A WORKERS INTRODUCTION TO THE SHARE INCENTIVE PLAN (SIP)

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FOREWORD

This booklet is not intended as a negative statement even though it may be criticising both Trade Unions and the Government, The first for showing such a negative attitude to Employee Ownership and the second for introducing a scheme for employees that is so heavily slanted towards employers.

Rather my paper should be judged as it is intended, that is as a constructive criticism of both bodies. Firstly as a waking up call for the Trade Unions and secondly for the Government to understand that you may achieve the aim of doubling the companies which run share schemes but you will fall short of your ultimate aim of increasing productivity through greater employee commitment if workers feel that they are getting a worse deal than before just to appease the employers. I fear this would result in the Inland Revenue loosing revenue by doubling the numbers of employees and employers enjoying tax concessions but the Government losing out on the rewards.

EMPLOYEE OWNERSHIP

Academics theorise about it

Advisors promote it

Politicians legislate for it

Trade Unions ignore it

Employers administer it

BUT ONLY EMPLOYEES WORK IT

Question: If you take employee out of employee ownership what have you got?

Answer: Not a lot

ABOUT THE AUTHOR

After leaving school at the age of 15 David Wheatcroft worked in the Engineering Industry as an Iron Moulder for many years. His non-vocational education was progressed through the Trade Union Movement serving as Shop Steward, Branch Secretary and Area Representative for 18 years. In that time he experienced and learned the 'Hard Knocks' approach to Industrial Relations.

The steel recession of the 1980's saw his factory close and he moved into the Transport Industry as a Bus Driver for Chesterfield Transport in 1983.

In 1986 he was elected as Worker Director of Chesterfield Transport. Since that time he has been involved in the Privatisation Process that took the company from Public Ownership, through 5 years of a 100% Employee Ownership, to the present position of the Private Ownership of Stagecoach.

David is presently serving as a Trustee on the Stagecoach ESOP, APS and QUEST Boards. He was a founder member and Chairman of the Centre for Employee Ownership and Participation (CEOP) which was a National Organisation set up and run by worker owners to give them a voice in the Employee Ownership Movement. He is also a Director of Job Ownership Limited (JOL) which is a 'Broad Church' organisation promoting Employee Ownership World-wide as well as serving on the Board of the European Federation of Employee Share Ownership (EFES).

In 1995 he was awarded the Philip Mayo Award for Outstanding Contribution to Employee Ownership and has travelled extensively in his native country (UK) and abroad including Russia, Romania, Poland, Belgium, America, Spain, Hungary, Slovenia, Slovakia, Germany, France and the Federal Republic of Macedonia - studying, presenting and advising on Employee Ownership.

He is arguably the most experienced and knowledgeable worker owner in the UK on the subject of Employee Ownership and its practical experiences.

ACKNOWLEDGEMENTS

I would like to thank David Pett (Pinsent Curtis Biddle) for planting the idea in my head in Brussels in 2001. Pam McNammee [formally Pam Landells] (Tullis Russell Group), Richard Leonard (GMB), Hugh Donnelly (Employee Ownership Scotland), Robin Blagburn (Unity Corporate Advisors) and Graeme Nuttall (Equity Incentives Limited) for helping to convert my "rough Diamond" into one with at least smoother edges even if it doesn't quite sparkle.

Many thanks go to Robert Oakeshott of course who has been my guide and greatest encouragement along my employee ownership path

OTHER BOOKLETS BY DAVID WHEATCROFT

A WORKERS INTRODUCTION TO EMPLOYEE OWNERSHIP "How to Recognise the Power of Ownership and How to Use it"
September 2001

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Note

The statutory provisions are printed in Blue
The Employers Options are printed in red
My comments are printed in green and italics

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INTRODUCTION

In April 2000 the "New Labour" Government introduced a new employee share scheme called the **ALL EMPLOYEE SHARE OWNERSHIP PLAN (AESOP).** Its aim is to double the number of companies that offered shares to its employees. In order to do this it was felt that the plan needed to appeal more to the small and medium sized private companies.

