PN-ACB-778

Zimbabwe: Employee Ownership Study Tour

Final Report

U.S. Agency for International Development

Prepared for: USAID Zimbabwe

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Foundation for Enterprise Development

Sponsored by: Private Enterprise Development
Support Project III
Contract No. PCE-0026-Q-00-3031-00
Delivery Order No. 56
Prime Contractor: Coopers & Lybrand, L.L.P.

August 1997

Coopers
&Lybrand

EMPLOYEE OWNERSHIP STUDY TOUR

This report provides a summary of the educational tour on employee ownership organized for seven[1] Zimbabwean delegates that took place during the period of June 1-7, 1997, in conjunction with Phase I of the employee ownership component of the Zimbabwe Enterprise Development Project.

The purpose of the educational tour was to expose key business and political leaders in Zimbabwe to the successful experience of Hungary and the United Kingdom in implementing policy reforms to facilitate the use of employee ownership to help privatize state-owned enterprises and to promote the use of employee ownership plans in corporate restructuring initiatives.

The following individuals comprised the Zimbabwe delegation:

The Honorable Cephas Msipa, Minister of State in the President's Office
The Honorable Mischeck Chinamasa, Deputy Minister of Finance
Mr. Charles Manzira, Chief Economist, Ministry of Finance
Mr. Munashe Munodawafa, Deputy Director, Ministry of Enterprise and Indigenization
Mr. Owen Tshabangu, Deputy Secretary, Ministry of Industry and Commerce
Mr. Thompson Mabika, Chief Financial Officer, Dairibord Zimbabwe, Ltd.
Mr. William Nyemba, Managing Director, Trust Merchant Bank

Accompanying the Zimbabwe delegation were Mr. Donald Greenberg, Private Sector Advisor for USAID Zimbabwe, and Mr. David Binns, International Team Leader of the Employee Ownership Project from the Foundation for Enterprise Development.

Employee ownership advisors in Hungary and the United Kingdom organized and hosted separate programs for the delegation, working in consultation with the International Team Leader and Coopers & Lybrand. The organizer and host of the Hungarian program was János Lukács, Executive Director of the Share Participation Foundation. The organizer and host of the United Kingdom program was Robert Oakeshott, Executive Director of Job Ownership Limited.

Notebooks containing detailed schedules and handout materials were provided to the delegation members in both Hungary and the United Kingdom. Copies of those materials are attached to this report as Appendix A and Appendix B, respectfully.

[1] Preparations were actually made for eight delegation members, but Mr. Sam Malaba, Head of Planning for the National Economic Planning Commission, was obliged to cancel his participation at the last minute.

HUNGARY: JUNE 1-3

June 1

The delegation arrived in Budapest, Hungary on Sunday, June 1. Following a welcoming lunch, János Lukács of the Share Participation Foundation led a 4-hour afternoon discussion session focusing on the development of employee ownership in Hungary. Also participating in the discussion were Janos Szantai, General Secretary of the Hungarian National ESOP Association; Daniel Vaughan-Whitehead, Senior Advisor for the International Labor Office and an author of several books on employee ownership; Sinclair Cornell, a U.S. professor conducting research on Hungarian ESOPs; and Liona Eros, Manager of the Share Participation Foundation.

The presentations focused on an overview of the Hungarian experience with the implementation of ESOP legislation within the framework of the privatization law, a detailed explanation of the legal structure and tax attributes of ESOPs, an analysis of the Hungarian experience with ESOPs to date, and how ESOPs were used in actual practice in the context of privatization. Delegation members engaged in an active dialogue with the speakers concerning questions about various aspects of employee ownership and the political process.

Following the afternoon session, the discussion of employee ownership issues continued informally over dinner at a traditional Hungarian restaurant in Budapest.

June 2

The second day began with an early morning meeting with Ms. Zoltanne Lucz, Head of Department of the Ministry of Finance and Mr. Shagi, Assistant Secretary of State in the Ministry of Finance. Discussion at this meeting focused on the tax treatment of ESOPs in Hungary, the impact of ESOP tax incentives on the federal budget, and the public policy analysis and political debates associated with the establishment of the ESOP legislative framework.

The delegation then traveled to the town of Solymar and the PEMU Plastic Processing Company for a meeting with Mr. Bernat Sarlos, President and CEO. PEMU is a company with 1,200 employees and US$25M in annual revenues that is owned 64% by the employees through an ESOP, 30% by a bank and 6% by the local government. Mr. Sarlos provided the delegation with a detailed introduction to the company followed by an extensive explanation of the structure of their ESOP and the role that it played in their privatization and subsequent revitalization. Delegation members received a detailed packet of information on PEMU and its product line.

Following the visit to PEMU, Mr. Sarlos accompanied the delegation for lunch at a nearby restaurant where the discussion continued informally over an enormous lunch.

In the afternoon the delegation returned to Budapest for a meeting with Mr. Arpad Kovacs, President of the Board of Directors of the State Privatization and Holding Company. Mr. Kovacs described the role of the SPA and its success in selling off the majority of the government's stake in almost 2,000 enterprises, which resulted in net income to the government of approximately

US$20B. Interestingly, Mr. Kovacs was not a supporter of ESOP privatizations and offered a number of criticisms which resulted in a lively discussion of the pros and cons of employee equity participation in privatization transactions. Delegation members received a packet of information on SPA and its programs.

In the evening the delegation ate dinner at the Karpatia Restaurant in downtown Budapest, followed by a visit to a nearby theater for a performance of traditional Hungarian dances.

<u>June 3</u>

The third day began with a visit to the Hungarian House of Parliament for a meeting with Mr. Tamas Szabo, former MP without portfolio responsible for privatization, and Mr. Imre Csuhaj, Executive Director of the Hungarian Development Bank. Mr. Szabo was the primary political supporter of the ESOP legislation and spoke at length on his views of the public policy rationale for including employee equity participation in privatization and corporate restructuring in a market economy. He also discussed the political process related to implementing ESOP reforms and reviewed the key aspects of the ESOP legislation and why they were introduced. Mr. Csuhaj described the role of the Hungarian Development Bank and its goals of promoting economic modernization, regional economic development and foreign investment in Hungary.

The delegation then traveled to the city of Tata for a visit to the Rooftile Producing Company of Tata and a meeting with Mr. Janos Vali-Toth, President and CEO. Mr. Vali-Toth described his company's experience to lobbying the State Property Agency to use an ESOP to buy out their division from a failing state-owned enterprise. Against great odds, the company's 130 employees were able to organize a 100% ESOP buyout and to turn the company around from near bankruptcy to profitability. Mr. Vali-Toth reviewed the structure of the ESOP and the operational changes that had taken place since the implementation of the ESOP and then provided the delegation with a tour of the manufacturing plant. Delegation members also received a packet of information on the company.

Mr. Vali-Toth then joined the delegation for lunch at the Oregto Restaurant in Tata.

Following lunch the delegation returned to Budapest for a boat trip on the Danube River on the boat of MASPED, the First Hungarian Forwarding Company which is 35% owned by an ESOP. Mr. Istvan Kautz, President and CEO provided an overview of MASPED's experience with employee ownership and also facilitated discussions with several journalists who went along on the boating trip. Delegation members fielded several questions about their interest in employee ownership and its potential application in Zimbabwe.

After the boat trip the delegation traveled to the airport for a flight to London.

UNITED KINGDOM: JUNE 4-7

June 4

The first day in London consisted of a full-day presentation at the offices of Unity Trust Bank, a bank specializing in financing ESOP buyouts.

Robert Oakeshott of Job Ownership Limited first provided an overview of the development of employee ownership in the U.K. He was followed by Nigel Forman, a former MP who discussed the merits of employee ownership from a Conservative political standpoint. Denis MacShane, a Labour MP from Rotherham then made a presentation on employee ownership and New Labour.

Following a coffee break, Robin Blagburn, Senior Manager with Unity Trust Corporate Advisors made a presentation on finance and credit for employee buyouts and employee ownership. His presentation was followed by a discussion of management and employee participation in employee-owned companies by Patrick Dolan, consultant, founder and first Director of the British Deming Association. David Farmer, a retired senior civil servant with the Inland Revenue, then discussed the logic and principles underlying tax relief for employee share ownership in Britain.

After lunch Graeme Nuttall, Tax Partner with Field Fisher Waterhouse provided a review of the main employee share ownership schemes supported by tax relief in Britain. David Wheatcroft then provided a review of his experience of five years of employee ownership at Chesterfield Transport, a local bus company privatized through an ESOP buyout. His presentation was followed by a discussion of policies and attitudes to employee ownership in Britain's trade unions by Janet Williamson, Policy Officer of the Economic and Social Affairs Department of the Trade Union Congress.

June 5

The delegation traveled by bus to Stoke-on-Trent to the Tullis Russell Paper Company, a company owned predominantly by its employees. Richard Downes, Managing Director of the plant and Roger Brindley and Tony Border, company share counselors, led a discussion of Tullis Russell's unique ownership structure. Following an extensive discussion of the employee ownership structure, delegation members were provided with a packet of information on the employee share ownership plans and were given a tour of the company followed by a buffet lunch.

The delegation then traveled to Rotherham where they quaffed some local brews with several employee-owners of the Mainline Bus Company (compliments of the hosts, of course) and had dinner at the Elton hotel.

June 6

The morning was spent with representatives of Mainline Bus Company including Peter Sephton, Chairman and Chief Executive; Dave Edwards, Employee Director; and Peter White, Employee Director. Mainline was privatized through an employee buyout in which with employees negotiated significant control rights. Mr. Sephton described the overall business operations and the management challenges in operating an employee-owned company and Msrs. Edwards and White discussed the structure of the ESOP and the corporate governance provisions of the company.

Following lunch, the delegation returned to London and attended an evening reception at the residence of Robert Oakeshott. They departed for Zimbabwe on the following afternoon following a free morning in London.

CONCLUSIONS

The tour was clearly successful in exposing the delegation members to the potential impact of public policy initiatives supporting employee ownership. The Hungarian model focused primarily on the role of employee ownership in privatization initiatives and the U.K. model offered examples both of privatization and of private sector transactions involving employee ownership. Both countries' experiments with tax policy and financing strategies for facilitating employee ownership were of particular interest to the delegation members and generated extensive discussion and debate. Each of the delegation members seemed to be quite engaged with the issue and appeared inclined to want to pursue further efforts to promote the development of employee ownership in Zimbabwe.

Based on the positive experience they were exposed to involving employee ownership in Hungary and the U.K., it would be advisable to follow up with each of the delegation members to try to build interest within Zimbabwe for introducing employee ownership reforms.

APPENDIX A: EMPLOYEE OWNERSHIP STUDY TOUR OF HUNGARY

June 1-3, 1997

Contents

Draft Workplan for the Employee Ownership Study Tour[1]
June 1-3, 1997

June 1

10.00 **Budapest, Ferihegy Airport**	**Arrival** The Zimbabwean Delegation meets the representative of Share-Participation Foundation (SPF), Project Assistant Kate Hegedűs
10.30 **Hotel Astoria**	**Check-in**
13.00 **Hotel Astoria**	**Lunch** with the participation of János Lukács, Executive director of SPF
14.00-18.00 **Hotel Astoria-Green Room**	**Presentation and discussion on Employee Ownership in Hungary** Partners: János Lukács , (SPF) János Szantai, General Secretary,National ESOP Association Daniel Vaughan-Whitehead, Editor of the volume: „Privatization Surprises - Employee Ownership in Central and Eastern Europe" (1997) International Labor Office (ILO) Ilona Erős, manager, SPF
19.00 **Kárpátia Restaurant** **(V., Ferenciek tere7-8, Budapest)**	**Dinner**

1.On all its programs and meetings the delegation will be accompanied by an interpreter and one or two representatives of SPF, including their trips to and from the airport.

June 2

8.30-10.00 **Ministry of Finance** **(József Nádor tér 2-4, Budapest)**	**Meeting with Ms. Zoltánné Lucz, Head of Department** Information on privatization and taxation question
11.00-12.30 **Company visit[2]** **(PEMŰ Plastic Processing Co., Ter-styánszky út 89, Solymár)**	**Meeting with Bernát Sarlós, President-CEO** Discussing the experiences and results of the company in the field of employee ownership
13.00-14.00 **Korona Restaurant, Solymár**	**Lunch**
15.00-16.00 **State Privatization and Holding Co.** **(Pozsonyi út 56, Budapest)**	**Meeting with Árpád Kovács, President of the Board of Directors** Information on the beginnings and the present state of employee ownership in Hungary
18.00-1900 **Kárpátia Restaurant**	**Dinner**
19.30 1	**Cultural program - to be decided on later**

2 All companies to be visited are, in different rates, employee owned.

June 3 Breakfast at hotel w/ Sinclair Cornell

7.30-

8.30-10.00 **The House of Parliament**	**Meeting with Tamás Szabó, former MP without portfolio responsible for privatisation, and** **Imre Csuhaj V, executive director of Hungarian Development Bank, formerly principal private secretary to Tamás Szabó** Information on the present state of the privatization and on its past
11.30-13.00 **Company visit** **to Rooftile Producing Co. of Tata** **(Faller Jenő u. 9., Tata)**	**Meeting with János Váli-Tóth, President-CEO** Discussing the present state, success and role of employee ownership at this particular company
13.30-14.30 **Öregtó Restaurant** **Tata**	**Lunch**
15.30-18.00 **Boat trip on the Danube** **on the boat of MASPED First Hungarian Forwarding Co.**	**Meeting with István Kautz, President-CEO** Information on the results and challenges of the company life at present
Press Conference	This option depends on Coopers & Lybrand's consent
18.00-18.30 Ferihegy Airport	**Departure to the airport, Check-in**

Report
on Privatization through ESOP in Hungary

Since the Hungarian ESOP (Employee Stock Ownership Program) Law was passed by the Parliament on June of 1992, it has become an important channel for selling the Hungarian state property. This technique served its purpose best in the years 1992-1994. See Figure 1 and Figure 2 attached.

Later the privatization policy of the new government preferred cash paying investors, and that caused unfavorable conditions for the application of ESOP, namely:

- the new privatization law in 1995 restricting the amount of the credit that can be used by ESOPs
- increased taxes on dividends of ESOP organizations.

Despite these facts, **in about 230 companies more than 75,000 employees have become co-owners of shares at a face value of about 50 billion HUF** by the end of last year (1996). However, in the last two years there were less than 40 ESOP transactions, namely 27 in 1995 and 11 in 1996.

The registered capital of the ESOP companies extends from a couple of million HUF to a few billion HUF. The ESOP organizations bought property mainly in smaller and medium-size companies, but there are also some big companies with minority ESOP share. You can notice the number of ESOPs and the number of employee-owners in ESOP companies with different ownership ratio on Figure 3 and Figure 4.

Generally speaking, ESOP became a popular privatization technique in almost every sector of economy, but mainly in the labor-intensive activities, especially in trade (see Figure 5). If we have a look at production data of ESOP companies on Figure 6, we can see that the profitability of ESOP companies is 6 percent higher than that of non-ESOP companies in general.

Most of ESOP organizations are in the repayment period, some of them being in the grace period (see Figure 7). More and more ESOP organizations have managed to pay back the loan, and have finished the allocation of the shares to employee-owners. Although in many cases allocation rules of property and voting rights inside the ESOP organization allow management to acquire control packet and strong influence, there are a lot of good examples how to secure fairness during and after the repayment period among the employee-owners.

Yet, the State Privatization and Holding Company has started to implement a simplified privatization technique implied by the regulation of the new privatization law, which allows further state-owned companies to be privatized through ESOP in 1997.

The Results of Privatization in Hungary

(1990-1996)

- 1857 state owned enterprises in 1990
- GDP produced by private economy: 10% in 1990
70% in 1996
- Direct foreign investments approx. 15 billion USD, out of which 50% realized as privatization proceeds
- 67% of companies controlled by foreign investors, out of 200 largest firms 134 controlled by foreign investors
- 1209 companies privatized totally or partly, out of which 232 (19%) privatized through ESOP

Figure 1
The number of ESOP transactions, 1992-1996

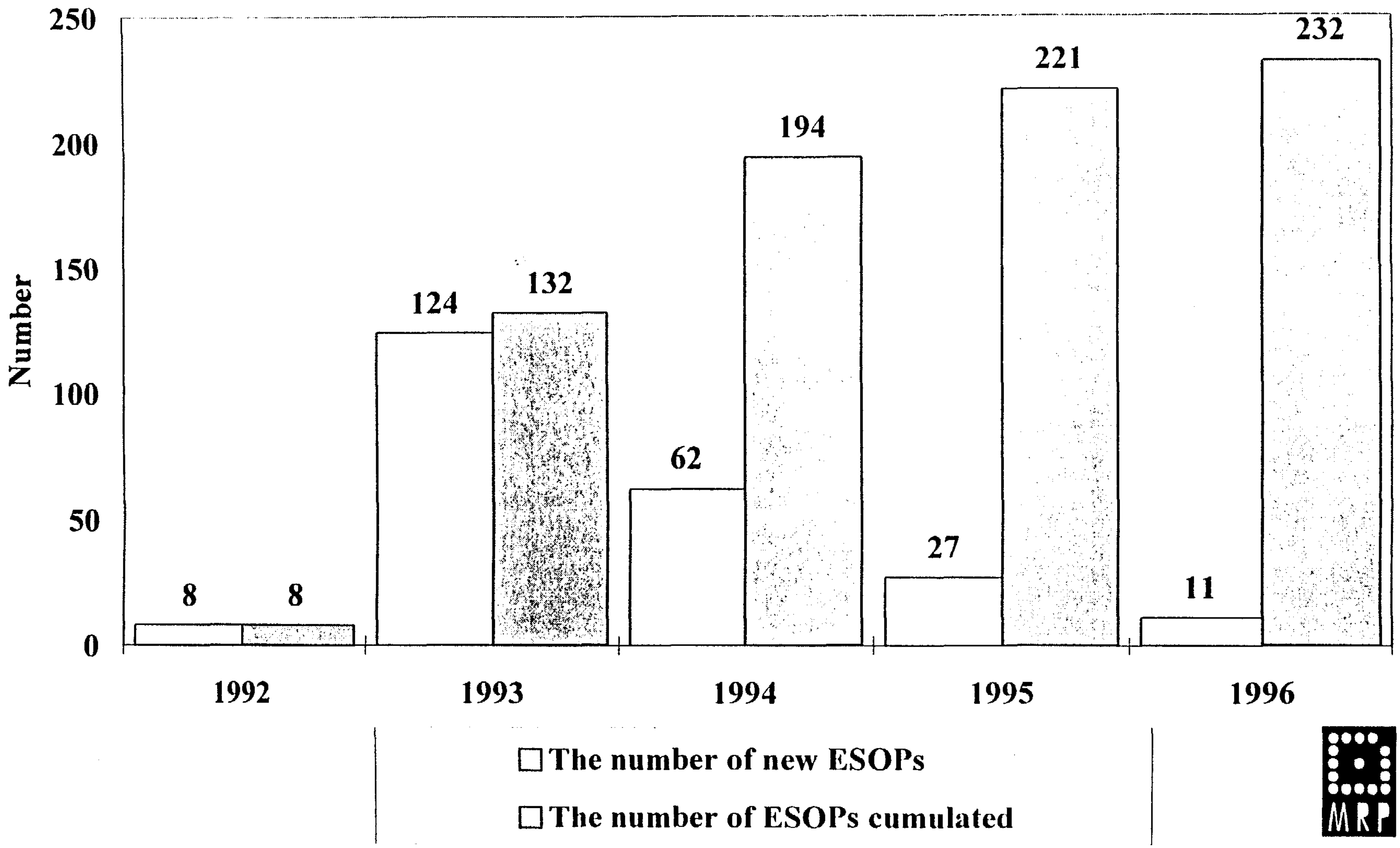

Figure 2
The face value of ESOP transactions, 1992-1996

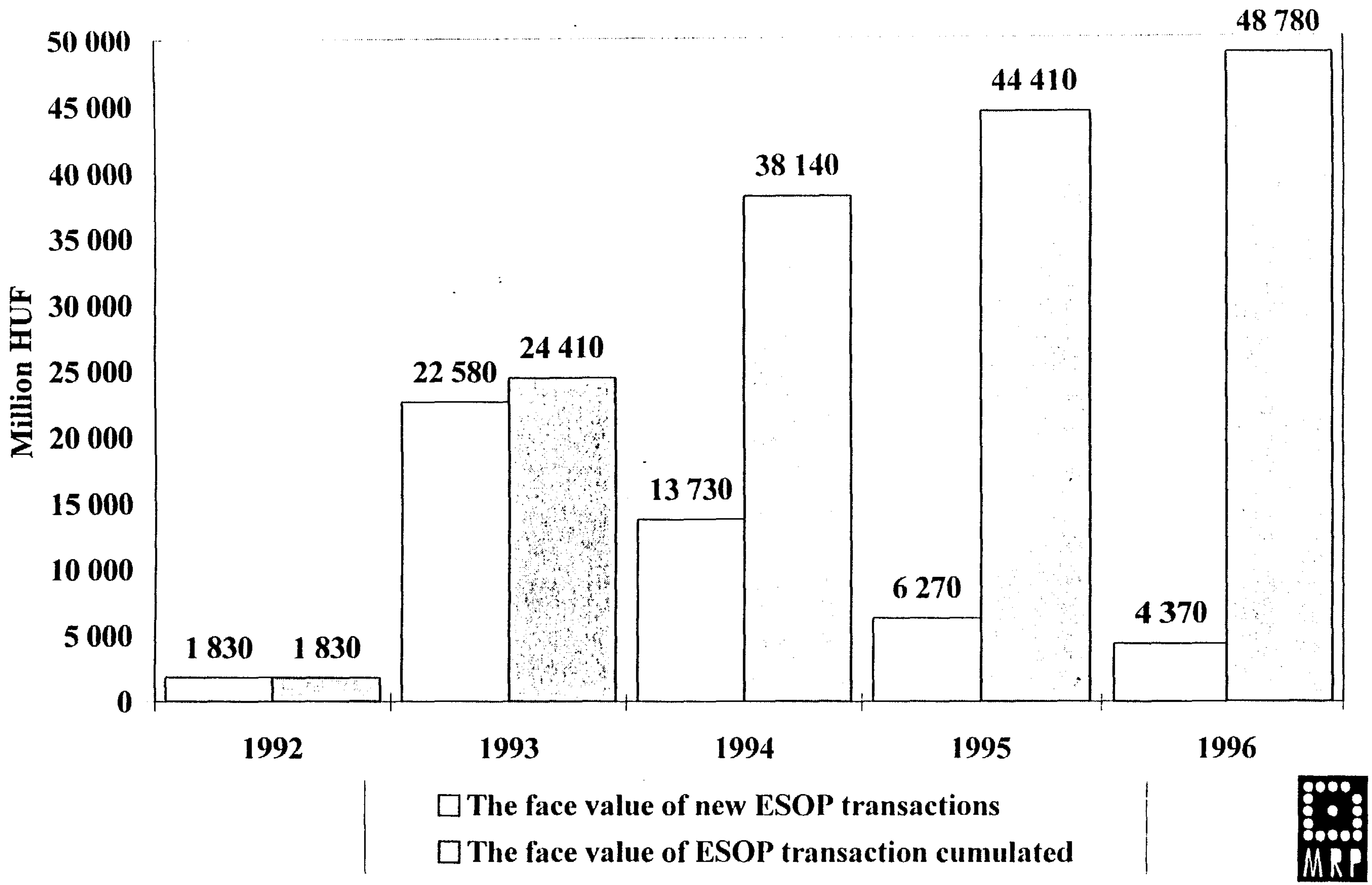

Figure 3
Number of ESOPs in categories of ESOP companies with different employee ownership ratio (percentage)

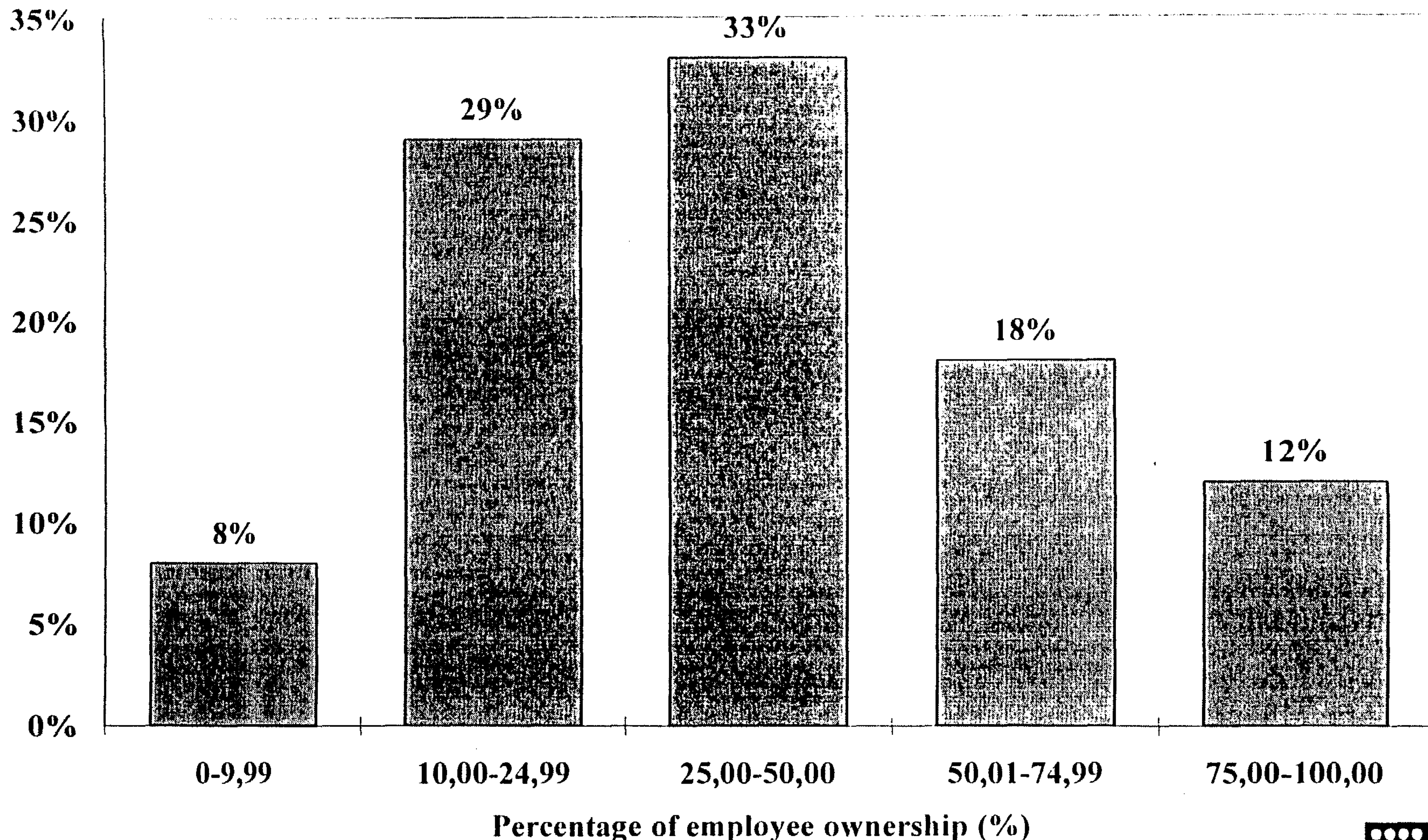

Figure 4
Number of employee owners in ESOP companies with different ownership ratio (percentage)

