Employee Owned Businesses – Access to Funding

Final Report

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Executive Summary

1. Introduction

This report presents findings from a research project concerning access to funding for employee-owned businesses (EOBs) in Scotland. The two main objectives were: first, to examine the role of funding for firms moving into employee ownership - especially to ascertain if this constrains or curtails firms becoming employee-owned. Second, to examine the issue of funding as a constraint on growth for existing employee-owned businesses and to judge whether lending institutions view these firms as 'atypical' in terms of their perceived credit risk.

2. Methodology

This research project began with a brief *review of studies* on funding, succession and employee-owned businesses.

The *primary, interview, data collection* focused on interviewing two groups of companies: (a) current EOBs (n=12) (representing around a quarter of all EOBs operating in Scotland) and (b) firms considering, or who have considered, some form of employee ownership (n=19). A number of intermediaries (n=8) were also interviewed. The sample of firms interviewed comprises a sizeable proportion of the overall population of EOBs in Scotland.

To contextualise the interview data collected, s*econdary research* was also conducted to assess EOBs in the wider economic context and included analysis of relevant business statistics to assess potential future succession businesses and a rough market sizing for EOBs.

3. Findings

The findings set out results for existing EOBs, those that are in the process or considering the move into EOBs and those that have 'definitely' rejected the idea of a move into EOB. The issues considered are: the transition to employee ownership; funding for share buy-back; other funding issues confronting current EOBs; EOB views on alternative sources of funding; attitudes towards financial institutions; institutions used during transition; and attitudes towards intermediaries.

Transition to employee ownership

Most of the firms considering, or who had considered EOB status, did so because of *succession planning* and *age of the owner*(s). Trade sales, MBOs and MBIs were other exit options being actively pursued by many of the current owners and were generally seen to be easier and quicker forms of exit, especially in the case of a trade sale. Owners often wished to partially exit in a controlled manner, so as not to destabilise the firm. The exit process seemed to be an 'entrepreneur-led phenomenon' with a lack of employee consultation. It was a dynamic evolving process which changes over time, so even if they had ruled it out for the time being owners felt that the situation could change in future.

Funding for Share Buy-out

The majority of firms interviewed required capital to undertake the transition to employee ownership, predominately in the £1-5million range to purchase equity from the original owners.

Retained earnings appeared to be an important source of funding for the buy-back as well as for working capital and sometimes growth. The banks generally appeared to play a relatively small role.

Firms *financed the transition in a number of ways* including: vendor finance through retained earnings (the predominant method); through the specialist intermediaries such as The Baxendale Partnership (n=2); or a combination of both. All firms interviewed noted that they raised as much capital as they had hoped to and did not perceive a gap in funding.

For firms considering employee ownership, several financial issues seem to play a part in shaping the nature of the entrepreneur's exit decision. Indeed, the interviews suggest that there is a complex set of factors (both financial and non-financial) mediating the exit process facing entrepreneurs. These include:

- the speed which entrepreneurs wish to exit;
- a strong preference for not using bank finance to enable such a transaction;
- many entrepreneurs considering EO intending to finance share buy-back using company retained earnings;
- many entrepreneurs questioning the ability of their employees to provide investment, especially as many were not highly paid.

Other Funding issues confronting current EOBs

For working capital the picture was similar. The majority of EOBs (n=8) relied on retained earnings, supplemented by bank overdraft, credit cards and other loans (e.g. members' loans; loans from Baxendale) when absolutely necessary. Only 1 firm relied solely on bank loans and overdraft for working capital. Reinvestment of retained earnings was also the predominant approach to *growth funding* undertaken by the EOBs (n=7).

Asked about their intentions to raise finance in the next 2 years, for buy-back, working capital, or growth, the majority of EOBs noted that they have no plans to raise any finance, preferring to draw on retained earnings.

EOB views on alternative sources of funding

For the EOBs interviewed, most were very negative about the idea of bringing in outside equity and did not see this as a viable option, even if there were implications for growth. For example, one company's reluctance to give away equity had limited its ability to expand beyond regional markets, whereas competitors that had been able to accept equity funding had subsequently grown to UK and international size.

Attitudes towards financial institutions

A mixed picture emerged as to the willingness of EOBs to borrow from traditional lending institutions. Some opposed bank lending but others felt banks to have been relatively supportive. There appeared to be a general reluctance to borrow, rather than one based on previous negative experiences with traditional lenders, and this predated the firms' transfer to employee ownership. In the past five years, only two of the EOBs had been turned down by lending institutions. The research revealed the idiosyncrasies of bank attitudes to employee ownership, and here the individual attitude of banks' Relationship Managers was critical, with many being supportive. None of the firms considering EO reported problems with their banks and the majority reported very positive relationships.

Attitudes towards intermediaries

Based on their experiences during transition to employee ownership, the EOBs that had used accountants had found them quite helpful. However, one participant articulated that their accountant "just didn't understand what we were trying to do".

Findings from the interviews with banks and corporate lawyers were clear and consistent. Although most of the banks admitted to having few dealings in the past with employee-owned firms, all were keen to work with these firms in the future. There were three main issues raised by these interviews which may determine the likelihood of banks assisting employee buy-outs:

- the unanimous view was that banks and other external lenders treat businesses the same irrespective of their ownership structures;
- when a firm becomes employee owned they effectively become a different entity with a different level of credit risk; and
- quite a number of the banks mentioned the need to get the new owners properly incentivised to ensure the continued success of the business following the exit of the incumbent entrepreneur.

4. Conclusions and Recommendations

Overall our findings suggest that for most firms interviewed, there is not a significant funding gap. It appears that a wide range of factors coalesce to hamper firms making the transition to employee ownership. Given the complex forces which shape these decision processes policy makers will need to be imaginative with policy responses to effectively help promote greater employee ownership. It should be noted however, that while 19 of our sample were considering, or had considered, moving to employee ownership, only three had formally decided against it (although a number of others suggested that they were unlikely to move to employee ownership).

The report raises two key issues in particular where policy could potentially be re-formulated:

Focus and targeting

- In terms of the targeting, the work seemed to suggest there would be merit in a stronger level of policy focus aimed towards three different groups: entrepreneurs close to retirement age, employees working in firms considering employee ownership and key industrial sectors which have strong synergies with this form of ownership structure. By improving targeting toward these groups there may be the potential for more traction in terms of facilitating and promoting employee ownership across the Scottish economy.
- Research examining the factors shaping the exit intentions of a large sample of Scottish entrepreneurs would also be of benefit to policy makers. Given that relatively few in the sample had formally decided against employee ownership, further research on a greater number of such firms (i.e. those that are definitely or unlikely to move into employee ownership) may yield further insight.

Thematic nature of support

- In terms of support measures a number of issues were raised which suggest there could be scope for the provision of further thematic types of support. First, it may be appropriate to stimulate the demand within SMEs for external lending to help overcome the problem of 'reluctant borrowers'. A lack of interest in external borrowing seems more a matter of 'demand' than a question of supply-side constraints.

- The merits of a government loan fund (or alternative peer-to-peer lending) are raised by this research. Some form of state-funded loan programme is potentially a high risk policy intervention which would require very careful consideration to prevent market distortions. A lower risk alternative is for state bodies to help promote a peer-to-peer lending fund to aid the transition towards employee ownership, perhaps in conjunction with support from larger EOBs. Assistance with the costs associated with the transition to employee ownership is another form of support which would appear quite beneficial to potential EOBs.

1. Introduction

This report presents findings from a research project concerning access to funding for employee-ownership businesses (EOBs) in Scotland. The work has two main objectives. First, to examine the role of funding for firms moving into employee ownership, to ascertain whether this inhibits or constrains firms becoming employee-owned. Second, it examines the issue of funding as a constraint on growth for existing employee-owned businesses and to judge whether lending institutions view these firms as 'atypical' firms.

Research context

In recent years, there has been a significant growth in the numbers of firms who are becoming employee-owned. It has been estimated that the UK employee owned sector is now worth £25 billion annually, representing around 2% of GDP[1]. Employee ownership can take different forms (direct employee ownership, indirect employee ownership and combined direct and indirect ownership[2]), covers a wide range of business types and sectors, and is a growing force in the economy. Several high profile examples of successful EOB models (e.g. John Lewis Partnership, the Tullis Russell Group, Clansman Dynamics, Aquascot and Scott Bader) have given momentum to the growth of EOBs.

Businesses which have greater levels of employee involvement (or 'voice') and financial transparency appear to outperform businesses which have more traditional and concentrated forms of ownership[3]. Previous research[4] has found that EOBs reported stronger employment growth during the period preceding the 2008 recession and that, during the recession, the rate at which EOBs were reporting employment growth was increasing. It has also been found that EOBs are more profitable and productive, that there is more stability over the business cycle, higher levels of employee satisfaction and an ability to create jobs more quickly[5]. Some contribute to Scotland's high growth firms[6].

Funding issues confronting EOBs are important for two key reasons[7]. First, access to funding is a crucial enabler facilitating the transition into employee ownership. Secondly,

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[1]Lampel, J., Bhalla, A., & Jha, P. (2010) Model growth: Do employee owned businesses delivery sustainable performance, page 10. Available at: http://www.caseplace.org/pdfs/All-EOA-2010-Model%20Growth.pdf

[2]Employee Ownership Association (2010). About Employee Ownership: http://www.employeeownership.co.uk/employee-ownership/about-employee-ownership/

[3]Timming, A. and Brown, R. (2014) Employee Voice Through Open-Book Accounting: The Benefits of Informational Transparency, *Journal of Social and Environmental Accounting*, *forthcoming*

[4]Brown, R., McQuaid, R., Raeside, R. and Canduela, J. (2014) The performance of employee-owned businesses in Scotland: some preliminary empirical evidence, *Fraser of Allander Institute Economic Commentary*: 37, 3, 108-117.

[5]Between 1992 and 2011, the employee ownership index of the share valuations of UK's leading EOBs considerably outperformed the FTSE-All Share index http://www.ffw.com/latest-news/2012/march/eoi-growth-q4.aspx; Pendleton, A, Wilson, M & Wright, M (1998) The perceptions and effects of share ownership: empirical evidence from employee buyouts, *British Journal of Industrial Relations*: 36, 99-123.

[6]Mason, C. and Brown, R. (2010) found EOB among Scotland's high growth firms (HGFs), High Growth Firms in Scotland, Scottish Enterprise. The range of EOBs in Scotland is great (e.g. Tullis Russel to Highland Home Carers, who have recently seen employment rise by 80).

