Australian Government
Department of Employment and Workplace Relations

Employee Share Ownership
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EMPLOYEE SHARE OWNERSHIP IN AUSTRALIA: ALIGNING INTERESTS

EXECUTIVE SUMMARY

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For:
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EMPLOYEE SHARE OWNERSHIP RESEARCH
SUMMARY OF FINDINGS

1. BACKGROUND TO THE RESEARCH

Employee share ownership (ESO) is a human resource or workplace relations strategy that can be used to motivate employees by giving them a stake/share in the company's success. In 2000, the Nelson Report (*Shared Endeavours: An Enquiry into Employee Share Ownership in Australia*) highlighted the lack of comprehensive information on the nature, number and extent of ESO plans in Australia. Furthermore, the Nelson Report recommended that the government should investigate the take-up of ESO in Australia and explore the barriers that prevent businesses from setting up ESO plans.

In response to the Nelson Report, the government established the ESO Development Unit which provides information on ESO, undertakes activities to raise awareness of the benefits of ESO and provides guidelines and materials to assist businesses to implement their own plans. The ESO Development Unit commissioned this research to consolidate existing knowledge about ESO and to investigate the issues facing businesses implementing ESO in Australia. The research provides government, business and advisors to business with a better understanding of how ESO is viewed by business and related issues for implementing ESO more successfully.

2. RESEARCH METHODOLOGY

The research was conducted in three stages, beginning with a literature review which identified the key concepts and issues. This was followed by qualitative research, involving in-depth interviews with specialist and non-specialist advisors, in-depth interviews with human resource managers and business owners in organisations without ESO; and case studies of businesses with ESO plans. Case studies included interviews with CEOs, senior managers, human resource managers, finance officers and a range of employees to understand ESO from a range of different perspectives.

The final stage of the research was a quantitative survey which collected data from a sample of 1000 businesses, via telephone interviews with human resource managers or the owner/operator. The scope of the survey was all businesses with five or more employees and stratification included business size and major industry groups. This stage was intended to provide representative and statistically reliable information on the incidence of ESO, reasons for take-up and the impact on issues such as staff motivation and organisational productivity.

3. RESEARCH FINDINGS

The key findings of the research are structured around three key areas:

- Awareness and incidence;
- Attitudes and endorsement; and
- Increasing take-up.

3.1 Awareness and Incidence

The research confirmed that ESO is a complex area and that while general awareness of the concept among businesses is high, there is a lack of depth of understanding of issues related to design, implementation and management of ESO plans. This lack of knowledge also extends to some advisors, for whom the complexity of specific tax and legal issues can be overwhelming.

Awareness of broad based schemes (‘*share plans that are open to all employees’*) was highest among:

- Public companies listed overseas (87%);
- Companies with over 100 employees (85%);
- Companies with annual turnover of over $50 million (81%); and
- Companies with mostly white collar workers (79%).

Lack of familiarity with ESO was reported most often among businesses:

- in the Health and Community Services industry (70%);
- in the Transport and Storage industry (73%);
- who rated their organisational culture on a range of measures as Good (65%) or Average (64%) but not Excellent; and
- with mostly blue collar workers (60%).

The incidence of ESO reported in the survey was low, with one in ten businesses (10%) having a plan. Only 4% of all businesses had a broad based plan which was open to at least 75% of employees. Industries with higher incidences of ESO were:

- Manufacturing (22%)
- Finance and Insurance (19%)
- Communication Services (15%)

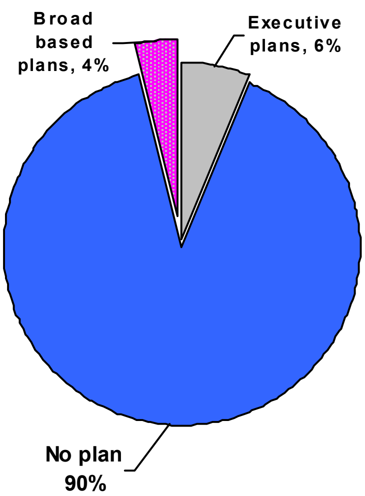
While there was some variation in take-up by industry, differences across other company characteristics were more prevalent. Larger businesses, for example, were far more likely to have plans, as were publicly listed companies and companies listed overseas. From the qualitative research it was clear that the size of the company was an important, if not the most important, influence on the take-up of ESO rather than the industry of the business or other company characteristics. Smaller businesses often felt ESO was not relevant, too hard and too costly.

