BUILD IT

EMPLOYEE

HOW TO GET YOUR EMPLOYEES

SHARE

TO THINK AND ACT

OWNERSHIP

LIKE BUSINESS OWNERS

PLANS

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INTRODUCTION

I've been a strategic accountant and adviser to small businesses for more than 20 years – and throughout that time I have identified a number of key steps that business owners can take to dramatically improve the financial performance of their businesses. One of these is having an employee incentive program that motivates staff to think and act less like employees and more like business owners. The ability to attract, retain and motivate people to peak performance means being able to attract and retain business – and it is a significant competitive advantage. In fact, it can mean the difference between success and failure.

Until now the most attractive employee incentive systems have been created to meet the needs of large corporates rather than smaller companies. In this book we highlight the Peak Performance Trust (PPT), an employee equity plan that has been created specifically to give smaller companies access to the same sophisticated incentive benefits that are used by large companies. The PPT enables you to create a structure within which your employees' lifestyle and financial goals are aligned with your business objectives. The result? A cohesive and committed team that is single-minded about working toward, and sharing in, the benefits of a successful and profitable business.

This book is broken up into 3 parts:

- Part 1 – gives you an overview of the key issues involved in implementing a Peak Performance Trust (PPT) within your company. It is a general discussion for business owners who want an overview of ESOPs and in particular PPTs
- Part 2 – provides more technical explanation for accountants, financial planners and business owners on how ESOPs work
- Part 3 – provides the academic research behind how and why ESOPs exist and the use of ESOPs as a viable business succession and exit planning tool.

When you're ready to talk about how a PPT can benefit your company's growth and profitability, you'll have a good understanding of the requirements and scope of the process. So please, enjoy this short read and then let's talk about your peak performance needs.

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PS. For more worksheets, articles, advice and information on employee incentive schemes visit www.successionplus.com.au.
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PART 1

OVERVIEW OF ESOPs

Is this the competitive edge you've been overlooking?

"People are definitely a company's greatest asset. It doesn't make any difference whether the product is cars or cosmetics. A company is only as good as the people it keeps."

Mary Kay Ash

Staff recruitment, satisfaction, motivation and retention are often dismissed as being part of the 'soft' skill set – of lesser importance than the real business of generating revenues and earning profits. But ask any owner of a small or medium-sized business what his or her greatest challenge yet most valuable asset is, and all will agree – it's their staff. What would it mean to your business if your employees were as committed to achieving success as you are? Recent surveys confirm what most owners of small and medium-sized businesses know only too well – their number one concern, above even cash flow problems or a lack of sales, is finding and keeping the best people. In an employment market that is experiencing the impacts of an ageing workforce, skills shortages and a new generation of employees that is more mobile, more demanding and less loyal to employers, employee retention is becoming one of today's hottest competitive issues.

Not investing in your employees is too expensive

Employee turnover can represent significant costs to businesses in terms of:

- recruitment and training
- disruption to the team dynamic
- disruption to relationships with customers, suppliers and other third parties
- disruption to business continuity
- and a variety of other direct and indirect costs.

One estimate suggests that businesses lose at least two months of productive time through recruitment, training, loss of momentum and other factors when a staff member leaves. And it is said to cost anywhere from two and a half to three times a person's annual salary before the business is up to speed again – not to mention the cost of the intellectual property and business knowledge that has just walked out the door. Simply, losing staff means replacement costs, foregone opportunities and even increased competition if that's whose recruiting your best performers. According to the PWC Family Business Survey

in 2014, 48% of SMEs said that their biggest internal business issue was staff recruitment, followed by business and product development as well as cash flow and cost control challenges.

Employee incentive schemes as a strategic business tool

Recruiting staff is an expensive, time consuming and often haphazard process. And in a job market where the best candidates are often interviewing you, rather than the other way around, businesses need to find ways of differentiating themselves through innovative and attractive terms of employment.

Specific strategies aimed at attracting, motivating and retaining employees can deliver valuable payoffs. Employee incentive schemes that get your people thinking and acting less like employees and more like business owners are an important tool. Their primary objective (and the reason for their success) is to align your employees' financial objectives with those of your business – and that translates into a major competitive advantage.

Research shows that Employee Share Ownership Plans (ESOPs) are identified as a means of enhancing enterprise performance through promoting worker productivity. (Relations., 2000) There have also been studies related to use as a means of reducing agency costs through directly monitoring employees and through adopting incentive-based forms of remuneration. (Pendleton, 2006)

A Principal – agent behavioural theory argues that employee logical self-interest, aversion to risk and effort creates costs for an organisation. In the absence of complete information, the principal (business owner) has to increase productivity through a mixture of compensation and monitoring of agents (employees). ESOPs are a way to align principal and agents efforts to improve productivity, however, a free rider effect is expected to diminish the effect of ESOPs in larger firms. (Sesil & Lin, 2011)

They have also been argued to reduce wealth inequality and improve firm and aggregate economic outcomes (Kozlowski, 2013). ESOPs are also considered by policy makers and advocates to be an important

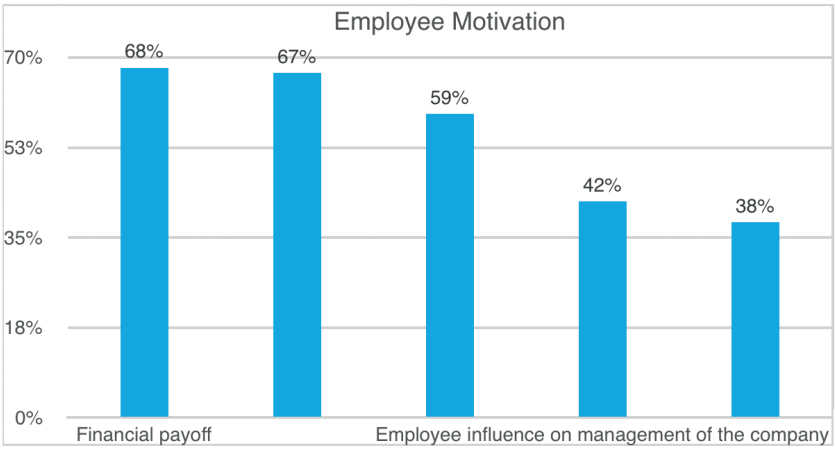
mechanism to encourage Start-up activity by enabling Australian employers to improve cash flows and attract and retain talented staff at lower rates of wage compensation (when supplemented with shares or options) (Department of Prime Minister and Cabinet, 2014).

