ESOP centre

Royal Mail Employee Shareholding

Thoughts from the past - lessons for the future

ESOP Centre
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The Employee Share Ownership Centre

Spreading the Wages of Capital

1. Summary & introduction

The Esop Centre is an independent social enterprise which supports the idea of employees owning shares in the companies they work for. Founded in 1985 it has members among companies large and small, law firms, accountants, trustees and specialist consultants.

The Esop Centre arranged two round table discussions with members of the parties, think tanks, unions and employee share experts.

The purpose of the meetings was not to examine the case for divestment nor the attitude of unions towards it. The aims were to review various models that had been used in the past when privatising state companies for the benefit of those unfamiliar with employee share schemes (Esops), then to consider ideas for a form of employee share ownership in a future Royal Mail which would benefit the company and its workers.

An employee share scheme can take many different structures. Some initial suggestions are made below as to best serve future stakeholders in Royal Mail – private investors, employees, management and customers.

With the CWU determined to fight privatisation the structure, governance and communication of the share shceme could have paramount political importance in determining its passage through Parliament.

Three broad models have emerged for employee shareholding in enterprises divested by the state:

- The BT model – largely devised by New Bridge Street Consultancy and, according to its late founder, Laurie Brennan, followed overslavishly in subsequent divestments
- The demunicipalisation model – popular with Labour councils forced to sell bus companies by Conservative central government
- The Irish model – where unusually the leading trade union SIPTU became advocate of employee shareholding in privatisation

Other than SIPTU, few unions have espoused employee share ownership, exceptions being BALPA in the UK, Teamsters in US and CISL in Italy.

The demunicipalisation period was an exception, with employees typically receiving about half the company.

Union guidance has tended post facto to be ineffective in dissuading members from taking part.

Often unions have expended effort on opposing privatisation without a plan B to get the best for their members out of a divestment. They have been left with a last minute plan Z. Thus the normal union view has been an unfruitful one – fighting privatisation rather than considering what they could do for their members when the privatisation happens. It is best if everyone looks at the possibilities while it still uncertain how the privatisation will present itself.

Many studies on both sides of the Atlantic have shown the employee share ownership can bring economic and social benefits, including increased employee engagement, innovation, business sustainability and productivity.

Research shows that employees in companies with an employee share scheme are less likely to take time off sick and more likely to address poor behaviour in colleagues directly, to take a direct interest in the finances of the company, and to recommend the company as a good place to work.

Employee share ownership, if communicated in the right way, can also improve workers' attitudes. Royal Mail therefore would be well advised to go through the culture of employee share ownership rather than simply allocating shares to employees. BT and Eircom both provide examples where after initial share issues a culture of employee share ownership was instilled. At BT, regular state approved employee share schemes are offered.

The right context for change must be fostered involving management and all employees to achieve the best results.

2. Review of the past models

The BT privatisation in 1984 took place following the repeal of the telecommunications monopoly in 1981 and a general election in 1983 where one of the main battlegrounds had been over privatisation. It was clear that change was coming to the telecommunications industry in the UK.

It was seen as a vital part of the privatisation that a proportion should go to employees. Ten percent of floated shares were thus allocated. Various methods were introduced to transfer these shares using the structure of the Profit Sharing Scheme, which had been introduced under the LibLab pact.

- i) Free shares – every employee received £70 worth of shares at £1.30 per share, with the condition that they must be left in trust for a period of two years. If the shares were then left in the trust for a further five years (a total of seven years) they could be disposed free of tax, giving the employees a reason to hold the shares for a longer period.
- ii) Matching shares – for each share bought, the employee received a further two shares free. So an employee who bought £100 worth of shares would receive £370 worth of shares including matching and free shares.
- iii) The remainder of the ten percent pot was offered to employees at a discount of ten percent.

The offer proved to be very popular. Alongside these, BT also ran approved share schemes from a different pot. BT continues to operate SIP and SAYE Sharesave all-employee share schemes.

The Transport Act 1985 signalled the start of the deregulation of bus companies in the United Kingdom. This came into effect in October 1986 and required local authorities to transfer control of municipal bus services to separate companies.

The outcome of the bus companies was fundamentally different to that of BT. Managers and employees together took complete control, with managers given a 51 percent stake and employees 49 percent. The shares were distributed using a trust and a Profit Sharing Scheme. A further option was granted to all employees through a Save as You Earn (SAYE) Sharesave.

On the whole, when the question was asked how to award the shares to the employees, a decision was taken to reward the longest serving members as they would have less time remaining with the company.

In the case of West Midlands Travel 75 percent was held in employee trusts using a Profit Sharing Scheme. One of these held 25 plus 1percent of issued share capital so that it could form a voting block to protect against changes in company structure. A company was formed specifically for the purpose of representing the employees on the board of trustee directors for this trust. One of the trusts was emptied by gradual transfer of shares to the employees and the other was sold on to National Express and First Group.

Generally speaking, the bus companies had low overall net asset worth and their acquisitions were funded through debt. It was therefore difficult for them to raise capital.

In the mid-nineties Telecom Ireland was facing several simultaneous problems. EU deregulation rules coupled with changes in technology, such as mobile and internet technology meant that the company was facing a huge structural change. The union, SITPU, became involved in the discussions early on in the process, around 1994/95.

A strategic review was undertaken as the state realised it could not be both referee and player. After a series of 'pay for change' cycles where the eventual change was never achieved, privatisation was seen to be essential.

Delegations were sent on fact-finding missions to the USA to see what models were available to the unions and United Airlines was seen to be an attractive model. The unions returned convinced that a 'meaningful stake' should go to the employees.