Table 1 - Companies most likely and least likely to have an ESOP

Most likely to have ESOP	*Least likely to have ESOP*
▪ Public listed companies (52%) ▪ Companies with offices overseas (32%) ▪ Large Businesses: • 100 or more employees (30%) • More than 50 offices in Australia (39%) • Annual turnover of over $50 million (32%)	▪ Private companies (8%) ▪ Companies with only one office in Australia (10%) ▪ Small Businesses: • 5 – 19 employees (9%)

Narrow or executive plans were the most common types of ESO plans reported in the survey, however, the majority of plans implemented in the last year (63%) were open for all employees, indicating a move towards broad based plans over the last 12 months. Of businesses with plans, 40% (4% of all businesses) had a broad based plan which was open to at least 75% of employees. Among businesses with an ESO plan, most (62%) used shares as the main form of equity.

Figure 1 - Incidence of broad based plans (%)



3.2 Attitudes and Endorsement

The research found a high level of endorsement for the notion of ESO among businesses with plans and those without plans. Overall, businesses with plans rated ESO more positively than those without, indicating high endorsement of the concept as a productive human resources strategy for those with practical experience.

Rationale for Implementing ESO

The findings show that the initial rationale for implementing an ESO plan may vary considerably. The key rationales for action can be broadly grouped into three categories:

1. Business and workplace relations strategy;
2. Facilitating organisational change; and
3. Employee benefit/market competition.

Each of these is outlined in turn below.

1. Business and workplace relations strategy:

Some businesses described the rationale for implementing an ESO plan as a business strategy providing financial benefit to the bottom line and directly impacting employee productivity. While seen as an effective workplace relations strategy, businesses were quick to outline the separateness of the schemes from any formal wage setting arrangements, preferring to view the schemes as a benefit offered over and above any salary agreements.

ESO plans were also used by some to promote an identity or affinity with the business for employees with the intention of influencing productivity and performance, i.e. building a sense of ownership and belonging, focusing and motivating employees. ESO plans were also seen as a means of fostering a **two way commitment** between the business and the employee, particularly where the plan asked the employee to contribute ('buy-in'). This was both rewarding for the employee and the business, also working towards achieving long term loyalty from key employees who were seen as vital to the success of the business.

Employee share ownership plans were generally seen as contributing to **improving business performance**. While companies found it difficult to establish a clear (and quantifiable) link between ESO and absolute increases in productivity, some proponents were adamant that their plan had positively impacted on their bottom line and would recommend ESO as an effective business strategy as a result. Other companies saw the main benefit of options in particular as a long term incentive related to **retention and loyalty**, that is, as a powerful human resource strategy to retain key performers given the restrictions on length of service before options could be exercised – 'a golden handcuff'.

2. Organisational change:

The literature review revealed the possibility of ESO being a core tool for achieving or supporting organisational change, a view supported by interviews with businesses. This may include, for example, integrating and unifying different parts of a business after a merger or acquisition which was commonly reported among larger businesses in the study.

ESO was also used as a way of achieving a smooth transition of ownership/succession planning for owner operators in smaller family businesses. Particularly in regional areas or specialist areas where sale of the business is not guaranteed due to lack of buyers when owners choose to retire, ESO provided a way for owners to spend less time in the business and ease into retirement.

Schemes were seen as increasing the interest in company performance, and positively impacting on the culture of the company. Share plans were also reported to create 'a vibe' about the office particularly when employees could track the share price. Business also reported that share plans can align the work of employees with company goals or a changing direction for the business; and/or encourage cultural change in organisations, for example, towards a more customer (or share holder) focused mode of operations.