This is all evident in Computershare's Employee Share Plan Survey in 2017, which found:

- 52% of plan participants say that the plan reduced the chance they would leave the company either "to a great extent" or "to some extent"
- 63% of participants feel "very loyal" to the company, and
- 73% of plan participants agree or strongly agree that the company is a good place to work.

Why do workers get into an ESOP?

In a recent Melbourne University study, a group of employees were asked certain questions and below are what they ranked as the most important elements of an ESOP:



Source: Michelle Brown, Rowan Minson, Ann O'Connell and Ian Ramsay, Why Do Employees Participate in Employee Share Ownership Plans? Employee Share Ownership Project, Melbourne Law School, The University of Melbourne, 2011

ESOPS are used for several reasons:

- **Savings Vehicle** – Most ESOP plans have a long-term focus (3-7 years), allowing employees to accumulate savings through acquiring and holding shares.
- **Participation** – ESOP participants tend to experience a greater sense of community and involvement with the decision-making process, leading to increases in employee engagement levels.
- **Succession Planning** – An ESOP can be an effective employee buy-out instrument when the owner(s) want to retire (or change their business direction) and need to sell. Funding Retirement – ESOPs can give founders the ability to extract cash prior to retirement.

Case Studies

Below are examples of businesses in Australia that have introduced ESOPs into their business:

LJ Hooker Commercial real estate office on the Central Coast was the Winner of the 2011 ESOP of the Year award using a Peak Performance Trust. The award was based on substantial reduction in sick days and improved staff retention, as well as a noted increase in performance and participation.

Ty Blanche of LJ Hooker said "we have created a more understanding team of people, and added value to the individual's performance congruently."

"Both financial services and property management referrals from employees participating in this scheme increased at a higher level than before. I put this down to their seeing value in contributing to the company's bottom line because they will share in the profit."

The National Personnel Group said "since kicking off our Ownership Thinking program, absenteeism has already dropped by at least one third! Overall, productivity is higher and our employees are taking more interest in the financial wellbeing of the business."

Academic Research on the Impact of ESOPs

- ESOPs appear to increase sales, employment and sales per employee (Drs. Joseph R. Blasi and Doulas L. Kruse School of Management and Labor Relations Rutgers University).
- ESOP companies that combine employee ownership with a participative management style grow 8-11% per year faster than they otherwise would have been expected to grow based on pre-ESOP performance (National Center for Employee Ownership, Harvard Business Review September/October 1987).
- Compared to 500 private non-ESOP companies, ESOP companies paid better benefits, had twice the retirement income for employees, and paid higher wages than their non-ESOP counterparts. (Wealth and Income Consequences of Employee Ownership: A Comparative Study from Washington State, Kardas, Peter A., Scharft, Adria L., Keogh, Jim, November 1998).
- Studies between ESOPs and productivity growth have found greater productivity and profitability in the first few years after a company adopts an ESOP (Dr Doulas L. Kruse, School of Management and Labor Relations, Rutgers University, 1995).
- The number of ESOPs in the UK increased by 10% during 2012 (National Centre for Employee Ownership, February 2013).

While the research undoubtedly shows an increase in employees looking for equity in the business they work for – Australia lags behind on the world stage in providing a mechanism to achieve this. According to recent research in both the United States and Europe, a little over 30% of employees have some kind of equity interest in the business they work for, while in Australia that number is around 8%. Of the estimated $8 trillion of corporate equity in the United States, employees own about $213 billion through ESOPs and similar stock plans.

One of the main reasons for this low participation rate is that many businesses don't realise that share ownership is appropriate for them, even though it can be used in any business – even those that are not publicly listed on an exchange. Equity replicator plans can replicate

the operations of share plans without the need for shares. These plans create units, which represent notional equity, and awards are calculated by using a formula that measures business value.

ESOPs and Gen Y

A workshop on generation Y in the workplace raised an interesting statistic; 72% of the Generation Y population want to own their own business. Back in my dad's generation less than 12% of school leavers wanted to run their own business. Most people wanted to go and work for a big bank or a corporate and stay there till they were 65 then retire on a good retirement plan.

If you have Generation Y employees this is an important point to know, as they may leave to pursue their goals if equity ownership is not an option. However, another interesting statistic was that over 90% of those wanting to own a business said they didn't want to own it on their own. Generation Y workers look for freedom and flexibility and the opportunity to have three months off to travel to Europe.

Most baby boomers look at that and think it's all too hard, they get it too easy or they are too much risk. But the fact is this is the way our workforce is heading, and rather than fight it we need to look for ways to accommodate it so that we can retain good people.

Most 25-year-olds can't afford to start their own business or buy one. So, an employee share plan gives younger employees the opportunity to part own a business while enjoying the security and lifestyle that comes with being an employee. And over the next five to ten years, that employee has an opportunity to build equity and gradually take over ownership of the business, if they want it.