[7]Sharing Success: The Nuttall Review of Employee ownership, BIS, 2012; *Share Value: How employee ownership is changing the face of business.* Short Inquiry, The All Party Parliamentary Group on Employee Ownership. May 2008; Keohane, N. (2013), Mutually assured growth? Employee ownership and the UK economy, Social market Foundation; Brown A. & Watt

access to funding enables EOBs to obtain growth finance to support their growth and expansion.

First, one potential reason for the small size of the EOB sector, both in Scotland and the UK as a whole, may be due to difficulties in accessing finance at critical stages in a business' lifecycle. However, up until now there has been no specific examination of this sub-set of firms in terms of their funding and its relation to their growth dynamics; and there is a lack of evidence on the specific issues faced by EOBs in the Scottish context. The succession stage in a business' lifecycle appears to be where there is a particular lack of EOB finance[8]. While there are some tax benefits for EOBs[9] and organisations exist which specifically target firms undergoing the transition into employee ownership, such as Baxendale Ownership (formerly the Baxi Partnership), uncertainty over funding these transitions may inhibit the emergence of more EOBs.

Succession, such as the founder passing on the business to employees on their retirement or disposing of the business, is a significant source of new EOBs[10], and an alternative to a trade sale or management buyout. This may allow a business owner to potentially achieve a competitive price for the business, while keeping the business in the hands of employees. EOBs account for a small proportion of the economy, suggesting that this option may not be frequently used. As around two thirds of businesses in Scotland do not reach a second generation, increasing the numbers passing on to EOBs might help maintain some firms that would otherwise close. Demographic changes suggest that the likely older age profile of small business owners may result in the issue of succession becoming greater in the next years, with opportunities for creation of more EOBs through this method.

Second, access to finance may also be an important obstacle preventing the *growth and expansion* of EOBs. It is well known that financial constraints apply to many small firms, but this may be particularly the case for EOBs. This could be due to lenders being unfamiliar with the structure of EOBs, which in turn can result in more risk-averse attitudes towards this type of business by lenders. According to the minutes of the BIS Implementation Group on Employee Ownership, the Access to Finance Forum (formerly the Banking Forum) which first met on 18 January 2013[11] reported that *"barriers that are specific to employee ownership and not just related to the general economic climate, or sector the business operates in, need to be identified"*.

L. (2013), Soft Finance, Hard Choices: A review of the finance market for public service mutuals. Page 23. http://mutuals.cabinetoffice.gov.uk/sites/default/files/documents/Soft%20Finance%20Hard%20Choices.pdf.

[8] 'Business transfers to Employees under the Form of a Cooperative in Europe: Opportunities and Challenges' June 2013, CECOP-CICOPA Europe; European Parliament's Committee on Industry, Research and Energy Report: 'On the contribution of cooperatives to overcoming the crisis', 12 June 2013

[9] *Finance Bill 2014 Draft Clauses – KPMG Report*. 10th December 2013

[10] McQuaid, R., Hollywood, E., Bond, S., Canduela, J., Richard, A and Blackledge, G. (2012) *Health and wellbeing of employees in employee owned businesses*, Report for John Lewis Partnership and Employee Ownership Association. www.napier.ac.uk/employmentresearchinstitute/projects/Pages/EOAWellbeing.aspx

11 Minutes of meeting: Implementation Group on Employee Ownership, 1.45pm 29 January 2013 at BIS

Research objectives

The key objectives of the research underpinning this report were to inform our understanding, and provide evidence of, the issues associated with EOB funding, focusing on access to funding at the succession and growth stages of a business' lifecycle, and considering how these are different from other businesses. In order to help answer this complex question, the research had the following objectives:

- To assess why firms (and exiting entrepreneurs) consider entering into some form of employee ownership;
- To ascertain the importance of finance as a deterrent for firms considering becoming employee-owned;
- To identify how EOBs have been funded in Scotland to date and their sources of funding to aid growth and expansion;
- To examine the extent to which the current arrangements for, and supply of, finance meet the needs of Scottish EOBs and the extent to which there are (and size of) any gaps in provision identified;
- To identify an indicative population of potential business successions which could be targets for CDS to help facilitate greater levels of employee ownership;
- To provide outline policy recommendations on how Scottish Enterprise and CDS can increase the uptake of firms wishing to move into employee ownership.

A key intention of this project has been to help inform the policies and activities undertaken by Co-operative Development Scotland, who promote and assist the formation of EOBs in Scotland. The report is structured as follows:

Section 2 of this report sets out the methods used;
Section 3 presents the main findings of the interviews;
Section 4 discusses these finds; and
Section 5 presents recommendations.
Appendix 1 sets out the main questionnaire.

2. Methodology

This research project began with a brief *review of studies* and the literature on funding, succession and employee-owned businesses. This review formed the basis for the analytical frameworks for the primary and secondary analysis.

The *primary, interview, data collection* focused on interviewing two groups of companies: (a) current EOBs (n=12) and (b) firms considering some form of employee ownership (n=19)[12] (see Appendix 1 for a list of interviewees). A number of intermediaries (n=8) were also interviewed. Research participants were interviewed by telephone or face-to-face and asked to discuss a number of issues relating to financing (see Appendix 2 for the interview questionnaire). Participants were generally forthcoming in their responses and raised a number of important insights which will be discussed in detail in Section 4.

The sample appears relatively representative of Scotland in terms of geography (including the Highlands, Northeast and Central Belt), sector, age and size (see below for further information), although micro firms are underrepresented. The 12 EOBs interviewed represent around 40% of those based in Scotland or a smaller percentage of those operating in Scotland. Overall, the diversity and size of the sample suggests that the findings are reasonably representative of both EOBs and firms considering becoming employee-owned. The sample of existing EOBs is generally comprised of larger profitable businesses and the sample of firms considering employee ownership tended to be smaller less profitable firms.

To contextualise the interview data collected, s*econdary research* was also conducted to assess EOBs in the wider economic context and included:

- analysis of relevant business statistics to assess potential future succession businesses
- rough market sizing for EOBs

The secondary research used the BIS Small Business Survey and the FAME (Financial Analysis Made Easy) database, which provides profit and loss, balance sheet, ratios and trends for major public and private British companies (see http://fame2.bvdep.com) in order to estimate the scale of businesses that might be potential transfers/succession, although these are very broad estimates (see section 4.8). FAME has been used in previous studies comparing EOBs and other peer group firms[13].

[12]This category comprises both those firms considering ownership (pipeline transactions) and those which, at this point, have not chosen to transition to EO (failed transactions). The main reason for combining these two groups was that many interviewees were still uncertain about their likely exits (section 3.1.2) and the need to retain confidentiality and anonymity.

[13]Lampel, J., Bhalla, A., & Jha, P. (2010) Model growth: Do employee owned businesses delivery sustainable performance. http://www.caseplace.org/pdfs/All-EOA-2010-Model%20Growth.pdf; Brown, R., McQuaid, R., Raeside, R. and Canduela, J. (2014) The performance of employee-owned businesses in Scotland: some preliminary empirical evidence, *Fraser of Allander Institute Economic Commentary*: 37, 3, 108-117.

3. Findings

These findings set out results for existing EOBs, those that are in the process or considering the move into EOBs and those that have 'definitely' rejected the idea of a move into EOB. The issues considered are: the transition to employee ownership; funding for share buy-back; other funding issues confronting current EOBs; EOB views on alternative sources of funding; attitudes towards financial institutions; institutions used during transition; and attitudes towards intermediaries. Many EOBs or prospective EOBs are fast growing and financially healthy, although these companies appear to have comparatively fewer problems with financial gaps than others, hence many of the findings relate to smaller, lower growth firms.

3.1 Transition to employee ownership

3.1.1 Current EOBs

Nature of the Cohort

Focusing specifically on the group of existing EOBs (n=12 firms), all but two of the firms interviewed were 20+ years old. Some (3) had become an EOB 10+ years ago, while others (4) had transitioned 2-5 years ago and 3 in the last 2 years. Three of the interviewed firms are in the final stages of completing their transition. Although these three have been set up as an EOB, they are continuing to purchase the company from the original owners over several years and are therefore finishing the transition to employee ownership rather than operating as established EOBs.

Table 1. Characteristics of EOB firms interviewed[14]

Firm Size Band	Number of Firms	Average Turnover	No of years EOB
Micro (0-9 employees)	0	n/a	n/a
Small (10-49 employees)	7	£4.8m	9
Medium (50-249 employees)	3	£17m	14
Large (250+ employees)	2	£7.25m	15

The turnover for Medium firms is heavily influenced by one firm.

Reasons for undertaking transition

Participants cited a number of reasons for becoming employee owned. These included having an exit route for owners that was both socially responsible and best for the business, ensuring succession upon retirement of the owner and when there was no suitable family successor, and instituting an ownership form that the business passionately believed in. In other words, the central rationale behind the wish to become employee owned in most cases hinged on the succession issue within firms who had been previously family-owned.

[14] The turnover figures for medium sized firms are heavily skewed by the inclusion of one firm with a very large turnover.

The majority of these firms adopted or retained their Limited Company legal structure, in conjunction with both Employee Benefit Trusts (EBTs) and Share Incentive Plans (SIPs).

3.1.2 Firms considering employee ownership

In addition to examining the funding issues in relation to existing EOBs, this study examined a cohort of companies who are not currently employee owned but are considering some form of employee ownership. This category comprised both those firms considering ownership (pipeline) and those which chose not to transition to EO (failed transactions). As our interviews revealed, many entrepreneurs and firms were still uncertain about their likely exits, so separating pipeline firms from failed transactions is difficult. The interviews with firms considering EO revealed a number of issues which directly or indirectly impinge upon their desire and ability to undertake various forms of employee ownership. This included an examination of financial issues within these firms, which were extensively examined during these discussions.

Nature of Cohort Interviewed

In total 19 firms who are considering (or have previously considered) some form of employee ownership were interviewed.

The firms interviewed comprised a very heterogeneous cohort across a wide range of sectors. The vast majority were owned by a single owner-manager or were family-owned and controlled businesses. In one exceptional case, the firm was part-owned by local authorities. In a couple of cases, the firms had been formed from previous ownership changes such as management buy-outs (MBOs) and management buy-in (MBIs). Therefore, a number had already undergone changes to their ownership structure.

All of the firms were SMEs with less than 250 employees. The largest collection of firms were small businesses employing between 10-49 employees with a turnover of roughly £1.5m. While around a quarter had 50-100 employees, the majority had less than 30 employees. Only two firms had a turnover in excess of £5m. The profitability of the firms was not always declared, but the majority were operating profitably and experienced on average around 10% per annum growth.