> *'We have been doing considerable work over a considerable period of time to try and develop some sort of an ongoing reward scheme for our award staff. That's an area where we believe there is much to be gained for the organisation …primarily from the point of view from driving a workplace culture which values performance and also …aligning individual goals with corporate goals.' (Workplace Relations Manager)*

3. Employee benefits:

ESO was used by some businesses as a way of attracting and retaining employees in a competitive labour market. For some industries, the decision to include shares and/or options in a remuneration package was driven by competitor behaviour and the need to match the marketplace as part of being an employer of choice. This was of course, dependent on the capabilities and skills of 'potential' employee shareholders including consideration of their capacity to earn and be 'poached' by other employers. One employer who did not currently have an ESO plan was keen to investigate the possibilities:

'We have done quite a lot of work in relation to salary structure for executive staff and … when you look at total employee reward we come out significantly behind the market and that is basically because of the extent of shares and options which exist in the private sector at these executive levels …This area of employee share ownership is one I have been conscious of for some time.' (Workplace Relations Manager)

These employers (and the employees) recognised the potential of shares and options as means of increasing employee wealth in a tax effective way and on a long-term basis thus representing an attractive benefit for senior management or other key personnel. Even for the average worker, shares were seen as a way of saving for the future:

'We offer shares to staff at a 15% discount. Its just one of the many benefits we offer employees… People see it [shares] as another form of superannuation.' (Human Resource Manager)

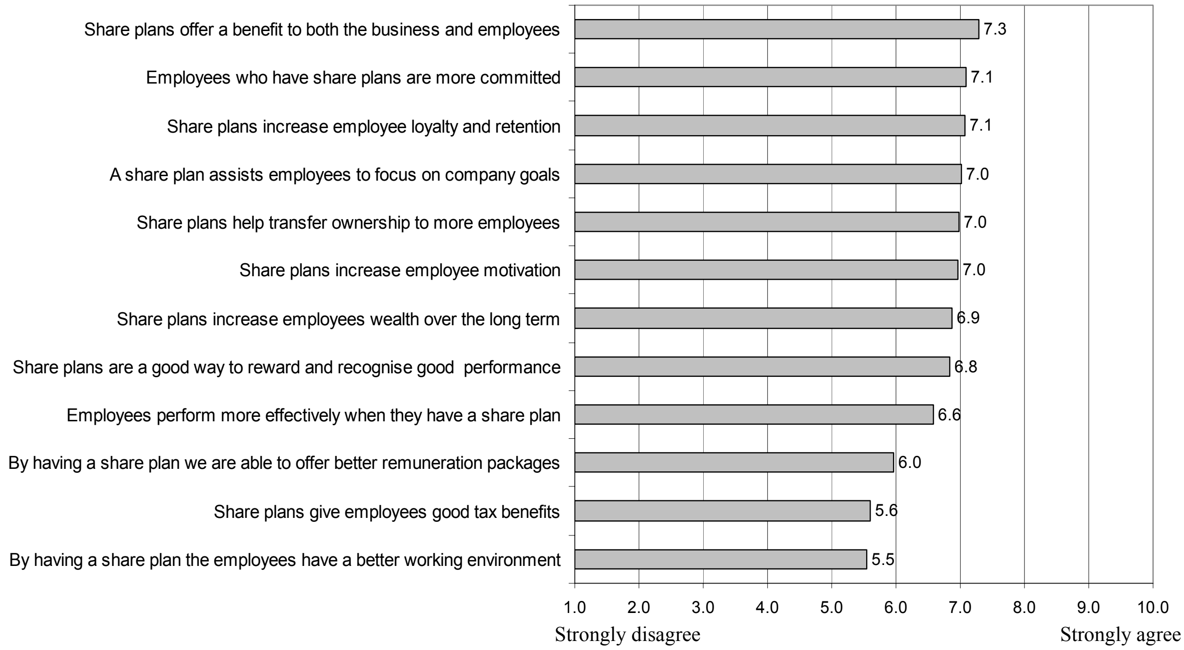
Perceived benefits of ESO

The key benefit recognised most frequently among all businesses (with and without plans) (agreement rated 7.3 out of 10) is the recognition of a dual benefit of the plan, that is, ESO benefits both the business and the employee.

Figure 2 shows full survey results. The two key findings are:

- Businesses were more likely to agree with benefits related to organisational culture and workplace relations/human resource strategies; and
- Agreement was lower when considering elements such as the relationship between ESO and effective performance, a better working environment, and competitive salary packaging and tax benefits.

Figure 2 – Benefits of ESOP, businesses with and without plans (average level of agreement out of 10)



Negative perceptions and barriers

The main barriers to increased implementation of ESO plans related to a perception of a lack of relevance of ESO to their business, practical issues regarding legal and tax complexities, and employee resistance**.** There was also a range of legislative/taxation issues raised in particular by advisors who saw these issues as significant barriers for business. These key issues included:

- limited tax incentives and/or unattractive and complicated tax treatments depending on the plan type or transfer of ownership (capital gains tax issues);
- burdensome corporations law disclosure requirements; and
- annual valuation requirements which can be expensive, complex and difficult for unlisted companies.

