



Covid 19 – Impact on Scotland’s Employee-Owned Businesses

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Introduction

These are challenging times for most companies. [Previous research](#) carried out by Cass Business School in 2010 and revised in 2014, suggested that employee owned companies were better equipped to deal with downturns and challenging times.

Scotland is very much an SME economy, and according to a [report by Simply Business](#) SMEs are likely to be more severely impacted by the Coronavirus crisis. Ownership Associates decided to undertake a survey to examine how much Scotland's employee owned businesses believe they will be affected. The survey was sent to the Managing Director/Chief Executives of 37 companies and there were 26 responses.

Ownership Associates UK is a consultancy working solely within the employee ownership sector, active in three main areas:

- Advice for business owners considering their succession options
- Project managing the business transfer process for owner-managed businesses moving employee ownership structure
- Ongoing support for employee owned businesses helping them drive the benefits from their ownership model
- In house and open courses in employee ownership and business skills for employee owned firms.

In 2019 Ownership Associates UK supported 11 companies in their move to employee ownership and has helped 6 companies in the first six months of 2020. In total, the two principals have worked on 70 plus employee ownership transitions.

About employee ownership

As an ownership structure, employee ownership has been in existence for a long time (John Lewis Partnership has been owned by its employees since 1929). However, it was the introduction of the Employee Ownership Trust in the Finance Act 2014 that created the surge in interest. The legislation created a specific vehicle, the Employee Ownership Trust, to hold the shares on behalf of the employees. This same legislation bestowed Capital Gains Tax exemptions on business owners selling a controlling interest their company to an Employee Ownership Trust. If the majority of shares are held in Trust, then employees can benefit from a bonus, which is tax free up to an annual threshold of £3600, when the company is profitable.

Most companies become employee owned as a succession strategy for the former owner/s. There are around 76 employee-owned firms in Scotland across a range of sectors:

engineering, consultancy, hospitality, manufacturing amongst others. According to a 2020 survey by the White Rose Centre at University of Leeds, Scotland is the second fastest growing area for employee ownership after London, comprising 17.1% of the UK increase in 2019.

A sale to employees has been an increasingly popular option for business owners looking to exit their company. The Employee Ownership Trust provides a stable model to hold the shares for the long term, the legislation enshrines fairness and equitability, and the future of the company is in the hands of the people who know it best; the employees. Employee-owned businesses tend to outperform conventionally structured businesses on just about every business metric.

It is likely that the market for mergers and acquisitions will decline significantly as the economy heads towards recession. A sale to an Employee Ownership Trust is likely to become a more feasible option for many business owners as they seek an exit from their business.

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Summary of Findings

Business Impact 10 companies had to close temporarily and 7 had to downscale operations. 6 reported they operated as normal and 3 said that business levels had increased.

Financial Support 20 companies accessed the Job Retention Scheme. 8 companies took on loans from one of the government schemes. Only 2 respondents did not seek any support.

Financial Hit 22 companies state that the crisis will have a negative impact on financial performance; 11 report that this will result in a shortfall of more than 20% and 4 of these reporting a shortfall of more than 20% state that it will be a decrease of more than 50%

Redundancies 12 companies do not foresee redundancies whereas 6 believed it might be necessary. 8 companies reported they were unsure at the time of the survey.

Salary Cuts 17 companies did not see salary cuts being required. 9 companies planned to reduce salaries by 20% or more.

Recovery 11 companies believe that recovery will take more than one year. One company is not confident that there will be a recovery for them. 9 predict recovery will be less than one year.

Innovation 9 companies had changed products or services during the Covid19 crisis.

Employee ownership 19 companies believed that their employee ownership model would help the company get through the current crisis. 3 recent entrants into employee ownership believed it was too early to say.

Participants

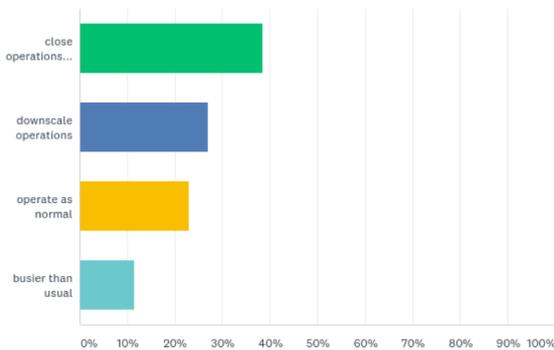
A huge thanks to the following companies for their participation:

Grossart Associates	Structural Engineering Consultancy	East Kilbride
Bentleys Shopfitters	Fit out specialists	Dundee
Design company *	medical device design	Edinburgh
GS Brown (Precision Engineering)	Precision engineers	Ladybank
Laurence Odie Knitwear	Design, production, export of quality knitwear	Hoswick, Shetland
Aquascot	Salmon Processing	Alness
Page\Park	Architecture	Glasgow
Palimpsest	Publishing	Falkirk
Mediascape Ltd	Audiovisual design, supply and installation	Glasgow
Clansman Dynamics	Robotic engineering	East Kilbride
Jerba Campervans	Campervan refurb and hire	North Berwick
Architect practice*	Architects	Edinburgh
Classic Restorations	Automotive restoration	Alyth
ESPL Ltd	Pharmaceutical Regulatory Consultancy	Lunna, Shetland
Priory Hotel	Hotel	Beaully
2020	Project Management Training and consultancy	Aberdeen
Optimat	Strategy consultants	East Kilbride
Stewart Buchanan Gauges	Design Manufacture of gauges and valves	Kilsyth
Financial advisory service*	Financial Advisers	Glenrothes
Buzzbase	Internet Retailer	Dundee
Keil Centre	Occupational Psychologists	Edinburgh
Exmos	Software engineers	Grangemouth
Accord ESL	Hydrocarbon Accountants	Aberdeen

Companies marked with a * have not publicised their employee ownership at this time.

Results

1 Has the current crisis meant you have had to:

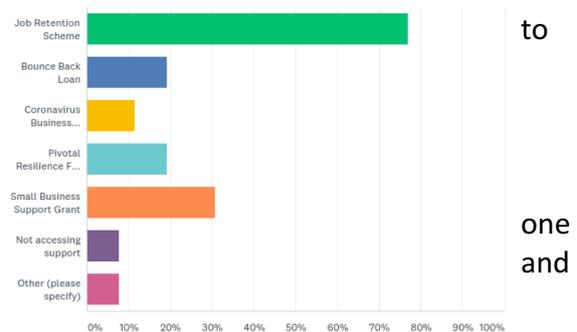


10 respondents reported that they had closed operations temporarily. For some businesses particularly in manufacturing, that was to put safety measures in place and they reopened within a few weeks. Some manufacturing companies changed shift systems to continue production and maintain physical distancing. 7 companies downscaled operations usually due to decrease in customer demand. 6 companies were able to

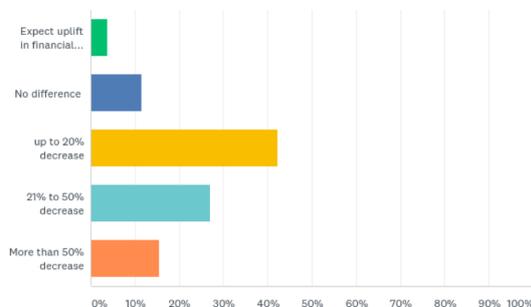
operate as normal, although this often meant switching to home working. 3 companies reported that they were busier than usual.

2. Have you applied for/implemented any of the following government support ?

Uptake of government support was similar what is happening in the wider SME economy. As with many conventionally structured businesses, the furlough scheme proved very valuable to employee-owned firms. 8 firms had applied for or received of the government backed loan schemes, five had applied for the Pivotal Resilience Grant.



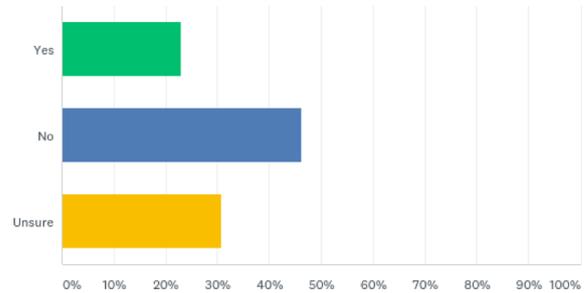
3. How will the crisis impact your 2020 financial performance in terms of turnover?



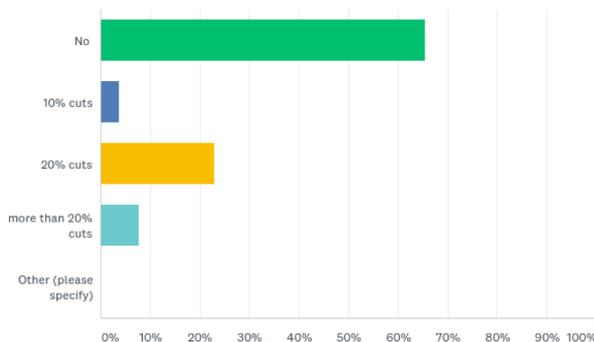
Only one firm reported an uplift in the performance. 3 said no difference and the rest reported decreases. Worryingly, 4 employee-owned firms believe the decline to be more than 50%. These are worrying figures, although slightly more positive than what is being predicted in the wider Scottish economy. [Industry bodies](#) predict a contraction of between 25% and 70% across a range of sectors.