Table 2. Characteristics of firms considering or have considered employee ownership*

Firm Size Band	Number of Firms	Average Turnover
Micro (0-9 employees)	1	£250,000
Small (10-49 employees)	10	£1.5m
Medium (50-249 employees)	4	£3m

**Financial Data unavailable for four of the firms interviewed*

Rationale for Seeking Exits

In the vast majority of cases, the firms interviewed were currently owned by either a single entrepreneur or a small group of co-owners (often but not exclusively other family members) seeking exit. All but one were exploring EO as part of succession planning – the one that was not felt that their particular needs (of a young, growing firm) was more to do with putting in place suitable incentives to retain key members of staff.

The single biggest factor driving these entrepreneurial exits was the age of the owners and their wish to either retire or to take a less hands-on role within the businesses. In the majority of cases, the entrepreneur(s) were aged over 55 and many were reaching retirement age. As is common in many smaller businesses, for many of the entrepreneurs no direct pension provision had been made and many regarded their business as their 'pension pot'. In all the cases the owners were examining different exit options, EO being just one of the many being investigated. Trade sales, MBOs and MBIs were other exit options being actively pursued by many of the current owners. Indeed, in the majority of cases these **other exit options** were seen to be easier and quicker forms of exit, especially the case of a trade sale. This seemed to be the best option for entrepreneurs who are seeking a rapid exit.

In many of the cases the entrepreneurs wanted to remain involved in the business after their personal exit. The partial nature of these exit intentions was driven by the belief that continuity of senior management would be needed to ensure the transition did not de-stabilise the firms. Therefore, a key aspect shaping their exit behaviour was the desire to "*exit in a controlled manner*". Various ways of enabling this **partial exit process** were outlined, such as wishing to retain an equity stake, remaining either full or part-time within the business.

Despite the clear implications for the rest of the workforce, in very few cases was the exit option explicitly discussed with other senior members of staff and **in no cases** were the employees as a whole involved in these decisions. It appears that the exit process is very much an 'entrepreneur-led phenomenon' despite having huge implications for the workforce and firm as a whole. In fact, one EOB interviewed stated that the **lack of employee consultation** before the transfer had had a significant and negative impact on the health of the business. While potentially increasing the costs of transfer, they strongly believed in the benefits of appointing a separate legal advisor for the employee body before the form of employee buy-out was finalised.

Rationale for Considering Employee Ownership

There seemed quite a consistent picture in terms of the reasons why sole entrepreneurs or co-owners wished to explore employee-ownership.

First, many of these firms already operate high levels of **employee engagement** and devolved decision making. One company maintained that they are already run as a "*very consultative operation"*, with a large degree of employee voice and participatory decision making, thus making employee ownership an attractive proposition. This was true for the vast majority of the firms interviewed, which did not envisage that the nature of how they operate would be unduly affected by a change in ownership.

Second, for many of the firms interviewed employee-ownership was a means of securing the **long-term safety of employment** within the businesses. A very strong driver for entrepreneurs was that the exit process protects employment within their companies. For some it was a case of "putting something back" into the community. Indeed, a number of entrepreneurs used the term "*soft sell*" to indicate they were not seeking to maximise their return from the sale so that it would remain locally-owned.

Third, in a number of cases the desire to become employee-owned was a means of **rewarding** staff. Many of the firms believed that employee-ownership could help recompense staff members for their hard work. One firm said they were "*driven by a sense of loyalty to staff members*".

Fourth, employee-ownership was seen as a means of **retaining** key personnel. A number of firms - especially in service-related businesses - expressed the belief that they could retain staff better by becoming employee-owned. Employee ownership was seen as a way of enhancing rewards to employees which would in turn increase staff loyalty. Using EO to retain employees was particularly important in knowledge intensive businesses such as consultancies, or where individual staff members were key income generators.

Finally, an interesting aspect raised by the interviews was the fact that exit options are very much **a dynamic evolving process** which changes over time. The interviews found that while some exiting entrepreneurs had considered employee-ownership, they had ruled it out for the time being. However, while EO was not deemed suitable at the current moment in time, a number of firms felt that the situation could change in future.

3.1.3 Firms that did not move into employee ownership

In three cases, firms which had considered employee ownership had decided against completing the transition for the foreseeable future. However, a number of the firms considering employee ownership had effectively ruled it out. The reason behind this decision is now explored.

Reasons for considering EO

For one company, the firm had been generating *"healthy cash flows and is pumped for exit opportunities"*, with the founders seeking to "*exit in a controlled manner".* Socially responsible succession planning and owner exit underpinned their rationale for exploring employee ownership as the company considered itself to be "*driven by a sense of loyalty to staff members*" and wanted to remain "*sticky to the local community*" even after the current founders move on.

For another of those who had ruled it out, the owner had thought of the company becoming an EOB since start up, as he believed that "*spreading ownership made sense*", as it promotes employee engagement. Employees are more interested and committed and, if the company does well, so does the employee, so everyone is working together for a common goal. The entrepreneur believed that employee ownership is both an incentive and a reward – employees are more knowledgeable about the company and take a bigger perspective rather than just focusing on their own area and they have an interest in the profitability of the business. He had also seen employee ownership in practice, as a previous venture was briefly employee owned.

Institutions to be used during transition

For one of the firms, Scottish Enterprise and CDS were critical for signposting during their exploration of employee ownership. As part of this process, a consultant was commissioned to undertake a feasibility study of becoming employee-owned. They did not seek assistance from their accountants nor their bank on this matter. As experienced entrepreneurs they did not feel that these sources of advice were that valuable.

The firms found support from CDS very helpful. They were given three days free consultancy, but did feel that within "*one hour"* it was clear that it would be difficult to find a suitable mechanism to allow the owner to withdraw cash from the business. The firm also went to their accountants, who felt that the concept of employee ownership was a "*bizarre idea"*. There was also the belief that an accountant's first response to the concept of EO would be "*why would you want to do that?!"*

Reasons for stopping transition

The reasons underpinning this decision seemed to be complex, but hinged on the need for the owners to withdraw value from the business. One company needed to obtain immediate payback as the current owners wished to receive a substantial amount of funding (1/3 of the value of the business) up front. The longer payback period recommended by advisors did not meet this timescale and therefore the transition was stopped. For the other firm, there was no adequate mechanism for the owner to withdraw sufficient value. Given the volatility of the business (in terms of both turnover and profitability), it was difficult to put an appropriate price and mechanism in place that might have been easier in a more stable and predictable business.

One of the firms articulated that they felt let down by a lack of support from the government during this period. Given that they had received support from Scottish Enterprise in terms of grants for IT and other softer business development support, they felt SE should have taken a more hands-on role in assisting with the transition. Indeed, they claimed that there is "*no reason why government shouldn't - in return for resources - retain some form of control*". However, they felt that in the current environment SE and CDS do not have the powers or mechanisms in place to properly facilitate the transition towards employee ownership by providing the funds to entrepreneurs seeking an exit. Instead, they felt the "*whole ecosystem drives them towards a trade sale*".

This issue of sales was also identified by the other firm, who noted that employee ownership is not always forever, despite what EOBs and organisations like Baxendale say. Employees may want to sell out to private sector investors – and this is a good thing if the employees feel it is in their best interest.

The firms retain an interest in the employee-ownership model, but they remain reluctant to proceed unless they can cash-out quickly and retain a stake in the firm. One owner stressed that they are very busy with a "*limited amount of time*" to explore different options. Given his antipathy towards acquisition, it was inferred that if a proper funding mechanism was provided they would potentially pursue their 'exit' via employee ownership.

3.2 Funding for Share Buy-out

EOBs had mixed responses to ideas of seeking external funding, although this is probably representative of the views held in the wider business community. Retained earnings appeared to be an important source of funding for the buy-back as well as for working capital and sometimes growth. The banks generally appeared to play a relatively small role. Some EOBs had never borrowed money and preferred to draw on retained earnings, while some were comfortable with bank debt or debt to non-traditional lenders. A few EOBs (n=2) asked employees to invest quite considerable sums to help fund the buyout and minimise the need for external funding, as well as showing to their commitment to the other funders.

3.2.1 Current EOBs

The majority of firms interviewed required capital to undertake the transition to employee ownership, predominately in the £1-5million range to purchase equity from the original owners.

A mixture of funding routes to finance the transition to employee ownership had been used. The majority of EOBs had used retained earnings to fund the buy-out, either as a one off payment or more frequently as a phased buy-out process. Others had to raise funds for the buy-out, through the specialist intermediary The Baxendale Partnership (n=2), banks or through partial equity finance (n=1). Some EOBs (n=2) had to raise c. £200k each from employees. There was a cost to all EOB conversions and, although Scottish Enterprise provides a grant to help cover some of these costs, the fees from lawyers and accountants can mount up. One company mentioned that employees should have a different lawyer from the exiting owner to scrutinise the deal.

Firms were also asked to discuss financial difficulties they encountered during their transition (see Table 3). These varied depending on the specific contexts of each firm's transition, with some firms finding certain elements more or less difficult.

Table 3. Main financial difficulties encountered during transition to employee ownership
1 = not difficult, 3 = neutral, 5 = very difficult

	1	2	3	4	5
Obtaining suitable Advice	6		1		
Financial uncertainty on behalf of employees	4	1	1		
Financial uncertainty on behalf of incumbent owners	4				1
Obtaining sufficient finance	5				1
Obtaining suitable finance	4				1
Constructing the Vendor finance agreement	4	1			
Legal difficulties	5				
Resistance from bank	2				2
Taxation issues	6	1			
The current economic environment	5		1		

N = 12

Given that many EOBs used retained earnings to fund their transition, the majority of participants did not perceive significant financial difficulties during their transition, although this was certainly not the case for all firms. For example, one EOB emphatically stated, *"I would never go back to the bank because they had no idea what I was talking about!"* While those EOBs that had experienced difficulties with banks were relatively few in number, this experience proved to be a qualitatively important issue when it came to speaking to companies considering transition.

3.2.2 Firms considering Employee Ownership

During the interviews we explored the problems that interviewees perceive in terms of moving towards some form of employee ownership. Several financial issues seem to play a part in shaping the nature of the entrepreneur's exit decision. Indeed, the interviews suggest that there are a complex set of associated financial factors mediating the exit process facing entrepreneurs.

