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Employee Equity Trends

Attitudes to sharing ownership with the team among UK SMEs

2020 edition

Introduction

Incentivising and rewarding people with equity has proven business benefits and is becoming the norm among progressive startups and SMEs.

We wanted to explore sharing ownership trends in 2020. To that end we commissioned an independent study of 500 founders, owners, partners and C-level executives in SMEs across the UK.

In this report we will share the results of the survey and provide commentary around the key issues and opportunities.

Our mission is to encourage as many company founders as possible to use equity as a key lever for business growth.

If you need any help then don't hesitate to get in touch.

Ifty Nasir
Co-founder and CEO at Vestd

Table of contents

1. What proportion of SMEs share ownership?
2. Which scheme to use?
3. The most popular scheme types
4. The five main benefits of share schemes
5. Why don’t SMEs share ownership?
6. Why launch a share scheme now?
7. Who would you ask for help?
8. The regional view
9. Company size
10. Sectors
11. Methodology
12. Talk to us
13. About Vestd

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What proportion of SMEs share ownership?

Let's start with the good news: **one in four SMEs now share ownership with employees**.

25%

ONE IN FOUR SMES INCENTIVISE THEIR EMPLOYEES WITH EQUITY

A quarter of respondents have a share or options scheme in place for all employees, to align everyone towards the company's goals.

The unavoidable bad news is that **the vast majority of SME employees are not currently being incentivised by equity**, despite the positive effect it can have on performance, cashflow, loyalty and company culture.

Furthermore, some firms stop short of making share schemes inclusive right across the business.

The study found that **executives are twice as likely to benefit from equity rewards** compared to the wider team. Of those companies that have a share scheme just 34% make it available to all employees.

Non-employees can also be given equity, but this is relatively rare, with only 6% of SMEs incentivising advisors, consultants and contractors in this manner.

Which scheme to use?

Choosing the right scheme is essential. There are a few key differentiating factors, beyond **‘shares’** and **‘options’**.

For example, certain schemes can be **conditional**. Goals and milestones can be set and must be achieved before equity is released. Option schemes are somewhat conditional by their very nature, as recipients usually need to adhere to a vesting schedule (e.g. stay with the business for four years).

Some schemes are **flexible** and can be used to reward anyone, whereas others are just for employees.

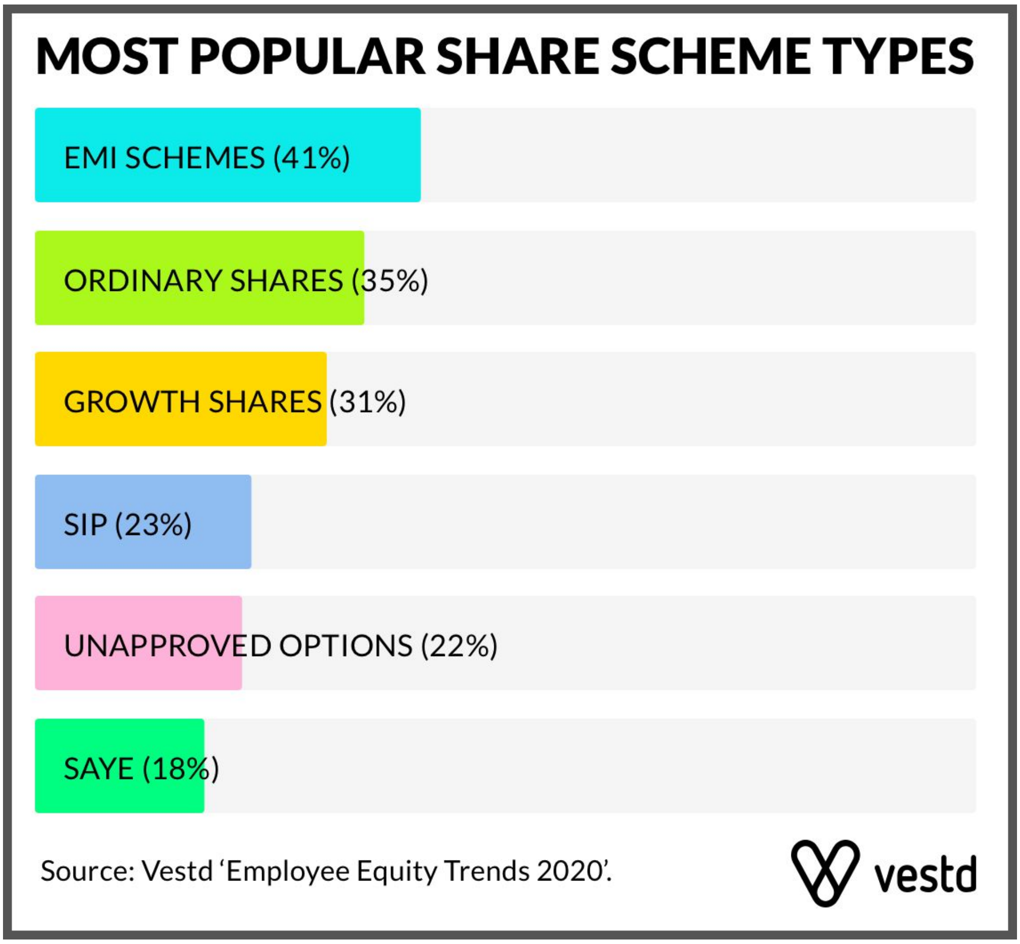
A handful of schemes require **HMRC approval** in advance, but once secured will provide the employer and employee with benefits, typically in the form of reduced tax.