4. Do you anticipate there will be a need to implement redundancies?

Typically, employee-owned firms are more likely to strive to hold on to staff. Indeed, the Cass report referred to earlier believes this staff retention was a key factor in enabling employee owned firms to return to business more quickly than their peer companies. An [IPPR report](#) estimated that 150k jobs would be lost in Scotland as a result of the Covid19 crisis. Our survey suggests that Scotland’s employee-owned companies are intending to hold on to their staff. 6 companies did anticipate redundancies and at the time of the survey, 8 were unsure. 12 did not anticipate redundancies. Obviously, resourcing requirements is very sector specific. The Covid 19 crisis has hit hospitality, retail, leisure etc. particularly hard and it is likely business levels will not require the full complement of staffing.



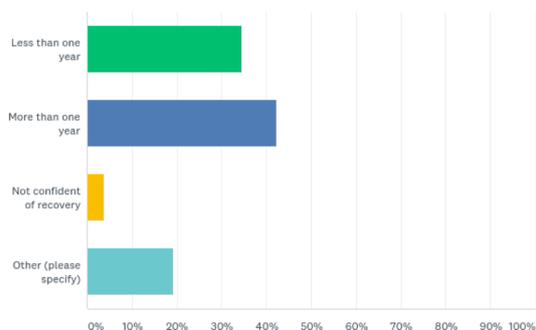
5. Are you implementing salary cuts



The majority of responses reported that there would not be salary cuts. Of the remaining 9 companies, 6 stated that salaries would be reduced by 20% or more. Many companies stressed that this was done with the full support of staff.

6. How long do you estimate it will take for your business to recover to pre Covid business levels?

The Federation of Small Businesses reported that 35% of their members feared they would not reopen post Covid19. The Fraser of Allander Institute predicts that it will be 2023 before the Scottish economy recovers from the current crisis. The results from our employee-owned businesses were more optimistic. One third of respondents believe they will return to pre Covid levels in less than a year, and 11 reported that they it will take longer than a year. Only one company said it was not confident that recovery would be possible.



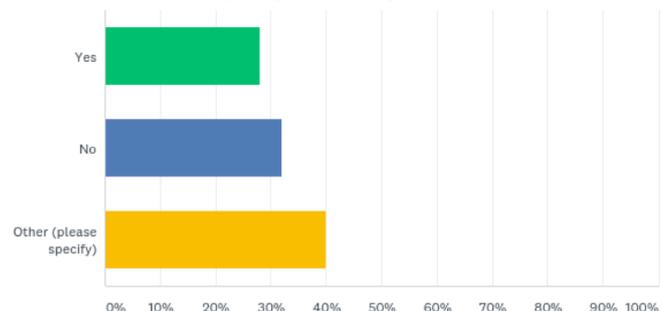
7. Have you changed your business/offered new services or products as a result of the COVID crisis?

17 respondents reported that they had not made any changes to their business as a result of the crisis. The remainder reported as follows:

- Hired an additional engineer.
- Not really but customers delighted with the working from home service and turnarounds being offered.
- rapid conversion planned from classroom courses to virtual and elearning
- Yes - registration of PPE
- yes, doing more development work and preparation for future
- Not materially. More emphasis on remote working and support
- Yes, online training, webinars and workshops
- Not yet although we expect the medium/long-term business landscape to be altered as a result of Covid.

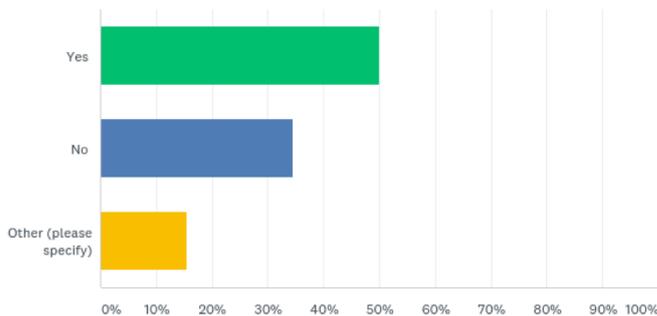
8. If your company has an outstanding vendor loan, are EOT repayments continuing as normal?