First, is the **speed** in which entrepreneurs wish to exit. As mentioned, many firms were owned by people who were nearing retirement age and who are looking to realise some liquidity from their business. Often the time horizon they are wishing to exit in is between 2-3 years. This meant the entrepreneur wished to get some up-front payment from the firm to enable them to exit. However, in many cases the entrepreneurs felt that there would not be sufficient time to put in place the necessary steps to achieve some form of employee-ownership. Many felt a lack of time and the inability of the employees to provide some up-front funding would make employee ownership difficult. This does not necessarily represent a firm-level funding gap, if the employee contribution is in order to show personal commitment rather than the need to raise capital. However, there is a potential funding gap due if the speed with which the owner seeks an exit is great if the potential EOBs are focussed on are exit routes that replicate a trade sale in speed and up-front payment. While some existing EOBs faced funding constraints, they have tended to use slower exit routes using Retained Earnings. In many of these cases, the entrepreneurs were viewing MBOs or a trade sale as a much quicker exit option.

On the other hand in a number of the firms interviewed owners were not wishing to exit quickly. These people had longer-term time horizons in which they wished to withdraw from the business. Some of the entrepreneurs were in their early fifties and had only recently started to explore their exit options. Most of them wanted to remain in charge of the business for the medium term. They did not seek a quick up-front payment and envisaged that the process of becoming employee-owned would be a long-term and incremental process. In these firms the entrepreneurs often viewed the purchase of their equity stake as something which would happen very gradually. These entrepreneurs we label as 'patient capitalists'.

Second, another financial consideration identified by the entrepreneurs was the vast majority did not envisage using **bank finance** to enable such a transaction. In very few cases were banks seen as an instrumental factor in facilitating the transition to employee ownership. Interestingly, overall very few firms explicitly mentioned that finance would be a major barrier preventing the move to employee ownership. Indeed, many stated that they "*can't see finance being a stumbling block*". Many entrepreneurs had not properly examined funding issues and some admitted that it was the "*baffling point*" about employee ownership. The lack of importance attached to funding may be a result of the lack of exploration of this matter, however.

That said there were financial issues related to the firms which seemed to play a part in determining the exit process. Many of the firms were very small with little in the way of substantial financial reserves. Although profitable, most did not generate huge internal surpluses. Many firms are of a size where cash flow is critical to ensure the long-term viability of the business. Most of the firms were not hugely capital intensive and the majority did not have high levels of fixed assets such as property, capital equipment etc.[15] Related to this point is the fact that these types of firms are also viewed cautiously by banks (small, few fixed assets and low profitability).

Third, many entrepreneurs considering EO expressed themselves as reluctant borrowers and intended to finance share buy-back using company **retained earnings**. However, it was a common concern that a lack of internal reserves (or the time taken to amass sufficient reserves if the firm is less profitable) meant that there was a lack of a potential funding 'pot' to buy-out the entrepreneur(s) to enable them to establish an employee benefit trust. For some (n=4), the recession had reduced company profit and delayed transition to EO through insufficient retained earnings. In the majority of cases, the only mechanism to undertake the transition to employee ownership would be through vendor financing, where the owner is incrementally paid back by the EBT through retained profit. However, a number of entrepreneurs raised the point that this effectively meant that their own profits were being used to buy them out of the business. Again, this relates back to the fact many owners envisaged that they would remain involved in the business in some shape or form.

Finally, as previously noted, in nearly all the companies considering employee ownership there has been very little engagement with the employees. Therefore, very little was known about the appetite employees have for investing in these businesses. Many entrepreneurs **questioned the ability of their employees to provide investment**, especially as many were not highly paid. At the same time, some entrepreneurs talked about the need for employees to get "*skin in the game*" to provide some form of personal financial investment or up-front payment to the exiting entrepreneur. This is a term used to denote the situation were people who are liable to incur monetary loss are more likely to be committed to making the venture successful. Indeed, one owner talked about "*as I step back they [the employees] step forward*". However, this clearly creates a 'chicken and egg' situation where exiting owners want employees to provide up-front funding but the employees have limited 'surplus' savings to provide such funds. If the purpose of such an employee contribution is to show personal commitment, rather than raise capital *per se*, then this may not represent a funding gap for the firm itself, but rather a gap in access to personal funding for employees. Interestingly, most companies considering transition had not discussed bank loans with employees. Perhaps, since employees were sometimes not involved in the decision-making at this stage, these exiting owners are making decisions on whether to continue with transition or not based on incomplete knowledge of the views of employees.

[15] Or, where there were physical assets, the exiting owners felt that employees would not be able to afford to buy them out without using bank loans.

3.3 Other Funding issues confronting current EOBs

Funding for working capital

A similar picture emerged for working capital. The majority of EOBs (n=8) relied on retained earnings, supplemented by bank overdraft, credit cards and other loans (e.g. members' loans; loans from Baxendale) when absolutely necessary. Only 1 firm relied solely on bank loans and overdraft for working capital.

Funding for growth capital

Reinvestment of retained earnings was also the predominant approach to growth funding undertaken by the EOBs (n=7). A number had also used bank loans (n=3) when looking to raise significant capital (from £100k to £13m).

Intentions to raise finance

Asked about their intentions to raise finance in the next 2 years, for buy-back, working capital, or growth, the majority of EOBs noted that they have no plans to raise any finance, preferring to draw on retained earnings. Three EOBs noted that although they will continue to use retained earnings for working capital, they do intend to raise significant funding for growth (from 100k to £10m). One company specifically noted that this would come from 'private debt capital' rather than traditional bank funding, whereas the other two are looking for bank debt and loan capital debt. Overall, the EOBs took a pragmatic approach to debt financing.

For those firms intending to raise finance, they are very optimistic about the process. All three EOBs expect to raise the full amount they are looking for, and rate their current funders (banks and other private lenders) as 'very willing' to lend. A number of companies noted that obtaining finance is relatively straightforward if the business is healthy. This view that it was the health of the business that was crucial to raising finance was repeated by several businesses.

3.4 EOB views on alternative sources of funding

Views on outside equity

For the EOBs interviewed, most were very negative about the idea of bringing in outside equity and did not see this as a viable option for growth funding. For example, one company's reluctance to give away equity had limited its ability to expand beyond regional markets, whereas competitors that had been able to accept equity funding had subsequently grown to UK and international size. For transition into employee ownership, preference loans were sometimes used.

This reluctance to bring in external equity often stemmed from the nature and structure of the firm as an EOB, as significant borrowing decisions become an 'all employee' issue rather than a management issue. As one EOB explained, if they wish to borrow any amount over £50,000 the company needs to have a staff vote. All members of staff, regardless of whether or not they own shares, have a vote. A number of EOBs indicated that loan repayments both saddled employee owners with debt and also reduced their share dividend payments. There was thus a collective debt aversion and an individual earnings consideration.

A number of EOBs were turning down offers of equity financing – and also turning down approaches for loans from banks. Given this reluctance to relinquish equity, EOBs were unlikely to consider many of the traditional sources of equity finance including venture capitalists, business angels and private equity firms. One firm noted that, for EOBs, venture capital is "*absolute anathema*". There was more willingness to consider relinquishing equity to employee ownership specialist funders like Baxendale, and interest in finding out more about government funded equity funders and government funds to specifically assist EOBs. Interestingly, one long-standing EOB stated that they would consider relinquishing a small amount of equity but only in the form of a debenture.

However, one firm not likely to move into employee-ownership felt that the share of outside equity should be able to go change over time in *both* directions, up and down, according to the business needs and there was no sacrosanct level of 50% or whatever of employee ownership. This seemed a minority view.

Views on non-equity finance

Similar reluctance was evident in the EOBs when asked about pursuing other forms of non-equity finance. Five were not willing to consider any types of non-equity finance, whereas others were willing to consider loan based finance (n=1), lease / asset based finance (n=2) and peer-to-peer lending. Crowdfunding was not something that many of the EOBs were willing to consider. However, some non-EOBs would consider crowdsourcing in principle, but did not really know its details. One company was looking at how others were using crowdfunding, but was unsure how it would work for their company. They perceived that crowdfunding was predominantly for businesses operating in the Business-to- consumer (B2C) sphere rather than Business-to-business (B2B) firms like their own.

3.5 Attitudes towards financial institutions

3.5.1 Attitudes towards traditional lenders

Current EOBs

A mixed picture emerged as to the willingness of EOBs to borrow from traditional lending institutions. Five firms were very opposed to borrowing from banks, noting that they were "*able but wouldn't do it*" and "*we're trying to avoid it… our philosophy is to try and avoid borrowing money*". Another two were neutral on the prospect, with one noting that, although they are not opposed to borrowing from traditional banks, they did not feel confident in being able to satisfy bank requirements for personal guarantees by directors in place of assets as security. Another two EOBs were very willing to borrow from banks, having previously used them for loans.

There appeared to be a general reluctance to borrow, rather than one based on previous negative experiences with traditional lenders, and this predated the firms' transfer to employee ownership. In the past five years, only two of the EOBs had been turned down by lending institutions. In one case this was due to a lack of assets for collateral; in another, the bank wanted to undertake additional (and very expensive) due diligence on the company as its ownership structure had changed and the bank's policy is that due diligence be undertaken after any 'significant change' in a business.

The research revealed the idiosyncrasies of bank attitudes to employee ownership, and here the individual attitude of banks' Relationship Managers was critical, with many being supportive. However where relationship managers were unsupportive this was experienced both as a significant business problem and also as a business-to-business trust and relationship problem. Consequently, where the response by a bank to employee ownership was poor, the EOB had changed banks pretty swiftly.

Firms considering employee ownership

None of the firms considering EO reported problems with their banks and the majority reported very positive relationships. Those which had spoken to their bank about EO plans had received supportive responses – which one described as "*surprising*" despite their existing good relationship. Such a perception, that banks would view employee ownership plans in a poor light, was shared by a quarter of other pipeline companies (n=4), despite not having approached banks with their plans, and having existing good relationships with these funders. These perceptions may be driven by the small number of EOBs who do experience difficulties with bank attitudes – making the quantitatively small number of traditional lender problems a qualitatively important issue that might be creating a barrier to transition. So while the negative perception of banks towards EOBs may be less wide spread than commonly felt, these real or perceived problems with banks are still important.

For example, one firm has a very healthy and strong relationship with their bank. Evidence of this was the sanctioning of the acquisition undertaken by the business. When asked about their perception of employee ownership, it was revealed that the firm had not approached the bank to seek their views. Interestingly, it was mentioned that if the firm became employee owned they would probably need to switch banks because their current bank would see "*it* [employee ownership] *as an alien thing*".

However, one company was extremely negative about the role of banks and their attitudes towards SMEs. Although they have an "*account manager*" they have not "*seen anyone in years*". In fact, the participant's attitude became quite hostile towards the banks. This was partly due to their perception of an unreasonable level of personal security for loans that needed to be offered.