There are a number of eligibility requirements for HMRC schemes, and some rules to adhere to. A **disqualifying event** can be horrific. We’ve seen examples where shareholders would have been liable for millions in unnecessary tax, had we not found and fixed the problems.

We estimate that **around half of all historic schemes are non-compliant**. Many people only become aware of the issues when it is too late, such as after a company has been sold.

The most popular scheme types

So, with all that in mind, let's take a look at the most popular schemes chosen by UK SMEs.



The most popular method among SMEs is the **Enterprise Management Incentive (EMI) scheme**, which has been adopted by 41% of companies with share schemes.

This comes as no surprise. EMI option schemes are the most tax efficient of all, with recipients paying just 10% CGT on any gains.

41%

EMI SCHEMES ARE THE MOST POPULAR WAY OF DISTRIBUTING EQUITY

It gets better: the company can offset both the cost of the scheme and the tax benefits achieved by employees against its tax liability.

EMI schemes allow employers to set various conditions to govern the release of equity, such as time-based and / or **performance milestones**. The vesting schedule can also be customised in various different ways. What's not to like?

Around **a quarter of SMEs use Ordinary Shares**, which get people in the game with immediate effect, unlike options, which are subject to a vesting period (typically three or four years).

More than **one in five of SMEs use Growth Shares**. This is an excellent approach for founders who have built up some existing value in their company. Recipients *only* share in the capital growth of the business from the point at which the shares are issued.

Growth Shares can be given to anyone, and conditions can be attached (if the scheme has been configured to enable this). These shares also limit the risk of the recipient having to pay Income Tax on receipt of the equity.

Other scheme types used include **Share Incentive Plans (SIP)**, **Unapproved Options** and **Save As You Earn (SAYE)**.

Unapproved Options provide the most flexibility and are the easiest to set up. They do not require any approval from HMRC and can be given to anyone, but are not as tax efficient as EMI schemes.

There are a few other less common ways of distributing equity, such as **Company Share Option Plans (CSOP)**, **Restricted Stock Units (RSU)** and also our new, proprietary **Agile Partnerships™** framework.

Agile Partnerships™ provide founders and employers with the ability to set equity rewards based on **agreed performance milestones**. Everybody knows what they're expected to bring to the game. Equity is then released in a way that is **proportionate** to what people contribute.

People create Agile Partnerships™ to launch, transform and exit companies. They are fair, flexible and affordable, and designed to prevent recipients from walking away with a chunk of the business before delivering what was promised.

The five main benefits of share schemes

We asked founders, owners and C-level people what a share scheme has done for their business.

Based on the results, it is clear that **employees feel and behave differently when they own a piece of the action**.

KEY BENEFITS OF SHARE SCHEMES

1. Employee retention
2. Increased productivity
3. Team alignment
4. Better company culture
5. Attracting talent

Source: Vestd 'Employee Equity Trends 2020'.

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Loyalty was ranked in first place. More than **six out of ten SMEs pointed to increased employee retention** as the primary benefit.

There is considerable value here, given how much it costs to hire and train new team members (said to be between £5k-£30k, depending on the role).