It is normal for employee ownership transactions to be funded by the company. A price is agreed and confirmed by an independent adviser. If the company has surplus cash then the vendor would receive this as an initial payment, with the remainder paid out of profits made by the company. These payments are usually calculated very prudently to ensure the business will not be stretched. The usual term of this vendor loan would be between 5 and 7 years, although many companies prioritise repayment and repay sooner.



It is very unusual that employees are asked to contribute to the purchase price when the shares are sold to an Employee Ownership Trust. As the Covid 19 crisis prevented many companies from generating their usual income, it is likely that some companies would agree with the vendor that payments would be deferred. Of the 26 companies who responded, 6 had no outstanding vendor loans. 7 companies continued to make the usual payments, with the remainder coming to an agreement with the former owners.

9. Have the Trustees met with the Directors to review plans and actions



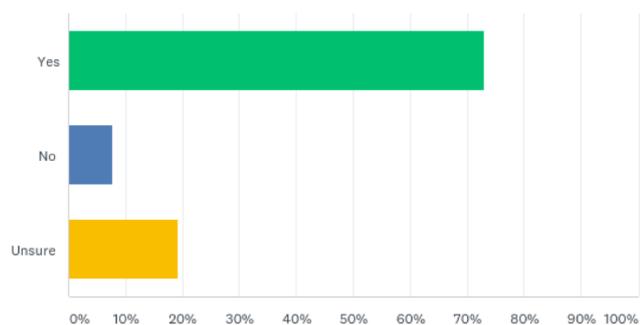
When a company has the majority shareholding in an Employee Ownership Trust, the Trustees have an important role in the governance structure, possessing similar powers as a major shareholder would hold in a conventionally structured business. It is usual for the Trustee Board to consist of elected employees and an

independent Trustee who is unconnected with the company. The purpose of the Trustees is to hold the Board to account, and ensure that the company is run in line with the best long term interests of the employees. A balance of challenge and support is a sign of a healthy employee-owned business. Most companies had regular meetings with the Trustees, sometimes informally.

10. Do you believe your employee ownership model will help you through the crisis?

This is possibly the most encouraging result of the survey.

Three quarters of respondents reported that their ownership model would help the company get through the crisis. Two companies felt they were too early into employee ownership for there to be an impact, and 5 were unsure whether employee



ownership would be the differentiator. Overwhelmingly, respondents believed that employee ownership would help the business recover, with many businesses citing the enhanced engagement, transparency of information and commitment to recovery as being key factors. Several companies reported that employees were more flexible than would be expected, and also that leadership felt supported in their decisions and actions.

Comments from respondents on employee ownership and Covid response

We have been open with staff from beginning and they are aware of severity of situation and impact on business. As a whole, they have supported leadership in tough decisions. Humbling.

Everyone understands what's going on and that their help and ideas make a difference. There's an urgency to use our time wisely to come out this stronger in terms of our technology.

Employees should be more understanding regarding actions necessary to keep the business viable moving forward.

I believe that the owners (staff) will support our actions to keep their company afloat

Staff all being kept well informed on sales outlook and regular accounts being presented via Zoom whole company meetings

As we are all in this together and people are not feeling isolated. We are keeping communicating with everyone.

Team spirit evident in willingness to modify work practices, adopt shifts and work together pragmatically

Employees are fully aware of all company finances so totally understand the impact of Covid on 2020 profits. They are fully involved in restart risk assessment planning and without fail are desperate to return to work. Vendor payments were due to be complete within 2 years and employees are very keen to still make that happen. All furloughed staff have received full salaries with the company paying the 20% shortfall and many employees have said that they need to repay this support through extra hard work and further productivity increases.

Too early in the EOT to really get the staff behind us.

I hope there is a bit more buy-in from employees and a willingness to possibly go the extra mile however my gut tells me I could name now the employees that will assist because of EO and those for whom it makes no difference.

Good governance. Staff taking ownership. Self policing. Transparency. I.e. Everything that is great about an Employee owned Company.

Employee Ownership is a huge factor in our approach to transforming our business

The team had been part of our 3 month "bridge" actions and continuous updates are exchanged all round

It appears staff are more understanding and adaptable than what they possibly would otherwise be (possibly).

As with previous down-turns affecting our industry the fact that we do not have a parent company or external share-holders to consider means that we able to take the appropriate decisions for the long-term benefit of the company without undue external considerations.

Partner reaction to the challenges has been a joy to watch, flexible to shift and operational changes required to remain compliant to Gvmt recommendations.