3.5.2 Traditional lenders' attitudes towards EOBs

In terms of how companies perceive traditional lenders' attitudes towards EOBs, a number of issues were raised. In some instances the companies put the banks' attitude down to the positive health of their business, meaning that the banks are very willing to lend.

Conversely, others have cited their form of organisation (e.g. asset poor but with high turnover) as a barrier. It seems that the issue is partly associated with the nature of the business and partly to do with individual banks, with one company noting that their business (and ownership form) elicited two very different responses from two different banks. They had a negative reaction from the bank that the company had been using before the buy-out, then switched to another multinational bank and have had no problems.

Individual bank managers are also an important consideration. Two companies noted that bank representatives "*struggled to really understand employee ownership*" which therefore hindered the lending process. For others, a very helpful bank relationship manager made sure that the business was taken care of, particularly in relation to its employee ownership structure.

It is also worth noting that the companies spoken to were mostly client managed by SE. For most, this meant that before transition to employee ownership the companies had been assessed by SE for their financial health. In this way, the companies selected for the study had already experienced a form of sifting – they had all been assessed as financially healthy enough to support a transition to employee ownership.

It seems that some traditional banks may be missing business opportunities due to poor knowledge of the EOB sector, which is alienating some EOBs, who then take their business to other traditional or non-traditional lenders. None of the EOBs spoken to mentioned difficulties with repaying loans. Rather, it was notable that they made considerable efforts to clear their debts.

3.5.3 Attitudes towards specialist lenders

Current EOBs

Approximately half of the EOBs interviewed had had interactions with specialist lenders such as Baxendale during their transition to employee ownership, noting that this organisation has been largely very useful. One company noted that their involvement with Baxendale was a critical turning point in the firm's transition to employee ownership. However, the EOBs interviewed by and large did not continue to use specialist lenders for working or growth capital. One EOB noted that they raised working capital from Baxendale however, as discussed, retained earnings was the primary source of working and growth capital in the majority of EOBs (and indeed the capital form Baxendale is funded in the longer term from retained earnings). An important issue was raised about the logistics of borrowing from specialist lenders if bank financing had already been secured. One EOB noted that when security belongs to a bank through bank loans, it makes it hard to go to other lenders like Baxendale. However, in at least one case Baxendale and the Co-operative Bank had accepted lower security when the bank insisted on very high levels of security over assets in its favour. So, at least in this case, the specialist funder was more flexible than banks.

Firms considering EO

The companies interviewed were not at a stage where any had approached specialist funders. Most assumed that the transition would be funded through retained earnings.

3.6 Institutions used during transition

There was a very mixed picture in terms of the institutions used by firms while undergoing the transition to EOB (see Table 4). Not all institutions were consulted by every firm during their transition, reflecting the differing types of businesses and in particular the date of transfer (e.g. some transitions predated CDS). Not all firms had the same experience with particular institutions. For example, banks were considered to be quite useful by some, but not by others.

Table 4. Institutions used by EOBs during their transition
1 = not useful, 3 = neutral, 5 = very useful

	1	2	3	4	5
Banks	1	1		1	1
Legal Institutions		1			2
Accountants				5	1
Funding Intermediaries (Baxendale, Capital for Colleagues)			1		4
Industry Associations (e.g. Employee Ownership Association)			1	1	
Scottish Enterprise/CDS				2	4
Other public Sector Organisations					
Trade Unions					
HMRC		2			
Co-ownership solutions					1

N = 12

3.7 Attitudes towards intermediaries

3.7.1 Accountants and lawyers

Current EOBs

Based on their experiences during transition to employee ownership, the EOBs that had used accountants had found them quite helpful. One EOB noted that their accountants *"were the first people who raised the possibility of employee ownership… I had a long chat with them about it and they said I should go and see Clansman Dynamics and I should speak to Scottish Enterprise, and that's how it all started*". For others, accountants were helpful if somewhat uninformed about the nuances of employee ownership. Another EOB drew on the services of their existing company accountant during transition, but noted that there was "*a lot of ignorance on their part*". One participant articulated that their accountant "*just didn't understand what we were trying to do".*

A more diverse range of attitudes emerged in response to lawyers. Four EOBs had very positive perceptions of the assistance provided during their transition to employee ownership. Three had used a law firm specialising in EOBs recommended by Baxendale, the other had legal advice based on guidance from SE. Other firms found lawyers to be "*nightmarish*" and "*the biggest obstacle*" during the transition. One firm noted that their lawyers "*didn't get the concept at all*", although they now have a reputation as specialists in employee ownership having learned from that particular deal. Another noted that when they transitioned to being an EOB they used the main recommended law firm, but they were very expensive due perhaps to the lack of competition.

Firms Considering Employee Ownership

Very few of these companies had contacted their accountants, lawyers or banks to discuss the potential transition to employee ownership. This may be reflective of the fact that many of these firms are still very early in their plans for such a move. One of the firms that decided not to complete the transition to employee ownership opted not to seek assistance from their accountant. They view them very negatively and feel that all the accountants want to do is "*put the company up for sale*". The other contacted their accountants, but noted that they did not fully grasp the concept of employee ownership and why this could be an attractive proposition to an organisation.

One firm has requested their accountant to explore the tax advantages of different ownership structures. This was a larger firm with quite well developed plans for an MBO. In the rare occasion where firms had attempted to seek assistance from these sources it was not very positive. On one occasion, the accountancy firm were very hostile and dismissive about their client's plans for employee ownership. They claimed that the company was not a "*suitable type*" of business to become employee owned and that they were "*too small*". Another firm who contacted their accountants in relation to such a move was similarly advised against such a move as being "*an expensive business*".

3.7.2 Scottish Enterprise and CDS

Current EOBs

Around half of the interviewed EOBs had used Scottish Enterprise and/or CDS during their transition process (others had transitioned before CDS was established). Those that had used them found both organisations to be helpful. One EOB noted that, in addition to specific employee ownership support from CDS, they also have "*a close relationship*" with SE and have received "*a lot of guidance*" which has been "*important to the growth and development of the company*".

SE recommends a few consultants to help companies with conversion (and provides a grant to cover about one third of their fee). Only one company had a negative assessment of their consultants (and this was where they took an equity share – before CDS existed). Since this company converted, more consultant firms have set up, introducing some competition among EO specialist consultant firms. All other companies (where they elaborated on this) had a very positive assessment of the consultants used.

Firms considering EO

A significant proportion had been signposted by Scottish Enterprise account managers to CDS for advice. This had really been their first experience or insight into employee-ownership. Therefore, at present the main source of advice for all the firms interviewed seems to be coming from the public sector.

3.7.3 Attitudes towards HMRC and tax

Current EOBs

Generally, EOB attitudes towards HMRC were negative; none of the EOBs interviewed noted anything particularly positive. One company had had a particularly poor experience with HMRC, noting that they were "*obstructive, unhelpful and very difficult to get in touch with*". This may reflect the lengthy process these EOBs had to undergo to get a SIP approved. As of April 2014 this approval is no longer required and companies can self-certificate.

Another found the HMRC "*pathetic*" as they had treated the firm as a large organisation (and charged the higher rate of corporation tax) because of external share ownership (which had financed the buy-out). Had this finance been in the form of a loan, the tax would not have been an issue, but the HMRC "*would not shift*".

All the EOBs interviewed intend to make use of the forthcoming £3,600 tax exemption on bonuses paid to staff in employee owned companies, apart from one company which believed this as only applicable to newly transitioning EOBs and another company which was not in a position to pay bonuses in the short term. Others noted that their structure (e.g. EBT) was chosen for being a more tax efficient way of distributing money to employees, but that the new exemption may affect the strength of this structure. As one firm noted, "*in some way [the tax exemption] has removed some of the incentive for [staff] to be shareholders… so some of the incentive for them to put their hands in their pocket to buy shares has been removed if we just pay a tax free bonus.*"

Firms considering EO

Finally, there seemed some uncertainty around the **tax** advantages of becoming employee-owned. In many firms, especially the smaller ones, they did not know the tax advantages or disadvantages of becoming employee owned. This probably reflects the fact that most do not have any in-house accountants or financial directors. In one larger firm the main attraction to the employee ownership model had been the perceived "*tax advantages for the exiting parties*".

3.7.4 Attitudes of Banks and Corporate Lawyers

Findings from the interviews with banks and corporate lawyers were clear and consistent. Although most of the banks admitted to having few dealings in the past with employee-owned firms, all were keen to work with these firms in the future. There were three main issues raised by these interviews which may determine the likelihood of banks assisting employee buy-outs.

First, the unanimous view was that banks and other external lenders treat businesses the same irrespective of their ownership structures. Banks unanimously declared they were "*keen to look at all angles to provide facilities*" to employee owned firms. As far as banks are concerned, the key criteria which businesses have to fulfil are the ability to repay debt safely and securely. In this respect, banks look at the level of turnover and profitability when making lending decisions. Ideally, banks like to lend to firms with 'decent' levels of profitability so that they can meet the repayment schedule within a loan. By 'decent' levels of profitability within SMEs most banks envisage at least a six figure level of profits. Given the relatively modest nature of many of the firms considering employee ownership this would preclude most of them obtaining bank funding. Indeed, several of the banks questioned the feasibility of putting debt into very small, low profitability businesses.

Second, another issue which emerged from the work concerned the nature of the credit risk associated when a firm becomes employee owned. This arose because when a firm becomes employee owned it effectively becomes a different entity with a different level of credit risk. Therefore, the move into employee ownership may erase the financial track record of the existing business. Banks are wary when organisational changes occur which are sometimes deemed "high risk events". This seems to be the case when employee ownership occurs, especially in firms with marginal profitability. One core consideration for banks would be that the "successor management has the right skills" to take the business forward. The indication was that larger firms with established management teams are deemed safer bets.

Third, quite a number of the banks mentioned the need to get the new owners properly incentivised to ensure the continued success of the business following the exit of the incumbent entrepreneur. Many of the banks felt that there was a pressing need for management in newly converted firms to get some 'skin in the game' early in the transition towards employee-ownership. Most banks were unaware of the capacity for employees to directly buy-out entrepreneurs but most felt that in most cases a benign vendor-inspired "buy-out" was the best option to ensure this outcome. Typically, this would involve a 'soft sell' over a generous pay-back period to ease cash-flow and the transition towards employee-ownership.