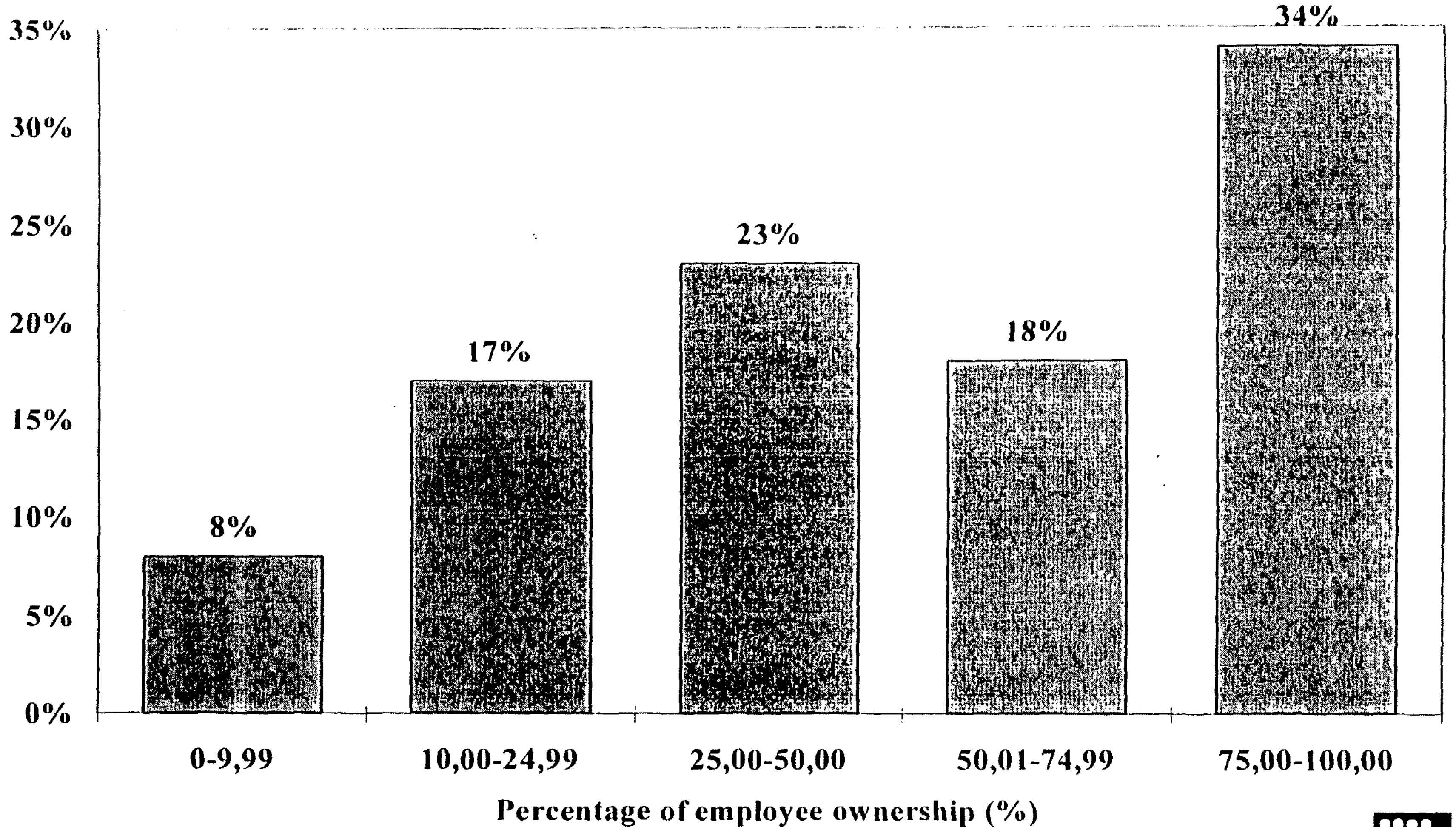

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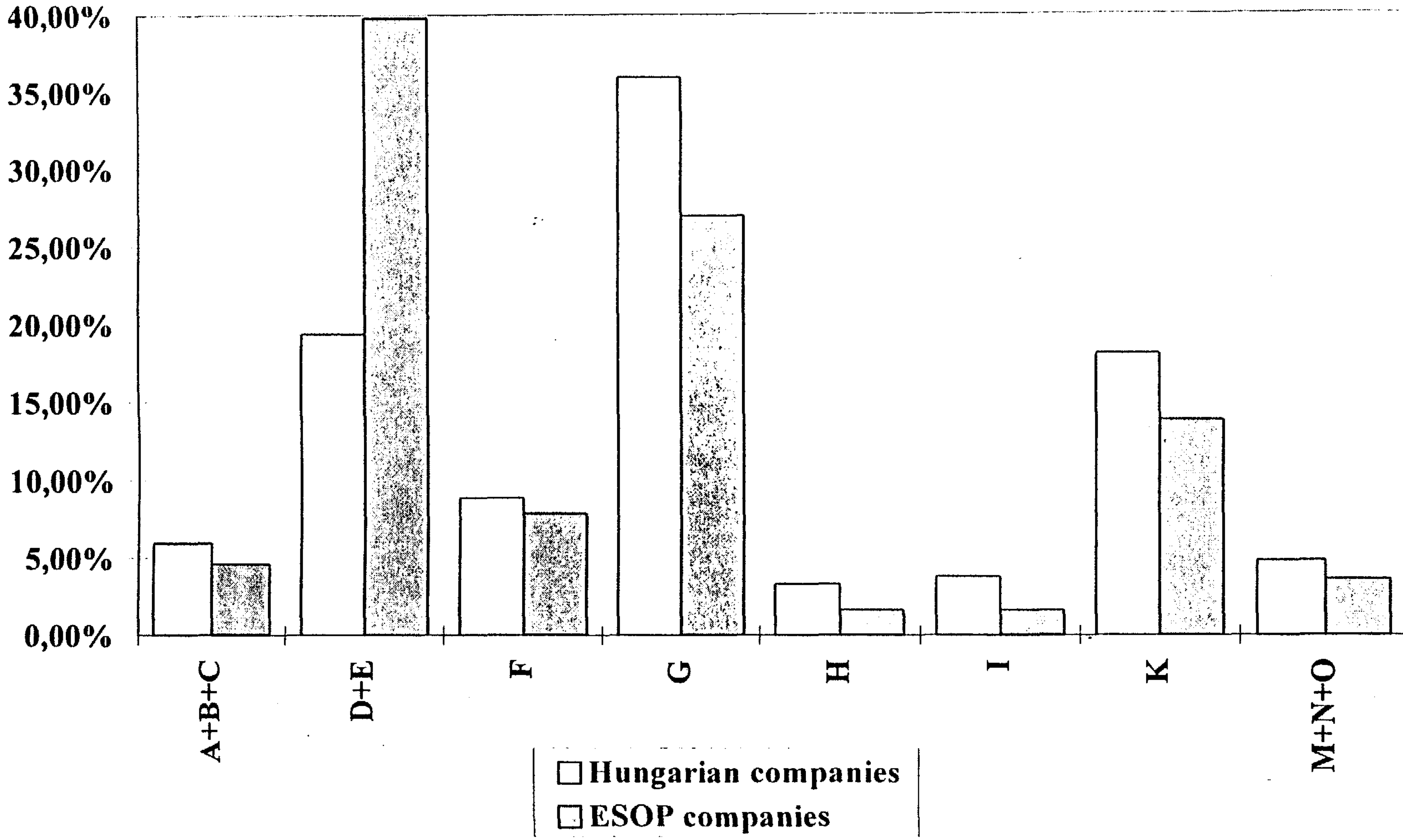
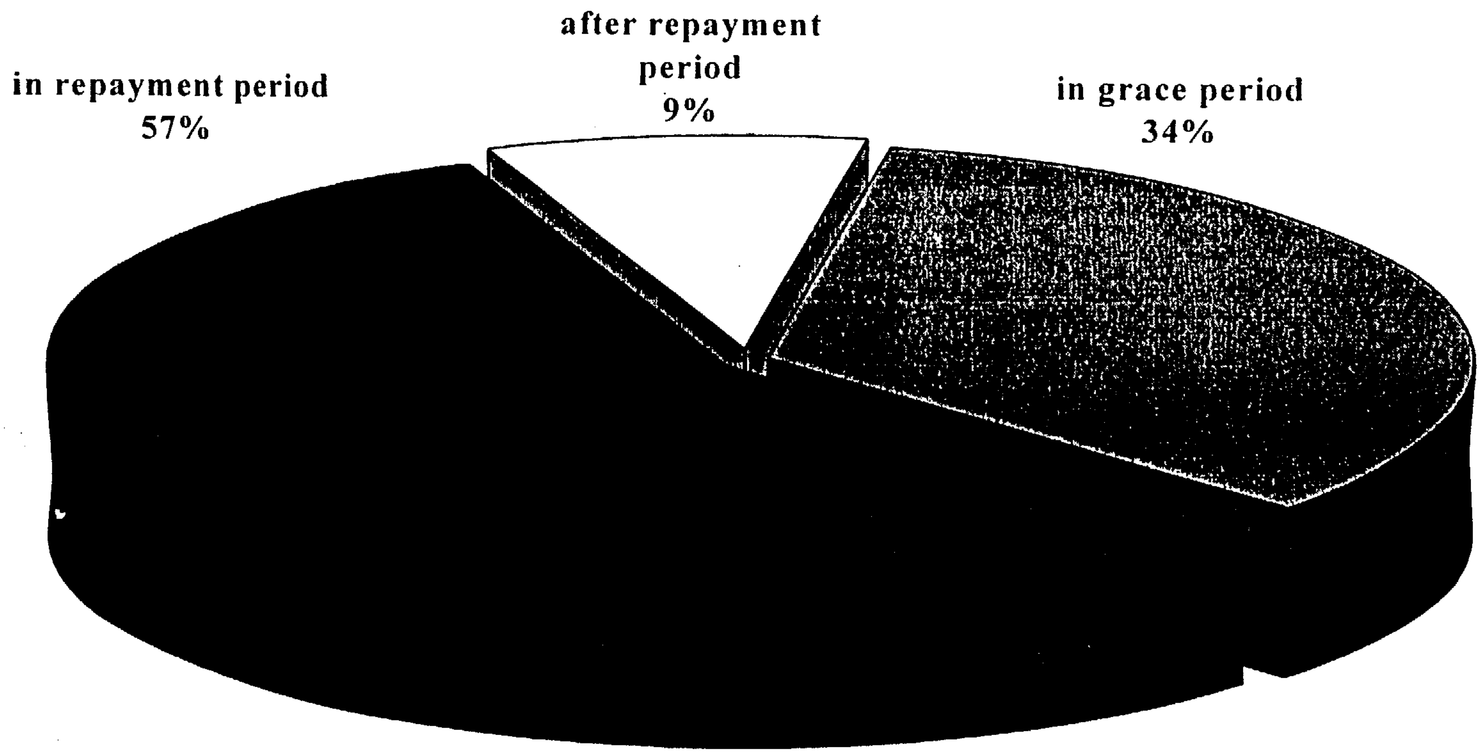
Figure 5
Breakdown of ESOP and non- ESOP companies into sectors (percentage)



Appendix to Figure 5

Code	Sectors of the economy
A+B+C	Agriculture, wild animal husbandry and forestry + Fishing + Mining
D+E	Manufacturing industry + Electrical, gas, heat and water supply
F	Construction
G	Commerce, repair and maintenance of consumer goods
H	Hotel service and catering
I	Delivery and telecommunications
K	Administration, trade and renting of real estate
M+N+O	Other educational, health, social and cultural activities

Figure 7
Breakdown of ESOPs
regarding the status of financing the program



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THE JOURNAL OF EMPLOYEE OWNERSHIP LAW AND FINANCE

Volume 7, No. 4 • Fall 1995

PRIVATIZATION THROUGH EMPLOYEE OWNERSHIP

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Privatization and Employee Ownership in Hungary

János Lukács

The history of privatization in Hungary falls into four stages. First, in the late 1980s some managers of state-owned enterprises took advantage of newly passed laws for their own enrichment. Second, the government reacted to the managers' actions by taking control of privatization; however, most investors were foreigners at this point. In a third stage, the process was opened up more to domestic investors, especially rank-and-file employees. Finally, in 1992 the Hungarian Parliament passed an employee stock ownership plan (ESOP) law.

After about two years of intense public debate, conceptualization, and legal preparation, the Law on Employee Stock Ownership Plans was passed by the Hungarian Parliament in June 1992. This was a surprising development, if we look around in Central and Eastern Europe, where an unexpected and unprecedented political, social, and economic transformation has taken place during the past six years. In the process of this economic transformation, the procedures used in dismantling the overwhelming weight of state ownership—privatization or denationalization—have been much discussed in the region. Hungary took a special route in this transformation and is unique in many ways compared to other countries in Central and Eastern Europe.

First, Hungary based its privatization on sales and not on any kind of voucher or giveaway scheme. Although domestic investors received certain credit opportunities and employees received some price concessions, if they wanted to participate in the privatization process they had to com-

As an industrial sociologist at the Institute of Sociology of the Hungarian Academy of Sciences, János Lukács studied employee control, participation, and ownership in 1986 and 1989 at the University of California at Berkeley. He also spent six weeks at the employee-owned Weirton Steel Co. in West Virginia. As a result, he became an advocate of employee ownership and participation. He co-founded in 1989, and has since directed, the Share Participation Foundation, the main promoter of ESOPs in Hungary. He has served for almost four years (1991-95) in the State Property Agency, the state authority controlling privatization in Hungary, as a member of the board of directors.

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pete with foreigners and each other to buy assets and equity from the state.

Second, the process took all employees—not only managers—seriously into consideration as possible buyers of small, mid-sized, or even large companies. The almost unanimous vote for the Hungarian ESOP law in the Hungarian Parliament is an important sign of this support for broad-based ownership, despite the doubts, counter-arguments, and suspicion against ESOPs still existing in some circles of the Hungarian public.

Many questions can be raised in this context. How could the concept of employee ownership in general and ESOPs in particular be accepted? To what extent are managers and employees prepared in cultural and mental terms to become owners? What are the first results of this process? To answer these questions, we must begin by examining the four periods of Hungarian privatization.

PERIOD 1: "VULTURE PRIVATIZATION" FOLLOWED BY THE SO-CALLED SPONTANEOUS PRIVATIZATION

The first wave of privatization arrived in Hungary in 1989 after the Company Act was enacted. Before that date the private sector, though it had to overcome numerous legal, economic, and political barriers and work in a hostile environment, slowly began to take root as early as in the 1960s and 1970s in the form of the so-called second economy. The private sector was first given real legal recognition only in 1982, when legal measures allowed private entrepreneurs to set up new kinds of business organizations.

The Company Act allowed for private individuals to set up limited liability companies with as little as U.S. $1,000 in founding capital, or joint-stock companies with U.S. $100,000. Initially there were some restrictions as to how many employees these companies founded by private individuals were allowed to employ, but despite these limitations and especially after they were lifted, the development of the private economy started at a breathtaking speed.

The term "vulture privatization" does not refer to the above process, but rather to managers of state-owned enterprises using the enterprises' assets, as well as tax breaks and other incentives in the legal framework, for their personal advantage. By controlling and persuading the enterprise councils of self-governing state enterprises, many such managers established small, profitable companies, in many cases joint ventures, that extracted assets, profit-making business operations, and profits from their enterprises. By appointing themselves as highly paid managers of and taking a personal stake in these newly established companies, many of these managers accumulated resources for the upcoming "real" privatization, i.e., the sale of assets and equity by the state.

Despite some positive developments, such as the splitting of unprofitable industrial conglomerates into separate profitable ventures, many such transactions concluded in public scandals. The resulting public outcry compelled the government to take legal actions to regain its control as the ultimate owner of the assets; that is, it temporarily "re-nationalized" state enterprises, transforming them into limited liability or joint-stock companies and selling them.

PERIOD 2: PRIVATIZATION WITH STRONGER STATE CONTROL BUT FEW DOMESTIC INVESTORS

To protect state property from the above-mentioned abuses, a law on privatizing state-owned companies was passed in 1989, followed by the Law on Protection of State Property, enacted at the beginning of 1990. At this time the State Property Agency (SPA) was founded.

In these laws there were provisions regulating the valuation, transfer, and sale of property of state-owned companies. The establishment of new companies and transfer of assets above a certain value limit required the prior written approval of the SPA. For the transformation of an entire state enterprise into a joint-stock company, a plan of transformation had to be prepared with help from professional consultants, and the approval of the SPA had to be obtained.

This way, privatization was put under government control. Initially this meant, however, that under the control of the SPA, enterprises and companies took care of selling themselves, both in terms of assets and equity. Management could ask for bids and in many cases decided who would own the company. Of course, without the necessary financial tools they themselves—alone or together with their employees—or other domestic investors had little chance to bid and succeed.

As a consequence, the limited amount of assets and equity sold in the first two years of privatization went mainly to foreigners. In 1990, little more than 5% of the SPA's privatization revenues came from Hungarian citizens. Although there were certain credits already available facilitating privatization, the most important of which was the existence credit (E-credit), there were many difficulties hampering investors in making use of them. The relatively high interest rate, 20.5%, which was 75% of the National Bank's base rate must be mentioned first, although the rates offered by commercial banks were much higher than that. On the other hand, the reduced rate of the E-credit was still considerably higher than the profit index (7% compared to the value of the assets in 1990). In addition, investors had to invest a great deal in cash, at least 50% of the sale price, to qualify for the E-credit. Under these conditions, domestic investors and especially employees had little chance to buy state property. The investment opportunities of domestic investors changed somewhat when the interest on the E-credit fell by 4% to 16.5% (the inflation rate was around 20% at that time).

During this period, decision makers in the SPA intended to sell the state property to those bidders offering the highest price in cash. Breaking the hegemony of the already rickety state-owned companies was considered the most important goal, and finding "genuine" owners and contributing to the state budget was the immediate goal of privatization.

Around this time the Property Policy Guidelines, an annual resolution of the Hungarian Parliament was passed, partly with the aim to give employees preferential terms in purchasing state property. According to these preferences, workers could purchase 15% of the shares of their company for 50% of the price the majority investor had paid. The reduced price could also be paid in installments over three years. Another option was purchasing 10% of the registered capital in the form of a special class of shares (called "employee shares") for 10% of their face value.

However, granting this preference was not mandatory, and if the pressure from the employees was not strong enough, the SPA staff never thought twice about ignoring it, especially if the investor objected even to minority ownership by employees. The SPA staff was not very eager to inform employees about these possibilities, because that conflicted with the goal of maximizing cash revenues.

PERIOD 3: MAKING PRIVATIZATION MORE OPEN, PROVIDING BETTER OPPORTUNITIES FOR HUNGARIAN INVESTORS

The breakthrough year in the Hungarian privatization process was 1992. During the preceding two years there were many debates on how the Hungarian public could be more actively involved in the privatization process, what financial resources could be made available, and to what extent laws and institutions should be modified. In 1992 it became obvious that for many reasons (e.g., economic, political, and even military crises in the region, as well as a public outcry against foreign domination of privatization) the former rate of foreign participation in privatization could no longer be sustained.

That is why the preparatory work was given a new impetus. This paved the way for the introduction of new privatization laws, an ESOP law that could facilitate property acquisitions of the employees in an organized and collective way, the modification of the terms of the E-credit, and the establishment of a system of credit guarantees that could improve access to privatization credits.

New laws on privatization enacted in August 1992 offer some preferences to domestic investors, first of all to employees. If business organizations including at least 25% of all employees in a company submit a bid for the direct purchase of shares at a value equal to or better than other bids, they receive first priority. Participants in an ESOP organization are given second priority, and employees submitting their bids as entrepreneurs are given third priority.

The new law on privatization introduced the so-called privatization leasing, which could be characterized as a special arrangement for paying in installments. This method is designed especially for transferring to private individuals majority ownership of companies that are barely profitable, are quickly losing their capital, and cannot be sold for cash. In return for their management services, lessees are remunerated in cash, which the company can account for as costs incurred. Lessees then pay this sum to the SPA as leasing fees, and if the company operates profitably, the lessee can become the owner of the company in eight to ten years.

The chances of domestic investors were also improved by the purchase of compensation vouchers (restitution coupons) on the secondary market. According to the Compensation Act, those who lost property during the communist era are eligible for compensation in the form of vouchers that can be freely bought and sold on the open market and used to acquire state assets.

Most Hungarian citizens, being quite short on cash, could only use credit to participate in privatization. The E-credit was supposed to fill in the gap by having reduced its former 16.5% interest to 7%, with a maximum term of 15 years and with a maximum grace period of three years.

The improved credit terms and wider selection of state-owned companies available for sale resulted in domestic investors accounting for already more than 60% of the privatization-related revenues, totaling annually about U.S. $700 million. The increased domestic interest is also related to other factors. First and foremost, better and more extensive information about privatization was made available. The general public became much better informed about what assets were to be sold off and how deals could be financed.

The government aimed to increase the willingness of the banks to participate in lending to investors by establishing a credit guarantee system at the end of 1992, the Credit Guarantee Co. Plc., which may grant guarantees for 80% of the E-credits taken out for privatization.

PERIOD 4: THE ESOP ASSUMES SPECIAL IMPORTANCE IN HUNGARY AS A PRIVATIZATION TECHNIQUE

Back in 1989 when researchers, economists, sociologists, and legal experts introduced ESOPs to Hungary, the idea was the following: It was obvious that sooner or later it would be economically and politically inevitable that a relatively wide spectrum of the society be allowed to join the privatization process. This process also needed some incentives. In 1990, politicians of the first democratically elected government relatively quickly rejected the idea of handing out shares to everyone, just as they rejected the proposal of the largest opposition party (the liberals), who said that every citizen should be given a token amount of property free. On the other hand, it was easy to see that few Hungarians would be ready and able to assume the risk of purchasing properties on credit. Consequently, it was sensible that the structure of the largely successful U.S. ESOP be adapted to the Hungarian environment.

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Structure of the Hungarian Law

[Editor's note: The following paragraphs under this heading ("Structure of the Hungarian Law") have been inserted to provide an introduction to the Hungarian ESOP for readers with no background in Eastern European privatization. The text has been adapted from an article in the November/December 1994 issue of the Employee Ownership Report, *the NCEO's newsletter for its members]*

An ESOP can be considered if at least 25% of the work force assents. The employees form a committee that negotiates with the SPA for the sale of the company. There may be other bidders for the company as well. The committee is responsible for commissioning a feasibility study, negotiating with credit institutions, bargaining with the SPA, preparing draft articles for the ESOP, and setting up a plenary meeting at which 40% of the employees must attend and support the proposal. The bylaws for the ESOP can allow employees to become eligible for participation if they have worked for the company or its legal predecessor at least half time for six months. They can also require employees to work for the company for as many as five years. The feasibility study must be paid for by either the committee or the company (at the company's option), but once the ESOP is established, further costs are paid for by the company. If the feasibility study is negative, the committee must pay for the study.

The SPA considers the proposal and decides whether to sell to employees or another buyer. In so doing, the SPA can give preference to the ESOP relative to other buyers of 10% to 15% of the purchase price. In some cases, the SPA can sell to employees without a competitive tender. Generally, this happens only if there are no other qualifying offers. The ESOP can also make an offer for part of the company and have the rest bought by other investors.

The ESOP bylaws are established by the committee. The ESOP must cover the 40% or more of the employees who agreed to it and meet the participation guidelines outlined above. A general meeting of all ESOP participants acts as the governing body. An executive body is elected by the general meeting to govern the plan. The committee sets the rules for repayment of shares, participation of new employees, allocation of stock, and other rules that in the U.S. would be established by plan documents.

Employees must put up a down payment to buy the company equal to 2% of the purchase price up to 5 million forints plus 15% to 20% of the amount above that. Employees can buy shares through the ESOP at a steep discount. The payment can be made individually or through the company's own resources. For the remainder, the company can take out a loan at a subsidized 3% to 4% interest rate with a three-year grace period on a 15-year term. The company can repay the loan through the ESOP. Up to 25% of pretax profits can be used to repay the loan on a tax-deductible basis. Dividends can be used to repay the loan in pretax dollars, but all dividends must be used for debt repayment.

These incentives have helped make ESOPs one of the most popular methods of privatization. Most Hungarian ESOP companies have under 200 employees, but three have over 1,000. Eighty percent of the companies are majority ESOP-owned. A 1994 study showed that about 45% of the ESOP companies reported profits, 30% broke even, and the rest lost money.

Reaction to the Law in Hungary

ESOPs appeared to be a very reasonable idea to many politicians both before and after the first democratic elections in 1990. It was argued that despite the economic crisis, there were some relatively prosperous Hungarian companies whose management and employees seemed able to run their companies profitably themselves in the emerging market-based business environment if they could get rid of the state as an owner. The ESOP seemed to be able to give the company management, unions, and employees a tool with which to compete with individual domestic investors or even foreign investors in tenders called for by the SPA. From the SPA's angle, this increased competition was welcome because it drove prices up.