The research highlighted the key concerns of **cost and complexity** for businesses wanting to implement an ESO plan. The four main negative perceptions emerging from the survey were:

- businesses without share plans believe that share plans are not applicable to their organisation;
- employees would prefer other types of benefits, do not/would not understand ESO and some could not afford to be part of a plan;
- set up and maintenance costs are expensive; and
- legal requirements are too difficult.

Employee Perspectives

As noted above, employee resistance was one of the most frequently reported concerns for businesses with and without ESO plans). Qualitative research with employees found that while in many cases understanding was low, perceptions varied even within organisations. The views of employees towards ESO plans appeared to be driven by a range of factors, including:

- the performance of the share price – share volatility was not well received by some employees and a declining share price was seen as demotivating;
- the size and age of the company – different views for those in smaller or start up phases (i.e. employees can be part of business growth and development) as opposed to more established or larger businesses;
- the value and type of shares (needs to be significant/worthwhile);
- previous experiences (positive and negative) with share schemes;
- life stage and current financial position – younger employees looking for different types of investments or cash flow compared to those closer to retirement;
- understanding of share ownership generally and an openness to this type of remuneration as part of a wealth creation strategy; and
- existing employee relations and trust of management.

Well designed communication materials and strategies to educate employees and counter resistance were identified as key elements for successful implementation of an ESO plan.

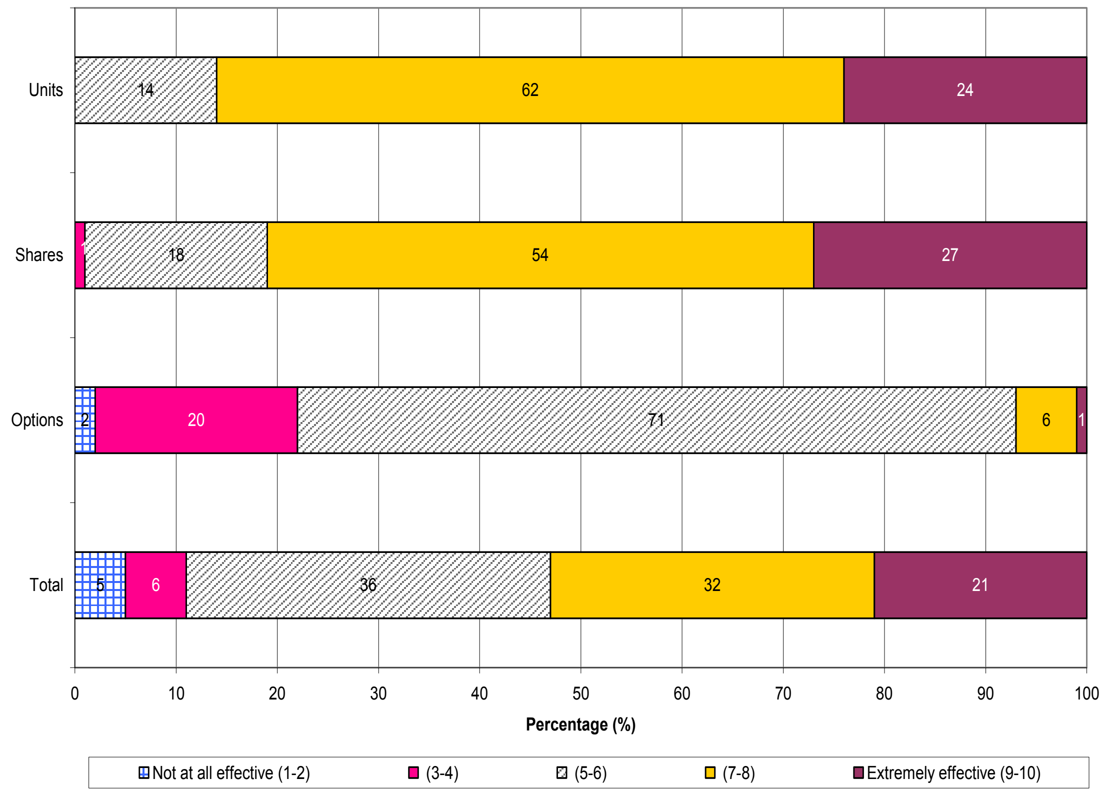
Effectiveness of Plans

The success of an ESO plan is related to the objectives of the scheme which varied across organisations. Considering most plans aimed at impacting such broad areas as organisational culture and employee attitudes, precisely measuring the success of an ESO plan is somewhat difficult. The survey asked respondents to recall the reason why their plan was implemented and rate the effectiveness of their plan against those objectives.