4. Discussion

4.1 Attitudes to banks

As noted, there was a mixed picture amongst EOBs in terms of their willingness to borrow from banks. Interestingly, this seemed to be less an issue of their ability to borrow (e.g. having been turned down in the past or not meeting current requirements) and more about the desire to avoid borrowing wherever possible, coupled with a belief that banks would view employee ownership negatively. It should be noted that this overall 'reluctance' to obtain external borrowings is pervasive across the majority of rapidly growing SMEs[16]. Also in the UK as a whole, the Bank of England Credit Conditions report (Q3 2014) suggests that demand for corporate credit from small businesses decreased in Q3 after rising for the previous 5 quarters (and falling in 2012). Given this 'reluctance', overcoming risk aversion within SMEs is difficult, but research suggests that the firms with closer contacts with financial institutions tend to be less reticent about accessing external sources of funding and have a greater understanding of alternative sources of funding[17]. Helping to increase awareness and connections with funders may be a useful focus for future policy initiatives.

However, the desire not to lose control or to relinquish autonomy is something that is fiercely resisted in the majority of EOBs. Whilst some EOBs did favour using bank loans, particularly for growth capital, the majority were very vocal about their desire to self-fund through retained earnings. There was a sense of pride in being able to be self-sufficient and not to rely on external organisations for financial help. This autonomy is reflected in exiting owners' desires to keep control of the company in the hands of employees and rooted in local communities. This seems to be a particular cultural element of the EOB sector, and a particular attraction for prospective EOBs.

4.2 Attitudes to debt

Given the reluctance of many interviewed EOBs to borrow from traditional lenders, there was generally a desire to avoid debt. These firms preferred to draw on retained earnings, noting that borrowing from the bank would occur if the business had no other option. This is not to say that EOBs as a group are debt-averse – there was a mixed picture in terms of willingness to borrow, as is likely reflected in the wider business community, with some more likely than others to turn to external sources of finance.

4.3 Attitudes to risk

In line with the attitudes of EOBs towards debt, the issue of risk-aversion was important to explore. A number of EOBs did appear to be quite risk-averse, but this might be due in part to the desire to protect the ownership structure and the individual employees. One company mentioned that the employee owners had voted to accelerate repayment of bank

[16] Brown, R. and Lee, N. (2014) Funding Issues Confronting High Growth SMEs in the UK, Institute of Chartered Accountants Scotland, Edinburgh. http://icas.org.uk/brown-lee/

[17] Seghers, A. and Manigart, S. (2012) The Impact of Human and Social Capital on Entrepreneurs' Knowledge of Financial Alternatives, Journal of Small Business Management, 50, 63-86.

debt to clear it as soon as possible, rather than continuing to the end of the repayment term.

In another EOB, the employees' desire for a dividend on their shares meant that higher bank debt amounts (to fund business expansion) were not considered because all profits would go to repaying the debt and not returned to employee owners. As this EOB is in a low pay sector, borrowing would have had a negative effect on employee owner welfare. The issue of risk aversion, although primarily raised in the context of financing, also extended to the issue of how the business would develop and grow. For example, one EOB viewed expansion with some suspicion, as there were worries that this growth (organic or acquisitive) would mean diluting their ownership stake. For some this inevitably resulted in a "*more patient attitude towards growth*" being undertaken by the firms.

4.4 Support needs

Generally, the EOBs interviewed felt able to access the financing that they need, whether for buy-back, working capital or growth. There did not appear to be a perceived gap in funding. The may be due in part to the nature of the businesses themselves, particularly their financial health. If the company is healthy financially then there appears to be no real funding gap as they can fund buy-in and working capital largely through retained earnings, while growth funding (and some working capital) is easily obtained from conventional lending sources if retained earnings are not sufficient. However, those firms with tighter profit margins do find it difficult to fund both transitions and growth. The EOBs are largely averse to giving up equity and therefore do not seek support from other forms of external finance such as venture capitalists, business angels, etc. The lack of willingness to bring in outside equity investors may have an effect on the growth of some of these businesses, particularly in terms of the development of their networks of intelligence and support.

Some firms did, at times, have some difficulty in raising finance, particularly:

1. Potential EOBs seeking a *rapid* exit with a lump-sum up front, i.e. a route that replicates a trade sale. This may sometimes prevent them from progressing with an employee buy-out, especially where employees have little investment capital (low wages).

2. Potential EOBs that are content to use retained earnings to fund the buy-out and not take a lump–sum up front, but where the company is not sufficiently profitable to permit this.

In these cases, it is the situation of and decisions of the company that appear to be the main issues and they would find some form of cash-flow supportive 'soft capital' useful (in at least one EOB case this was provided by Baxendale and The Co-operative Bank).

In terms of support for the transition to employee ownership generally, firms seemed to know what they wanted to do and so sought advice on *how to become an EOB* rather than on *whether or not to become an EOB*. Many of these firms have a longer-term mentality, are seeking to protect company autonomy and are prepared to change, but need specific advice and support throughout this process.

4.5 Transition to employee ownership

It appears from our interviews that there are significant differences between those firms who have made the transition to becoming an EOB and those who have failed to do so or are currently contemplating such a move. The firms who have failed in their transition seem much more critical of the lack of funding to help with this process. There seems to be a degree of uncertainty by the entrepreneurs as to how these firms could potentially enable their exit and enable a move to employee ownership, while at the same time ensuring 'reasonable' (not a maximum) financial value to the existing owner. It is also worth noting that for many entrepreneurs pursuing an exit through employee-ownership is just one potential option they examine rather than being the sole or preferred exit route. They also seem much more critical of the role of intermediaries, especially lawyers and accountants. The small sample of those formally not moving into employee ownership means that it is difficult to generalise these findings.

4.6 Long-term Planning for Transitions and Sustainability of EOBs

A longer-term mentality and long-term planning were very common among the EOBs interviewed. For example, one company had started putting aside earnings to fund the buy-out 10 years in advance. Another company had also planned the process over a number of decades. This suggests that the longer-term horizons often attributed to EOBs, as a result of employee ownership itself, may also be due to pre-selection where companies with a longer-term horizon are more inclined to consider a transition to employee ownership[18]. Likewise, the social sustainability indicator attributed to EOBs may be partly pre-selected – for example, two of the interviewed EOBs transitioned to employee ownership because of a concern with social sustainability.

4.7 Sectoral considerations

While the EOBs interviewed covered a number of sectors, sectoral considerations do appear to be important as employee ownership may be more important for some types of firms than others. For example, firms in the knowledge-based professional services industry benefit from employee ownership by motivating staff and keeping them on board. Such businesses, often consulting or specialist business services, often have relative low capital invested in physical assets and their key employees generate and complete most work. Hence employee-ownership is a useful business strategy to retain, and give a stake to, their staff. A high percentage of staff in such cases are revenue generators, so it is not onerous to offer employee-ownership to all staff. Staff expect – and respond positively to – the type of transparent management found within EOBs. Where profit and turnover growth is greater it is easier to both generate and use retained earnings to fund a move into EOB, but also the growth in profits generated during the transition (based partly on retaining key staff) can be shared between existing and employee owners, so incentivising both parties.

[18] However, this longer-term horizon was also seen by a few prospective EOBs as a barrier – where funding shares buy-back through retained earnings was described as 'charity'.

Some manufacturing firms will also benefit from this kind of transparency. EOBs paying low wages (e.g. in social care) may also benefit, as the bonus payments and feeling of ownership will add to the attractions compared to the standard wages elsewhere in the industry, and make retaining staff easier. Hence, both high salary, profitable business services and low pay firms may often be suitable for EOB structure, although the former, if profitable, do not appear to have major funding issues, at least in our sample.

4.8 Market size of potential EOBs

Whilst EO offers benefits to many different types of organisations, as further emphasised during this work, there are a number of considerations that may make some companies more inclined to pursue EO than others.

As discussed, the majority of EOBs and potential EOBs interviewed had considered EO given the need for succession – be it the owner retiring from the business or the owner looking for an entrepreneurial exit. For businesses that had completed the transition to EOBs, the central rationale behind pursuing EO hinged on succession, particularly within the context of firms that had previously been family-owned. In terms of estimating the market size of potential EOBs, the cohort of family businesses with owners reaching retirement age should be considered a key target market.

Of the 98,510 SMEs in Scotland[19], approximately 62% (61,000 companies) are family owned businesses[20]. Approximately 17% of all Scottish SME employers will be looking to transfer ownership in the next 5 years (2012 figures, with the figure for the UK being 14%)[21] and should be considered targets for further information on employee ownership as an exit and ownership transfer option. Of those SMEs anticipating the transfer of their business about a quarter (26 per cent - UK figure) will pass ownership to somebody within their own family, so there is a large number of others whom it may be useful to target about considering ownership (although those considering family transfers could also be targeted).

Approximately 28% of SME employers are aged 55-64 age and 8% aged 65+ in the UK (2007/08)[22]. Making large assumptions that each group is roughly representative of all SME businesses, and of Scotland, this suggests that there are at least 3,000 SME family businesses with an older entrepreneur looking to exit in the next 5 years (although the figure may be greater as older owners are more likely to want to transfer ownership). Whilst this is a very rough market sizing for potential EOBs, there are clearly a high number of businesses in Scotland that will be facing succession issues over the coming years and who may be receptive to information and guidance about EO as a succession option.

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[19] Scottish Government (2013) *Businesses in Scotland 2013*, Scottish Government, Glasgow.

[20] BIS (2013*) Small Business Survey 2012: SME Employers*, Department for Business, Innovation and Skills (BIS), London. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193555/bis-13-p74-small-business-survey-2012-sme-employers.pdf

[21] BIS (2013*) Small Business Survey 2012: SME Employers*, Department for Business, Innovation and Skills (BIS), London, p.41. Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193555/bis-13-p74-small-business-survey-2012-sme-employers.pdf

[22] Williams, M. & Cowling, M. (2009) Annual Small Business Survey 2007/2008, Department for Business, Enterprise & Regulatory Reform (BERR), Sheffield. Available at: https://www.gov.uk/government/publications/small-business-survey-2007-to-2008

5. Recommendations

The findings outlined within this report enable the researchers to draw a number of policy recommendations based on this study. While the focus of the research was on funding issues confronting potential and existing EOBs, the work uncovered a wider set of factors inhibiting the transition into employee ownership, which are worth considering from a policy perspective. *Overall, our findings suggest that for most firms interviewed, there is not a significant funding gap.* It appears that a wide range of factors coalesce to hamper firms making the transition to employee ownership. Given the complex forces which shape these decision processes policy makers will need to be imaginative with policy responses to effectively help promote greater employee ownership. It should be noted however, that while 19 of our sample were considering, or had considered, moving to employee ownership, only two had formally decided against it (although a number of others suggested that they were unlikely to move to employee ownership).