Some writers have rejected the idea of ESOPs, saying it is unnecessary for employees to own their company because they are unable to represent a consistent ownership concept and thus hinder the rational and harmonized control of the company. Other ESOP opponents were afraid of the return to a kind of collectivism regarded as a "third way"—an alternative to a "real" market economy.

Others considered ESOPs economically irrational because the repayment of credit borrowed for property acquisition (or in the case of installment purchases, the repayment of installments) and the payment of interest distracts resources from development. Others accepted and supported this privatization technique for political reasons, believing that it was only transitory because employees would sell their shares as soon as possible to people who offered cash for them.

Still others said that ESOPs were the last resort of an old-style management incapable of reviving itself, which had no ideas for dealing with the future but did not want to expose itself to a harsh new owner. They stated that managers and employees were culturally unprepared to cooperate to save their company and make it profitable. For about 10 to 50 years, they argued, a strong-handed individual should own and run these companies, and only if this individual would realize that cooperation and joint ownership would be in his or her interest should there be an opportunity to use an ESOP.

Many others accepted the concept of employee ownership, but not in Hungary and not then. It could be a good technique for some well-developed market economies, they said, where owners and managers might see in employee ownership additional resources for the company. In Hungary, they contended, owners and managers had not had the opportunity to experience the usefulness of employee stock ownership and cooperative management, so it was too early to establish ESOPs there. They said that managers must first gain a thorough knowledge of conventional management techniques, and ESOPs and participation might come some time later, when the conditions would be ready for them.

It would be an oversimplification to say that these opinions were completely irrelevant, but in the debates about the concept and the details, the pro-ESOP arguments, buttressed by the positive experience in the U.S. and other countries, proved stronger. ESOP proponents contended that employees as shareholders are able to make decisions together, following the requirements of economic rationality, if they are given adequate information and are continuously trained in how to interpret this information. For this, among many other things, good communication within the company is needed. This many-sided, internal communication together with participation at the company level and the acceptance and practice of genuine "total quality management" brings additional profit.

In an economy where the conditions of a market economy are predominant, it is impossible to follow "third ways." No one can really consider ESOPs either as some sort of collectivist-socialist formation or

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as a "third way"; rather, the ESOP is a technique that revives the traditional capitalist economy and helps create a broad layer of the population with capital income. ESOPs can make the necessary payments only based on profits of the company, which increases the corporate tax income of the state, thus counterbalancing the tax allowance given to ESOPs. In recent years even the trade unions—one time strong opponents—have adopted a more positive attitude towards ESOPs; in some cases they have even been very supportive.

Following their own interests, most of the old and new generation of the Hungarian managers are able and willing to control the company successfully, even if one of the owners is the ESOP. Many Hungarian top managers have been able to meet the requirements of a market economy, so it would be irrational not to rely on them. Most Hungarian managers are teachable, able and willing to learn new and effective techniques that are applied on a large scale in modern market economies. This ability and willingness is true not only in the case of traditional management styles (e.g., authoritarian, dictatorial, non-cooperative) but also in the cases of management based on teamwork and cooperation. The learning of the latter is more unusual, tiresome, and slower; however, such teamwork and cooperation make companies, especially ESOP companies, much more competitive than those using traditional styles of management.

The ESOP law was finally passed by the Hungarian Parliament on June 9, 1992, and since then the ESOP has become one of the important channels for selling off state property, even though hardly anyone in the government really wanted it and there is still much suspicion about its merits.

An ESOP element can be found in about one-fifth of all privatizations involving the equity of companies owned by the state. In about 220 companies more than 75,000 employees have become co-owners of shares at a face value of about $45 billion Hungarian forints (ca. U.S. $400 million). ESOP organizations bought about 6% of all assets and equity sold by the state. In many cases, ESOP organizations were the only bidders, but recently they have often teamed up with the management or even with domestic or foreign investors in a consortium.

All these ESOPs came to life in the process of privatization. The reason for that is the fact, that although the ESOP law allows their establishment in any company, the tax, credit, and other benefits are closely and exclusively attached to the purchase of equity from the state. The ESOP Organization is a completely new type of legal entity created by the Hungarian ESOP law. It is similar to the trust in the U.S. and the U.K., but somewhat closer to a foundation or an association. If a Hungarian ESOP would like to buy from a non-state owner, financing of the deal could happen only through a bank loan or an installment purchase, and no tax concessions could be used for repaying the loan and the interest payment. In short, the Hungarian ESOP is designed more to help the state in its privatization effort than to help companies, managers and employees in building a more successful company and contribute to the economic democratization of the country. The establishment of a non-privatization ESOP based on these conditions is very difficult to imagine.

CONCLUSION

The Hungarian ESOP law needs to be amended very soon, not only because it ignores the use of ESOPs outside of privatization, but because it does not address such important issues as "fairness." For example, it is possible to establish an ESOP Organization by approval of at least 40% of all employees in the company, but the law does not require ESOP companies to keep even this level of participation later on. Thus, should membership of an ESOP Organization established in a privatization buy-out procedure decrease to one person, e.g. the CEO, the organization still could get full tax concessions. Further, there are no regulatory measures in the law on allocation and distribution. Various misuses and abuses have occurred. Experts associated with the Share Participation Foundation foresaw these contradictions based on their experience in the U.S. and the U.K., but in the final stage of the parliamentary process it was not possible to have a loud enough voice. The fear is prevalent that the abuses will discredit the concept itself.

ESOP companies in Hungary do not have a long enough history to give one an opportunity to make clear statements about their success or failure. Most of them made their first interest payment obligations in the grace period, and a few of them have already begun to pay the principal of the loan. Research on performance issues still lies ahead, but research also is needed to study how managers and front-line employees have thought and behaved in ESOP companies since the process of transformation and ESOP buyouts began.

Even by taking a superficial look at these companies, we find a wide variety of intentions, interests, hidden thoughts, and good and bad will. They range from fear among CEOs and their deputies of losing top managerial positions, through simple greed, to strong values in people and belief in the possibility of consciously turning around the company to make it successful.

Only in a few ESOP companies have top managers realized their responsibility and opportunity to create an internal atmosphere of mutual trust, two-way communication, involvement, empowerment, and cooperation on a team basis in order to increase dedication, effort, productivity, and profitability. It is an important and challenging job to help managers and employees of such companies to be successful and become a benchmark to ESOP and to non-ESOP companies alike.

Act XLIV of 1992 on the Employee Stock Ownership Plan[*]

For accelerating privatization and in order to promote that the employees can acquire - in addition to previous forms of property acquisition - ownership share in the economic association employing them, depending on their decision, in organized form and in a preferential system, Parliament enacts the following Act:

General Provisions

Article 1

(1) The shares [business quotas (hereinafter: property share)] of a company limited by shares or limited liability company (hereinafter company) incorporated in Hungary can be acquired by the persons employed by the company as beneficiaries (hereinafter: employees) in the framework of the Employee Stock Ownership Plan (hereinafter: ESOP) in the way regulated by this Act.

(2) An employee employed for at least half of the legal worktime, and has been employed by the company for at least six months, is entitled to participate in ESOP, including the employment with the legal predecessor of the company. The statutes of the ESOP organization (hereinafter: organization) can stipulate a longer time as condition of eligibility, but this shall not exceed 5 years. The employees entitled to participation can waive their entitlement only in writing.

(3) Employees, who comply with the conditions defined in section (2) and announce their intention to participate in writing to the organizing committee [Article 2 section (1)], or, after the institution of the organization, to the administrative and representative body (hereinafter: executive body) can participate in the ESOP.

(4) Upon the termination of the employment the employee's right of participation in the ESOP terminates as well.

(5) ESOP can also be started in the course of the transformation of state-owned enterprises, of subsidiaries or of companies owned by certain legal entities. Upon the request of the organizing committee, the state trustee organization can withdraw the property of a separated organizational unit of the state-owned enterprise and transform it into a company with the purpose of starting ESOP there. In these cases the rights to which the company is entitled under this Act are exercised by the property administering organ which participates as founder in the transformation process.

(6) The financial institutions and insurance institutions do not come under the force of this Act.

Article 2

(1) If at least 25% of the employees want to acquire property share in the framework of ESOP, they shall entrust in writing for this purpose an organizing committee consisting of 3 persons. If the property of the separated organizational unit of the state-owned enterprise is withdrawn by the property administering organ with the purpose of starting ESOP, the basis for the calculation of the 25% ratio of participation shall be the number of the employees employed at the separated organizational unit. The organizing committee agrees, in the name of the mandators and in consensus with them - with those owners who want to sell their property shares to the organization to be founded by the employees - for the case of the formation of the organization - on the conditions of the sale, especially on the service to be performed and the compensation, in case of payment by instalments, on its conditions as well as on the collateral obligations guaranteeing the contract.

(2) If, in the case of sale by the state trustee organization there is a possibility to have recourse to the Existence Loan, the term of the property sale tender shall not be shorter than 35 days. This rule shall also apply if the state trustee organization grants payment by instalment.

(3) The organizing committee shall prepare a feasibility study (hereinafter: study) on the possibility of fulfilling the agreement referred to in section (1). This shall indicate whether under the conditions defined in the agreement the financial situation of the company allows the amortization of the selling price and interests of the property share the employees wish to acquire, and the degrees of property share and face values of shares at which the programme can be realized. The study shall be countersigned by the company certifying that its contents are technically correct.

(4) The company shall supply the data required for the preparation of the study. In case an organization is formed, the costs arising in connection with the preparation of the study are borne by the company.

Article 3

(1) In possession of the study the organizing committee may have recourse to a financial institution with loan application or can make an offer for payment by instalments to the owner selling the property share.

(2) As a result of the credit review, the financial institution can issue a loan promise, and the owner as seller can make a declaration, according to which he shall accept the offer to pay by instalments in case an organization is formed.

(3) The statutory meeting of the organization shall be called by the organizing committee. In addition to what has been laid down above, this also requires that the shareholders' meeting (members' meeting) of the company consents to the formation of the organization in accordance with the content of Act VI of 1988 on economic associations (Companies Act, hereinafter: CA), and the articles of association (the statutes) of the company.

(4) In case of consent the right of pre-emption due to the members (shareholders) of the company (on the basis of CA) or the articles of association (the statutes of the company) cannot be exercised with regard to the property share offered

The Formation of the ESOP Organization

Article 4

(1) The organization is a legal entity with self-government and registered participants created voluntarily by the employees for the purpose of acquiring property share in the company employing them. The statutes cannot deviate from the purpose defined in this section.

(2) The property share acquired by the organization becomes the property of the organization which shall deliver it into the property of the participants according to the conditions set forth in this Act and in the statutes.

(3) For the formation of an organization it is necessary that at least 40% of the employees of the company declares the formation of the organization at the statutory meeting, they adopt its statutes in accordance with the requirements set forth in this Act (Article 9) and elect its administrative and representative body (hereinafter: executive body). The organizing committee ceases to exist after the formation of an organization.

(4) One employer can participate only in one organization at the same time.

Article 5

(1) After the formation of an organization its court registration has to be applied for. The minutes of the statutory meeting, the statutes of the organization and the declaration of consent of the company [Article 3, section (3)] shall be attached to the application.

(2) The registration of the organization cannot be refused if the founders have complied with the conditions set forth in this Act. The organization becomes a legal entity by the registration.

Article 6

(1) The organization shall be registered by the relevant County Court or the Budapest Court (hereinafter together: Court) having jurisdiction over its seat.

(2) The Court decides on the registration out of turn, in non-contradictory procedure. The Court sends the resolution on the registration to the attorney's office.

(3) The change of the data of the statutes shall be reported to the Court within 30 days after the change has taken place.

The Functioning of the ESOP Organization

Article 7

(1) The supreme organ of the organization is the general assembly consisting of the all the participants.

(2) The following are within the exclusive competence of the general assembly:

b) the definition of the annual budget;
c) the election and revocation of the executive body, the determination of the remuneration of its members;
d) the acceptance of the annual report of the executive body;
e) determinate the measure of the property share to be transferred into the property of the participants;
f) decision on the acceptance of the conditions of raising a loan and/or of payment by instalments and on all matters which are referred by the statutes to the exclusive competence of the general assembly.

(3) The general assembly shall be convened as necessary, but at least once a year. The general assembly shall also be convened if this is ordered by the Court or if this is the wish of one-third (or smaller proportion as defined in the statutes) of the participants indicating the reason and the purpose for the convention.

(4) The general assembly meeting can also be held in the form of an incomplete session in the way defined by the statutes.

Article 8

(1) The members of the executive body shall be elected by the general assembly by secret ballot for a definite period.

(2) The executive body represents the organization through its member named in the statutes vis-a-vis third parties as well as in court, and before other authorities. The executive body elects its president from among its members by itself.

(3) Unless the statutes provide otherwise, each member of the executive body is entitled to management of the organization.

(4) Any person, who is not prohibited to participate in public affairs, can be a member of the executive body of the organization. At least half of the members shall be elected from among the participants of the organization. At most one third of the executive body can be delegated by the company.

(5) The members of the executive body are responsible for their activity according to the general provisions of Civil Law.

Article 9

The following shall be defined in the statutes of the organization:

a) its name, purpose, seat, and the name of the company whose property share will be purchased by the organization;
b) name of the representative of the organization;
c) the way of summoning the general assembly, its quorum and the procedure in case of the lack of quorum, the conditions and way of exercising the right to vote;
d) the number of the members of the executive body, the way of their election, their sphere of competence and the term of their functioning;
e) the way and degree of the contributions paid by the participants;
f) the way the property share owned by the organization is transferred into the

g) the rules of re-purchase of the property share that has been transferred into the property of the participants, and in case of their sale, the way of exercising the right of pre-emption;
h) the way the resolutions are published;
i) the rules of joining by the employees after the foundation of the organization;
j) the rights and obligations of the participants;
k) the rules of the alienation of the property share remaining in the property of the organization after the full amortization of the loan and the interests;
l) the principles for the division of the property in case the organization ceases to exist;
m) anything that the participants wish to regulate in the statutes.

Article 10

(1) Any illegal resolution on the part of the general assembly or the executive body of the organization can be challenged by any participant in court within 30 days from obtaining knowledge thereof.

(2) Challenging of the resolution does not hinder the implementation of the resolution, in justified cases, however, the Court can suspend the implementation of the resolution.

Article 11

The Attorney's Office exercises supervision of legality over the organization according to the rules of its government. If the legality of functioning cannot otherwise be ensured, the attorney may have recourse to the Court.

Article 12

On the basis of the statement of claim by the participant and the attorney, the Court:
a) can repeal the illegal resolution of the organization and can order, if necessary, the adoption of a new resolution;
b) can convene the general assembly for the restitution of legality of functioning;
c) if the legality of the functioning of the organization cannot otherwise be ensured, it can suspend its activities and appoint a supervising commissioner for its control.

Article 13

The whole property of the organization is a guarantee against its debts. With the exception of the content of Article 19, section (1), the participants are not liable for the debts of the organization with their own property.

Article 14

(1) The organization purchases the property share offered for sale through a loan or payment by instalments, as well as by using its own financial resources in accordance with section (4). In case of sale by the state trustee organization the indemnity bill shall be taken into account at face value, as own financial resource necessary for the loan or for the payment by instalments.

(2) With the exception of transfer to the participants, the organization cannot alienate the property share acquired by loan or by payment by instalments until the termination of the amortization; the lending financial institution, or, in case of payment by instalments, the state trustee organization have right of pledge thereon.

(3) The profit (dividends) due for the property share purchased by using loan or payment by instalments shall be spent on the amortization of the existing debt. This provision shall also apply to the property shares transferred into the property of the participants in the course of the amortization.

(4) A condition of granting a loan and payment by instalments is that the organization should have its own financial resources. The measure of the own resource is defined as follows, as a function of the average purchasing price falling on a participant:

The average bands of purchasing price falling on one participant	Basis of own resources	% of the part within the band
0 - 5 million HF	0 HF plus	2%
Above 5 million HF	100 000 HF plus	15%

The ratio of the own resources in accordance with the above shall be established by projecting it on the property share purchased by the organization.

(5) The term of the loan and of the payment by instalments is maximum 15 years, from which at most three years can be the grace period.[1]

(6) The company is responsible as guarantor for the repayment of the loan, or for the performance of the payment by instalments in default of other securities offered in addition to the right of pledge defined in Article 14, section (2) and in Article 19, section (1).

(7) Article 38, section (3) and Article 39, section (2) of Act LXIX of 1991 on financial institutions and the activities of financial institutions shall not apply with respect to this Act.

Article 15

(1) The interest on the loan granted for the purchase of the property share owned by the state trustee organization shall be identical with the prevailing interest conditions of the Existence Loan. The revenues of the state trustee organization

financed by the preferential loan scheme shall be spent wholly on the reduction of the state debt.

(2) The conditions of the sale of the property share owned by the state trustee organization in the framework of payment by instalments are identical with those described in section (1), with the exception of the interest margin.

Article 16

(1) In addition to those described in Articles 14 and 19, the organization cannot engage in any other economic activity.

(2) From the point of view of reporting and book-keeping, the rules of accountancy relating to other organizations shall apply to the organization.

(3) The receipts of the organization include the sum remitted by the company, the payments of the participants, other natural persons and legal entities as well as the dividends (proceeds) due on the property share owned by the organization, furthermore, the receipts resulting from the alienation of the property share.

(4) The organization can only charge the disbursements directly connected with and necessary for the realization of the aims of the organization to its operational costs.

Article 17

In accordance with the statutes, the organization shall exercise its membership rights derived from the ownership of the property share through its representative. Other persons, too, can be entrusted with exercising the voting right in the way defined by the statutes.

Article 18

(1) The executive body shall open a share account for the participants on which the value of the property share transferred into the property of the participants shall be indicated.

(2) The aggregate sum on the share accounts of the participants cannot exceed the face value of the property share already amortized.

(3) The property share becomes the property of the participants if the sum on the share account reaches the face value of the share, or, in the case of business quotas, it complies with the provisions in Article 159, section (1) of Act VI of 1988 on economic associations relating to the measure of the primary stake falling on the business quota.

(4) The acquisition of property on the basis of section (3) is free of stamp duty.

(5) The statutes can also provide that the property shares acquired by the organization - with the exception of those purchased from own resources - remain for a definite period and measure in the property of the organization even after the termination of the amortization.

(6) The organization shall transfer the property shares purchased by using own financial resources immediately into the property of the participants in the proportion

countervalue of the property share remaining in the property of the organization shall be registered in the same proportion on the share account. If the own resources are not paid in by the participants, the delivery of the property shares purchased from own resources shall be governed by the statutes.

Article 19

(1) The property shares transferred into the property of the organization in accordance with Article 18, section (3) cannot be alienated until the termination of the amortization of the loan debts still subsisting in relation to the property of the organization; the lending financial institution, and/or, in case of payment by instalments, the state trustee organization is entitled to right of pledge thereon. These property shares continue to be administered by the organization, this, however, does not affect the shareholder's (member's) rights deriving from the legal relationship of company membership.

(2) The organization is entitled to the right of pre-emption for the property shares already transferred into the property of the participant in case of the retirement or death of the participant during the period of amortization. In other respects, the prohibition of alienation and right of pledge described in section (1), as well as the right of administration of the organization cease to exist at the time of the retirement or death.

(3) In other cases of the termination of the participant's relationship during the period of amortization, the organization can repurchase the property shares transferred into the property of the participant within the period defined in the statutes, but at latest within 6 months. The right of repurchase shall be exercised by the organization at the value defined in the statutes, but this shall not be less than half of the market value. In case the employee terminates his employment illegally or if the employer terminates it by extraordinary notice, the organization can pay the purchase price within the maximum of five years, and in other cases, within two years in instalments, too. If the organization does not make use of its right of repurchase, the provisions of section (1) shall apply until the termination of the amortization.

(4) Under the conditions defined in the statutes, the other employees of the company, the participants and the members of the company are entitled - in this order - to the right of pre-emption for the repurchased property shares.

(5) The provisions of this Article shall not apply to property shares purchased from own resources.

Article 20

(1) If the organization does not comply with its obligations towards the financial institution or the state trustee organization at due date, the further procedure shall be governed by Decree 39/1984 (XI.5.) MT on money circulation and bank loans.

(2) If the procedure of execution against the organization was unsuccessful, the financial institution or the state trustee organization shall inform the Court about this,

time the Attorney's Office - abolish the organization with immediate effect. An appeal can be lodged against this decision on abolition within 15 days.

Article 21

In case the property shares are not sold by the state trustee organization, the parties can deviate from the provisions of Article 14, sections (1) and (4) to (6).

Article 22

If pursuant to the provisions of another Act, a definite part of the revenues of the state trustee organization from privatization are due to another organization, for this part, the benefit of payment by instalments can be granted instead of the preferential loan construction regulated by this Act, under conditions identical therewith.

Article 23

If the state trustee organization sells property shares to the organization, Article 21, section (1) of Act XIII of 1989 on the transformation of business organizations and economic associations shall not apply.

The Cessation of the ESOP Organization

Article 24

(1) Once the organization has transferred the property right of all the property shares, the executive body shall convene the general assembly within 30 days, which shall decide on the abolition of the organization and the distribution of its property.

(2) The provisions of section (1) shall apply also if the company is abolished without a legal successor.

(3) Apart from the cases described in sections (1) and (2) of this Article and in Article 20, the organization can only be abolished on the basis of the initiative of the majority of the participants, after an agreement concluded with the company, the lending financial institution or the seller providing the benefit of payment by instalments, and after the final settlement with the participants.

Concluding Provisions

Article 25

This Act comes into force on the 15th day following its promulgation.

Article 26

(1) Article 6, section (1) paragraph e) of Act XC of 1991 on the income tax of private persons shall be replaced by the following provision:
[No revenue, unless provided otherwise by law:]

"e) the pecuniary value obtained in the form of co-operative business share, co-operative property share, property bill or share granted without direct compensation (countervalue) with respect to his legal relationship to the member, ex-member of the co-operative, to the heir of the member, to the employee of the co-operative, in case of agricultural co-operatives to the helping member of family, furthermore, the property bill granted by the employer to the employee without direct compensation (countervalue), the sum of the face value of the employee's share reduced by the compensation of the share (business quota) acquired in the framework of the Employee Stock Ownership Plan (ESOP), the sum with which the individual share (business quota) account of the participant of ESOP has been credited above the own payment (hereinafter, all of them together: gratis securities), until this has been alienated by the private person, and/or the other conditions enumerated in Article 33, sections (4) to (6) have not arisen;"

(2) Article 35, section (1) of Act XC of 1991 on the income tax of private persons shall be complemented by the following:

- "..., furthermore, the sum actually paid in by the participant in the year of reference in the framework of the Employee Stock Ownership Plan under the title of own payment from his after-tax income."

(3) The organization is not subject to corporation tax, as it does not engage in business activity.

(4) Article 4, section (2) of Act LXXXVI of 1991 on corporation tax shall be complemented by the following paragraph k):
[At the calculation of the basis of tax assessment, the pre-tax profit shall be reduced by:]

"k) the sum remitted by the subject of taxation to the Employee Stock Ownership Plan (hereinafter: ESOP) organization in the framework of ESOP connected with the privatization of state-owned enterprises or companies owned in part or as a whole, by the State, as well as with the sale of the property shares owned by them, in the interest of the realisation of the basic objective of the ESOP organization, during the period of the organization's obligation of loan amortization, but not more than the sum defined in Article 5, section (7). In case of the joint alienation of state-owned and not state-owned property shares (in the framework of ESOP), the part of the sum remitted, proportional to the quota of the State property can be taken into account, which, however, shall not exceed the measure defined in Article 5, section (7). In case of the alienation of the property share in a company owned in part, or as a whole, by the State (in the framework of ESOP), the proportional part corresponding to the State's ownership quota in the company can be taken into account which, however, shall not exceed the measure defined in Article 5, section (7)."

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Have established several subsidiary cos., including foreign subs and indep cos when they own majority stake
5 before priv + 48 since! $5M invested in subs
Forwarding is 60% of revs
ESOP ownership
10% equally
30% according to downpymt propor
60% salary
Emp made big downpayment

MASPED Joint-stock Company

Complete name of company	MASPED First Hungarian General Forwarding Company.(Első Magyar Általános Szállítmányozási Rt.)	
Head-quarters	Budapest, Kristóf tér 2.	
President-CEO	István Kautz	
Offices	10 offices in towns of Hungary 4 offices abroad: Vienna, Koper, Rijeka, Rotterdam	
Year of foundation (predecessor) Year of privatization	1948 1993	
Registered capital	2,681 million HUF	
Number of employees	330	
Participants in ESOP	300 employees	
Main activity	international forwarding	
Activities	forwarding of containers forwarding by rail air cargo forwarding by sea and river other special services	
Structure of ownership joint bid mgmt emps	ESOP Organization MBO Company Hungarian investors Local governments	50 % 35 % 10 % 5 %
Structure of capital	Own capital Registered capital Retained earnings	3,229 million HUF 2,681 million HUF 245 million HUF
Important financial indicators	Revenues Pre-tax profit	15,300 million HUF 468 million HUF

Doubled since 5 yrs

301 m — '93

Introduction to the company

MASPED has been the leading international forwarding company of Hungary. The scope of activities include all types of forwarding. The company has a network of offices in the countryside and abroad. It has representatives in the most important European ports and the important Hungarian industrial and commercial centers. After the structural changes in Hungary's economy, the Company still preserves its leading role because of strength in capital, trust and knowledge of employees.

If we look at the sales figures of the Company, MASPED belongs to the big forwarding companies of the world.

Privatization

When the Company was preparing for privatization, managers and employees had to be very careful because of the decay of foreign markets, and that many foreign trade companies had gone bankrupt. In 1993 the consortium of the MBO and ESOP won the privatization bid of the State Property Agency for the company.

Results

The Company started its development program 4 years ago, in 1993. After the decay of the market, instead of a defense, it started looking for new opportunities. It built up its network in the countryside and opened new offices abroad.

Since then the turnover of the company has exceeded 4,3 million tons in 1996, which meant 15,3 billion HUF in revenues. Based on revenues it is the first among forwarding companies. Compared to any type business company in Hungary, it was the 72^{nd} concerning revenues in 1996, and the 59^{th} concerning pre-tax profits. Regarding profitability, it is among the biggest foreign trade companies in Hungary.

The daughter companies of MASPED have been working also very successfully. The Hungarian companies aim at widening the range of services of the Company. In 1995 these companies generated 10 billion HUF in revenue, their total pre-tax profit was more than that of the parent company's with 433 million HUF. The Company together with the daughter companies generated revenues of more than 25 billion HUF, their total pre-tax profit was 900 million HUF.