Around half of all respondents rated their plans as being effective, with more than one in ten rating plans as extremely effective. Plans which provided units were the most effective plan types, with a quarter (24%) rating them very highly, and the vast majority (86%) rating them 7 or higher out of 10 for effectiveness. Share plans also rated favourably with 71% of businesses rating them as 7 or higher out of 10.

Figure 3 - Effectiveness of plans (rating out of 10)

Q: Thinking about the main reasons your business implemented a share plan, how effective has the share plan been in delivering the objectives?



Businesses that rated their plans as extremely effective (rating of 9 or 10) reported the following specific benefits: *share plans…*

- provide benefits to both the business and employees (mean rating 9.6)
- are a good way to reward and recognise performance (mean rating 9.4)
- increase loyalty and retention (mean rating 9.2); and
- mean we can provide better remuneration packages (mean rating 9.1).

The survey found that many businesses were linking their plans to performance hurdles and the majority of these were for executive plans and options plans. The very large majority of these businesses believed that the share plans were positively affecting performance and/or that ESO was a good way to reward and recognise performance. Of those who used performance or recommendation from a manager as a criterion to decide which employees are eligible to participate in an ESO plan, 95% agreed that share plans are a good way to reward and recognise good performance (54% rating 10 out of 10). Almost all these businesses (94%) agreed that employees perform more effectively when they have a share plan.

One of the reasons cited for less successful plans was the volatility of the share price. Common problems also reported by businesses related to plans being difficult to manage and maintenance costs being too expensive. Employees not understanding or preferring other types of benefits, and ESO plans not really being suitable for their organisation were also reported as reasons for plans being less successful.

Additional or alternative strategies to ESO

ESO plans are one of many choices open to businesses wanting to reward, recognise and motivate employees. Of those businesses interviewed, many had in place a variety of reward schemes including gifts, prizes and cash bonuses for both short and long term incentive programs. Alternative forms of financial participation might also include commission schemes, profit sharing or gain sharing. Often those businesses with ESO were also using other strategies:

> *'ESOPs …are only one plank in a whole range of HR initiatives and so usually companies that have strong share plans and responsive employees probably are doing 30 other things very well as well ... If you have a highly motivated work force that is well paid, working in a good work environment being encouraged to participate on every level and they have got a share plan… does that mean it's the share plan that's done the trick or all these other things?' (Advisor)*

The research also shows that many businesses simply prefer alternative (more conventional) employee benefits such as profit sharing and often businesses believe that employees would also prefer cash. The survey found that 54% of all businesses agreed (rated 7 or higher out of 10) that there are better ways of rewarding employees and 67% felt that employees would prefer other benefits. Of those who preferred other means of reward, 80% were offering at least some employees cash bonuses.

3.3 Increasing Take-up

Businesses in the study were categorised according to their attitudes and behaviours regarding ESO. Businesses (and individuals within business) will usually move through this behaviour change continuum as they become aware of ESO, contemplate and weigh up the benefits and problems they associate with using ESO, and prepare to trial it for the first time or implement/maintain it on an ongoing basis. Most businesses in the survey (40%) had never thought about ESO at all (see Figure 4).

Figure 4 – Stages of behaviour change (all businesses aware of ESO concept)

Pre-contemplation 40%	**Those who have not thought about employee share ownership as an option for their business.**
Contemplation 33%	**Those who have thought about employee share ownership or tried employee share ownership in the past but have decided that they are not likely to use it in the future.**
Ready for Trial 16%	**Those who have thought about employee share ownership and are likely to use it in the future / considering implementing.**
Maintenance 11%	**Those who are using employee share ownership.**

Key differences are apparent between businesses in each stage. For example,

- around half of all medium sized businesses (47%) and half of all managing partnerships (53%) have never thought about ESO at all (Pre-contemplators). These businesses may be content with current arrangements given the size, age, and stage of their business' development.
- Blue collar organisations and those without a bonus structure were also likely to be Pre-contemplators. These businesses are likely to have particular cultures and/or wage setting arrangements which underpin working conditions within which ESO may not traditionally ever be considered.
- In contrast, the types of businesses more likely to be maintaining an ESO plan are much larger, public listed companies with greater revenues, and bonus structures for all employees in place.