The report raises two key issues in particular where policy could potentially be re-formulated (discussed in more detail in sections 5.1 and 5.2):

Focus and targeting

- In terms of the targeting, the work seemed to suggest there would be merit in a stronger level of policy focus aimed towards three different groups: entrepreneurs close to retirement age, employees working in firms considering employee ownership and key industrial sectors which have strong synergies with this form of ownership structure (these include high value ‘consultancy’ type firms and low pay social care firms, in both cases EOB may support the retention and motivation of valued staff). By improving targeting toward these groups there may be the potential for more traction in terms of facilitating and promoting employee ownership across the Scottish economy.

Thematic nature of support

- In terms of support measures a number of issues were raised which suggest there could be scope for the provision of further thematic types of support. First, it may be appropriate to stimulate the demand within SMEs for external lending to help overcome the problem of ‘reluctant borrowers’. A lack of interest in external borrowing seems more a matter of ‘demand’ than a question of supply-side constraints.

- The merits of a government loan fund (or alternative peer-to-peer lending) are raised by this research. Some form of state-funded loan programme is potentially a high risk policy intervention which would require very careful consideration to prevent market distortions. A lower risk alternative is for state bodies to help promote a peer-to-peer lending fund to aid the transition towards employee ownership perhaps in conjunction with support from larger EOBs. Assistance with the costs associated with the transition to employee ownership is another form of support which would appear quite beneficial to potential EOBs.

Some issues with funding do appear for some of the firms:

1. First, potential EOBs seeking a rapid exit with a lump-sum up front, i.e. a route that replicates a trade sale. This prevents entrepreneurs progressing with an employee buy-out, especially where employees have little investment capital (or low wages) supplement the up-front funding.

2. Second, potential EOBs that wish to use retained earnings to fund the entrepreneur's buy-out, but where the company is not sufficiently profitable to permit this.

In these cases, there may be potential for 'soft capital' to ease the buy-out process as most of these firms appeared reluctant to consider traditional lending due to the debt burden it would place on employees and the company. Such soft capital could be in the form of loans sensitive to cash flow or perhaps non-voting equity transfer to a government or peer-to-peer EOB fund could be considered (see 5.2 below). So, the soft capital that eased cash flow and was debt-light might be attractive (depending on the actual conditions and position of the firm).

5.1 Focus and targeting

In terms of the focus for future policies, the work seemed to suggest there would be merit in a stronger level of targeting towards three different groups. First, the interviews clearly found that the *types of firms considering employee ownership* are typically family businesses owned by entrepreneurs who are close to retirement age (50 years +). Many of these entrepreneurs do not have a clearly defined exit strategy and often consider a number of different exit options (e.g. trade sales, MBOs, EBO). Quite often these entrepreneurs require assistance in helping explore all of their exit options, including employee ownership. What seems clear is that family-ownership appears to be the strongest predictor of a firm wishing to become employee-owned, so this sector should be a focus for policy targeting.

The research also discovered that there are a number of exiting entrepreneurs who are pre-disposed towards the concept of employee ownership, but who are not necessarily part of a family business. Policy makers may wish to consider how they can identify and assist this *cohort of entrepreneurs* to make them aware of employee ownership as an exit strategy. While this has been happening to a certain extent through the current Account Management system within Scottish Enterprise, most of the firms referred to CDS are owned by entrepreneurs who require relatively quick exits from their businesses. In these cases, the entrepreneurs are typically in their late 50s and early to mid-60s. Given that transitions to EO seem quite protracted and lengthy, there may be merit in targeting younger entrepreneurs in their early to mid-50s, who are able to embark upon more incremental exits which can entail longer-term vendor payback periods.

Another potential future focus for policy makers is *employees*. At present the vast majority of promotion and assistance provided CDS and the EOA is directed towards entrepreneurs and business owners. While this is necessary, it is not in itself sufficient to help the process of fostering a culture of employee ownership. Most interviewed firms had had very high, or even exemplary, levels of employee participation in general, however, in nearly all of the firms interviewed, both firms considering employee ownership and existing EOBs there had been little or no involvement of employees in early stage discussions about the implications of employee ownership for employees. While clearly other issues around the buy-out may be more crucial to any decision, greater involvement of employees may lead to greater commitment and desire from employees for employee ownership. If entrepreneurs witness reluctance about the idea from employees, this may reduce the chances of them seeking employee buy-outs in favour of more straightforward transactions such as a trade sale. Fostering greater levels of knowledge and understanding within the workforce of different ownership structures would arguably help nurture a greater appetite and culture of employee ownership. Early employee engagement and buy-in is also critical to ensure a smooth exit and transition to EO, particularly in terms of ensuring business sustainability and growth. This is a long-term process and something which requires input from other workplace partners such as trade unions, educational bodies etc.

Third, the range of sectors that might be targeted is large. Indeed all sectors with suitable entrepreneurs seeking exits are targeted. However, where employee ownership may significantly assist in retaining key staff, in both high value added sectors of business services (e.g. in higher profit sectors such as oil) but also in low paid areas such as social care, then there is a clearer logic to move into EOB even where the owners are not seeking rapid exits.

Research examining the factors shaping the exit intentions of a large sample of Scottish entrepreneurs would also be benefit policy makers. Given that relatively few in the sample had formally decided against employee ownership, further research on a greater number of such firms (i.e. those that are definitely or unlikely to move into employee ownership) may yield further insight. Tracking and re-examining the pipeline entrepreneurs interviewed after a period of time may also help us to develop a deeper appreciated of the factors shaping the exit process.

5.2 Thematic nature of support

Turning to the thematic nature of support, a number of other issues were raised by the research. In terms of funding we found little evidence to suggest that lenders such as banks treat EOBs significantly differently to other traditionally structured SMEs. Likewise, our interviews with banks found that these firms are not viewed as 'atypical'. There seems a strong reluctance on behalf of SMEs to undertake external borrowings owing to the perceived loss of control that accompanies debt funding. Many of the views expressed by EOBs in terms of banks and other external sources of finance resonate strongly with the SME sector as a whole. In this respect, EOBs are no different to the majority of the SME sector. Measures to stimulate the demand within SMEs for external lending is something policy makers may need to address to overcome the problem of these 'reluctant borrowers'[23].

In terms of facilitating firms becoming employee-owned, a more complex picture emerged. Given the strong reluctance to involve banks in funding their exits, a few firms expressed the need for some kind of 'government fund' to help leverage the exit of entrepreneurs. Most of these were relatively small firms with little cash surpluses. Although such a fund was deemed desirable, the firms did think the chances of this being developed were "*slim at the moment*". A number of banks also felt that a co-investment fund between the public sector and themselves could potentially help mitigate the risks of lending to smaller firms with fairly low profitability. The interviewed EOBs and potential EOBs did not generally experience resistance from banks and could access lending if they desired. However, they appeared to share an attitude to bank debt and in some cases to broader debt aversion. On paper, a government loan fund could potentially facilitate employee buyouts, by giving entrepreneurs liquidity from their businesses. This would be particularly attractive for smaller firms, which are less likely to be able to secure external sources of funding to enable such transactions to occur.

However, implementing such as fund may be difficult on two accounts. First, it may drive firms towards considering this option so that entrepreneurs can get a guaranteed up-front payment when exiting their business. This may have unintended consequences in terms of promoting firms who are unsuitable for employee ownership but where an entrepreneur is anxious to seek any exit option available. It may also have negative repercussions on the cash-flow and so transition, sustainability and growth of the business in the future. Second, the public sector would have to shoulder quite a high debt burden to put in place such a scheme. Owing to the relatively low profitability of these potential firms, firms would only be interested if there were offered low rates of interest. The public sector could perhaps use existing strategies, policies and regulations for taking equity stakes, although these existing approaches do not seem to have been used for EOBs (e.g. Scottish co-investment

[23] Brown, R. and Lee, N. (2014) Funding Issues Confronting High Growth SMEs in the UK, Institute for Chartered Accountants Scotland, Edinburgh. http://icas.org.uk/brown-lee/

Fund). Designing a scheme that would be consistent with current strategies, and which would avoid the pitfalls mentioned above, would require very careful consideration.

In order to mitigate the risks involved in establishing a fund one alternative for the public sector to pursue would be to encourage others to establish an employee-ownership fund. A recent report[24] suggested two funding models. First an EOB to EOB fund – a suggestion also made by at least one of our sample – where the main problem is considered to be starting the process (which could perhaps be assisted by a fund). Larger, financially sound EOBs, along with bodies such as the EOA, could be consulted to see if they might consider a multi-partner fund. Second, investors would buy bonds through a clearing house institution that uses funds to invest in local employee-owned businesses. Here the challenge is that 'the bonds will have to be underwritten, and public bodies, even if they were willing to take on the risk, are prohibited by Treasury rules'[25].

Finally, other key issues raised by a number of firms were the anticipated costs (legal, financial etc.) of implementing employee-ownership. Quite a number of firms expressed their fear that the costs of becoming employee owned would be too onerous, despite many not having yet investigated the matter fully (e.g. with their bank or other financial institutions). Smaller firms in particular felt that they would not be able to afford some of the up-front costs for legal, accountancy and taxation reasons. At present, CDS offer free feasibility studies on the viability of becoming employee-owned. However, often this was at the start of the process to employee ownership rather than at the end when high levels of costs are incurred. In future, there may be scope to wider this kind of support towards subsidised help with the legal, financial and taxation issues of becoming employee owned.

[24] Reeves, R.V., Wilson, B. and Sims, S. (2014) Local Owners: Promoting Employee Ownership Locally, Centre for London. http://www.johnlewispartnership.co.uk/content/dam/cws/pdfs/Resources/local-owners-promoting-employee-ownership-locally.pdf

[25] Ibid. p. 66

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Appendix 1: Interview questionnaire for EOBs

Note. A modified version of this questionnaire was used during interviews for those firms transitioning into EOBs and those that decided not to complete the transition.

Funding Issues Confronting Employee-Owned Firms: Questionnaire 6/6/14

What is the purpose of the project?
This project is to investigate the Access to Funding for Employee Owned Businesses in Scotland. It is funded by Scottish Enterprise and being carried out by Stirling Management School, University of Stirling and the Centre for Responsible Banking and Finance, School of Management, University of St. Andrews.

What does it involve you in doing?
It involves you taking part in a face-to-face or telephone interview lasting up to 45 minutes. You can, of course, choose to stop the interview at any point and not to answer any question you choose.

Anonymity
All interviews are anonymous. The interviewee and their organization will not be identifiable in any published report without their explicit approval. Data on the interviews will be kept securely and according to the Data Protection Act.