It seems the **AESOP** was intended to replace existing employee share ownership plans namely **Matching Shares Scheme** more commonly called **Buy One Get One Free (BOGOF**), **Approved Profit Share Scheme (APS)** and the **Save As You Earn Share Option Plan (SAYE).** The APS was to be phased out by the year 2002. There were elements of the existing schemes in the new plan i.e. free shares as in the APS, buying shares as in the SAYE and Bonus Shares as in the BOGOF.

Like all umbrella schemes that try to encompass many plans and be "all things to all men" there are bound to be winners and losers on a swings and roundabout theory. However it has to be said that from a workers point of view the new plan's winners are the companies who seem to be getting more of the swings than the roundabouts.

This I believe is for two main reasons, firstly the fact that the Inland Revenue wanted to make it more attractive to companies and secondly because of the almost total lack of response from the workers representatives, i.e. the Trade Unions, in the consultation process.

There are some three and a half million (3.5m) individual employees in share schemes operating at the moment, one and a quarter million (1.25m) in the APS, one and a half million (1.5m) in the SAYE and seven hundred thousand (0.7m) in the AESOP (SIP). If you allow for overlap i.e. one person involved in more than one scheme at once then it could be estimated that there are around two and a half million (2.5m) worker shareholders in this country.

You could further estimate that seven hundred and fifty thousand (0.75m) are Trade Unionists. In fact one could be almost forgiven for accusing the Trade Union Movement of neglecting their members interests. More so when you consider that they promote and publicise almost every other financial service except employee ownership.

TRADE UNIONS PROMOTE

Banking	Yes
Pensions	Yes
Credit Cards	Yes
Personal Loans	Yes
Mortgages	Yes
Holiday Clubs	Yes
Insurance (all types)	Yes
Telephone Discounts	Yes
Road Rescue	Yes
Mobile Phones	Yes
Employee Ownership	NO
Employee Shareholding	NO

Indeed the only Trade Union publicity of the “new plan” to appear so far as I am aware is an article by myself published in the Unity Trust Bank Newsletter and an article in the GMB Newsletter “Bargaining Brief” in April 2000.

In 2002 (the year when entry to the APS scheme closed) the Government re-launched the New Scheme (AESOP) with a series of “Road Shows” and renamed it the Share Incentive Plan (SIP).

If the SIP does double the number of companies that use share schemes the extra employees who join will definitely gain because they will be getting something that they never had before.

However the employees already enjoying share schemes will find the new scheme a backward step and this deterioration will increase if the employer exercises all the choices available to them.

The fact is that for existing workers it is like walking up a downward moving escalator in that you take one step forward but finish up several steps back.

It is also important to stress that the benefits of employee ownership should not be a substitute for wages and conditions. In the USA it is sometimes used that way in what is called “investment bargaining” and this has resulted in some spectacular and disastrous outcomes as far as workers are concerned, particularly where shares have been used in pension plans (401k plan) creating a triple blow, for example in Enron where many workers lost share value, pensions and their jobs.

In fairness it has to be said that even allowing for the retrograde steps in the plan as far as workers are concerned, the SIP is regarded by many in the employee ownership movement as being the most generous legislative share scheme in the world.

This booklet is an attempt to allow workers to learn about the scheme in Layman’s Language and from a workers point of view.

Details of all the share schemes can be found on the Inland Revenue website www.inlandrevenue.gov.uk/shareschemes and in their booklets. As a tip I recommend that you look at both employee and employer booklets in order to see both sides.

The one thing that SIP does not address is the provision for employees to hold shares in Permanent Trusts as a way of sustaining Majority Employee Ownership that we have seen in some of our most successful Employee Owned Companies like John Lewis Partnership or Scott Bader. Rather it promotes individual employee shareholding that tends to lead to a fragmented shareholding power base and encourages just financial interests from the employee owners.