Improved performance was another key benefit of equity incentives. 58% of respondents said their team had become **more productive**, something that has been repeatedly highlighted in other studies.

A further benefit is **team alignment** (56%). We believe that equity aligns interests like nothing else, as The Ownership Effect is an incredibly powerful motivator. Alignment will become increasingly important as more companies allow their employees to work remotely.

Share schemes are also an excellent way to strengthen **company culture** (49%) and they make it **easier to attract talent** (45%).

Why don’t SMEs share ownership?

It’s not all good news though. Many firms still choose not to give their team equity, for a variety of reasons.

So what puts people off?

In short, the **perception of costs** (30%), **dilution** (24%) and **other priorities** (21%).

30%

PERCEPTION OF COSTS IS THE MAIN REASON FOR NOT LAUNCHING A SCHEME

With regards to **costs**, we built Vestd to make it easy, safe and affordable to launch and manage a share scheme, but along the way we’ve heard so many horror stories about fees.

One lawyer quoted more than £12k to set up an EMI scheme for 11 people. An accountant tried to extract £9.5k from one of our customers, to launch a scheme for just three people. For the record, our fees are a fraction of these quotes.

Dilution is par for the course when you issue new shares, but there are ways of mitigating the effects and if the overall business value grows sufficiently then it shouldn’t be an issue. Especially if the team is more loyal, more productive and more aligned to the goals of the company.

With that in mind, one in three respondents said their share scheme had **increased the value of the business**.

Another reason why founders don't distribute equity among the team is because they aren't aware that you can pick and choose who gets equity. Some 17% of respondents haven't launched a scheme because **they don't want the whole team to have shares**.

Schemes don't need to be universal, and all too often they're not. We know that executives are twice as likely to receive equity as the whole team.

Figuring out who to reward (and the amount of equity to set aside) really comes down to the personal philosophy of the founders, or in some cases, the **investors**. Companies are often mandated to launch an options scheme by those funding the business, which speaks volumes as to the effectiveness of incentivising people with equity.

Around one in six respondents felt that setting up a share scheme was **too complicated**, so haven't yet pursued it. There's no doubt that this can be a complicated area but share schemes do not need to be overly complex. There are some **tried and trusted pathways** to follow.

Why launch a share scheme now?

NEW SHARE SCHEMES MAY BE LAUNCHED AS A DIRECT RESULT OF COVID-19

Those who are considering launching an employee share scheme have cited **COVID-19** as a primary reason for doing so. Almost half of respondents felt that "**COVID-19 has made us rethink how we operate**".

The same amount (48%) said that **"COVID-19 has demonstrated the importance and value of our team"**.

These top two reasons echo the many conversations we've had with company founders and execs since the crisis began. Many of them have reflected on the future shape of their business, their operational processes, their team and their culture.

There is much talk around how companies may transform their operations on a more permanent basis, having been forced to embrace **remote working** during the pandemic. Many have done so successfully and will continue to allow teams to work in distributed locations from now on.

Team alignment was the third most referenced reason for launching a scheme (42%). As mentioned, we believe that equity aligns interests like nothing else, and it can be used as a pivotal tool among partially or fully remote businesses to keep everyone on track.

It's probably worth mentioning that Vestd operates as a fully remote business, and has done so for years. Our own share scheme definitely helps everyone to pull in the same direction (and we all love to work remotely).

Employee incentives (39%) and **retention** (35%) are two other big reasons for launching a new share scheme. Retention, you may recall, was cited as the number one benefit of having a scheme in place.

Equity can also be used tactically, when the going gets tough and **cashflow** is tight.

Around **15% of SMEs expect to cut salaries in the next 12 months**, according to our data. 48% of SMES intend to keep salaries at the current rate, with a further 17% undecided. Equity can be used in these circumstances to offset short term pay issues. In the long run it could be worth many times more than any gap in salary growth.

During the COVID-19 crisis we have launched a number of share schemes for SMEs that wanted to **compensate employees**, who have in some cases been asked to reduce their salaries and / or hours.

Others have recently started a share scheme as a way of **thanking their team** for helping them in difficult times.

Who would you ask for help?

48% of respondents yet to launch a scheme would ask their **accountant** for guidance on setting one up. Just under a third would approach a **lawyer**.

MOST PEOPLE ASK AN ACCOUNTANT FOR HELP IN SETTING UP A SHARE SCHEME

Only one in four people would go to a **specialist share scheme platform**, despite the fact that 45% of those with existing schemes use a digital platform.