The structure of the corporation is market-oriented. Business activities are coordinated by three commercial directors and the president-CEO. There are 8 specialized fields. There are special fields in forwarding which the company serves through its joint-venture companies. Now the Company has joint-venture companies in the former Soviet Union (Russia, Belorus, Lithuania, Latvia, Kazahstan), and in Slovenia, Austria, England.

The Company employed 330 people at the end of 1995, since then it has been employing more and more people. 95% of employees are also owners of MASPED. Owners are satisfied with the results of the Company, they are ready to sacrifice their work for further development, thanks to the good spirit in the workplace, which is encouraging for better performances. Now everybody can see that the value of the stocks is growing together with the growth of the company.

PEMŰ Joint-stock Company

Complete name of company	Plastic Fitting Manufacturing Co. (Pest Megyei Műanyagipari Rt.)	
Head-quarters	Solymár, Terstyánszky J. u. 89.	
President-CEO	Bernát Sarlós	
Branches	4 in Budapest, Cegléd, Solymár, Zsámbék	
Year of foundation (predecessor) Year of privatization	1959 1993	
Registered capital	800 million HUF	
Number of employees	1100	
Participants in ESOP	800 employees	
Main activity	manufacturing of plastic products, shoes	
Activities	shoes special plastics shoe parts other	40% 40% 10%
Structure of ownership	ESOP Organization Postabank Local governments	64 % 30 % 6 %
Structure of capital	Own capital Registered capital Retained earnings	1,650 million HUF 800 million HUF 850 million HUF
Important financial indicators	Revenues Exports Pre-tax profit	4,000 million HUF 800 million HUF 60 million HUF

The Company at present manufactures a couple of thousand different products in 6 major branches, from Hungarian and imported raw materials. The branches were formulated at the time of the 1989 reformulation program. The branches have separate profit-and-loss accounts, and they do most of the sales activities, too.

History of the company

The legal predecessor of the company was set up in 1959 for manufacturing metal bulk products. The company first manufactured toy dolls. Since the beginning the Company has been involved in introducing new raw materials and new plastic-processing technologies.

1959 PEMŰ's legal predecessor was founded in Solymár
1968 Reorganized into PEMŰ Plasenterprise
1970 Plastic pipes technology and know-how were bought from ANGER Austria
1971 Teflon and PU processing was started

In the 70's during an extensive growth a number of companies in Pest County were added to PEMŰ.
1972 The Zsámbék Plastic Processing Company and the Cegléd Shoe Factory was joined
1978 The Zsámbék BŐRFA Company was joined to PEMŰ.

The Company widened its activities by founding joint-ventures in the 80's.
1981 Qualiplastik Ltd. was established in Zsámbék (as a PEMŰ-USA joint-venture)
1985 Kemipur Polyuretan System Ltd. was established in Solymár as a PEMŰ-B.A.S.F. joint-venture.
1987 Auto Trade joint venture was established in Budapest (PEMŰ-PUMA cooperation started)
1988 Multi Trade joint venture was established, PEMŰ-TEVÈS cooperation started in Solymár

The 90'-s reinforced export-orientation.
1990 PEMŰ-HAPPICH (Germany) cooperation started in Solymár
1993 PEMŰ RCL (Canadian) joint venture was established in Zsámbék
1993 PEMŰ HAPPICH Car Parts joint venture was established in Solymár
1994 PEMŰ Co. Ltd. turned into a privatized company
1996 PEMŰ Co. Ltd. turned into a joint-stock company
1996 The USAID - Share Participation Foundation OD training program started at PEMŰ.

Privatization

There were a number of alternatives when PEMŰ first was said to be privatized. The idea to transform the company into a holding and therefore formulate separate companies, was not supported by neither the majority of managers, nor the State Property Agency, nor the banks, which had given loans to the company. Employee buyout, as an idea appeared quite early, and within a short period of time it got support from both managers and employees. When the ESOP-Law got into effect, the ESOP organizational committee started the buyout process. After winning the privatization bid, the ESOP Organization got a majority stake in the company. They paid the price from compensation coupons, cash and a beneficial loan, which has to be paid back within 10 years, after two years of tolerance.

According to the agreement made with the State Property Agency, 30% of the shares was bought by the company itself, which they are planning to sell on a bid in the close future. The cash from selling the stake will be used for current assets, new developments and technological improvements.

Results

During the last four years the Company has paid back most of its loans (including the one from the World Bank), its financial position has gotten much stronger. PEMŰ has reached revenues of 4 billion HUF and exports make up 20% of all products especially for German-speaking countries. It was turned into a joint-stock company in 1996.

PEMŰ's main aim is to comply with the conditions of the market-economy formulating in Hungary now. Its quality control system was rearranged after following Japanese and Western-European examples. During the last few years it rearranged its company structure based on the advises of leading management counselling companies. Now it is aiming at developing internal co-operational abilities and stronger sense of ownership within the framework of Project for MORE (Management and Ownership Redefinition in ESOPs).

Tata Rooftile Manufacturing Joint-stock Company

Complete name of company	Tata Rooftile Manufacturing Joint-stock Company (Tatai Cserépipari Rt.)	
Head-quarters	Tata, Faller Jenő u. 9.	
President-CEO	János Váli-Tóth	
Seat of the company	Tata	
Year of foundation (predecessor) Year of privatization	1971 1993	
Registered capital	71.4 million HUF	
Number of employees	145	
Participants in ESOP	120 employees	
Main activity	manufacturing of roof-tiles	
Structure of ownership	ESOP Organization	100 %
Structure of capital	Own capital Registered capital Capital reserve	172.0 million HUF 71.4 million HUF 38.6 million HUF
Important financial indicators	Revenues Pre-tax profit	610 million HUF 73 million HUF

Introduction to the Company

The Tata Rooftile Manufacturing Company started in 1971 as the most up-to-date factory in Central-Europe, but it caused a lot of trouble for both the management and the employees that they did not buy a complete technology then. Nowadays the products of the Company are made of natural raw materials, and they comply with the taste of our age both in quality and in range. The shingle-tile, which was developed not long ago, is a good example for this, as it does not only widen the choice from an aesthetical point of view, but it opens up a way for new architectural solutions.

Privatization

The legal predecessor, which was seated in Győr had the toughest time in 1990, when the whole trade was in crisis. There were millions of tiles piled up on the yards of the factory, and the giant company chose the easiest solution: stopped half the production and laid off almost every second employee. The next year was not better either, when the first foreign buyers, potential buyers came looking for privatization opportunities. The management and workers faced a dilemma: to accept foreign ownership or stand on their own feet.

In January 1992 the management and workers' committee decided that they want to separate themselves from the giant company and try to privatize the factory through ESOP. The plan became reality, in 1992 the factory was turned into a limited company, in 1993 into a joint-stock company and in October the employees became real owners after the sales contract was signed.

The new company almost had to start from zero, because it almost had no communicational equipment. Technology was outdated, workers' wages did not even reach the national minimum wage. Within a few months, as a result of the struggles of the management and the employees, the company was up and running again. The millions of stocks were sold, the price for the company was paid, and they started to formulate a humanistic joint-stock company.

Results

Efficiency of the company has grown as a result of regular technological improvements and investments. In 1996 the burners in the kilns were changed into up-to-date ones, which will be followed by further modernization of equipment. The value of the total modernization is over half a billion HUF.

The product-development strategy of the company was proved by the market as shingle-tiles were very well received. More and more people want decorative houses and these tiles look really beautiful and make the building look unique. The tiles are also light and they are made in two colors: natural and red.

Primary aim at the company is to be flexible, to be able to adapt to the needs of the market. The quality of tiles have improved a lot since earlier years, it better satisfies customers' needs. The quality of Tata tiles is so good, that even in Austria and Germany it is demanded. These markets take environmental friendliness seriously.

The pricing policy of the company is the following: the products should not be expensive for most of the layers of society, and all layers should find the special product for their needs. These prices are 10-20% below those of the competitors. The company's business philosophy aims at fair profit.

New element in the marketing of the company: customer-awareness campaign. Besides intensive advertising, retailers are also asked to come to the factory to see new improvements and they are asked to tell their opinion, too. As a result of professional marketing activities, the market share of the company has reached 27%. Primary market is Hungary, but the company is open to foreign demand, too.

Employee salaries have changed to better after privatization. Salary raises have topped significantly the inflation rate during the last years, the aim is to raise the technical level of the factory and living conditions of employees parallelly. The basic conditions are given for this, as the company has no loans, no bad debts. The company has a good reputation for sponsoring many millions on schools, kindergartens, homes, churches, cultural and sport activities.

Employee awareness is broadened by regular publicity, training and education. In order to further develop company and ownership culture, we started Project for MORE (Management and Ownership Redefinition in ESOPs)in the end of 1996, which aims at improving company success through implementing management by participation within a period of two and a half years.

THE ACTIVITIES OF

SHARE-PARTICIPATION FOUNDATION

IN THE FIELD OF
ORGANIZATION DEVELOPMENT
AND CORPORATE TRAINING

MRP

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Share-Participation Foundation

Share-Participation Foundation was founded in 1989 with the mission to promote the full utilization of existing resources and growth potential of companies and the democratization of the Hungarian economy through employee ownership and participatory management, which factors are expected to contribute to Hungary becoming a stable competitor in the global marketplace.

The Foundation promotes this process by creating the appropriate legal and organizational environment, assists companies in becoming employee-owned, offers technical and informational support in issues concerning organizational development, training and participatory management, which is gaining importance in western economies nowadays.

The Foundation has been receiving grants and technical assistance from Hungarian and foreign companies and international development organizations. This support has contributed to the success of the Foundation's activity. The activity of Share-Participation Foundation has comprised:

- The Foundation has taken the initiative and participated in the creation of the concept of the Employee Stock Ownership Plan (ESOP) law and the final drafting of the bill (the bill was passed by Hungarian Parliament in June 1992);
- Through organizing the annual National ESOP conferences, workshops and presentations with the attendance of several hundred people, the Foundation offers information to the executives and experts of the companies interested in privatization and to the existing ESOP organizations about ESOP as a privatization and company management tool;
- In 1995 the Foundation launched its Project for MORE (Management and Ownership Redefinition for ESOP), a three-year organization development and training project, so as to spread up-to-date management practice based on participation, and re-define management and ownership in Hungarian ESOP companies;
- The Foundation organizes seminars and group training sessions for employee owners, so as to enhance their economic and business knowledge;
- The Foundation offers development consultation in the field of ESOP administration and communication;
- Engages in research in the field of the possibilities and the role of employee ownership in Hungary, shares and exchanges experience with experts, company managers and employee co-owners, collects and processes domestic and international literature and disseminates information about it;
- Regularly publishes its Newsletter (from 1996 every two months) information bulletins and video films and other information materials for the ESOP community.

ESOP

as an Instrument of the Improvement of Company Performance

"When we had formed our ESOP and became owners, most of the people were full of enthusiasm and expectations. We experienced changes even in people's attitude and behavior. Productivity also went up. But now things are back to where they were before the ESOP, or even worse.
We do not know what to do.
Our employees may be owners but they do not act like owners, they are shareholders, but do not do any more for the company than the simple employees."

ESOP is more than a privatization transaction. ESOP may become one of the fundamental instruments of improving company performance, especially when combined with employee-owners' commitment to the company's success and the evolution of an 'ownership culture'. But this rarely if ever happens by itself and is insufficient in itself. It is not so much the greater commitment of employee owners that brings benefits and profit for the company, as their ideas for improving quality and cutting costs and their new attitudes that they bring to the decision-making process in their own jobs and the company as a whole. Committed employees - if they are given the opportunity, supplied with appropriate knowledge and information and are rewarded - readily put forward their ideas and take part in the identification and solution of problems in production and sales, contributing to the cutting of costs, the improvement of quality and customer satisfaction. Ownership culture based on knowledge and commitment based on interest, combined with the opportunity to participate can become an important component of efforts to increase sales, improve productivity and company performance.

For this end, the implementation of a development process carefully tailored to the company's needs is required. It is a long process to formulate a corporate culture, which is aimed at constant growth of company productivity, which also involves changes in a number of different areas of the company. Companies need a special combination of the following elements in order to reach the aimed results:

- evaluation of the company's activities, identifying areas where change is needed;
- defining or re-defining the company's mission and vision;
- formulation of a corporate strategy in order to reach quality, punctuality, more effective work-process and less waste;
- planning and implementing "tailor-made" training programs in order to teach the abilities and knowledge which are part of a new corporate culture;
- planning of a communicational program for the improvement of in-company information-flow and to help employees focus on areas which are important for productivity;
- the development of a profit-sharing program, in which the employees' income is connected to profitability and the improvement of productivity and therefore it reinforces the aimed organizational culture;
- production of a general plan for alloying and realizing these different educational, communicational, participatory and profit-sharing strategies.

The Central Elements of the Development of an Ownership Culture

Communication

Successful ESOP companies develop an open, flexible and comprehensive internal communication system. Efficient communication systems promote the free flow of ideas and information and feedback both horizontally and vertically, company-wide. This enables employee owners also to monitor the profitability and financial figures of their team, department and the whole company. This is how the increased interest and participation of employees in problem-solving, better, more creative and timely decision-making and speedy execution can be achieved, and work morale can improve.

Participation

The findings of extensive international research pursued in this subject invariably and positively show that employee ownership combined with participation results in the faster growth of companies and improved productivity and profitability. However, to make employees consider themselves true owners, more responsibility must be given to them in decision-making and problem-solving, so that they can undertake responsibility for the company's performance. Participatory management systems can prove for the employees that the fact of becoming owners can change their status and way of living. For this end the company has to elaborate its specific participation system and implementation plan considering its operational and personnel possibilities and needs. As the first step towards this end, the creation of ad hoc problem-solving groups is a viable solution. In turn, these groups may become permanent ones and also increase in number. After large groups of employees have been trained and have joined problem-solving teams, the following step is to involve them in the determination of production and financial objectives and the elaboration of action plans. It is also expedient to involve large groups of employees in the formulation of the corporate mission, vision and strategy.

Owners' Education

So as to enable employee owners to become as true owners in their approach and acts, we have to provide them with information about ownership, the operation of ownership and proprietary position. They have to become acquainted with ESOP in general, about the benefits of becoming a co-owner, and about how and to what end owners' rights can be exercises. They have to have knowledge about their industry, the financial and business basics about their company and especially about their own sphere of work. Only in possession of this knowledge can they accumulate, evaluate and interpret the production and business data of their place of work, recognize their interdependency and work for the market and the financial success of their company.

Profit Sharing

For employees, ESOP may involve the increase of income, through dividends paid after repayment of the E-credit and eventually the principal of their shares. However, the chance to get dividends later on and receive shares at retirement - for the majority - is too remote to influence day-to-day work performance. Thus, it is reasonable to add to the benefits the regular sharing of the profit generated in the division and the whole company. The remuneration of the common contribution to the profit on group or division level strengthens organizational culture (commitment to the company, co-operation, etc.) and enhances the efforts to increase the company's productivity.

Employee Education in ESOP Companies

"Our workers still do not believe that ESOP will really benefit them. We have given them our ESOP Statutes and the annual financial statements, but the majority did not really seem to understand what they were about.
When we hold company or ESOP meetings, everyone complains, telling old-time laments about working conditions, disregarding our pressing production and financial problems. They expect us, managers to solve these problems."

There are lots of employees who do not know their company, the conceptual and financial background of ESOP and its operation. Many of them have never seen a balance sheet or profit and loss statement, let alone studying them. A comprehensive training program can enable employees to understand this information and give them an instrument to use these data in their work and co-operate in the solution of problems in production, profitability and marketing.

Share-Participation Foundation offers close co-operation to employee-owned companies in the design and implementation of training programs tailored to their individual needs. For this purpose, it

- assesses a company's training needs in accordance with its mission, vision and company strategy of change;
- assists in the planning of a long-term training strategy;
- plans a concrete series of training modules in accordance with the status survey and the direction of necessary changes;
- prepares training materials;
- offers training with the most up-to-date interactive group methods and facilitator support to group-work for all personnel levels;
- designs and develops its internal trainer capacity so as to be able to offer training with only its own staff.

Share-Participation Foundation plans and implements training programs which
- actively involve participants in the education process and group work;
- apply concrete, lively examples and relevant case studies;
- use informative, easy-to-understand and attractive graphic aids.

Share-Participation Foundation believes that ESOP training programs are most efficient when they are designed as a component of a comprehensive organization development strategy. This can ensure that training efforts are linked to change and to the essential business goals and support their implementation.

The Foundation strives to create a close technical contact, a "network" in training and organization development between ESOP companies, as regards the transfer of methods and knowledge and the sharing of experience. We wish that these companies were benchmarks both for one another and for non-ESOP companies, too - regarding corporate operation and profitability.

Training Modules
for the Education Program of ESOP Companies

Share-Participation Foundation applies interactive training methods. The content of its training materials is of high technical standard and easy to understand for all employee groups. The Foundation's trainers do their best to use many examples, case studies, etc. which reflect the status of ESOP companies and ESOP itself, enhancing interest and helping understanding.

The most important training modules:

Basic Business Concepts for ESOP Owners

This module offers basic knowledge about how profit is generated at companies. Taking the example of the budget of a household and concrete examples from the given company, it highlights the relationship between production, sales, marketing, customer relations, wages, profit, investment sources, dividend and share price and the role of the various units of the company.

Financial Data, the Balance Sheet and Profit

Building upon the previous module, it focuses on and teaches the employees the meaning of the data in the balance sheet and the profit and loss account, and enables them not only to read and interpret data but - if the necessary figures are collected for or by them - also to compile and monitor such data relating to their own division.

ESOP and You

In the end of this module participants will get answers to questions in relation to ESOP transactions, the Statute and the operation of the ESOP organization, owners' rights (voting, dividend, value assets' increase, etc.) and representation. They are also informed about when, how and in what circumstances the shares are allocated to the individual accounts of the participants and about when, how and within what circumstances discretional income is generated from the shares.

Corporate Mission, Vision and Strategy

Having recognized the necessity of change and having committed themselves to change, management and non-management level employee groups, with the contribution and facilitation support of the Foundation's experts, analyze the company's status quo, and define or re-define the company's mission or vision, and plan the series of steps needed to realize them (prepare a strategy and an action plan).

Effective Meetings and Consensus Decision-Making

This module acquaints employee owners with the principles and techniques serving as the basis and instrument of their group (team) work. With the help of these, each member of the team can provide his knowledge and expertise to the fullest extent, and can accept the common decision of the group and moreover, can and will execute it in a common way.

Additional Training Modules

Techniques of group problem-solving

This method is designed for participants already knowing group co-operation techniques. It gives them methods and techniques enabling them

- to identify problems in their own work and in company operation (to separate the problem from its symptoms);
- to diagnose these problems (collect data and information, find causes and - if necessary - redefine the problem based on these);
- to seek potential solutions;
- to chose the appropriate solution among these, with respect to time, cost, reliability, efficiency, applicability and acceptability;
- and finally to measure and evaluate the results;
- to decide about the continuation and further direction of the problem-solving process

The significance, techniques and channels of communication between members of the group

The development of knowledge and skills of bilateral and multilateral communication enables group members to share, process and use information in order to reach the group's objectives (primarily to identify and solve problems in connection with quality, profitability and customer satisfaction) and to be able to present their suggestions to others (e.g. a decision-making body) in a convincing way.

The understanding and handling of group dynamics and inter-member contacts (conflicts), how to turn from a "directing manager" into a "supportive leader"

By doing the exercises in this module, the participants will

- explore their values and aims and get to know those of their companions;
- gain knowledge about group atmosphere and the emergence of leading roles in the group, about the benefits of co-operation as contrasted to rivalry, and the techniques of conflict management;
- they get closer to accept each other and to build on each other's strengths;
- recognize that the ability to listen to each other, the stopping of bad habits and the application of efficient techniques are of key importance regarding the efficiency of the group.

The training of company trainers

In order to enable employee owners to know and apply the techniques of co-operation and group problem-solving and to make involvement as extensive and intensive as possible, internal company trainers (facilitators) have to be trained who can offer the basic training their colleagues and subordinates need in the majority of the above mentioned topics. This way it is easier to finance the upgrading of a co-operation and success-oriented company culture than it would be with the continuous participation of external trainers.

Communication in ESOP Companies

Communication in ESOP companies is an indispensable tool of creating an ownership culture that promotes profitability. The main functions of communication are:

- information sharing
- education
- motivation
- attitude modification
- team building
- concentration of attention on company objectives
- involvement in the preparation and implementation of decisions

A well-designed and complex communication strategy is a key element in developing employee attitudes and behaviors that are supportive of the profitable operation and market success of a company. This communication helps building up a company atmosphere in which employees can feel like owners and act like owners.

Communication programs are multifold and involve:

- making the aim and significance of employee ownership comprehensible to all employees involved;
- making the complex rules of ESOP and the possibilities involved known to all old and new employees in a simple, everyday language;
- supplying simple, regular financial information about the achievement of the company's objectives in a way to enable employee owners to monitor the performance of their department and the company as a whole, so as to motivate them to improve co-operation and work-performance.

Share-Participation Foundation can offer you assistance in the following ways:

- in assessing your communication needs
- in co-operating with your company management and ESOP management in order to determine the objectives and elaborate the annual communication plan;
- in helping to decide what media and forms can be best used in order to increase employees' participation and motivation;
- in designing communication programs to educate employee owners about the most important company issues and to prepare them for participation in decision-making process.

The staff of the Foundation

János Lukács
Qualifications: industrial sociologist, chemical systems engineer;
Professional experience:
from 1990 managing director and founder of Share-Participation Foundation;
1991-1995 board member, State Property Agency
1976-1990 research fellow, Hungarian Academy of Sciences, Institute of Sociology;
Organization development based on participation and training, consulting, teaching and publication in the field of ESOP and privatization, the elaboration of the concept of ESOP in Hungary, participation in the drafting of the ESOP law, international comparative research in industrial sociology.

Ilona Erős
Qualifications: economist, trainer, Durham University Business School, United Kingdom (1991), facilitator, Training Resources Group, Alexandria, Virginia, USA (1995);
Professional experience:
corporate organization development and training, trainers' training in entrepreneurship, project manager for the World Bank, lecturing at college, corporate planning. Manager of the Foundation since 1994.

István Antal
Qualification: computer system and network operator;
Professional experience: computer expert of the Foundation since 1996.

Róbert Becker
Professional experience: office duties, works for the Foundation since 1996 as a computer fellow.

Katalin Hegedűs
Qualification: teacher of English;
Professional experience: project planning, trainer assistant, conference organization, Project assistant of the Foundation since 1995.

János Hovorka
Qualification: economist;
Professional experience: research and teaching activity about ESOP, research fellow of the Foundation since 1993, scientific research, Labour Research Institute.

Mrs. Krajcsovics, Ildikó Pákozdy
Qualification: business-administrative clerk;
Professional experience: senior clerk, preparation for and organization of programs, study tours, handling documentation. Co-worker of the Foundation since 1991.

Éva Muszka
Qualification: administrator of finances, certified book-keeper;
Professional experience: financial assistant. Co-worker of the Foundation since 1996, responsible for conference-organization, publications.

Ákos Ritzmann
Qualification: certified book-keeper, financial administrator, software-operator;
Professional experience: management of financial projects, preparation of research documents, database operator, publication management and sales. Co-worker of the Foundation since 1995.

External experts of the Foundation

Mrs. Bujdos, Eszter Lengyel
Qualification: chemist-engineer, organization developer, trainer-teacher;
Professional experience: international comparative researches, researches on company success, preparation of an interest-enforcement system, management of organization examination and development projects, making of social maps, management training, building of non-profit institutional structure, organization of training, education, managing director of United Way Southern Hungary Foundation;
Reference works: MOL, United Way International, United Way Representation in Hungary, SZOMA Training Centre, SZETÁV, Progress Business Development Foundation, Excellence Corp., Seed Foundation, NM Phare Program Office, Hungarian Centre for Foundations.

Dr. János Diós
Qualification: chemical engineer, chemical organization engineer;
Professional experience: organization examination, status diagnosis, process control, planning and introduction of organization improvement systems, organization of information systems, organization development, managing director of Dinaxorg Organization and Management Consulting Ltd.;
Reference works: MOL Corp. Headquarters (1992-94), DUNAFERR Heat Resistant Materials Production Company Ltd. (1995-96), National Labour Centre (1996), GRAFIKA Trading Corp. (1996).

Lajos Joó
Qualification: teacher, trainer-consultant for small businesses;
Professional experience: organization-, service- and human resources development (Hunga-Lux Corp., MALÉV Corp.) in the areas of organizational culture of college and university education and human resources development. External expert of the Foundation since 1995 in organization development;
Reference works: MALÉV Corp., Baranya County Assembly, MÁV Corp., ÁV Corp.

Péter Kalmár
Qualification: economist, trainer-consultant in organization development, president of Hungarian Society of Organization Developers;
Professional experience: complex organization and management development, organization examination, strategic planning and communicational workshops, human resources management, management training, different aptitude-developing and communicational training;
Reference works: Coca Cola Amatil Hungary (1992-96), S and G Seeds (1995-96), Unicbank (1995-96), Wallis Holding (1995-96), Pannon GSM (1995), Tigáz (Trans-Tisza Gas Supplying Company).

Antal Szarvadi
Qualification: trainer;
Professional experience: development of organization culture, team-building, communication, he led trainings in negotiation techniques and conflict management, introduction of management based on participation (MBP) in organization culture, management of change, large-group programs, managing MBP projects - GE Tungsram.

Nándor Zettisch
Qualification: engineer-economist, psychologist, trainer-consultant in organization development;
Professional experience: management training, examination for organization development, human strategy, training of trainers, strategy developing series of trainings, marketing and management development trainings, preparation for the introduction of management information system for upper management, outplacement councelling, organization development program for management groups;
Reference works: ÉGSZI, KFV (now MOL Corp. Nagykanizsa Mining Plant), OKGT (now MOL Corp.), ÉGÁZ, DGÁZ, KÖGÁZ, TIFO, TUNGSRAM, ÁV Corp., MOL Corp. KTA, SHELL-INTERAG, MVA-PHARE, EVM, BASF Pharma Knoll Division.

