportunity of $12 trillion by 2030.
- The next decades offer an opportunity to address **African urban poverty** and **inequality** and shape development priorities to ensure that urbanisation helps foster well-functioning, liveable and sustainable cities.
- In Africa and in the LDCs, eradicating poverty by 2030 will require both **double-digit GDP growth** and dramatic declines in **inequality**, illustrating the scale of the current challenges faced.
- The economic catch-up of Asia with the West will continue in the coming decades - thereby reducing **global inequality** among countries and among world citizens.

(FS.3.05) Employee Share Ownership

- Considering 75 percent of the 2025 global workplace will be Millennials and Generation Z, it's critical that **organizations** keep a pulse on **employee engagement** and in a way that's consistent with how the emerging generations communicate.
- 2019 will see a continued evolution in designers' understanding of workplace optimisation with design that boosts office morale and **employee wellness** while facilitating a creative work environment.
- By 2018, Gartner Predicts Twice as Many Employee-Owned Devices Used for Work than Enterprise-Owned Devices.
- With proposed revisions to the UK Corporate Governance Code, from 2020, companies will be required to report on **employee engagement**, as announced earlier this **year** by Financial Reporting Council.
- For HR leaders looking to better determine the attitudes that drive employee turnover and increase retention, using AI to provide insights into **employee engagement** will be crucial.
- By 2021, Artificial Intelligence (AI) will allow the rate of innovation in New Zealand to double: **Employee productivity gains** are expected to increase 1.5 times.
- Artificial Intelligence will double the rate of innovation improvements and improve **employee productivity gains** by 1.5 times in New Zealand by 2021.
- US health benefit costs per **employee** will increase 4.1% next **year** - slightly higher than inflation and less than the double-digit increases seen in years past.
- With a tight labour pool, small businesses will find 2019 is the **year** to focus on **employee engagement** and happiness.
- Nearly 50 percent of companies also expect that automation will lead to some reduction in their **full-time workforce** by 2022, based on the job profiles of their **employee base** today.
- **Employee wellness** has been on trend for **years**, but expect to see some high-tech changes in 2019.
- By 2020, automation and artificial intelligence will reduce **employee requirements** in **business shared-service centers** by 65 percent, which says the RPA market will top $1 billion by 2020.
- This **year**, many **organizations** will look to employee scheduling software to solve problems around creating, publishing and managing employee schedules that include options to open shifts to select groups and integrate data on sales to help identify customer traffic patterns to optimize worker ratios.



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Resources - Webinars

18 May 2020	FS Club	FSG Anti-Money Laundering (AML) Task Force – The Professions	Graeme Gordon, Heather Brehcist, Mark Spofforth OBE
19 May 2020	Z/Yen Group	CommunityZ Chest - Featuring Tim Ward In Conversation With Michael Mainelli	Tim Ward
20 May 2020	FS Club	2020 Vision And The 21st Century: Looking Back To 2000 And On To 2040, A Gresham College Event Two Decades On	Roger Camrass, Richard O'Brien, Gill Ringland, Oliver Sparrow, Professor Richard Susskind, Chris Yapp, John Carrington, Professor Tim Connell
21 May 2020	FS Club	All Too Human: Behavioural Finance Biases In Trustee Decision-Making	Professor Iain Clacher
22 May 2020	FS Club	Banks, Blunders And Lessons Learned: Misadventures In A Data-Driven World And How To Solve Them	Jennifer Liu, Paul Hudson, Kieran Seaward
26 May 2020	FS Club	Insuring The Next Pandemic	Alistair Milne
27 May 2020	FS Club	Leadership In Financial & Technical Firms In A Time Of Covid-19	Toby Corballis
28 May 2020	FS Club	The Future For Information Rules & Permissions	Maury Shenk

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Thank You!

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