What use will be made of the information?
The information will be used to write reports for Scottish Enterprise, which may be made public, and to write academic papers (in all cases the information will be anonymous). After these are published the information will be destroyed.

What if I have concerns?
You can ask questions at any time and/or you can contact Professor Ronald McQuaid at the University of Stirling, r.w.mcquaid@stir.ac.uk, at any time.

1. Company Background

1.1 Briefly, what is the nature of your business? ___________________________________

Primary (agriculture, mining, oil/gas, chemicals etc.)	Secondary (Manufacturing, food processing)	Tertiary (services, retail etc.)	Others

1.2 When was the firm started and when did it become an Employee Owned Business (if over several years also which year did it reach 50% employee owned)?

a) How old is your business? Year:

Less than 2 years old	2 - 5 years old	6 - 10 years old	11- 20 years old	More than 20 years old

b) When did your firm become employee-owned? Year:

Less than 2 years ago	2 - 5 years ago	6 - 10 years ago	11- 20 years ago	More than 20 years ago

1.3 Why did it become employee owned? (Prompt: owner retiring, owner wishing to cash-out, lack of successor in a family business, closure of company, start-up as employee owned)

____
____

1.4 How would you describe the ownership of your business prior to becoming employee-owned?

Privately Owned by single owner	Jointly Owned by group of owners	Family Owned	Owned by a larger corporate entity	Publicly Owned

1.5 What is your firm's current legal structure?(Prompt: ESOP, cooperative (bona fide or BenComm), Community Interest Company – also if it is a Ltd Co)

1.6 What percentage of the company is owned by employees? What percentage is directly owned by employees and what percentage by a Trust or by others?

____

Directly Owned by Employees through Shareholdings a) SIO (share incentive plan)(%) b) Non SIP (%)	Indirectly owned through an employee benefit trust (%)	Other (Specify) (%)

1.7 Do you have voting shares, or one member one vote?

1.8 What is the size of your business?

a) By turnover __________

£0-499,999	£500,000-999,999	£1-4.9m	£5m-£9.9	£10m+

b) By employment ________

0-9	10-19	20-49	50-99	100 -249	250+

c) How many of these are employee owners? ___________

0-9	10-19	20-49	50-99	100 -249	250+

2. Transition to Employee Ownership

2.1 What types of external organisations were consulted during the transition to employee ownership and how useful were they in terms of assisting this transition? (If different assistance was provided after the company started becoming an EOB then note this)

Rank the organisations on a scale of 1-5 (with 1 not useful and 5 very useful) and N/A for not used.

Banks	
Legal Institutions	
Accountants	
Funding Intermediaries (Baxi, Capital for Colleagues)	
Industry Associations (e.g. Employee Ownership Association)	
Scottish Enterprise/CDS	
Other public Sector Organisations	
Trade Unions	
HMRC	
Others?	

2.2 a) How much capital was needed to fund the establishment of your company as an Employee Owned Business (total amount even if still in the process of paying it)?

£0-99,999	£100,000-199,999	£200,000-499,999	£500,000-999,999	£1-5m	£5million +

a) How much of this was to purchase equity from the original owner(s)?

____

2.3 How was this move into employee ownership funded?

Purchase of Individual Shares by Employees	Loan from original owner	Vendor Financed (when the employees buy it back from the owner gradually over a certain period of time)	Equity or mezzanine financing from specialist Intermediaries (Baxendale Partnership, Funding for Colleagues)	Bank or other conventional	Others (specify)
%	%	%	%	%	%

2.4 When moving into Employee Ownership, did the firm raise as much capital as it wanted?

____
_____

Yes	No

If not, a) how big a gap in funding was there? b) Why was there a gap? c) What were the consequences for the firm?

2.5 Did potential or actual funding sources influence your choice of your particular legal structure?

____
_

2.6 What were the main financial difficulties encountered during the transition to employee-ownership? Rank the factors on a scale of 1-5 (with 1 not important and 5 very important)

Obtaining suitable Advice	
Financial uncertainty on behalf of employees	
Financial uncertainty on behalf of incumbent owners	
Obtaining sufficient finance	
Obtaining suitable finance	
Constructing the Vendor finance agreement	
Legal difficulties	
Resistance from bank	
Taxation issues	
The current economic environment	

Please expand on the most important ones, especially difficulties in obtaining sufficient/suitable finance

____

2.7 Is there a financial problem with the time needed for employee owned firms to purchase back shares from their original owners?

Yes	No

If yes, what are the main issues and how might they be addressed?

____

2.8 Doesthe current tax system affect (either positively or negatively) Employee Owned Businesses raising finance? (If so how and what might improve this?) (Also consider mainstream business tax issues such asEnterprise Initiative scheme[1].)

____

3. Funding Issues Confronting Employee-Owned Firms

3.1 What are the main types of funding normally used by the firm –for working capital, growth, purchasing the firm?

	Working capital	Growth investment
Bank Overdraft		
Bank Loans		
Credit Cards		
Directors' Loans		
Members' loans (other than directors)		
Specialist funders (Baxi etc.) – specify		
Retained earnings		
Money from members' family/friends		
Asset-based finance (from bank or other provider)		
Commercial Mortgage		
Invoice finance/factoring		
Pension fund loan		
Credit from Suppliers		
Crowdfunding		
Grants		
Venture capital/business angels		
Other (specify)		
None of these		

For those not used – has your company considered using them? Why did the company decide not to use them?

[1] http://www.hmrc.gov.uk/eis/

3.2 Can you elaborate on the use of banks as a source of working capital or a vehicle to fund the growth of the business or both? ____

3.3 In terms of the most <u>recent</u> funding raised for <u>growth investment</u>, please provide the source of the funding and the approximate amount provided:

	£0-9,999	£10,000-49,999	£50,000-99,999	£100,000+
	Amount Raised			
Directors Loans				
Retained earnings				
Money from family				
Money from friends				
Bank – loan				
Commercial Mortgage				
Invoice financing/factoring				
Suppliers				
Business angels				
Venture capital fund				
Crowdfunding				
Government Grant				
Other source – please specify				

3.4 Do you expect to raise finance within the next 2 years? If so what for (e.g. shares buy-back,working capital, growth,):

____

Working capital		Growth	
Yes	No	Yes	No

If Yes, approximately how much:

	£0-9,999	£10,000-49,999	£50,000-100,000	£100,000+
Working Capital				
Growth				
Other (specify)				

3.5 On a scale of 1-5, how likely do you think your current funders will fund this? Are others (specify) likely to be willing to fund this?

(One being unwilling and 5 being very willing to lend)

	1	2	3	4	5	Don't know/not relevant
Current funders (name, type, source of funding)						
Current funders (name, type, source of funding)						
Current funders (name type, source of funding)						
Current funders (name type, source of funding)						
Others						

3.6 Do you expect to be able to raise the entire amount you specified in Q3.4?

(Prompt: if no, why?)

Yes	No

3.7 Have you been turned down by a lending institution for funding in the last five years:

Yes	No

If yes, what reasons were given? (Prompt: was being an EOB an issue?) How much funding was involved? What was the funding for? What impact did the refusal to finance have on the business?____

3.8 Are you **willing** and able to borrow from commercial lending institutions such as banks? How would you describe your reluctance to borrow on a scale of 1-5? (1 being not willing and *5 being very willing* to borrow from lending institutions)

Not Reluctant Very Reluctant

1	2	3	4	5

3.9 N/A

3.10 In your view, in obtaining access to finance was your (employee-owned) firm treated the same as a conventionally structured firm? If not, why and what can be done?

____

Yes	No	Don't Know

3.11 Have you ever made use of the Government's Small Firm Loan Guarantee Scheme to overcome problems with bank guarantees?

Yes	No	Don't Know

4. Attitudes Towards Growth and Financial Institutions

4.1 How fast has your business grown in turnover during the last financial year?

Decline	No growth	0-5%	6-9%	10-19%	20%+

4.2 How fast do you expect your turnover to grow in the coming financial year?

Decline	No growth	0-5%	6-9%	10-19%	20%+

4.3 Do you feel the growth of the business is being influenced by the firm's ownership structure? (On a scale of 1-5, with 1 meaning employee ownership is a negative influence and 5 meaning a positive influence)

Negatively influenced Positively Influenced

1	2	3 Not influenced	4	5

4.4 What are the most important barriers to growth facing your business? (Rank the factors on a scale of 1-5 (with 1 not important and 5 very important)

Attracting Suitable workers	

The Current Economic Environment	
Breaking into new markets	
Obtaining sources of finance	
Developing new products and services	
Others	

5. Views on Alternative Sources of Funding

5.1 Can you describe your attitude to bringing in outside equity on a scale of 1-5? (One being very negative to bringing in outside equity and 5 being very positive to bringing in external equity)

Very negative   Very positive

1	2	3	4	5

5.2 Would you consider relinquishing equity in order to obtain external finance from the following sources of funding? Rank the factors on a scale of 1-5 (1 very unlikely to 5 very likely)

Venture Capitalists	
Business Angels	
Private Equity firms	
Crowdfunding platforms	
Employee ownership specialist funders (Baxi, Funding for Colleagues)	
Government funded equity funders (e.g. Business Growth Fund)	
New Government Fund to assist employee owned firms	
Others	

5.3 What other types of financial assistance would be useful for employee owned firms?

____

ONLY IF THERE IS SUFFICIENT TIME, THEN ASK THESE

5.4 Would you consider the following alternative forms of non-equity finance for your business?

Type of Funding	Yes	No	Don't know

Crowdfunding (loan-based)[2]			
Crowdfunding (donation-based)			
Peer-to-peer lending[3]			
Invoice-based funding[4]			
Loan based finance			
Leasing and asset-based finance (leasing assets rather than buying them)			

5.4 What are your views of 'Crowd funding' as a potential source of funding?

Don't know enough to say	Does not seem appropriate	Sounds like a good idea but not for my business	I'd like to explore this option further for my business	No opinion

Thank You for Your Cooperation

[2](Also known as crowd financing or crowd-sourced capital) involves a number of people each investing, lending or contributing smaller amounts of money to your business or idea. This money will then be pooled to reach your funding target. Possibly via internet sites. (e.g. http://crowdfunding.trampolinesystems.com/crowdfunding/).

[3]Peer-to-peer lending directly connects people and organisations who want to lend, with vetted, established businesses who want to borrow (e.g. Funding Circle https://www.fundingcircle.com/about-us).

[4]Raising money by selling your unpaid invoices to a third party for a fee (e.g. https://www.gov.uk/business-finance-explained/overview).