Why might this be?

Well, it is a new space. Vestd was the first platform of its kind to launch in the UK and has only been around for a few years. Many people only become aware of the few digital platforms that exist when they start researching 'employee share schemes' and similar terms via Google.

Bigger firms - those with more than 100 employees - are more inclined to look to a digital platform, as they look for ways of eliminating the many **headaches** that occur when managing share schemes manually.

The regional view

Certain parts of the UK are more likely than others to share ownership with some or all of the team.

Areas that scored above the benchmark are as follows:

- North East
- London
- East England
- North West
- Northern Ireland
- West Midlands
- Yorkshire

However, employee share schemes were less prevalent in the following regions:

- East Midlands
- Scotland
- Wales
- South West
- South East

The **North East** has the highest proportion of SMEs that use Growth Shares.

Six out of ten SMEs in the **East Midlands** with share schemes use a specialist platform, making this area the biggest adopter of digital. By way of contrast, just 36% of

London-based SMEs with share schemes have taken this route so far.

Only 26% of those **Scotland-based** firms that share ownership have an EMI scheme in place, despite the many benefits. A considerable drop from the average of 41%.

At the other end of the spectrum, half of those SMEs in Wales with share schemes have chosen EMI as a method of distribution.

Company size

Bigger companies often struggle with managing share schemes, so it is no surprise that they are more likely to choose a digital platform, which automates many of the more mundane tasks.

58% of firms with 51-100 employees look to a digital platform for equity management, compared with 34% for smaller firms.

Compliance is a huge issue, especially considering the amount of people who still use spreadsheets. Making mistakes in Excel when schemes grow past a certain point can result in shareholders having to pay millions of unnecessary tax. Bigger SMEs need to digitise their share schemes to avoid this kind of nightmarish scenario.

The smaller companies are also most concerned with the effects of dilution. Some **39% of 11-25 employee companies pointed to dilution as a reason for not yet launching a scheme** (the average among all companies is just 24%).

74 of the 500 companies polled have a turnover in excess of £100m, potentially making them ineligible for EMI schemes, which have an asset cap of less than £30m, and a maximum of 249 employees. A campaign is underway to increase this ceiling, to make EMIs more inclusive for scaleups and bigger companies.

Sectors

Some sectors are more likely to share ownership than others. Those that scored above the benchmark are as follows:

- Automotive
- Finance & banking
- Food & drink
- Hospitality & leisure
- Insurance
- Oil & gas
- Manufacturing
- Professional services
- Property
- Retail
- Technology & media

Other sectors are less likely to distribute equity among the team, such as:

- Construction
- Consumer goods
- Health & pharmaceutical
- Transport & distribution

Methodology

The data was collected via an online survey by 3Gem, an independent research provider.

The sample size was 500 SMEs based in the UK (companies with 10-250 employees).

We only asked the most senior people in the business to participate in the survey.

221 of the 500 respondents were either a **founder** or **owner/partner**. The remaining 279 were CEOs or other C-level execs.

The survey was conducted in May 2020.

Talk to us

If you need any help understanding how to get the best from your equity then book a free discovery call.

We will explore:

- Your company structure
- What you are looking to achieve
- The best scheme types for your needs
- Setting conditions and milestones
- How to protect existing shareholders
- The costs and tax implications

We'll also answer any questions you have about sharing ownership. There's no obligation to use Vestd but if you'd like a demo then we'll show you the platform too.

Media enquiries

Contact: Anne Cantelo
Email: anne@onyxcomms.com

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About Vestd

Vestd is the first and only regulated equity management platform for SMEs in the UK. Thousands of people use it to manage and monitor their equity.

The platform was specifically designed and built to help SMEs launch and manage share and option schemes. Our customers also benefit from ongoing access to our in-house team of equity specialists.

Why choose Vestd?

- Choose from five types of share / option schemes (EMI schemes, Unapproved Options, Growth Shares, Ordinary Shares and Agile Partnerships™).
- Guided setup & support from our team of specialists.
- Full two-way Companies House integration. Issue shares and options immediately via the platform.
- 100% accurate real time and historic cap tables.
- Regular company valuations from our analysts (no need for accountants) and industry standard legal docs provided (no need for lawyers).
- A personal dashboard for all of your shareholders.

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