Studies have shown that financial employee involvement on its own will not create the maximum impact and results. In order to achieve this goal employee ownership should also be accompanied by a participative style of management to create a feeling of belonging for the workers.

2

EXISTING EMPLOYEE SHARE SCHEMES

Before moving on to the New Scheme (SIP) it is necessary to explain briefly the 3 former and existing Employee Schemes for 2 reasons. Firstly in order to compare the similarities and the differences between the old schemes and the new scheme (appendix i) and secondly because although entry to 2 of the "old schemes" have been phased out they are still destined to run for up to another 3 years.

Approved Profit Share Scheme (APS)

This is a scheme where part of the pre-tax profit can be transferred to the employees in the form of "free" shares. The Allocated shares have to remain in a Profit Sharing Trust for a period of 2 years and if they are held in the trust for a further year (Total 3 years) they are passed on to the employee free from Income Tax liabilities.

Save As You Earn Share Option Scheme (SAYE)

This scheme allows you to save money from your salary in a Bank or Building Society for a period of either 3, 5, or 7 years and after that time you have the option to buy shares at a pre-determined Discount (up to 20%) price or take your savings. *(this scheme gives you a no lose option)*

Buy One Get One Free (BOGOF)

Rather than a scheme the BOGOF is more of an arrangement whereby for every share you buy you get another share free. The free shares are usually delivered using an APS scheme and because the APS has now ceased it will mean that the BOGOF will also cease. However the BOGOF arrangements are fully incorporated in the new SIP scheme be it in a different format with different limits.

3

A BRIEF OUTLINE OF SIP

As with the past schemes SIP's aim is to encourage employees to hold shares in the company where they work, also like the past schemes SIP is Inland Revenue approved and as such attracts tax concessions for both employer and employee alike.

In order to enjoy these tax concessions the old schemes had to comply with strict rules and criteria. After great pressure from the employers in the consultation process and to make SIP more attractive to Small and Medium private companies SIP enjoys much more flexibility.

However there are still compulsory elements to SIP and some of them like the extension of the allocation period lead to a worsening of benefits for workers compared to the previous schemes.

To add to that if the Flexibility and Employer Options are carried out to the full then it can only mean a negative and worsening situation for the workforce who already enjoy the benefits of employee share schemes.

This is why it is so important for workers and their representatives i.e. the Trades Unions, to learn about SIP and the effect it can have on them.

The Share Incentive Plan (SIP) is basically made up of 4 types of share award although it needs to be stressed that all of them are Ordinary Shares.

However there is a provision that the employer can limit the voting rights of the shares to the extent that the shares can have no voting rights at all.

Although I have to say this existed to a certain extent in the old schemes for example it is possible to use non-voting shares (or shares with inferior rights to dividends etc) provided that the majority of the same class of shares were held by non-employees.

The 4 categories are:-

Free Shares. Employers can give each employee's free shares worth up to £3,000 each year. (taken from the APS scheme)

Partnership Shares. Employees can use up to £1,500 per year (before Income Tax and National Insurance Contributions, NIC) out of their pay to buy Partnership Shares (taken loosely from the SAYE Share Option scheme)

Matching Shares. Employers can give up to 2 matching Shares for every Partnership bought by employees (taken from the BOGOF arrangement)

Dividend Shares Companies can allow employees to use up to £1,500 of Dividends from their SIP share plans to buy further shares (Taken from present arrangements)

These 4 elements can be used as a mix and match package that can use one (except in the case of dividend shares of course) or more elements to make up the plan.

This provision of allowing voting restrictions to the point of non-voting shares is a backward step from the previous schemes. It seems strange that although research has shown that financial participation alone does not produce the best performance this is in fact what they are allowing.

I believe it would have been far better to pursue the argument for greater employee involvement as a equal shareholder and not treated as a second rate participant because I'm sure that is how many of them will see it and their performance will reflect this, threatening the prospect for greater employee commitment which is of course the ultimate aim of SIP.