Our publications

- Employee property (Budapest 1992)
- Anthony Martin: Be Owners Together (Budapest 1993)
- János Lukács: 100 Questions - 100 Answers About ESOP (Privatization Booklets 7, Budapest 1993)
- To Participate in Success (Video tape 1993)
- ESOP Newsletter (Budapest 1993-95)
- ESOP Newscurier (Budapest 1996-)
- ESOP Conferences 1993, 1994 (Budapest 1995)
- Project for MORE (Management and Ownership Redefinition for ESOP) - organization development and training program
- Bulletin on the objectives, process and conditions of the Project for MORE

Project for Management and Ownership Redefinition in Post-Privatized Hungarian ESOP Companies

Outline

Context and Background

It is well known that Hungary is in a period of rapid social and economic transition from an outdated, centralized power structure to a democratic market economy. Current conditions present a tremendous opportunity for Hungary to emerge as a stable, productive business partner to the world. One way this will be accomplished is through widespread privatization of state-owned business and industry, which will put much of the economy into the hands of private domestic and foreign owners. Privatization is a large-scale formal transformation, and the next step in the process is to ensure that newly-privatized companies have the best infrastructure for continued success.

Many recently privatized Hungarian companies have critical weaknesses in the areas of corporate governance and management. These were inherited from the past state command economy and aggravated by the present conditions of the Hungarian economy. In many cases, these weaknesses are causing deterioration in the companies' financial positions and threatening their economic future. Solutions to these problem must be introduced into the overall Hungarian business culture as well as into individual companies.

Research shows that 50% of all privatized Hungarian companies have serious existing financial problems. Analysis indicates that these companies are losing capital because productivity is not even matching the inflation rate. Profitability is not growing and access to new resources is limited. Also, recently privatized companies are ending a 2-3 year privatization loan payback grace period, and there is concern that unless companies begin optimizing their efficiency and productivity, they will default on the loans.

The critical and immediate challenge facing all recently privatized companies in Hungary is to make these post privatized companies economically viable in a changing, crisis-driven, and very competitive market. If successful, these companies will contribute greatly to establishing a market-oriented economy. Their failure, on the other hand, could discredit privatization and thereby threaten the processes of marketization and democratization more generally.

Project Goal

The multi-faceted goal of this Project for Management and Ownership Redefinition in Post-Privatized Companies is to provide models, materials, and strategies for the success of Hungarian companies through training, organizational development, and information sharing. Over 200 Hungarian companies will receive information and access to materials based on work done with pilot companies selected to receive contemporary training and organizational development materials and support. Ultimately, these companies will form a benchmark of corporate success in Hungary, demonstrating successful business practices, methods, techniques and materials to help post-privatized companies avoid failure.

Transforming these companies will include creating an awareness of customers, quality, and costs through employee empowerment and participative management. Pilot companies will be selected based on a commitment to change, a history of success, a training and organizational development infrastructure, and a *willingness to contribute one-fourth of the costs* to fund their transformation. Other Hungarian and Eastern European companies will be able to examine the transformed companies and recognize the value of contemporary management strategies. Materials and assistance will also be available to help support their own change processes.

The following graphic shows how many of the primary project stakeholders will work together to achieve the project goals.

The ESOP Role in Transforming Hungarian Business Culture

One of the approaches taken by several countries of Eastern Europe in their transition from a state-controlled system to a market economy is employee ownership, modeled after the U.S. Employee Stock Ownership Plan (ESOP).* In this approach, employees (including management) buy some or all of the shares of their company from the state on credit, which is gradually paid from the profits of the company. Successful ESOPs hold the potential of making the privatization process both more equitable — supporting the democratization of Eastern European societies — and more politically acceptable, which assists in maintaining popular support for privatizing the economies of Eastern Europe.

ESOP companies, in this case, includes all companies where employees are partial owners, including companies where there has been a management buy-out and/or strategic investment. The average employee ownership share in Hungarian ESOP companies is around 45%.

The most advanced country regarding the application of employee ownership in Eastern Europe is Hungary, where employee ownership has proven to be one of the most popular and successful avenues of privatization. The use of ESOP privatization plans in Hungary has been supported by information sharing activities beginning in 1990, and since the enactment of the Hungarian ESOP law in June 1992, over 60,000 Hungarian employees have become owners of assets valued at close to 40 billion HUF (USD $340 million). At the current rate, by 1996 there will be over 300 Hungarian ESOP companies with over 100,000 employee-owners.

In the United States, ESOP companies — such as Polaroid, Walmart, and General Electric — have proven the success of employee ownership and participative management.[1] Because of their democratic ownership structure and changing management style, ESOP companies are an ideal gateway for new ideas into Hungarian business culture. Participants have already successfully undergone a major change process to transform themselves into an ESOP, and because of this there are high expectations of success and flexibility from both management and front-line employees, giving ESOPs the advantage of openness and receptivity to change.

The Share-Participation Foundation

The Share-Participation Foundation, founded in 1989 and located in Budapest, has been instrumental in creating an environment for ESOP success in Hungary. The Foundation has received financial support from contributing Hungarian businesses and has also been awarded funds from foreign resources such as USAID, The Financial Services Volunteers Corporation, and the British Know-How Fund. Based on that support, the Foundation has succeeded in building a healthier environment for ESOPs in Hungary by:

- Providing information about ESOPs as a tool for privatization to potential and current ESOPs and newly privatized companies through workshops, lectures, videos, and newsletters;
- Holding annual ESOP conferences in Hungary with hundreds of participants each year;
- Writing the concept of the Hungarian ESOP law and participating actively in finalizing the legal text, which was adopted into law by Parliament in June 1992;
- Providing development advice to ESOP companies in areas of administration and accounting; and
- Participating in the privatization process through the Foundation director, who has been sitting on the board of the State Property Agency for over three years.

The Foundation has accumulated specific knowledge and experience related to ESOPs and corporate governance over the past five years, and all staff members have backgrounds in social science, business, and training. Foundation management personnel also have experience in administrating funds, coordinating technical assistance, and the change process. The Foundation has several critical strengths related to the ultimate success of this project.

- A Not-For-Profit Organization — The Foundation, with external financial support and technical assistance, can make the initial investment of developing the necessary concepts, methodologies, and materials; create an interest for them; and provide these services at cost — without the profit burden held by private consulting agencies.
- Relationships with Hungarian Privatization Authorities and the Hungarian Ministry of Finance — The past actions and successes of the Foundation has allowed good working relationships with the Hungarian Privatization Authorities and the Ministry of Finance to be forged through shared personnel, legislation development, and common goals for democracy and privatization.
- Existing Information Network — The Foundation, already working directly with nearly 300 newly-privatized and privatizing companies in Hungary, has the mission and the information network infrastructure to effectively and efficiently disseminate materials and

knowledge to support successful business practices. In addition to Central Europe, the Foundation has a network with not-for-profit organizations and companies in the United States, Canada, the United Kingdom, and the Middle East. Building on this existing information network, the Foundation can provide information and support related to organizational development, needs assessment, and training.

- Cooperation with the Hungarian ESOP Association — The Foundation and the Association participate regularly in providing training, workshops, and technical assistance to the ESOP community. A bi-monthly newsletter is also produced to disseminate current ESOP information.

Proposal

The target audience for this project is the constituency of over 200 ESOP companies currently existing in Hungary. (By the end of the three-year grant period, this number is expected to be closer to 300.) The Share-Participation Foundation proposes a three-year, multiple phase project that will address human resource utilization problems facing Hungarian post-privatized companies. Companies will be selected through a tendering procedure to form the basis of a "pilot project" designed to facilitate and showcase corporate success.

The Foundation, with some assistance from foreign and domestic technical assistance agencies, will introduce contemporary operating processes through training and organizational development interventions. The inclusion of these agencies to facilitate the change process will develop the consulting community by providing new materials and knowledge while creating a market environment for consultants. The pilot companies will be transformed from under-producing, centralized, authoritarian organizations into more economically stable, streamlined institutions that focus on customer quality, employee involvement, and productivity.

These "pilot" companies will help create an awareness of new problem solving strategies and serve as benchmark examples that can be emulated other companies. Materials and methodologies — including training courses, evaluation instruments, and other resources — will be developed and used for transforming the pilot companies and will also be made available to all Hungarian ESOPs by the Foundation through publications, conferences, workshops, and meetings. Non-ESOP companies in Hungary and the rest of Eastern Europe will also benefit from this information. The relationship between the pilot companies, other Hungarian ESOP companies, and all others that are potentially affected is illustrated in the following diagram.

The Three Pilot Companies

At present, there is not a "culture for success" in Hungary. The ideas of Total Quality Management, customer-driven service, and participative management are not integrated into the business society. Given these conditions, a project that provides more focused, in-depth assistance to fewer companies will be more effective than one that gives limited assistance to more companies. The creation of fewer, but more successful, models will fuel a long-lasting cultural transformation. Initially transforming three pilot companies — with a continued focus on disseminating materials, strategies, and methods — will provide the catalyst for long-term change and the more thorough integration of contemporary management techniques, ensuring that Hungary develops into a strong, stable business partner in the international community.

Objectives and Benchmarks

The primary objective of this project is to develop and disseminate new knowledge and practices that fundamentally contribute to the economic success of Hungarian companies. This can be initiated through the successful transformation of the pilot companies into stable, productive organizations with effective organizational development structures, a high level of employee participation in job-level decision making, and efficient problem solving based on employee involvement. During and after the transformation of the three pilot companies, all non-company specific information and general materials will be shared with the rest of the Hungarian ESOP community. This primary objective of the Project for Management and Ownership Redefinition in Post-Privatized Hungarian Companies can be broken down into three main categories.

Training Design, Development, and Delivery

- Selection, translation, and adaptation of existing methodologies and public domain training materials will occur. Materials selected will address human performance requirements identified in the needs assessment.

  Each of the three pilot company will have between 6 and 10 training courses that will be offered to management and line employees. Nearly 100% of the managers and line employees of the pilot companies will have received all the suggested training by the end of the project period.

- New needs assessment, organizational development, and participative training methods will be introduced into Hungarian business culture by using contemporary training interventions.

  Each of the pilot companies will receive a complete organizational assessment report, including recommendations for training and other change strategies. (Please see Appendix A for more complete information on the change process.)

Culture Building

- During and after the project period, information sharing activities — including newsletters, conferences, and workshops focusing on the materials and results of this project — will be conducted by the Foundation. This will include translation and distribution of business literature related to efficiency, employee ownership, and participative management.

  There will be an annual conference each year to showcase the change process and materials. Newsletters will be created every two months and disseminated to all privatized Hungarian companies. Two workshops per year will be offered to the general business community on change strategies.

- Interpersonal and corporate networks of ESOP companies and support groups — such as the Hungarian ESOP Association — will be formed based on the activities of the project. This sharing of knowledge, skills, and materials will increase cost effectiveness.

  The Share-Participation Foundation and the Hungarian ESOP Association will work together on many of the information sharing activities, including newsletter production, press releases, and conferences.

- The systems, structures, and practices of the pilot companies will form successful benchmark examples for other companies in Hungary and Eastern Europe.

Hungarian businesses will have access to all materials that are not company-specific. The success of the pilot companies will be "marketed" to the Hungarian (and Eastern European) companies through the information sharing strategies.

- The successful legislative work conducted by the Share-Participation Foundation, focusing on shaping national laws relating to ESOPs, will be continued. This will promote a favorable legal and fiscal environment for ESOPs.

  In conjunction with the Hungarian ESOP Association, a workshop on employee ownership will be held for the members of the Hungarian Parliament.

Expected Outcomes

Due to the broad scope of the project, there will be varying short and long term benefits. The pilot companies, due to the more intense and direct intervention, will naturally be farther along in the transformation process than companies using the pilot companies as models. The Share-Participation Foundation will aim for the following expected outcomes by the conclusion of the grant period. It is expected that all of these processes will continue after the grant period. (Please see the section on Diffusion and Project Continuation.)

Companies in Hungary

- These companies are aware of the workshops and OD activities in the pilot companies and are requesting similar technical assistance.
- Workshop designs, facilitator guidelines, and other training materials are in wide circulation among other ESOP companies in the country.
- Company CEO and other senior leadership are knowledgeable about corporate governance options and participative management techniques. They will be actively pursuing information and beginning to implement these governance options on their own.
- Employees in some of the companies have begun to receive training related to participative management and total quality operations.
- Some organizational development (OD) activities — including training, financial techniques, and new managerial strategies — are being implemented in non-pilot companies.

The Three Pilot Companies

- Company staff (particularly the CEO and other senior leadership) are very knowledgeable about corporate governance options and participative management techniques, and view these options and techniques as credible, fair, and the right approach for the company.
- Company employees in the three pilot companies are able to describe positive changes in their company as a result of the training and organizational development (OD) activities.
- Three pilot companies attribute improvements in financial performance and profitability at least in part to the OD and training activities.
- The three pilot companies are initiating in-house training and OD activities independent of grant-supported activities.

Implementation Plan

This project will take three years to complete. The following narrative is a brief description of the principle tasks of the project.

For the selection of **pilot companies**, the Share-Participation Foundation will issue a tender document to all Hungarian ESOPs. The purpose will be to select three or more partially employee owned companies of different sizes and business sectors that will be willing to participate and *co-finance* the transformation process. *Participating companies will be required to contribute one-fourth of the total estimated costs for transforming the companies.* This will ensure company commitment and help limit costs. Management must demonstrate a high level of commitment and flexibility and be willing to dedicate time and effort to the project.

For the **organizational and needs assessments**, the Foundation and technical assistants will develop a plan for collecting information from the pilot companies using focus groups, personal meetings, and surveys. The collected company data will be analyzed, and decisions about organizational development needs and training requirements for each of the pilot companies will be based on these assessments.

Following the organizational and needs assessment, a **change planning** phase will occur for each company. Decisions about organizational development and training needs, management development, and human resources will be made. An action plan will be developed to guide the change process in each of the pilot companies.

Once organizational needs have been identified and a plan for change completed, the **acquisition, adaptation, and development of training interventions** will result in training curricula that address the human performance problems in each of the pilot companies. (Please see Appendix A for an overview of Primary Change Phases.)

Once organizational development and training strategies have been finalized, the **development of a change infrastructure within the company** will occur. This will include delivery of training and the introduction of new organizational strategies, resulting in a commitment to becoming a learning organization.

The above implementation steps, once completed, will be part of a cyclical process for change for the subsequent 12-18 months of the grant period. There will also be several important implementation steps that will be **ongoing activities** for the duration of the project.

- Approximately $50,000 of grant funding has been allocated for joint **information sharing** projects exclusively with the Hungarian ESOP Association. Throughout the ESOP and non-ESOP business community, information will be disseminated through newsletters, workshops, the annual ESOP Conference, and open meetings conducted by the Foundation and the ESOP Association. A framework for networking and a positive environment for benchmarking will be created.
- **Domestic expert consultants** will contribute to the change process in each of the pilot companies. Their activities will be coordinated by the Share-Participation Foundation.

Foreign Technical Assistance

To ensure success, this project will require foreign technical assistance. The Foundation has received technical assistance for several years, and it is hoped that this will continue and be focused on the successful completion of this project. This assistance will be necessary to facilitate the organizational assessments, the development of OD and training curricula, the design and development of training interventions, and to provide external evaluation advice.

Appendix — Primary Phases of Organizational Change-Sample Implementation Plan for Pilot Companies

The following outline is an overview of the organizational change process that will be followed for each of the pilot companies.

- Organizational assessment conducted by the Project team
- Corporate governance retreat for 5-20 leading managers and personnel of the company (e.g., CEO, upper management and some middle managers in the most important areas), the unions, and the ESOP organization
  - Development of a mission statement and a common set of values
  - Development of a vision (direction and strategy) based on the mission statement and the common values
  - Development of an action plan for the establishment of
    - a social contract (quid pro quo) in connection with the changes,
    - a supportive organizational infrastructure
    - an environment in which information and the skills to gather and use information to improve performance are available
- Total Quality Ownership (TQO) course built around the mission statement, core values and an action plan. Participants are middle managers, functional staff, and front line employees with high reputations who will get ESOP orientation, team building, and problem solving training. They should be prepared to serve as future co-trainers and facilitators.
- Department-specific organizational assessment and training interventions
- Training for front-line employees in ESOP orientation, team building, and problem solving
- Follow up retreats and coaching of upper management on the creation of a learning organization

APPENDIX B:
EMPLOYEE OWNERSHIP
STUDY TOUR OF THE UNITED KINGDOM

June 3-7, 1997

Programme for employee ownership study tour from Zimbabwe.

United Kingdom: Tuesday June 3rd - Saturday June 7th

TUESDAY 3rd
21.05 ~ group arrives at London Heathrow Terminal 2.
Met by Robert Oakeshott and/or Thecla Mallinson and taken by minibus to the Charing Cross Hotel, on the Strand, London WC2.

WEDNESDAY 4th
From **7.00** ~ breakfast.

8.30 ~ after breakfast, go with Robert Oakeshott by underground to Unity Trust Bank, 130 Minories, London EC3. *See attatched page for list of speakers and titles.*

20.00 ~ dinner at Charing Cross Hotel.

THURSDAY 5th
From **7.00** ~ breakfast.

9.30 ~ leave for Stoke-on-Trent by minibus, accompanied by Robert Oakeshott.

12.30 ~ introductory speech by Richard Downes, Managing Director of Brittains, specialist employee owned subsidiary of employee owned Tullis Russell Paper Group.

13.00 ~ buffet lunch.

14.15 ~ tour of paper mills by share counsellors, Roger Brindley and Tony Border.

15.30 ~ leave for Elton Hotel, Rotherham.

20.00 ~ dinner at Elton Hotel, with a group from employee owned Mainline Bus Company.

FRIDAY 6th
From **7.15** ~ breakfast

9.30 ~ meeting in *Mackay Room* of Hotel. Speakers will be from Mainline Bus Company:

Dave Edwards - Employee Director
Peter White - Employee Director
Peter Sephton - Chairman and Chief Executive.

13.00 ~ lunch in hotel.

14.00 ~ return to Charing Cross Hotel in London, by minibus.

19.30 ~ reception held by Robert Oakeshott, with supper and music, at 14 & 15 Lichen Court, Queen's Drive, London N4.

SATURDAY 7th
From **7.00** ~ breakfast.

12.00 ~ check out of hotel. Luggage may be left at hotel until departure for the airport. Free time.

16.15 ~ meet in hotel lobby to leave at 16.30 for Gatwick airport, North Terminal, by minibus for 19.00 flight to Zimbabwe.

WEDNESDAY 4th MEETING AT UNITY TRUST BANK.

ORDER OF SPEAKERS :

9.00 ~ Selected extracts from _A Piece of the Action_, international employee ownership video. Selected and presented by David Wheatcroft - Employee Director with Chesterfield Transport, before, during and after its employee ownership.

9.30 ~ _Introduction to employee ownership in Britain with special reference to employee ownership outcomes of privatisation._
Robert Oakeshott.

10.00 ~ _Employee Ownership from a Conservative political standpoint._
Nigel Forman - lately Conservative MP for Carshalton.

10.30 ~ _Employee ownership and New Labour._
Denis MacShane MP - Labour MP for Rotherham.

11.00 ~ coffee.

11.30 ~ _Finance and credit for employee buy-outs and employee ownership._
Robin Blagburn - Senior Manager with Unity Corporate Advisers.

12.00 ~ _New ways of looking at management with special congruence for employee owned companies._
Patrick Dolan - consultant; founder and first Director of the British Deming Association.

12.45 ~ _The logic and principles underlying tax reliefs for employee share ownership in Britain._
David Farmer - formerly a senior civil servant with the Inland Revenue.

13.15 ~ lunch.

14.15 ~ _The main employee share ownership schemes supported by tax reliefs in Britain._
Graeme Nuttall - tax partner with Field Fisher Waterhouse.

14.45 ~ _Five years of employee ownership at a local bus company, Chesterfield Transport, in the Midlands._
David Wheatcroft.

15.15 ~ _Policies and attitudes to employee ownership in Britain's Trade Union Congress (TUC)._
Janet Williamson - Policy Officer of the Economic and Social Affairs Department of the TUC.

15.45 ~ tea.

16.15 ~ Round table of questions and discussion (optional).

17.00 ~ Closing remarks and return to Charing Cross Hotel for the evening, including dinner.

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USEFUL NUMBERS AND ADDRESSES

Job Ownership Ltd.
Abford House
15 Wilton Road
London
SW1V 1LT
tel: 0171 821 9298 / fax: 0171 828 5013

Elton Hotel
Main Street
Bramley, Nr. Rotherham
South Yorkshire S66 0SF
tel: 01709 545 681 / fax: 01709 549 100

Charing Cross Hotel
Strand
London
WC2N 5HX
tel: 0171 839 7282 / fax: 0171 839 3933

Brittains
Ivy House Paper Mills
Commercial Road
Hanley
Stoke-on-Trent
ST1 3QS
tel: 01782 202 567 / fax: 01782 202 157

Employee Ownership in Britain in 1997.

1. *The Conceptual & Legal Framework and the ESOP.*

With three main qualifications identified later in this paper, it is a pardonable oversimplification to say that employee ownership in today's Britain is derivative from that in the U.S: derivative both conceptually and in terms of the main mechanism and tax reliefs that support it. Nevertheless among those who know the subject, many - including some Americans - will argue that the British schemes of law and tax reliefs are superior to their US counterparts in at least two respects:

they have been kept quite separate from pension legislation and from tax reliefs associated with pension contributions.

Since 1994, they have allowed for the possibility that, *without loss of tax reliefs, a part of an employee owned equity may be held indirectly on employees' behalf in a permanent collective trust and not* by employees as individuals. This possibility - it is neither less nor more than that - makes Britain's employee ownership that much more easily sustainable than it is in the US.

The logical and conceptual background common to employee ownership in each of the two Anglo-Saxon countries has four main components resulting from four common perceptions.

that because, under systems of conventional capitalism, new investment is typically financed in ways which benefit existing shareholders, those systems must result in ever greater concentrations of wealth among the few.

that even when a business raises new capital for investment from *new shareholders*, ordinary working people will a) *not* normally have sufficient savings to subscribe for the new shares and b) *will* normally have levels of risk aversion which prevent them from borrowing the needed cash on the basis of their own individual credit.

that if we want to reverse the trend towards ever greater concentrations of wealth - and thus of power - broadly based E.O. offers the only solution which has both theoretical appeal and has now been tested in practice.

and that the best, perhaps the only, serviceable mechanism which allows E.O. to happen at all widely is the ESOP. It can do that because it enables employees to acquire shares in the companies for which they work without either a) paying cash for them or b) buying them on individually based credit. Instead they use the ESOP as a mechanism to secure a collectively based credit which will be repaid out of future profits. So both the workers' lack of savings and their risk aversion are simultaneously overcome.

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It follows from these four perceptions that a statutory recognition of the ESOP mechanism is at the base of the employee ownership legislation in both the US and the UK. Moreover in both Britain and America, once a business has established its ESOP then, so long as the ESOP's rules satisfy a range of conditions specified in the law, tax reliefs of various kinds and up to various limits become available a) to the company and b) to its employee shareholders.

2. The Main Tax Reliefs.

In both countries the two most important conditions on which the associated tax reliefs depend have been desinged to achieve employee ownership which is broadly and equitably based.

In both countries the most important reliefs are those which allow businesses to finance out of pre-tax profits the acquisition of shares for their employees by the ESOP.

For individual employees the main tax advantages are:

> in the UK a complete relief of income tax subject only to a retention period of two years.
>
> in the US a deferral of income tax coupled with the possibility of a tax relieved transfer into a tax sheltered pension scheme upon retirement.

There is one other major ESOP tax relief which is common to both countries and is of special importance in relation to the ownership succession problems of private companies - that is of companies not quoted on any stock exchange. Subject, as always, to the satisfaction of numerous conditions, shareholders who sell their equity to a statutorily approved ESOP trust may reinvest the proceeds of sale and defer their tax liability for capital gains.

3. Criteria for Judging Employee Ownership Significance.

Both in theory and in actual practice on the ground of both the US and the UK, the amount of employee owned share capital in any particular business varies from a fraction of one percent all the way up to 100%. In both countries, the great majority of companies that have introduced broadly based employee ownership have done so in respect of small or marginal percentages of their total equity. We need some criteria of significance. A double criteria is I think persuasive:

> To be significant, the *total* percentage of the share capital owned by employees must be such as to entitle them to a voice in the top decision making bodies of the business.
>
> Secondly in relation to the individual employee owners, the financial benefits flowing from that ownership must be

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potentially sufficient to modify the individual behaviour. Money benefits amounting to no more than a week's wages at Christmas are unlikely to satisfy the second criterion.

4. The Population of Employee Owned Companies in the UK & US.

If we are talking about employee ownership on the margin, which is unlikely to satisfy either or anyway both of the two criteria identified above, then the numbers are quite large. No two estimates are the same partly because of data difficulties and partly because judgements of what is marginal and what is significant are bound to differ. But as orders of magnitude estmiates:

in the UK, the number of businesses with broadly based employee ownership on the margin is probably slightly more rather than slightly less than 1000.

the corresponding total in the US is probably slightly less rather than slightly more than 10,000.

Allowing for the different sizes of the two economies, the American numbers are roughly twice those in Britain. The most probable main explanation of that difference is that the important tax reliefs were enacted that much earlier in the US than in the UK.

When we turn to the companies where employee ownership is not simply at the margin but satisfies at least one of my two criteria of significance, the numbers are inescapably much smaller. Once again no two estimates are the same. But for what it's worth my own are:

in the the UK, the number of businesses with significant amounts of employee ownership is probably between 50 and 100 and may be closer to the latter.

The corresponding number in America is probably between 500 and 1000 and is probably closer to the latter.

The relative size of the two economies and the earlier enactment of the main tax reliefs in the US lie behind the differences in these numbers as well as in the earlier ones.

To avoid any possible misunderstanding, I should make clear that all these estimates of employee ownership undertakings ignore small and very small undertakings and certainly those with less than say 50 employees.