The Irish state sold to strategic partners - KPN and Telia, who were seen as appropriate strategic investors as they had taken a lead in mobile technology. The government wished to retain 50.1 percent, so 14.9 percent was available to employees, which was acquired through a value added transformation, a pension pot leverage and raising capital through other means.

3. Moving towards a Royal Mail model?

The more all parties involved, including government, unions and company (both employees and management) that are committed to the change from the beginning, the more successful the change seems to have been.

A key difference between the above models is that in the case of Eircom, the unions had representation on the board as it had become involved in the negotiations at an early stage. Con Scanlon, the general secretary, became deputy chairman to Tony O'Reilly.

Although transformation agreements have been agreed with CWU, these have yet to be fully implemented. Unless unions are satisfied with their role in the new structure of Royal Mail, this could lead to early problems for private investors.

4. The context for change

Whether through residential education courses for management, employees and unions leaders, fact-finding visits to America to see models in place or through the need to modernise technologically, the need to create a context for change is paramount.

In the case of the transport companies, this took around a year. In Ireland, Eircom took four or five years from the realisation that change was coming to the setting up of the trust. In the case of BT, national elections were fought over the issue.

The context for change allows an air of excitement to build rather than one of apprehension. British Telecom would have the capital to be a global player in the market, for example, a selling point which was used widely in promotion of the privatisation.

For postmen to have a meaningful stake in the company would be beneficial, but it is harder to envisage what the motive for change could be in this instance. Although new technologies have been implemented in the last few years, many within the company remain sceptical of their ability to deliver an improved service. Here again trips to global leaders could help to generate ideas.

Anecdotal evidence suggests that employees are not excited about the coming changes. Employees are concerned that Royal Mail should remain above all a community service and maintains its universal service commitment. This should not be ignored in any proposed restructuring.

Although preferable to create excitement for change beforehand, the example of West Midlands buses, where staff also felt they were part of the community and served a vital role within it provides a useful case study. The process here started with hostility and fear of a management-led structure with worse pay and conditions. In this example, a thorough education process was able to create a sense of excitement even at a half-way stage. Esop Centre interventions had similarly helped at Yorkshire Rider and CentreWest.

5. The Eso Advantage

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6. A structure for Royal Mail's employee shareholdings: shares in trust or individual shareholdings?

The Postal Services Bill states that at least ten percent of shares in any privatisation deal will go to Royal Mail employees. However, it is unclear whether these shares be held in trust with a percentage of the dividend being paid out annually to each employee or will there be a pot of shares to be handed out to individual employees as shareholders?

If there is an offer of shares to the employees of Royal Mail, how will this be made most attractive to employees? Will there be an offering along the lines of two or three for the price of one?

A free or matching share system allows lower-paid employees to participate in the scheme to a greater extent than would otherwise be the case. This increases employee interest in the company from top to bottom.

7. Multiple ESOP pots?

Experts agreed that in the ideal structure there could be multiple pots of shares for employee benefits, one in the form of a SIP or SAYE Sharesave to take advantage of HMRC tax incentives.

In a SIP shares would over time transfer out of the trust into direct ownership by the employees. A SIP would be able to provide for free/matching shares for employees and is extremely tax efficient.

A further pot of shares could be set up for training, bursaries etc which would be held in trust. This is something which CWU members are known to support. These rewards could also be linked to transformational targets.

8. How to future-proof the employee share ownership structure?

Any structure proposed for the future of Royal Mail must be stable for the good of its customers and its employees.

In the case of the bus companies it was not uncommon for there to be a 'golden share' with a blocking resolution attached to it or for the trust to hold a 25 percent blocking share.

Often this did not prevent takeovers as the offers were held to be in the interests of the employees by the trustees, because the value of the bus companies increased dramatically due to increases in their property portfolios. This will not be the case with Royal Mail.

Due to EU state aid rules, which will come into play if the pensions fund is to remain on the government's books, all of the restructuring would need to happen at the same time so this will need to be right at the first time of asking.

9. Board representation for the Esop

John Lewis has often been cited as a model to follow for government organisations in recent months. John Lewis employees command a 49 percent voting stake for their 100 percent of the shares. A self-appointing board appoints the people trust board. If John Lewis is to be taken as a model, does that mean that the Esop will or will not have board level representation?

Whereas ordinarily a ten percent stake would not normally command a seat on the board (but would constitute a blocking vote in the case of a takeover) in the case of Eircom a 10 percent stake translated to two seats on the board. In this particular case, unions toured the US to see what models were available to them and returned less interested in the specifics of the design than the board representation.

Under the demunicipalisation model, directors were appointed to the trust board by the employees and then there was a separate management board with perhaps one or two places reserved for representatives of the trust board.

10. Dividends or benefits?

If the government is able to refinance and takes over the pension deficit, the Royal Mail will be worth perhaps £5-6 billion. If 10 percent were owned by the employees that would mean this stake would be worth about £500m. With a dividend of 4 percent, which would be good in the sector that would mean a dividend of £20m to be divided between 150,000 employees.

This is clearly not an attractive salary supplement, but could be used to provide other benefits, such as bursaries for Royal Mail employees' families.

While our research shows that a bursary fund for education would be popular with CWU members, we would recommend a further pot for shares in a SIP so that some actual shareholdership is introduced for employees.

11. Conclusion

These are preliminary findings of the Esop Centre's discussions with veterans of past privatisations, political parties, unions and Royal Mail management. We are ready to discuss any of these points further and to commission further work from our expert members.