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FREE SHARES

Firstly let me say I hate the term “Free Shares”, there is nothing free about these shares. The shares are an acknowledgement of working effort towards the success of the company and as such are earned by the worker. However as this is the word commonly used in the Inland Revenue Share Scheme publications I will continue to use it throughout this booklet.

Statutory

An employee can be awarded up to £3,000 worth of “free shares” in any Tax Year.

The shares have to be held in Trust for 3 years (except in the usual special circumstances of Death, Retirement., Redundancy and Ill Health Retirement). However if they are held in trust for a further 2 years (total 5 years) then they are passed onto the employee free of Income Tax liabilities.

In the APS Scheme the holding period was 2 and 3 years respectively. The lengthening of the holding period represents a huge backward step when you compare it with the 3 to 5 years in the SIP.

I believe that it is better to use the carrot instead of the stick approach and it would be better to reward employees if they held shares longer voluntary than to enforce a longer holding period.

It is also putting all the blame on the worker and their “Casino Desires” however I can tell you of one major PLC who encourage workers to sell their shares as soon as they come out of their holding period and offering reduced commissions if they sell the shares straight away.

Employers Options

The plan allows employers to allocate shares based on performance targets by individuals, teams or divisions of workers.

The plan also allows employers to "claw back" the allocated shares that are held in the Trust for less than 3 years if the employee leaves as a "Bad Leaver" of their own accord. This is known as the forfeiture provision.

It also allows employers if they wish to extend the holding period of the shares to up to 5 years before employees can receive their shares.

All these steps if implemented by the employer would be a further retrograde step for workers.

In the past the workers have enjoyed a much fairer distribution of shares that could only be based on salaries, hours worked or length of service.

Also in this climate of Trade Union abstention and a general lack of employee representation on the plans, guess who would be setting the parameters both in terms of numbers and performance targets?

As far as I am concerned the "free shares" are an acknowledgement of the contribution the employee has made in the past, after all you don't get them until you have worked for the company for a period. Therefore it is wrong that they can be taken away for whatever reason (see Chapter 8).

To rub salt into the wounds not only do employees have to wait another 2 years before they can have their shares Tax Free. But they may have to wait the same 2 years before they can receive the shares at all if the employer introduces the 5 year rule.

5

PARTNERSHIP SHARES

Statutory

An employee can purchase shares out of their salary up to a maximum of £125 per month or 10% of their wages, which ever is the lowest.

These shares are known as Partnership Shares and are purchased before Income Tax and National Insurance Contributions (NICs) are deducted. However if you sell the shares before 5 years you will have to pay back the Income Tax and NICs on them (reduced after 3 years).

The shares can either be bought every month or after an accumulation period of up to 12 months. The purchase price can either be at the start of the accumulation period or when they are handed to the employee (whichever is the lower).

In SIP employees are allowed to start, stop, restart, and change the amount of saving when ever they wish compared with the rigid, set price, set savings period of the SAYE Option Scheme.

In SIP the discount of contributions before Income Tax and NICs would balance with the up to 20% discounted option price of the SAYE Scheme.

In SIP there is no savings safety net if the share value goes down in the savings period like there is in the SAYE Scheme.

In SIP you will receive dividends on the shares you buy as you are saving, unlike the SAYE scheme where no dividends are paid as you do not own shares until you take the option to buy.

Employers Options

The company can set lower targets of savings in both maximum and minimum if they wish (within the I.R. parameters).

The SAYE Share Option Scheme is still continuing so there is an option for an employee to run one or both schemes at the same time, that is if the employer decides to run both schemes concurrently. The fact is each has merits and disadvantages over the other (see appendix ii).

It is noticeable that Stagecoach who only run the SAYE Share Option Scheme at the moment have reduced the saving period from 5 years to 3 years, while Tesco by running both schemes are giving their employees the opportunity to join either or both of the schemes.

Employees should be aware that by purchasing partnership shares they could affect any state benefit entitlement. This is because you will be paying less National Insurance Contributions. For further information see booklet IR 177 "Share Incentive Plans and your entitlements to benefits".