Figure 5 – Profile of Businesses (% of each type in each behaviour stage)

Pre-Contemplation 40%	Partnerships (managing/non equity)	53%
	Medium - 20-99 employees	47%
	Blue collar	45%
	Good culture	48%
	Do not offer bonuses	48%
Contemplation 33%	Public unlisted	60%
	$3-$50M annual turnover	48%
	Casual/temp: less than 75% of staff are permanent	39%
	Blue collar or both white/blue equal	38%
	Average culture	37%
Ready for Trial 16%	White collar	23%
	Excellent culture	22%
	Turnover $100K-$3M	21%
Maintenance 11%	Large: 100+ employees	30%
	With overseas offices	32%
	50+ Sites in Australia	39%
	Public	35%
	Public listed overseas	*72%*
	Public listed in Australia	*49%*
	Over $50M turnover	32%
	Offer bonuses	14%
	All employees eligible to receive bonuses	*15%*
	Do not have awards	14%

Barriers to behaviour change (take-up of ESO)

It is clear from the survey ratings that perceptions of those who are Ready to Trial are more positive relative to those in earlier stages. Contemplators feel the least positive about ESO than all other segments particularly about practical barriers and the complexity of implementation (as noted by advisors, some businesses simply do not get passed the point of total confusion and/or the costs involved). Key issues for Contemplators and Pre-contemplators are:

- Perception that ESO is not suitable for their organisation;
- Management resistance (don't want to give these kinds of benefits/give up control); and
- Employee resistance (a lack of understanding).

Strategies to move businesses from Pre-contemplation to Contemplation and Trial, thus encouraging a greater take-up of ESO, will need to address both awareness and specific barriers that currently prevent take-up of ESO by business. Figure 6 outlines these strategies.

Figure 6 – Summary of key strategies for take-up of ESO

Pre-contemplation	These businesses are typically not aware and don't see ESO as relevant i.e. it's not for them. ***Strategies***: Build interest in ESO. General awareness raising activities that challenge the view that ESO is only for large, publicly listed companies - 'normalise' ESO in the business community.
Contemplation	Businesses that are aware but negatively disposed to ESO (relative to other businesses). Practical barriers are key concerns. ***Strategies*****:** Address barriers/reasons for rejection (both real and perceived), including systemic and structural issues of costs, legal and tax issues. Challenge belief of lack of relevance and educate and support cultural change (e.g. Mgt doesn't want to give up control, employee resistance issues).
Ready for Trial	These business are already 'sold' on the idea, they just need help in implementing a plan (i.e. turning ideas into action). ***Strategies***: Assist and facilitate implementation by addressing the key areas where things can 'go wrong' in implementation. Facilitate development of professional help for all businesses (not just large corporations), address practical issues of paperwork and employee communication. Provide guidelines and real examples of how to easily implement a plan.
Maintenance	***Strategies***: Reinforce behaviours, support and encourage, reward and recognise. Help in maintaining a plan – employee communication, maintenance costs/considerations, e.g. developing procedures for when an employee wants to leave.

4. SUMMARY

The research indicates that there is broad support of the concept of ESO among Australian businesses. The majority of businesses with ESO plans are satisfied with the effectiveness of the plans as a workplace and human resource strategy. However, many businesses do not see ESO as a relevant strategy for their business and do not feel that their employees would want such a scheme. Furthermore, businesses entering into the design and implementation phases of ESO are challenged by the complexity and costs associated with the exercise and some comment on the resistance of employees.

This research highlights the need for greater information and practical advice for business about the benefits of ESO and the practical considerations for implementing plans. The Department of Employment and Workplace Relations can offer significant information and guidance for business. Industry advisors will also play a vital role in helping businesses use ESO strategies to improve workplace culture, productivity and performance.

More information on ESO can be obtained from:

- Website: www.workplace.gov.au/eso
- ESO enquiry line: 1800 181 088
- Email: employeeshareownership@dewr.gov.au
- Mail: GPO Box, 9879, Canberra ACT 2601