5. Where Britain's Experience differs from America's.

The main difference is that Britain's experience includes companies in which privatisation has been the source of their employee ownership. But before turning to that I should put on

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record two other differences, one of enduring importance, the other probably less so. As well as what are by their origin "ESOP" businesses, Britain's 1997 population of companies with broadly based employee ownership that satisfies the significance test also included:

a very few survivors from among what was originally a late Victorian population of "workers'" or artisanal co-operatives. A good example is Equity Shoes in Leicester which employs about 200 people in 1997, roughly the same number as it employed a century before.

a few examples of what may be called "employee ownership by benefaction", of companies whose original capitalist owners have passed the ownership to their employees on a mainly collective basis and *without* the benefit of tax reliefs. A good example is the John Lewis Partnership, one of Britain's leading players in the highly competitive and contiguous activities of department store and supermarket retailing. It now employs rather more tha 40,000 people. The corresponding workforce total when the ownership transfer took place in 1929 was 1,200. At John Lewis the employee ownership is entirely collective. It is perhaps the experience and example of John Lewis and a handful of similar, though much smaller, undertakings which explain the British concern about making employee ownership at least potentially sustainable. If only for that reason the impact of this "employee ownership by benefaction", which is hardly found outside the UK, could well be quite out of proportion to the actual numbers that fall into this category.

6. Employee Ownership Resulting from Privatisation.

There are important and positive British examples of employee ownership resulting from Privatisation and there are important lessons which other countries can learn from this experience. On the other hand the main employee ownership story that emerges from a study of the acts of Privatisation for which the Thatcher and then the Major governments in Britain were successively responsible is very different: a story *missed opportunities* and missed opportunities that are most unlikely to be repeated in the lifetime of any of us. With the exception of parts of the local bus industry, there was no encouragement by Government for rank and file employees to team up with their managers and bid for the undertakings being privatised. To be fair, and again with only minor exceptions, there was no trade union encouragement for that to happen either. Instead what was normally on offer to rank and file employees when their businesses were privatised was a kind of "sweetener package", normally consisting of:

a small parcel of free shares, with a value of perhaps between one and two weeks wages.

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a slightly larger parcel of shares priced at a discount compared to what was on offer to members of the general public.

the right to jump ahead of "Sid and Doris" from the general public in the queue of people wanting to buy shares at the general offer price.

The Appendix is a list of *Major Privatisations* prepared by the Treasury. Its first entry pre-dates Mrs. Thatcher's victory in the 1979 election. But that is a distracting detail. Those which follow run from 1980 to the end of 1996. So what we have is essentially a record of the big privatisations under Mrs. Thatcher and Mr. Major. The total number of entries is about sixty. But if we allow for entries which cover more than one business - for example the 62 separate subisidiary companies of what was formerly the National Bus Company, and the ten subsisiaries of what was formerly the Scottish Bus Group - the true total is closer to 170. If we ignore the local bus companies, there were just three businesses in a total of around 100 which emerged from privatisation significantly owned by their employees on a broad basis, namely:

The UK's largest road haulage business. It later changed its name from the *National Freight Consortium* to the acronym NFC, and employed some 24,000 people when it was privatized in 1982. Following *the pioneering* example of a management led employee buy-out [or MEBO] in Britain - and perhaps the world - over 10,000 of its employees led by its chief executive came to own just over 80% of its share capital.

Victaulic, a small to medium sized plastic pipe making former subsidiary of British Steel. In a MEBO led by its chief executive which took place in 1983, little more than a year after that of NFC, a majority of its then 800 odd workforce became the owners of over 50% of its share capital.

Unipart, a medium to large sized component making former subsidiary of the now defunct British Leyland [later the Rover Company]. It currently employs a total workforce of 3,800 - down by about 200 since privatisation. Roughly half of them own together some 12% of its share capital. Since it privatisated in 1987, Unipart has not applied for a stock market listing. Its shares remain privately held. Both its performance and its "significant minority" employee ownership are widely judged to have been a 10 year success story.

Employee ownership following privatisation in Britain's local bus industry is dealt with separately by Mr. Wheatcroft.

I do not have the data about the share price movement at Victaulic. But at NFC the price rose just over 100 times in 5 years between the buy-out and the 1987 float. At Unipart the employee shares are currently valued at £2.30 - up from 0.5p.

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APPENDIX

MAJOR PRIVATISATIONS

COMPANY	YEAR OF SALE
BP 3	1977
Fairey	1980
British Aerospace	1981
Cable and Wireless	1981
Amersham International	1982
NFC	1982
Britoil	1982
Associated British Ports	1983
International Aeradio	1983
Victualic	1983
Enterprise Oil	1984
Jaguar	1984
Sealink	1984
BT	1984
VSEL	1986
British International Helicopters	1986
National Bus Company (62 seperate subsidiaries)	1986
British Gas	1986
Leyland Bus	1987
Unipart	1987
British Airways	1987
Royal Ordnance	1987
DAB	1987
Rolls-Royce	1987
Istel	1987
BAA	1987
British Transport Advertising	1987
National Seed Development Organisation	1987
Rover Group 3	1988
Professional and Executive Recruitment	1988
British Steel	1988
Travellers Fare	1988
British Rail Engineering (BREL)	1989
General Practice Finance Corporation	1989
Harland and Wolff	1989
Short Brothers	1989
10 water and sewage companies	1989
Giroleasing	1990
Girobank	1990
Scottish Bus Group (10m separate subsidiaries)	1990
12 regional electricity companies	1990
National Power/Powergen	1991
Scottish Power/Scottish Hydro-Electric	1991
National Transcommunications	1991
5 Trust Ports	1992
BTG	1992
4 Northern Ireland Generating Companies	1992

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PSA Projects	1992
Northern Ireland Electricity (distrib. company)	1993
5 PSA building management companies	1993
DVOIT	1993
London Buses (10 separate sales to date)	1994
Forward	1994
DTEL's	1994
Belfast International Airport	1994
National Power/Powergen 2	1995
Railtrack	1996
British Energy	1996

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Brittains TR: The Experience of a Tullis Russell Subsidiary in the 1980s and down to the middle 1990s.

In January 1980, Brittains (TR), with the TR standing for Tullis Russell, was formed to buy from the receivers the assets of what had previously been Brittain's Converters whose parent company had gone bankrupt. Largely because of special factors, in its first four months trading it showed a significant loss - of some £142,000 on a turnover of just over £1.2m. For the 15 subsequent years, down to the time when this was written in the autumn of 1995, it was consistently and increasingly profitable, with trading profits reaching new records in each of the 4 years down to 1994/95. In that last year the actual trading profits were just over £2.25m. on a turnover of just over £12.3m. and these numbers had been achieved by a workforce of scarcely over 100.

Indeed by the end of the 1980s Brittain's contribution to overall Tullis Russell profits if measured against the size of its workforce was way ahead of that of any other part of the business. It would not be possible to demonstrate with any degree of objectivity that profit sharing and employee share ownership were directly responsible for the splendid results. As elsewhere in Tullis Russell these new incentives started to come in around the middle of the 1980s. Presumably they cannot have had any negative effects. And they can indeed be plausibly linked with a rather startling event which took place shortly before Mr. Richard Downes took over as Managing Director in 1992. I will turn to the specifics of that event shortly. But what is certain is that, especially through the profit sharing scheme, the Brittain's workforce participated handsomely in the outstanding results of early 1990s.

A cash scheme which, as in all the Tullis Russell businesses, allocates to employees 15.7% of operating profits is at the generous end of any spectrum. Still if profits are modest and have to be shared between large numbers, the cash per employee may not be more than the equivalent of two or three weeks pay. At Brittain's in the two most recent years down to the end of March 1995, the money per employee had become equivalent, after taking the available tax reliefs into account, to over 30% on top of annual basic pay. When a fork lift truck driver earning a taxable £12,000 a year basic pay, receives an after tax £3,000 as a cash profit share, he *must,* you would think, feel that things are changing somewhat in his world.

Brittains (TR) has just one product. It is made by applying special coatings to paper supplied by its sister company, Tullis Russell Papermakers, in Scotland, and is known by a wide range of technical names including, apparently, decalcomania paper. I expect that the one best known to the public is "transfer paper", which can also be understood as a functional description. Readers of middle age will be familiar with "transfers" from childhood: typically rather dark small postage

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stamp size pictures which go through a brightening up process of transformation when floated off from their original backing onto a bright field of clean white paper. Brittains makes what can simply be understood as transfer backing paper for grown up uses: for floating off brilliantly coloured decorations onto porcelain or enamel for example. Among their most important customers are the specialist printers who supply the up market porcelain manufacturers, businesses like Wedgwood and Royal Doulton in the U.K. Each of those two are close neighbours of Brittains in Stoke on Trent.

Turning from production to sales, it is not too much to claim that in the 15 years since it came to be owned by Tullis Russell, Brittains has become one of the two world leaders in a growing and quintessentially niche market that is growing fast. Believing that the information would be helpful to its chief and German competitor, the company does not publish a geographical breakdown of its sales. But it does acknowledge that well over three quarters of its output is exported and that at least since the start of the 1990s sales growth has been especially buoyant in the Far East. The big question about future sales, according to Mr. Downes, is whether the porcelain manufacturers on mainland China are going to move significantly to a decoration technique based on waterslide transfer paper. Up to the time of writing, in late 1995, they had no more than just started to put a first foot down that road.

A key feature in the detail of Brittains' experience over the 15 odd years since its acquisition by Tullis Russell has a striking similarity with that of its Scottish parent. If the movement of its numbers employed and its physical output are plotted as graphs and then superimposed over each other, the resulting pattern is again like a pair of scissors: after marking time for a bit, output goes sharply up. Employment comes almost continuously down. Here are the two series:

	Area of Paper Sold	Numbers Employed
1980/81	113,000	NA
1981/82	109,000	188
1982/83	108,000	171
1883/84	115,000	153
1984/85	123,000	161
1985/86	117,000	158
1986/87	120,000	136
1987/88	129,000	134
1988/89	133,000	132
1989/90	167,000	120
1990/91	190,000	123
1991/92	177,000	108
1992/93	188,000	107
1993/94	221,000	108
1994/95	232,000	107

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As a technical footnote for the specialist reader, it is worth putting on record the units in which the area of output is measured. They are so-called "medium reams" containing 500 sheets of transfer paper in the dimensions 18" x 23".

Of more general interest in relation to the statistics of output and employment is the proud claim of the Brittains' management that the "downsizing" of its workforce has been achieved without anyone becoming unemployed. Attrition and early retirement have been used as extensively as possible. When, in any year, they have not gone far enough, great and largely successful efforts have been made to help those affected by the restructuring to find acceptable alternative jobs in the Stoke on Trent area. Apparently there has been only one employee over the entire period covered by the table whose job had to go but for who it has not been possible to find alternative work elsewhere. She has been kept on to do simple odd tasks as they come up.

The management is also keen to emphasise, and rightly so, that the restructuring has been as painless as it has been because since the computerisation of most of the production process in the middle years of the 1980s, Brittains' employee shareholders have accepted what amounts to almost total job flexibility. In this context it seems reasonable to be explicit about the employees' shareholding. For, unusually, Mr. Downes is prepared to commit himself explicitly to the proposition that the acceptance of near complete "work flexibility" by the employees is linked at least psychologically to their situation as cash profit sharers and shareholders in the business.

In the absence of any convincing alternative explanation, Mr. Downes also attributes to Brittains' ownership and cash profit sharing arrangements a rather startling *"evenement"* which took place shortly before he took over the top job in 1992 and which I flagged earlier. What happened was that a deputation of all Brittain's shop stewards "waited on" Mr. Downes outside his office but without prior warning, one Monday morning. When the knock came on his door he was, he reports, quite at a loss about what to expect. But what they proposed was, he further reports, well beyond anything which he had anticipated or even dreamed of. Their proposal was simple: that they and the whole union arrangement in the company should disband - as having finished its useful shelf life. Faced with this bombshell, Mr. Downes' response was surely the right one. He suggested that no decision should be taken until the company and the unions had jointly sought and received advice from the statutory <u>Arbitration and Conciliation Service (ACAS)</u>. To shorten a potentially longer story ACAS duly advised that the functions previously performed by the trade unions should be taken over by an elected workers' council. That has since happened and the new arrangements are said to be working well.

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It is no doubt too early to say that an "ownership culture" is properly, let alone irreversibly "bedded down" at Brittains any more than it is elsewhere in the Tullis Russell group. But Mr. Downes and his team are ready to talk about the conditions which might make that happen and to do so rather helpfully. The first condition that they specify is that the value of an employee's shareholding should reach five figures, or even better, come to equal one year's pay. As elsewhere in the group that is still a goal which is some way off in the middle distance. But with one proviso it is not entirely out of reach.

That proviso is essentially the second condition which Mr. Downes specifies as being necessary if an "ownership culture" is to become properly bedded down at Brittains. It is of course, that the company should continue to be commercially successful and to make at least reasonable profits.

On the side of demand the great increase in Brittains' output over the eight years beginning in 1988, was partly a matter of an expanding world market and partly of the company's successful efforts to secure a larger share of it. The latter was essentially made possible by changes on the side of supply - especially by what amounted to the computerisation of most of the production process coupled up, as we have seen, with an acceptance by employees of almost completely flexible working.

Since its acquisition by Tullis Russell in 1979, Brittains has probably enjoyed, at least as against its main German Competitor, one rather specific supply side advantage: the fact that it is a one product business and that all the efforts of both its production and sales staff are concentrated on *transfer paper* and nothing else. No doubt that makes it vulnerable in the very long run. But there is little doubt that it confers a real advantage over the short and medium term.

As a footnote to that contention, it is worth noticing that the bankruptcy of the antecedent Brittains was widely attributed at the time to a rash of ill-considered "diversification" in the 1960s and 1970s. From its original core activities of paper making and coating the earlier Brittains had diversified by the middle 1970s into such non-contiguous fields as civil engineering, road haulage and insurance.

And that brings me to my final point which is unashamedly historical. Paper making and coating at the Brittain's Ivy Mills site in Stoke on Trent did not start quite as early as 1809, when, as we know, what became Tullis Russell opened for business in Glenrothes. But those activities are not of recent origin on the Stoke on Trent site and indeed go back to the 1820s. Of course there have been no bankruptcy discontinuities at Glenrothes. But on the Ivy Mill site in Stoke on Trent there have been not just one but two - the first in the 1830s. What then was the name of the original owners and paper makers on that site who went bankrupt? It is a name as illustrious as any in the history of paper making and we ran into it in the main section of this case study. It is the name Fourdrinier. But why the Fourdrinier brothers whose part in the mechanisation of paper making in the first half of last century was almost second to none in the world, should have gone bankrupt in the 1830s is, as they say, another story.

A Winning Combination: The Case of Tullis Russell.

Introductory Overview:

In a letter dated June 17, 1994, the family shareholders in Tullis Russell, a long established family paper mill business in Scotland's county of Fife , were made an offer. By the time it closed a little more than three weeks later, they had all accepted. Their acceptance set in motion a process which had already by the summer of 1995 had the result that a majority (52%) of Tullis Russell's shares had come to be held either by its employees as individuals or on their behalf by one or more employee trusts. Up to that time, as we shall see in more detail later, voting control of the business had been held for some twenty years by a well established charitable foundation, the Russell Trust. It held the balance of 48% at the end of 1995.

Because the business is of some size as well as profitable, the numbers involved in the transaction are more than peanuts. For the 55% of the share capital which they were holding in the summer of 1994, the family shareholders received the equivalent, essentially in loan stock, of £19m., in an offer which valued the company at £36.9m. It is a proud company claim that after two in Germany, it is the third largest private paper making business to remain independent in the whole of western Europe. Even after two significant employment cutbacks in the 1980s and early 1990s and a productivity explosion in 1994/95 , the the workforce of Tullis Russell's neighbouring pair of actual paper mills, the Auchmuty mill and the Rothes mill, still numbered 844 in 1995. In the twelve months to the end of March 1995 those employed there had broken all their previous production records by a large margin: achieving a total output of 106,000 tonnes of paper. It was a record which was just slightly improved upon in the following 12 months, when the figure climbed to 108,000 tonnes.

The acceptance of the offer by the family shareholders was an act of enlightened self interest. It is true that had the sale been made to a competitor the prices would almost certainly have been fixed at a level higher than the 80p per voting share and the 72p per non-voting share which were accepted. But that would only have been possible if the payment for the Tullis Russell shares had been made in the shares of the buyer. As we shall see in more detail later, the tax consequences for the family shareholders of that alternative would have been notably inferior in one key respect to what they actually accepted.

The ownership outcome of the process set in motion by the acceptance of that June 1994 offer - with a majority of the share capital already split a year later between the employees as individuals and an employee trust or trusts - has been designed to last, to be sustainable over an indefinite future. The French have a phrase La Perennite de L'Entreprise, the

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potential everlastingness of the business. The new ownership arrangements at Tullis Russell have been designed with the aim of lasting for ever. As for the current process of ownership transition, projections indicate that it will be completed some time between 2002 and 2009 when the shareholding of the Russell Trust will have been reduced to 25% . Having been founded in 1809, the year 2009 will mark the start of the company's third century.

The team which designed the offer and the eventual ownership outcome was led by David Erdal, the company's non-executive chairman who is also a family shareholder. In his own and the team's view the whole scheme has three main attractions:

> For the family shareholders, the unlocking of capital at a price which, taken together with the tax reliefs, was certainly acceptable and perhaps attractive.
>
> For the future employee owned business, the opportunity to remain independent indefinitely, perhaps for ever.
>
> For current employees,a good chance that if they remain so employed till the process of ownership transformation is complete, they may well have built up a nest egg of capital worth at least one year's wages.

This combination, of a commercially attractive offer to shareholders with a form of employee ownership which is both potentially sustainable indefinitely and financially of some real potential benefit to individual employees, is widely seen as a winner by employee ownership advocates. It was made possible by key changes in the rules governing Britain's employee ownership law, changes which were in fact only accepted by the Government in late March of 1994, barely three months before the offer was made.

Readers may be reminded of the three earlier case studies of what I have called "employee ownership by benefaction": those of the John Lewis and Baxi Partnerships in the U.K. and of the Carl-Zeiss Stiftung in Germany. In all those cases, and in a number of other similar examples in Britain and elsewhere in Europe, the ownership arrangements are indeed, as at Tullis Russell, intended to be indefinitely sustainable. On the other hand the former owners of those three businesses transferred their ownership rights either as complete gifts or at deep discounts. The relevant British law still needs to be improved after the changes in 1994 of which the Tullis Russell transaction was able to take advantage. However those changes unquestionably made possible what now looks like a winning combination.

Before the ownership changes of 1994, Tullis Russell had been an almost quintessentially family business for not far short of 200 years. In fact we are talking about two families in sequence and not just one. The Tullis family and then the Russells were in control one after the other, with an overlap period when a controlling interest was shared between the two families during the 50 years from 1874 to 1924. David Erdal's late mother was born Sheila Russell. He is in fact the fourth generation of that family to lead the business.

For readers with no more than limited knowledge of either the U.K.'s paper industry or the county of Fife, it may come as some surprise that there are still four separate paper making businesses within its borders, even though only two of them, Tullis Russell and the much smaller Smith Anderson, remain privately owned. The county's high level of pre-industrial prosperity is perhaps a factor. Certainly it can be traced back at least to the 1400s and the establishment at St. Andrews as Britain's third - and Scotland's first - university. But the main explanation seems to lie in Fife's swollen and fast flowing rivers. For paper mills which were established early, like the one at Auchmuty on the River Leven converted from grain milling by Robert Tullis in 1809, the chief attraction was probably the water *power*. But as doubtless many readers will know, water is also a vital ingredient of the paper making *process*. There is indeed a rule of thumb among paper makers that there is a gross requirement of 100 tons of water for the manufacture of a ton of paper, though when recycling is taken into account, the net figure is substantially less.

When Robert Tullis acquired the grain mill at Auchmuty in 1809 and converted it to paper making, he did so, according to tradition, to protect the paper supplies of his existing business. They are thought to have been under threat because of Napoleon's attempted blockade. His existing business combined printing and publishing with the sale of books and stationary, and was located not in Auchmuty, but in the larger market town settlement of Cupar some ten miles away. Robert never seems to have shifted his main interest to paper making and away from his original business. He added to the latter in the 1820s when he founded a local newspaper which soon became the *Fife Herald*. Moreover it was those businesses, rather than paper making at the Auchmuty mill, which were taken on at his death by his eldest son, George. During the founder's life time and for a few years thereafter ,the Auchmuty mill is probably best seen as a dependent supplier of paper to his linked business activities in Cupar.

It was left to two younger sons, William and Robert, to make a go of paper making. Robert died young but not before a second paper mill had been acquired. It was less than a mile from Auchmuty downstream on the River Leven at Rothes. This second mill was acquired in 1836. Though there have of course been great changes since then and total output in 1994/1995 was more than 200 times the figure in the late 1830s, it is still in those two mills, the Auchmuty Mill and the Rothes Mill, that the key processes of Tullis Russell's paper making continue to be carried out today.

The simplest summary account of those 160 odd years as well as the most consequential one for the local community is that they were marked by an almost uninterrupted increase in production even if not of employment. The milestone of 1000 tons of output seems to have been passed at some date in the second half of the 1850s, with a then record of 1133 tons in 1858/59. As we have seen the corresponding figure for the twelve months to end March 1995 was 106,000. Some time after Britain entered the Common Market in the 1970s, the tons became tonnes, namely 1,000 kilograms in place of the old imperial ton of 2240 lbs.

For the 100 years from 1896 to 1995, there are company production records. They are incomplete, but still good enough for our purposes, down to the end of the first world war. From then on they are complete and evidently reliable . Here it is enough to highlight the following milestones:

Tullis Russell Some Production Milestones: Tons & Tonnes

Year	Milestone		
1900	5,000	tons	exceeded.
1916	10,000	"	"
1928	15,000	"	"
1938	20,000	"	"
1950	25,000	"	"
1971	50,000	"	"
1993/4	80,000	tonnes	"
1994/5	106,000	"	
1995/96	108,000	"	

Partly because of the oil price increases, partly because of other more exclusively supply side factors, and partly because of faltering demand, the tonnage of Tullis Russell's output more or less stood still, and in some years actually declined, between 1975 and 1985. National statistics show that over those same ten years Britain's other manufacturers of quality printing and writing papers and boards, the grades in which Tullis Russell's output has been more or less concentrated at least since the 1920s, had similar experience and similarly flat output results. Then in the decade from 1985 to 1995, the output from Tullis Russell's two venerable mills, Auchmuty and Rothes, more or less doubled: from something over 50,000 tonnes to something over 100,000 tonnes. Moreover, as in the previous decade, this performance, mirrored quite closely what happened overall in the specialised part of Britain's paper making business in which Tullis Russell's output is concentrated . According to the statistics collected by the Paper and Board Federation of Great Britain, both output and what it calls "apparent consumption" of those grades of paper roughly doubled over those ten years.

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According to a standard history [The British Paper Industry 1495-1860 by DC Coleman, Oxford 1958 p202] Britain's total output of paper had reached 100,000 tons in 1860, which is roughly the date when the combined output of Tullis Russell's two mills exceeded 1000 tons for the first time. National statistics for the 1990s suggest that total UK paper consumption of paper had then reached between 11 and 12 m. tons - or a multiple of 110 to 120 times of the 1860 figure. Compared with that, the corresponding Tullis Russell multiple is at first sight elegantly close, with a respectable figure of 106. But that crude comparison ignores one huge difference between the position in the 1860s and the 1990s. There were virtually no imports into the British market in 1860. By contrast British manufacturers had not much more than one third of the UK market in 1995. In between there was a big contraction in the number of both businesses and mills: for the latter the decline was from just over 375 paper mills in the mid-19th century to less than 100 today. Those which could not keep up went out of business, either through a sale to a competitor or otherwise. The key achievements over nearly 200 years of Tullis Russell, or perhaps more exactly of the two families which have successfully guided its destinies, seem to be three: to have grown with Britain's market, to have adapted to a continuing flow of changes - and to have declined to sell out to a competitor.

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Mainline Partnership Ltd.: an Introductory Sketch.

1. *Mainline*, as it is called by most of its employees and customers, is by British standards a fairly large local bus company, employing around 2,500 people. It has its centre of operations in Sheffield, and a network of services extending to the three main neighbouring towns in South Yorkshire: Rotherham, Doncaster & Barnsley.

2. On November 16 1993, a privatisation deal was completed. Under it Mainline Partnership Ltd. acquired the entire share capital of the local bus business from its former owners: the South Yorkshire Passenger Transport Authority (PTA). The deal may be classified in general as having the character of a management led employee buy-out, or MEBO. Within that general category it was notable for at least two special features:

the influential role played by the company's unions, and especially by the Transport and General Workers' Union which enrols its bus drivers in:

a) the promotion and design of the deal itself
and b) perhaps even more so, in the design of the employee ownership and corporate government arrangements which came out of and after it.

the fact that the purchase price was only nominal and that the sellers are effectively being paid by a leasehold arrangement with an annual leasehold payment to the local authority which is due to run on for 20 years. Given the nature of the transaction, the company's new employee owners were not required to contribute even one penny of their own money to enable it to happen. That incidentally, namely one penny, was the value assigned to the shares allocated to the employees once the buy-out was completed.

3. The 1993 buy-out can sensibly be seen as both the end of one process and the beginning of a new one. It was the end of a process of gradual adjustment which started in the middle 1980s and changed what had been a heavily subsidised social service of local bus transport into a business which has to survive by its own efforts in a highly competitive market. The change associated with that process is strikingly highlighted if we compare the average fares in 1985, eight years before the buy-out, and in 1995, two years into the new employee ownership.

1985: Average Fare...............8.5p
1995: Average Fare................60p

The contrast can also be highlighted by comparing the amount of subsidy in 1985 with the amount of Fare Support ten years later.

1985: Subsidy £60m.   1995: Fare Support £8m.

It is worth noting that fare support is not just another way of describing a subsidy. This is money paid by the local authorities to enable Mainline to offer concessionary fares [e.g. to pensioners] and offset uneconomic services [e.g. in the late evening]. But their payment is subject to competition.

4. The final stages of this earlier process of change was marked by the movement from loss into profit as between the final year under PTA ownership and what followed under the new employee ownership arrangements. The results for the final PTA year were a loss of £4.3m. Over its short first accounting period of less than 6 months to end March 1994, Mainline Partnership Ltd. made a modest profit of some £140,000.

5. The new process set in motion by the completion of the buy-out may best be understood as including:

within reason and subject to a philosophy of appropriate social concern, a commitment to the achievement of adequate profits.

a commitment to maintain the independence of Mainline and its employee ownership with that.