The length of the saving period can be crucial. For example if an employee (whether a good or bad leaver, see chapter 8) leaves the company in the saving period before any shares are purchased, they will only receive their savings minus Income tax and NICs allowances. So the longer the saving period the more likely that employees will lose out if they leave the company for whatever reason.

The employers would argue that the shorter saving period would lead to more transactions and therefore more administration costs.

6

MATCHING SHARES

Statutory

The Employer can give employees up to 2 free Matching Shares for every Partnership Share they purchase.

There is a holding period as with the "Free Shares" i.e. 3 to 5 years.

Employers Option

An employer can also introduce a forfeiture rule also as with the "free Shares" i.e. up to the first 3 years of the holding period.

As the BOGOF Arrangement was linked to APS (now ceased) for Holding Period purposes, it means that with SIP the holding period has been extended from 2/3 years to 3/5 years. This again is a backward step for employees.

The provision of forfeiture of Shares for up to 3 years is once again a detrimental step from the BOGOF Arrangement (see chapter 8)

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DIVIDEND SHARES

Employers Option

Employers can provide for any dividends from employees SIP Shares to be reinvested in further shares. These are called Dividend Shares.

Statutory

There is a limit of £1,500 per year that each employee can convert into Dividend Shares.

If the shares are held for 3 years no Income Tax will be liable, giving you more shares for your money.

There is no forfeit penalty on Dividend Shares.

I cannot see why the Dividend Shares can enjoy a shorter holding period and a no forfeit penalty and the other categories of shares cannot, presumably it is an extra incentive for the employees to take up this arrangement.

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A WORKERS CASE AGAINST FORFEITURE

As far as I am concerned Free and Matching Shares that are held subject to the holding period should not be eligible for forfeiture for the following reasons:-

The shares have been "earned" by employees in the past and are a reward for helping build up the business. I believe the only reason they are not given out directly to the employee is for no other reason than to avoid Income Tax. Although some would add that it would also create some sort of stability in the shareholding.

The weight of the argument is further endorsed by the fact they are in effect shares that have a deferred ownership right and this is reflected by the fact that they are allocated to the employees and as such attract payment of dividends that are paid to the employees (their future owners).

In my opinion it is little short of legalised robbery when an employer can claim back shares that have been earned in the past just because the employee is a "bad leaver"

This brings me to the subject of what is a "bad or good leaver"? If a loyal employee who has given years of good service leaves the company through no fault of their own, for example, someone who leaves because their partner has a job elsewhere or someone who leaves to look after a sick relative. I ask you would any fair employer regard them as bad workers or "Bad Leavers".

For these reasons I feel that the forfeiture rule should be scrapped, even though there is a high percentage of take up of around 80% of SIP schemes that are using the forfeiture provision. It is clearly a rule that doesn't benefit the workers and can only have a disincentive effect.

CONCLUSION

Firstly let me applaud the Government's initiative to simplify the whole Employee Ownership legislation by bringing it all together in one plan.

However I feel it has to be said that in spite of the fact that many see this as the most generous Share Ownership legislation in the world, overall as a worker I still believe it to be a backward step from the old schemes.

Even with the fact of the generous concessions like investing before Income Tax and NICs and options for employers that is hoped will spread employee shareholding to a much wider audience, there is still the fact that the existing employee shareholders will have a worse deal than before.

Things like the lengthening of the holding periods, forfeiture of shares, allowing the employer to extend the holding period and performance based targets far outweigh the advantages as far as workers are concerned.

It is the Employer Options that stress the importance of employees to become involved in the setting up of SIP in the workplace. In most cases that is the duty of the Trade Unions to represent their members in this field. If they don't it is more than likely that the employer will consult with an advisor and devise a SIP that will be presented to the workforce on a take it or leave it basis.

While the target of doubling the number of companies that offer employee share schemes may be met. I fear the ultimate aim of increasing production would be jeopardised for following 2 reasons. The worsening provision of the existing Employee Shareholders and the feel that even the new employee owners could be "short changed" by limited voting powers.