6. The results for the most recent financial year - to March 30, 1997 - will be know only in August. As between the two full employee ownership years, 1994/95 and 1995/96, trading profit rose from just over £300,000 to close on £1.6m. on a turnover of approximately £53m. over the latter. Measured as a percentage of turnover those 1995/96 profits are, no doubt, no better than acceptable. Partly they reflect the intensity of the competition that Mainline has had to confront in its market. There is apparently some evidence that in recent months some of this competition has been seen off.

7. Profits in this first period may seem a little lacking in lustre but that has not prevented a good rise in the price at which the employee shares are valued. The latest valuation figure, fixed in September of 1996, was £2.10. The average shareholding of a Mainline bus driver who had been employed at the time of the buy-out was by then approximately 1300 shares.

8. An ability to withstand the competition is clearly a necessary condition for sustaining Mainline's independence and its employee ownership with that. But the company has also negotiated an extra protection: by arranging a mutual shareholding of 20% with the powerful First Bus, a quoted company which is also one of the industry's leaders. The hypothesis at Mainline is that a hostile bidder would see the First Bus shareholding as a deterrent.

9. Labour and the unions have a double lock on the corporate government at Mainline: through four elected employee directors with special powers and control of a key employee trust.

NBC Privatisation: Seven MBOs and One MEBO

Name	Year privatised	Year sold on	Interval Years	Price £m B/O	Price £m S/O	Gain £m B/O->S/O	Gain £m pa
Cheltenham & Gloucester	1986	1993	7.0	1.0	13.7	12.7	1.8
Maidstone & District	1986	1995	8.5	1.8	16.0	14.2	1.6
Midland Red (WEST)	1986	1988	1.5	1.9	10.5	8.6	4.3
Potteries MT	1986	1994	7.2	2.6	23.0	20.4	2.5
Eastern Counties	1987	1994	7.4	4.5	6.7	2.2	0.3
Provincial	**1987**	**1995**	**8.4**	**0.7**	**4.1**	**3.4**	**0.4**
Crossville (Wales)	1987	1988	0.8	3.0	6.0	3.0	3.0
London County (North West)	1988	1990	2	3.7	4.4	0.7	0.3

	Numbers Employed	Buy-out Participants	Remarks
Cheltenham & G	560	10 [M Thomas MD]	PSS or SOS promised
Maidstone	940	5 [S Trennery MD]	Employees given £200 NVS free
Midland Red W	875	3 & 16 [K Mills MD]	Promise of 30% of Equity for EP.
Potteries MT	1,000	4 [M Moors MD]	PSS or SOS promised
Eastern Cs	850	4 [P Brundle MD]	Promise of 20% of Equity for EP. *
Provincial	**220**	**About 190**	**Rule of Equal Investment**
Crossville Wales	930	3 plus** [I Reid MD]	Promise of all

THE EXPERIENCE OF CHESTERFIELD TRANSPORT

A CLASSIC CASE OF TRANSITIONAL POST - PRIVATISATION EMPLOYEE OWNERSHIP

A paper by Dave Wheatcroft, Employee Director of Chesterfield Transport, founder member and Ex - Chairman of The Centre for Employee Ownership and Participation and Director of Job Ownership Limited.

In the Conservative Government's Privatisation Programme of the 1980s and 90s the British Bus Industry is significant in Employee Ownership terms because it's Privatisation created more Employee Owned Companies in a relatively snort space of time compared to the number we have seen in the past few decades.

This was mainly due to the relatively small units (150-600 buses) that were already established or were created by the breaking up of larger units and secondly because the Industry is labour intensive with a high Employee/Capital Ratio. This high Employee to Capital Ratio made it easier for Managers and Employees to raise the reasonable sums required to buy the companies simply by spreading the investment sum to more people.

Chesterfield Transport was a company of 150 Buses with a Turnover of around £7m. It was formally owned by the Local Town Council and faced with the threat of Privatisation and the fear of an outside buyer, the Employees made a bid and subsequently purchased the company in April 1990.

The Model used was Tailor Made by Chesterfield, taking ideas from other companies and some of it's own. The Model was a combination of Individual Employee Investment of some 15% and the other equity 85% held in an Employee Benefit Trust holding shares on behalf of employees, some of which would be distributed by means of an ESOP over a period of years

301 out of 350 employees invested £800 (around 2 months of a bus drivers salary) to contribute to the £2.6m purchase price.

In order to reduce the investment risk £750 were in in Preference shares and £50 were in Ordinary shares.

The remaining Ordinary Shares were held in the EBT with the Trust being the Majority Shareholder and although some shares would be distributed out of the annual profit over the years the EBT shareholding would never be allowed to fall below 51% so ensuring the PERPETUAL ESOP, the level of shares in the EBT would be topped up by people leaving the company for whatever reason [illegible] they were not allowed to hold shares once they had [illegible] to be [illegible]

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To strengthen the sustainability of the Perpetual ESOP we had 3 major aims. only employees could hold shares in the company there would be equality in ownership as far as possible and employee representation and participation at every level of ownership and management.

The following 5 years were quite successful for although we had a slight fall in employees to around 230 we increased the share price from 10p to 70p

In the second year of the buy-out we introduced a Regulated Internal Share Market which with priority to new starters gave employees chance to sell or buy shares while still keeping to the theme of Equality in Ownership. In fact we always had 10 times more buyers than sellers and so spreading the shares available more widely.

The Culture Change that should accompany every Employee Buy-out allows me to tell you a strange story (you will hear more from different companies). At Chesterfield in order to see us over the recession and some fierce competition every employee, manager and Director took a voluntary 2.5% reduction in wages, this would have been impossible pre buy-out. we also set up a system where employees had a say in how to improve efficiency, this resulted in drivers setting the routes and frequency where they knew the passengers would use the bus more. this was so successful that we still operate them now after 3 years and even though we have been taken over.

The lessons to be learnt about creating a Culture Change are Openness, Honesty, Trust and Accountability between Managers and Employees alike out if you achieve all these you will see amazing results.

Unfortunately events overtook us at Chesterfield as the broken up Industry formed back into big groups which instead of before when we had publicly owned monopolies there were creating privately owned monopolies.

This was caused by 2 major factors. firstly the Government having broken up the big groups in order to stimulate competition gave no effective policing policy that would keep the situation in place, so the natural process of Capitalism took over and the Industry reverted back to big monopolies. Secondly the vast majority of the buy-outs were by Management Teams who after a couple of years were looking to cash in their Capital Gains. Once the big groups floated on the Stock Exchange their appetite for acquisitions became paramount in order to satisfy their new shareholders and unfortunately many employee owned companies were swallowed up in this need.

Another factor was the lack of support and interest from our National Trade Unions who were so intent on opposing privatisation they just wouldn't contemplate what to do if it became a reality. Well became a reality it did and it was left to the local Trade Union Official to face the situation on their own. most dealt with it admirably but it has to be said that if the British Trade Unions had taken the same positive approach as so of the American ones things could have been so much different.

After 5 years of employee ownership Chesterfield Transport was in a position where in order to survive in this aggressive market place it became obvious that we needed to bolt onto a larger company and after an unsuccessful attempt to merge with our large neighbouring employee owned company Mainline we accepted an offer from Stagecoach, the then biggest bus company in Britain.

The fact that we had lost our employee ownership was disappointing but many positive things came out of those years. apart from the experiences we can pass onto other companies who are either in or contemplating employee ownership our model has been used for many buy-outs since.

The other important thing to come out of it all is the fact that all the 330 employees enjoyed the benefits of the capital gains. So instead of a few Managers making in the low millions of pounds as happened in many of the management and management led buy-outs our 330 employees received from between £2,500 for 1 years service to £15,000 for the ones who invested the original £800. More than this however was the fact that the Employee Negotiators won guarantees for wages, sustained employment. pensions, membership of the Stagecoach ESOP (7% employee ownership). commitments on Capital Investment and Trade Union Rights. Non of these would have been forthcoming had we been a conventionally owned company where in practice the sellers just took the money and ran and left the employees to fend for themselves.

So I would recommend that you should look at Employee Ownership very seriously and "go for it". for in the least case scenario that you had to sell up you would enjoy the Capital Gains and in the most beneficial case you could be controlling your own destiny and enjoying the benefits for many years to come. not just for yourselves but for future Generations.

30.5.97.

BEST AVAILABLE COPY

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UNITY CORPORATE ADVISORS

Advisors on employee ownership and corporate affairs

BRIEFING FOR ZIMBABWEAN VISITORS

4TH JUNE 1997

ESOPs - FINANCING AND RELATED ISSUES

The Unity Trust Group and ESOPs - an introduction

- Unity Trust Bank established 1984 2/3 union owned 1/3 Coop Bank owned (Chair Coop Bank has say on Bd)
- Financing/Involved in ESOPs since 1987
- Unity Corporate Advisors
- Expertise in advisory field
- Promote employee ownership generally; ESOPs in particular
- Main growth area: ESOPs and family companies - succession planning

What is an ESOP?

- Employee Share Ownership Plan
- Unity's definition of an ESOP
  - Employee Benefit Trust
  - All employee share scheme
  - Other share schemes, etc.
- US concept - early 1970's
- Introduced to UK - 1987
- types - Statutory; Case Law
- Suitable for all sizes of company

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Situations where ESOPs can be used

- Raise capital from within
- Succession problems
- Buy-outs - turn MBO into MEBO or EBO
- Privatisation -politically more acceptable
- Exit route for venture capitalist
- In exchange for changes in working practices
- Rescue/receivership situations - but must be viable

ESOPs - Key Features

- Main Purpose - Improve Company's Performance
- First UK ESOP - RoadChef 1987
- ESOPs overcame problems for private companies of:
  - lack of marketability
  - uncertainty of valuation
  - repurchasing shares from leavers
- Original or "Case Law" ESOP is very flexible
- Can start any size (%) or value (£)
- Acquire further shares as and when appropriate
- Can stand alone or alongside other schemes

ESOP - Flow Chart (see attached)

Sources of Finance

- External - usually banks
- Company itself - loan and/or gift to EBT
- Employees
  - loan to EBT
  - Subscription in whole or part
  - on back of personal loan from bank
- Interest rate - should be same as loan to company

ESOP - Main tax breaks

- Assume loan repaid via PST
- On £5m loan - Corporation Tax saving is £1.7m
- No such tax break on "conventional" loans
- Employees leave shares in PST - no income tax payable
- Both company and employees benefit
- Interest on EBT loan - paid by tax deductible "gift" from company to EBT

ESOP Repayment

- Via PST (most tax efficient)
- Employee contributions
  - "BOGOF" or similar
  - Direct subscription
  - Wages/benefits sacrifice
- Other approved share schemes
  - SAYE share option
  - company share option
- Unapproved scheme
- Company contributions to EBT

Security for lending to EBT

- Charge over shares in EBT
- Guarantee from company
- Backed up by charge over company's assets?
- Same risk/credit assessment as if lending direct to company.

Succession Planning - the need for it

- Job Preservation (EU Study: 300,000 jobs disappear annually)
- Ensuring a fair price obtained for the business
- Unexpected events (contingency planning)
- Family members taking over
  - existence
  - willingness
  - competence
- Other exit routes
  - Flotation
  - Sale to trade buyer (competitor?)
  - Asset stripper?
- Sale to work-force via ESOP
  - Preserve jobs locally
  - Preserve/secure control locally
- Tax breaks
  - Retirement Relief
  - Statutory ESOP

ESOPs as a capital raiser

- Job creation?
- Raise new capital for investment
- Avoids third party investors
- Avoids need for flotation

- Capital raised from within
- Tax efficient - company/employees
- Widens/introduces employee ownership

Conclusion

The ESOP

- Encourages longer term shareholding.
- Better educated work-force (factors affecting company's profitability, etc.)
- Extends worker participation
- Pool of shares in "friendly" hands
- Provides shares for future employees (aid to recruitment)
- Possible nest egg for retiring employees (but in no way replacement for pension)
- Enjoys political support of all main parties

UCA

- Financial, accounting & legal expertise
- Practical experience since 1987
- Key additional niche
  - Credibility with work-force
  - Critical role in communications or "selling" it
  - Comfort for the work-force

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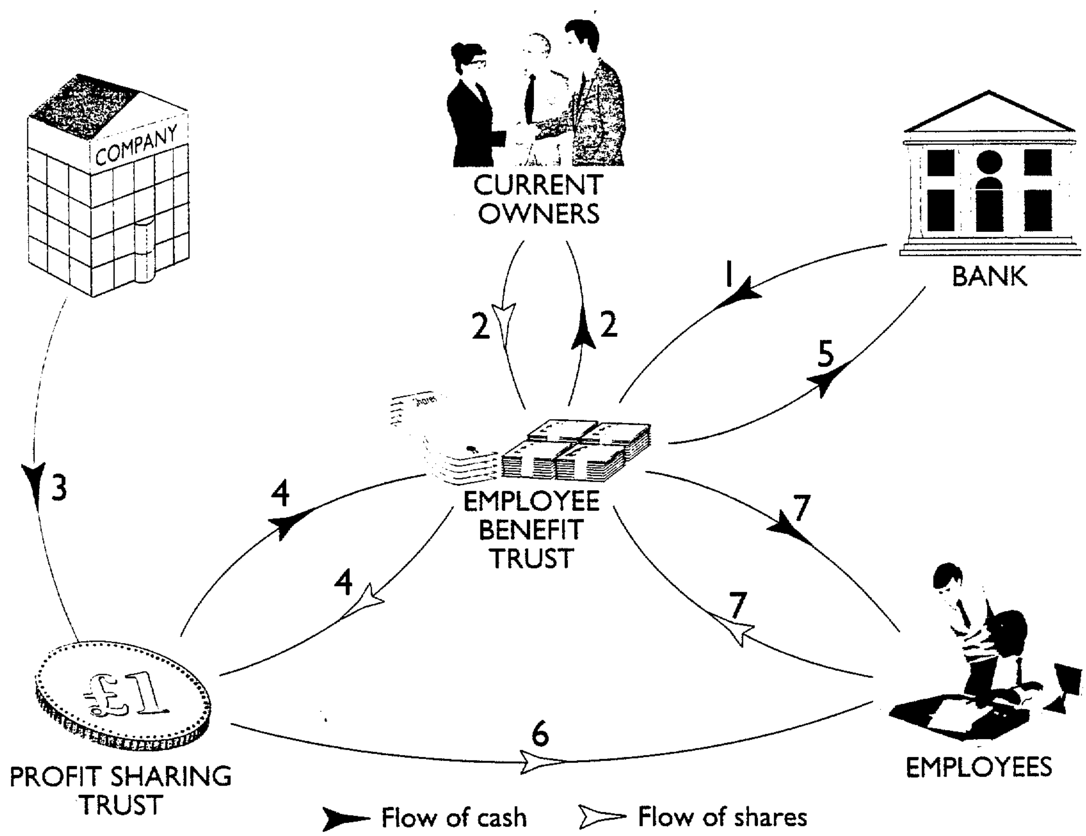
THE BASIC ESOP - FLOWCHART



1. Bank lends agreed amount of money to Employee Benefit Trust ("EBT").
2. EBT uses borrowed money to purchase shares from current owners. Shares now held in EBT on behalf of all employees on "Warehouse" basis.
3. On an annual basis, company makes a payment into an approved Profit Sharing Trust ("PST").
4. The PST uses the funds from the company to buy some shares from the EBT ("the warehouse"). These shares are then allocated, normally free of charge, to employees on a democratic basis.
5. The EBT uses the money from the PST to repay the original bank loan.
6. After three years, shares held on behalf of individual employees in the PST, are distributed free of any income tax charge.
7. When employees leave or retire, they must sell their shares to the EBT. Employees will normally receive the current market value of these shares.

...aring the future . . . leading the way aring the future . . . leading the way

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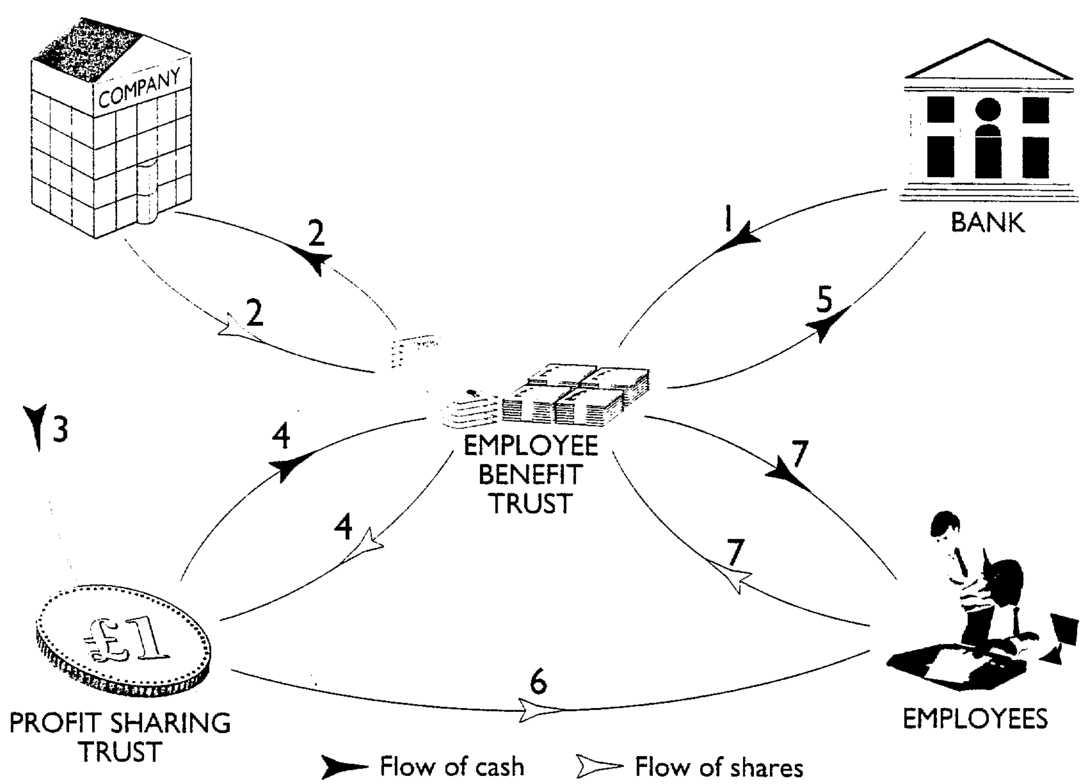
THE BASIC ESOP - FLOWCHART

RAISING NEW CAPITAL



1. Bank lends agreed amount of money to Employee Benefit Trust ("EBT").
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5. The EBT uses the money from the PST to repay the original bank loan.
6. After three years, shares held on behalf of individual employees in the PST, are distributed free of any income tax charge.
7. When employees leave or retire, they must sell their shares to the EBT. Employees will normally receive the current market value of these shares.

Please turn over for the ESOP FlowChart

**EMPLOYEE OWNERSHIP
STUDY VISIT
FROM ZIMBABWE**

**AN INTRODUCTION TO UK
EMPLOYEES' SHARE SCHEMES**

4th June 1997

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AN INTRODUCTION TO UK

EMPLOYEES' SHARE SCHEMES

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AN INTRODUCTION TO UK EMPLOYEES' SHARE SCHEMES

A. **Introduction**

1. This Memorandum provides an introduction to employees' share schemes in the UK. A general description of an employees' share scheme ("ESS") is provided by the Companies Act 1985 as "...a scheme for encouraging or facilitating the holding of shares...in a company by or for the benefit of...the bona fide employees...of the company..." (Section 743 CA 1985).

2. This Memorandum considers the objectives of an ESS (paragraph B below). It also considers the structures of particular types of ESS (paragraph C). This involves, in particular, distinguishing Inland Revenue approved schemes from other schemes. Certain taxation aspects of an ESS (not the full aspects) are considered (paragraph D). The position of a private company wishing to introduce an ESS is covered as a separate topic (paragraph E). Finally, there are comments on choosing an ESS (paragraph F).

3. An ESS will usually need to be considered as part of a remuneration package. It must be remembered that there are many cash based methods of encouraging employee participation or providing incentives (such as Profit-Related Pay).

4. This Memorandum does not deal in detail with all company law, trust law, employment law or Financial Services Act aspects of establishing an ESS, nor does it cover Stock Exchange and Investment Committee requirements applicable to quoted companies. There are other aspects that are not covered in detail. This Memorandum is not a substitute for detailed advice on specific transactions.

5. This Memorandum reflects law and practice as at 1st March 1997. A new budget will be announced on 2nd July 1997 which may change the taxation aspects of the ESS described in this Memorandum.

B. **Objectives**

1. In broad terms, an ESS may be used to provide either or both an **incentive** to an employee (including a director) and **increased participation** in a company. The use of an ESS might also be prompted by it providing, a **tax effective remuneration method** for an employee or other factors. In more detail, the following are particular objectives that could be involved:-

- increasing productivity

- ensuring employees benefit from a company's profitability
- improving loyalty to the company or attitudes
- as a response to wage claims and generally helping in wage negotiations
- helping recruitment
- reducing staff turnover
- increasing interest in and understanding of company performance (including the financial issues facing the company)
- improving communications and establishing involvement in the company
- providing a tax efficient method of reward for either or both the company and the employee
- raising finance (e.g. in a buy-out).

2. There are also macro-economic arguments behind wider share ownership and, in particular, employee share ownership.

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Categorisation of Employees' Share Schemes

ESS

Approved	**Unapproved**
Profit-sharing	**Share schemes**
SAYE options	**Share options**
Company options	**EBTs**
ESOTs	**ESOPs**

C. Structures

1. **General**

The following are important factors in describing or devising an ESS:-

- **an immediate or deferred interest** (An ESS may give an employee an immediate interest in shares (e.g. by a share subscription) or it may provide a method (e.g. a share option) by which an employee can acquire such an interest at some time in the future)

- **direct or indirect interest** (There is scope for an ESS to provide employees with an indirect (non-beneficial) interest in shares through, say, a discretionary trust for the benefit of employees (an employee benefit trust or "EBT") in contrast to owning shares directly)

- **all-employee or selective** (There is a distinction between an ESS which operates on an "all employee" basis and one operating for the benefit of, say, directors and senior employees only.)

- **no cost or some cost to employees** (The arrangements could be financed by the company (e.g. profit-sharing) or, at least, in part by employees (e.g. the option price))

- **approved or unapproved scheme** (Some schemes can be approved by the Inland Revenue, others operate without such approval but still subject to Inland Revenue scrutiny).

2. **Inland Revenue approved schemes**

2.1 Three types of ESS can be given formal approval (now under the Taxes Act 1988) by the Inland Revenue. These are known as approved schemes. Employees and shareholders may prefer a company to establish an approved scheme. There are tax advantages to such schemes. Each approved scheme has its own set of detailed conditions to meet before approval is given.

2.2 Some **basic conditions** apply in all approved schemes and include the following:-

- the scheme can only contain essential or reasonable features (e.g. as an ESS it cannot include a cash alternative)

- the scheme can only operate after formal Inland Revenue approval has been given. (Usually a company would submit draft documentation to the Inland Revenue for preliminary approval. After the appropriate Board/shareholders resolution has established the scheme then formal approval would be sought from the Inland Revenue)

- the scheme shares must be part of the ordinary share capital of the company (or possibly a company linked to the company establishing the scheme)

- the scheme shares must either be shares of a class quoted on a recognised stock exchange or shares in a company which is not under the control of another company (unless, in broad terms, it is a subsidiary of a quoted company)

- the scheme shares must be fully paid up, non-redeemable and not subject to any restrictions other than restrictions attaching to all shares of the same class or certain employee pre-emption restrictions which may be contained in the Articles of Association

- in broad terms, there must not be participation by anyone who has a material interest (as defined) in the company (or has had such an interest in the preceding twelve months).

- if the ordinary share capital of the company consists of shares of more than one class, the majority of the scheme shares must be owned in a particular way.

- certain terms in the scheme documentation must be defined in accordance with the relevant legislation.

3. Inland Revenue approved profit sharing schemes

3.1 The Inland Revenue approved profit sharing scheme was originally introduced by the Finance Act 1978. The scheme involves (with reference to documentation):-

- the company establishes an approved profit sharing scheme trust ("the FA 78 Trust") (trust deed)

- employees are offered participation in the scheme by the Board of directors (offer of participation letter)

- employees agree to participate (form of acceptance and contract of participation)

- the trustees of the FA 78 Trust receive contributions from the founding company

- the trustees acquire shares in the founding company

- the trustees appropriate shares in the FA 78 trust to employees, giving entitlement to any dividends etc. (shares appropriation notice and certificate of beneficial ownership)

- each employee must, in broad terms, retain their shares in the FA 78 Trust during a specified retention period (the minimum period is usually 2 years)

- after the retention period an employee can dispose of shares

- after 3 years (following enactment of the Finance Act 1996) shares remaining in the FA 78 trust are released to an employee absolutely.

The approved profit sharing scheme is a method of providing an immediate and direct beneficial interest in shares to employees at no cost to those employees. It is an all-employee scheme. As explained below it is a particularly tax efficient scheme. It can be operated on a "matching offer" basis; an employee buying a share and depositing it

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with trustees gets another for free under the approved profit sharing scheme.

3.2 In the case of an approved profit sharing scheme the particular conditions for Inland Revenue approval include:-

- establishing a trust, with trustees under a duty to administer the scheme

- ensuring that participation is available to every person who, in broad terms:-

  * is an employee or full time director,

  * has been such an employee or director during a qualifying period (not exceeding five years), and

  * is charged to UK tax as an employee (Case I of Schedule E).

- ensuring participation is on similar terms (variations by reference to length of service or levels of remuneration are permitted)

- ensuring participation is only allowed to current (or certain former) directors or employees of the participating company (or companies)

- providing that shares appropriated to employees must be retained in the FA 78 trust usually for at least two years

- providing that the maximum initial market value of scheme shares which can be appropriated in any tax year to an employee is (from 6 April 1991) £3,000 or 10% of salary, if greater, subject to a ceiling (from 6 April 1991) of £8,000.

3.3 Schemes approved before 1st May 1995 had to ensure only that participation was available to full time employees (not part time) and full time directors. Pre-1st May 1995 schemes can be altered (but not with retrospective effect).