I feel that if the workers believe they are facing retrograde conditions and are being treated as second class shareholders then it would have a de-incentive effect instead of the desired opposite.

Don't get me wrong, workers are not daft, they will gladly take the "free shares" and some may even buy partnership shares for purely financial reasons. But that will not guarantee or even encourage increased productivity.

Workers, their representatives and their Trade Unions need to become more involved in the setting up of SIP schemes so that they can influence their make up not just for the benefit of the employees but also to make sure the plan will work effectively and produce its ultimate aim of increasing commitment and productivity.

Companies need to realise that the ultimate aim of increased production will only be achieved if workers feel that they are not being offered a worse deal or they are not being treated as inferior partners in the shareholding structure.

Governments need to monitor and evaluate the schemes with a view of making sure that employees do not feel disenfranchised and that the SIP Scheme is for the benefit of employees and not for the purpose of achieving some numerical target.

THE WAY FORWARD FOR WORKERS

If an employer reduced a workers wages or conditions, you could expect the workers and their representatives (including the Trade Unions) to resist this and fight to regain the status quo and rightly so I say.

Yet this is in effect what SIP has done, but there has been no reaction to it from the workers, except from the TUC who have welcomed SIPs .I believe there are several reasons for this.

Firstly workers are not aware of the rules of SIPs. Secondly the TUC are not aware of the benefits of the previous schemes compared with SIPs and thirdly the Trade Unions do not see their role in Ownership and are therefore not interested in getting involved even though they have 0.75 million members who are worker shareholders.

There are three ways forward for workers to get a better deal from SIPs.

The first is to ensure that their representatives mainly the Trade Unions start to represent them in the field of employee shareholding, bearing in mind how many of their members are involved,

Secondly lobby the Government to reverse the holding period back to 3 years (as this is a statutory rule) and then to withdraw all the optional concessions it has given to employers.

Thirdly workers need to become involved in the setting up of the schemes at company level and argue that the flexible options are against the ideals of working in partnership with workers and that the company will benefit if the employees feel they are being valued as equals and not second class shareholders.

I feel if this battle is won at company level then it will be easier to convince Government that just to double the number of worker shareholders is not enough and in order to achieve its ultimate aim of increasing productivity it must reverse the detrimental aspects of SIPs and make workers feel they have not been used to achieve a statistic success.

I believe I have given enough evidence in this document for any worker and their representatives to convince any fair minded employer and Government Minister that a fairer deal is essential for the Share Incentive Plan to achieve its full potential and succeed in its ultimate aim of making Britain more productive and more competitive in the World Markets.

APPENDIX i

	OLD SCHEMES	SHARE INCENTIVE PLAN
APS	"free shares" held for 2 to 3 Years	"free shares" held for 3 to 5 years. Voting rights limitation Forfeiture of shares up to 3 years Performance related distribution
SAYE	SEE APPENDIX i	
BOGOF	Up to 1 for every 1 purchased Held for 2 to 3 years	Up to 2 for every 1 purchased Held for 3 to 5 years Voting right limitation Forfeiture of shares up to 3 years
SCRIP DIVIDEND	Dividends used to buy shares	Dividends use to buy shares before tax Holding period 3 years No forfeiture

APPENDIX ii

	SAYE	PARTNERSHIP SHARES
PURPOSE OF SCHEME	Cash saving scheme of 3, 5, or 7 years Option to buy at discount price	Share buying scheme before Income Tax and NICs Held in trust for 5 years
MAIN BENEFITS	No risk savings A guaranteed tax free bonus Possible option to buy at a predetermined discount price Set period and saving amount throughout the scheme	Efficient way to buy shares No I.T. or NICs to pay when you buy shares or when they mature after 5 years Cash Dividends Can start, stop or alter savings amount
RISK	None, you can take your savings and bonus after saving period if you wish	Share value could fall while they are in trust Forfeit shares up to 3 years Reduced voting rights

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