4. Inland Revenue approved save as you earn option schemes

4.1 The Inland Revenue approved save as you earn (SAYE) share option scheme was originally introduced in the Finance Act 1980. The scheme involves:-

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- The company establishes an approved SAYE option scheme (scheme rules)
- the Board of the company invite employees to participate (letter of invitation)
- employees agree to save on a monthly basis (by deductions from pay) over a period of 3, 5 or 7 years under an approved SAYE contract (application forms)
- employees are granted options to buy shares in the company using the proceeds of the savings contract. In broad terms, the option is exerciseable at the end of the savings contract (option certificate)
- at the end of the savings contract the employee chooses whether to exercise the options in whole or in part and receive shares or to take the proceeds of the savings plan in cash (notice of exercise of option)
- any shares bought belong to the employee absolutely.

The SAYE Scheme is a method of giving employees an opportunity to acquire a beneficial interest in shares at a favourable price. There is a cost to employees but an option is unlikely to be exercised unless the market value at the time of exercise exceeds the option price. The SAYE Scheme also has tax advantages. It is an all employee scheme.

4.2 The particular conditions to be met for Inland Revenue approval include:-

- ensuring that participation is granted to every person who, in broad terms, meets the conditions set out in 3.2 above
- ensuring participation is on similar terms
- ensuring participation is only allowed to current directors or employees of the participating company (or companies)
- ensuring that the price at which scheme shares may be acquired must not be manifestly less than 80% (90% before 27th July 1989) of market value when the option is granted
- providing that the scheme shares must be paid for with money not exceeding the amount of repayments and interest paid under the approved SAYE contract

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- ensuring that monthly contributions under the SAYE contract cannot exceed £250 (and that any minimum monthly contribution level must not exceed £5)

- providing that the option rights are not transferable.

4.3 Schemes approved before 1st May 1995 had to ensure only that participation was available to full time employees (not part time) and full time directors. Pre-1st May 1995 schemes can be altered (but not with retrospective effect).

5. **Inland Revenue approved "company" share option scheme.**

5.1 The Inland Revenue approved "company" share option scheme is introduced by the Finance Act 1996. The requirements the scheme must satisfy are in most respects the same as applied to Inland Revenue approved "executive" share option schemes (certain tax reliefs for such schemes were withdrawn in 1995). The Inland Revenue approved "company" share option scheme involves:-

- The company establishes an approved company share option scheme (scheme rules)

- the Board selects employees and invites them to participate (letter of invitation)

- the selected employees agree to participate (application form)

- the selected employees are granted options to acquire shares in the company within, usually, a ten year option period (option certificate)

- the option holders either exercise their options in whole or in part and acquire shares or allow the options to lapse (notice of exercise of option)

- any shares received belong to the employee absolutely.

The approved company share option scheme provides an opportunity to acquire a direct beneficial interest in shares. It involves a cost to the participants but, as above, an option is unlikely to be exercised unless it is "in the money". Although the scheme can be operated on an all employee basis it may be used on a selective basis. There are tax advantages. The scheme could attach certain objective conditions to the exercise of the options. The scheme could operate in parallel to an unapproved option scheme.

5.2 The particular conditions to be met for approval include:-

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- ensuring that participation is only granted to a person who is a full time (25 hours or more a week etc) director or an employee working for the company (or participating companies)

- providing that the market value of shares under option at the time an option is granted must not exceed the greater of either £30,000 or four times, in broad terms, the participant's earnings liable to PAYE (options granted under other approved company share option schemes and executive share option schemes are taken into account when calculating the £30,000 limit)

- ensuring that the option exercise price must not be manifestly less than the market value at the time of the grant of the option

- providing that the option rights are not transferable.

6. **Unapproved schemes**

An unapproved scheme generally means an ESS other than one of the three mentioned above. For the most part the structure of such a scheme is determined by commercial requirements rather than the requirements of the Taxes Act 1988. Such a scheme could use, for example, scheme shares that would not meet with Inland Revenue approval for approved scheme purposes. An unapproved scheme can also be less expensive and quicker to establish. It can be simpler to understand, involve less documentation and less administration. Although, this will not always be the case, particularly if the unapproved scheme is to operate on a regular basis for the benefit of many employees. If an unapproved scheme is to operate successfully many of the points required to be considered by legislation in approved schemes also have to be covered, in practice, in an unapproved ESS. The following paragraphs give examples of unapproved schemes.

7. **Unapproved share schemes**

An unapproved share (rather than share option) scheme will often involve an employee being given the opportunity to acquire an immediate and direct beneficial interest in shares in a company. If this is an incentive arrangement it would probably involve an employee paying nothing or less than market value for the shares. This could involve:-

- a board meeting at which directors decide to invite certain employees to acquire shares at, say, par value

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- the selected employees join the board meeting and subscribe for shares at their par value

- the relevant employees are issued with shares absolutely.

Variations on the above include employees purchasing existing shares or subscribing for shares partly paid. The company or shareholders might provide finance on beneficial terms. Employees can be allowed to make priority applications for shares (e.g. on a flotation). There could be no cost or some cost to employees. A scheme could be all employee or, more often, selective. The shares acquired could be held subject to restrictions on their transfer, voting and dividend rights for a period or until performance targets are met.

8. Unapproved share option schemes

This usually involves giving an employee the opportunity to acquire a direct interest in shares in the future. Such a scheme could involve:-

- a Board meeting at which directors decide to grant to certain employees options to acquire shares

- the selected employees, for the payment of a nominal sum, are granted options to acquire shares in the company at, say, market value at the time of grant. The options to be exercised within a seven year option period

- the employees either exercise the options in whole or in part or allow the options to lapse

- shares acquired on any exercise are owned absolutely by the employees.

In contrast to an approved share option scheme the option price could be considerably less than market value at the time of the grant. Also, there are no Inland Revenue limits on the value of options which can be granted to employees. There could be a cash alternative to acquiring shares (e.g. a phantom share option).

In devising an option scheme the company will obviously have to consider who will be eligible for options, the exercise price, the grant consideration and the number of shares subject to the option. Other points to consider are:-

- **when are the options exercisable?** (The options could be exerciseable from the time of grant until the end of the option period. Alternatively, exercise could be restricted to certain circumstances (e.g. exercise could be conditional on reaching performance targets) or periods.

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In which case, will early exercise be permitted in circumstances such as the death of the option holder or on ceasing to be an employee through injury, disability, redundancy or retirement? Will early exercise be permitted if the business or group company in which the employee works is sold?).

- **when do the options lapse?** (The options could lapse on the seventh anniversary of grant. Should the options lapse on other earlier events, such as the option holder ceasing to be an employee or becoming bankrupt?).
- **what happens in the event of a winding-up/reconstruction/takeover of the company?**
- **should options be transferable?**
- **what happens on a variation of share capital?**
- **what is the procedure for granting/exercising options?**
- **what limits should there be on available shares?**
- **what administration/amendment provisions are needed?**

9. **Employee benefit trusts**

An ESS may involve employees having an indirect interest in shares, through shares being held temporarily or permanently in an EBT.

The company might enter into the following arrangements:-

- a company establishes an EBT
- the trustees of the EBT receive contributions from the company
- the trustees use the contributions to acquire shares in the company
- the trustees hold the shares (and any dividends received on those shares) for the benefit of the employees (and possibly former employees) of the company in accordance with the terms of the trust.

Typically, the trustees would be able, at their discretion, to make distributions from the capital and income of the trust to the beneficiaries of that trust. It is possible for shares to be held in the

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trust indefinitely or for there to be regular distributions of shares. Employees might receive regular cash payments out of the trust income as part of, say, a discretionary bonus scheme or perhaps only in exceptional circumstances, such as in cases of hardship. Shares might be "set aside" for particular employees and transferred to those employees once performance conditions are met.

The trustees could subscribe for shares in the founding company or acquire shares from existing shareholders.

An EBT which owns shares has the effect of providing an *indirect* interest in those shares to employees, at no cost to those employees. An EBT can be operated so as to benefit employees on an "all employee" basis or on a selective basis. An EBT can be put to many uses.

The trust would usually meet the conditions necessary to qualify as an employee trust for the purposes of the Inheritance Tax Act 1984.

10. **Employee share ownership plans**

The term employee share ownership plan ("ESOP") is most often used to describe an EBT, which has borrowed funds from a financial institution as well as received contributions from a company, and is being operated in conjunction with an approved profit sharing scheme. The following is an outline of how an ESOP could operate:-

- A company establishes an EBT and an approved profit sharing scheme
- the EBT borrows funds from a bank
- the EBT acquires shares in the company
- the company makes payments to the approved profit sharing scheme
- the approved profit sharing scheme purchases shares from the EBT and then appropriates these to employees
- the EBT uses the share sale proceeds to service and repay the bank borrowings.

An ESOP arrangement can take other forms involving other approved or unapproved schemes to get employees a direct interest in shares.

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11. **The employee share ownership trust**

The employee share ownership trust ("ESOT") was introduced in the Finance Act 1989. The ESOT is also known as a "statutory ESOP" (because it has the statutory recognition of the Finance Act 1989). The ESOT has certain possible tax advantages. The ESOT can be considered as another type of approved scheme. The following is an outline of how an ESOT could operate:-

- A company establishes an ESOT and an approved profit sharing scheme
- the company contributes funds to the ESOT
- the ESOT acquires shares in the company from existing shareholders
- the company makes payments to the approved profit sharing scheme
- the approved profit sharing scheme purchases shares from the ESOT and appropriates these to employees.

If an ESOT is established on or after the date of enactment of the Finance Act 1996, then it can be operated in conjunction with an Inland Revenue approved SAYE scheme in addition or as an alternative to an Inland Revenue approved profit sharing scheme

ESOTs must meet certain statutory conditions. These are not set out in full in this Memorandum. It is worth noting that changes made in the Finance Act 1994 have removed what were seen as the main deterrents to making use of an ESOT. Conditions to be met include establishing a trust in which, in very broad terms:-

- the composition of trustees meets various conditions including a requirement for an employee trustee/s (selected by employees as their representative)
- the transfers of shares in the founding company out of the ESOT must take place within twenty years of their acquisition
- such transfers of shares must be to an approved profit sharing scheme (at, at least, open market value), pursuant to an approved SAYE scheme option or directly to beneficiaries on similar terms.

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D. Tax aspects

1. Unapproved schemes

1.1 Unapproved share schemes

The main tax concern with unapproved share incentive or participation schemes is that income tax is payable immediately shares are received. It is charged on the excess of the market value of the shares over any price paid. (If shares are acquired partly paid, a different income tax charge basis applies.) If an employee benefits from "stop loss" arrangements under which shares can be bought back then a further income tax charge could arise. Where an employee receives shares on or after the 26th October 1987 then no other charge to income tax will arise in respect of those shares unless certain anti avoidance provisions apply. Broadly, it is only if shares are subject to restrictions (which are removed or varied to increase the value of shares) or the scheme shares are in a dependent subsidiary (as defined) that problems are likely to arise.

After 26th November 1996, in broad terms, assessable income in the form of shares provided under unapproved schemes or arrangements which are capable of being traded on a recognised investment exchange or which are provided in circumstances where "trading arrangements" (as defined) exist will be subject to deduction of income tax and (from 5th December 1996) national insurance contributions under the PAYE system.

1.2 Unapproved share option schemes

In an unapproved share option scheme, no income tax is chargeable on the grant of the option (if it is not capable of being exercised more than seven years after the date of its grant). But once rights are exercised the employee is subject to a charge to income tax on the excess of the market value of the shares acquired over the aggregate of the option exercise price and any cost of the option. A similar charge to tax arises if the employee, for example, undertakes not to exercise his option for a consideration. The comment above relating to shares acquired on or after 26th October 1987 applies similarly to shares acquired as the result of an employee exercising an unapproved option.

The new PAYE provisions referred to above must also be considered in respect of the grant and exercise of unapproved options. There are aspects of the new PAYE provisions that have not yet been clarified by the Inland Revenue and Department of Social Security.

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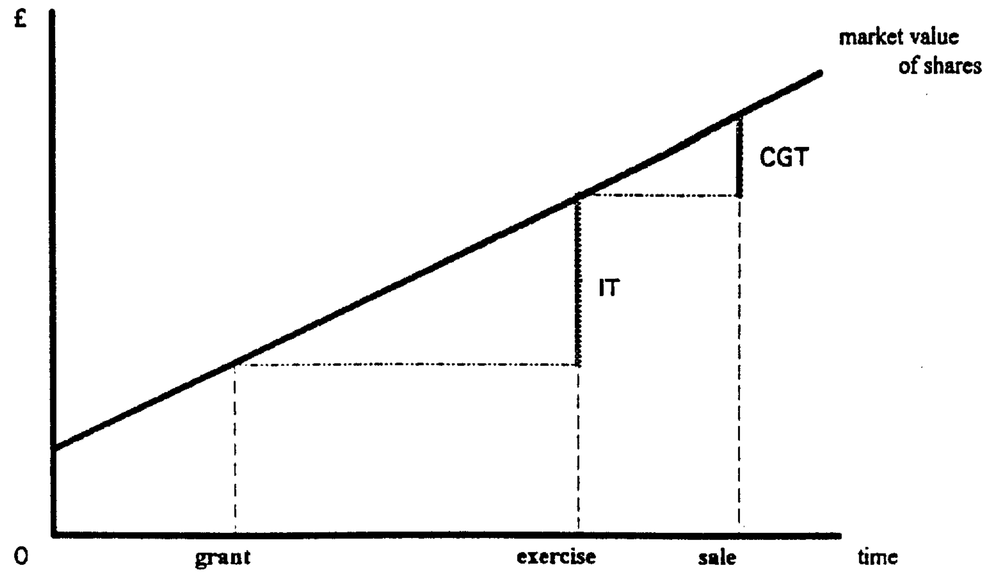
Taxation of an "unapproved" share option



1.3 **EBTs and ESOPs**

In the case of an EBT an employee should not be subject to any tax charge unless and until the trustees exercise their discretion in his favour.

If shares are received free or are bought at an under value direct from the EBT they will generally be taxable as in the case of an unapproved share scheme. In the case of an employee receiving shares from an ESOP through an approved profit sharing scheme then the position will be as described below.

The existence of an EBT or ESOP may mean there are "trading arrangements" as referred to in 1.1 above.

2. **Approved schemes**

2.1 **Approved profit sharing schemes**

In the case of an approved profit sharing scheme there is no tax charge when shares are appropriated to employees. If the employee does not dispose of the shares until after three years of their first being appropriated then, normally, no income tax will be due on the appropriated shares. If within the three year period, the employee ceases his employment because of injury, disability or redundancy or reaches retirement age, tax is charged at only 50% of the original market value. When the shares are disposed of the employee is liable to capital gains tax ("CGT") on the excess of the disposal proceeds

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over their market value (plus any available indexation allowance) when they were first appropriated. It may be that any gains arising are covered by the CGT annual exemption. From 1 January 1992 provided certain conditions are met there is no CGT charge if shares emerging from a scheme are transferred into a "single company" PEP (subsequent capital gains in a PEP are tax free, as are dividends). The above summary applies following the enactment of the Finance Act 1996. In some transitional cases under existing schemes, a period longer than the three years mentioned above may apply.

2.2 **Approved SAYE option scheme**

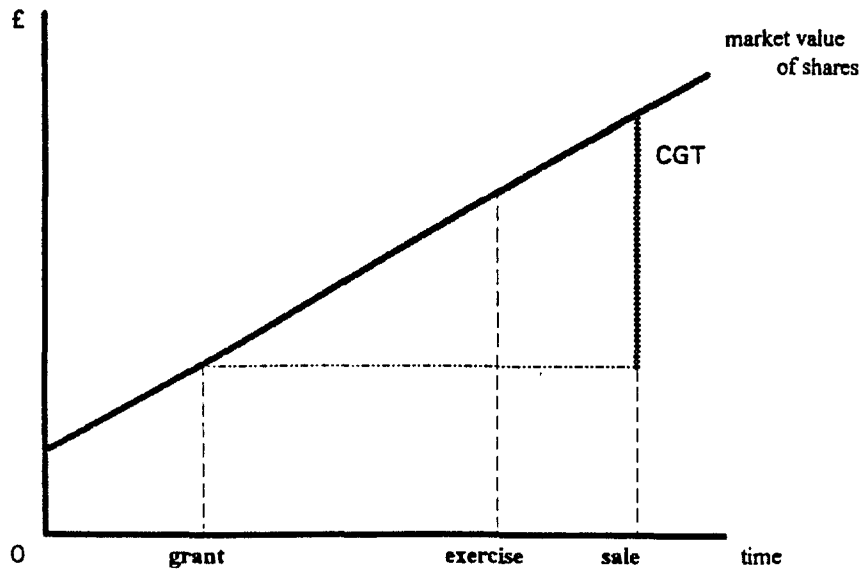
In the case of the approved SAYE option scheme neither the acquisition of options, nor their exercise, will give rise to any income tax liability. (There can be an income tax charge in some circumstances when early exercise within 3 years of grant takes place.) A CGT treatment applies on disposing of the shares and it may be that any gain arising will be covered by the CGT annual exemption and indexation allowance (or use is made of any "single company" PEP facility).

2.3 **Approved company share option scheme**

Similarly, the approved "company" share option scheme provides a method of avoiding an income tax charge on the acquisition and, in particular, the exercise of options. A tax free exercise can only take place on or after the third anniversary and no later than the tenth anniversary of the date of grant. The tax relief is not available when an option is exercised within three years from the date on which the employee last exercised such an option free of tax.

Consideration given for the grant of the option (if any) and for the acquisition of the shares is taken into account in computing any capital gain or loss arising on a subsequent disposal of the shares.

Taxation of an "approved" share option



3. **ESOTs**

In the case of an ESS which involves the company financing the arrangements, the company will be concerned to get a tax deduction in computing its profits for any expenditure. In the case of an EBT, the company must rely on general principles of tax law and its accounts' treatment of the EBT arrangement to get a deduction for its contributions (there is case law authority to support claiming a deduction). However, if an ESOT is used then there is a statutory right to a tax deduction. (The approved profit sharing scheme also provides a company with a statutory right to a tax deduction for the company's contributions provided certain conditions are met).

Following the Finance Act 1990 shareholders selling shares to an ESOT may obtain CGT relief provided certain conditions are met.

E. **Private companies**

The following are particular aspects which need consideration in respect of an ESS in a private company:-

- **valuing shares** (The absence of a quoted price for scheme shares may mean it is much harder to establish a market value for share scheme purposes. Although, if an approved scheme is used then the Inland Revenue, Shares Valuation Division are under a duty to agree the market value of scheme shares)

- **realising value** (The absence of a market for shares may discourage participation. An EBT could be used as a market maker if this is a

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problem. The absence of an immediate market may not be a concern if there is the prospect of a flotation or takeover.)

- **restricting rights of shareholders** (The existing shareholders may be concerned to attach restrictions to shares so that they cannot be transferred to persons who do not have links with the company. Perhaps the scheme shares will have no or limited voting rights.)

F. Choosing an ESS

There are various types of ESS and it can be difficult to decide which type or types of ESS are best suited to a particular company and its employees. The following are issues to consider:-

- Whether the company can in fact meet the detailed conditions imposed by the Inland Revenue for obtaining approval of an approved scheme?
- whether any of the approved schemes meets the company's commercial requirements?
- whether an unapproved scheme is better placed to meet the company's requirements?
- whether the tax position of an unapproved scheme is acceptable to the company and the scheme participants?
- whether there are any overriding tax advantages in favour of establishing an approved scheme?

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4th June 1997

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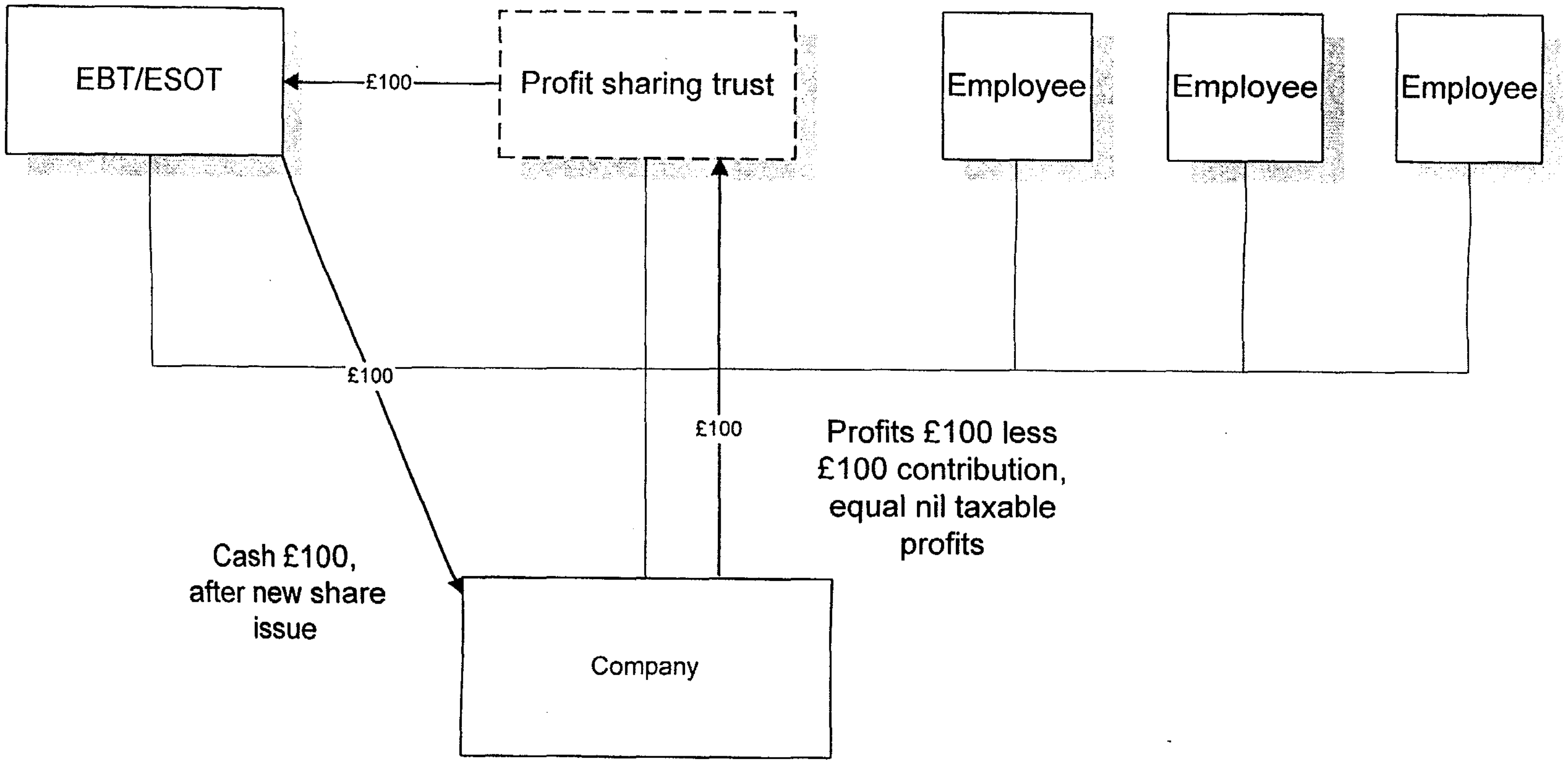
Type	Description	Statutory Tax deduction for Start-up costs	Income Tax exemption on option grant	Income Tax exemption on acquiring shares	NIC exemption on option grant	NIC exemption on acquiring shares	Statutory tax deduction for company "contributions"	Other advantages include:	Individual participation limit/s	Eligibility exclusions
Approved	Profit-sharing scheme	Yes	N/A	Yes[1] (must leave with trustees for 3 years)	N/A	Yes	Yes		Each tax year value of shares acquired is limited to £3,000 (or, if greater, 10% of salary up to £8,000)	Person holding 25% in close company in previous 12 months
Unapproved	Share scheme	No[2]	N/A	No (PAYE may apply)	N/A	No (PAYE applies if NIC are due)	No[3]	Greater flexibility in design of scheme	No limit	None
Approved	SAYE option scheme	Yes	Yes	Yes[4] (must save for a minimum of 3 years)	Yes	Yes	No		Limit of £250 p.m. savings. Depending on contracts option is to buy shares with a (current) value of 36,39,60,69 or 78 monthly contributions	Persons holding 25% in close company in previous 12 months before grant or exercise

1 Note: Capital gains tax ("CGT") charged on the income tax free benefit on an eventual disposal of shares
2 Note: Doubtful/not possible under case law
3 Note: There is scope under case law (subject to accounts treatment)
4 Note: Capital gains tax ("CGT") charged on the income tax free benefit on an eventual disposal of shares

Type	Description	Statutory Tax deduction for Start-up costs	Income Tax exemption on option grant	Income Tax exemption on acquiring shares	NIC exemption on option grant	NIC exemption on acquiring shares	Statutory tax deduction for company "contributions"	Other advantages include:	Individual participation limit/s	Eligibility exclusions
Approved	Company share option plan	Yes	Yes	Yes[5] (must wait 3 years before exercise)	Yes	Yes	No	10 year option period Discretionary	Limit of £30,000 of initial market value of shares over which unexercised options held	Persons holding 10% in close company in previous 12 mont before grant or exercise
Unapproved	Share option scheme	No[6]	Yes (if option period is 7 years or less)	No (PAYE may apply)	No (Paye applies if NIC are due)	Yes	No	Greater flexibility in design of scheme	No limit	No limit
Approved	Qualifying ESOT[7]	Yes	N/A	N/A	N/A	N/A	Yes	CGT "roll-over" relief for vendors of shares to statutory ESOT[8]	No limit	Persons holding : in founding company in previous 12 mont
Unapproved	Case law employee benefit trust	No[9]	N/A	N/A	N/A	N/A	No[10]	Greater flexibility in design of scheme	No limit	(optional) person holding 5% in company

5 Note: Capital gains tax ("CGT") charged on the income tax free benefit on an eventual disposal of shares
6 Note: Doubtful/not possible under case law
7 Note: Shares must be distributed within 20 years
8 Note: Statutory ESOT must acquire a 10% interest in the company
9 Note: Doubtful/not possible under case law
10 Note: There is scope under case law (subject to accounts treatment)


EBT/ESOT
£100
Profit sharing trust
Employee
Employee
Employee
£100
£100
Profits £100 less £100 contribution, equal nil taxable profits
Cash £100, after new share issue
Company