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COULD AWARDING SHARES TO EMPLOYEES HELP OUR RECRUITMENT & RETENTION CRISIS?

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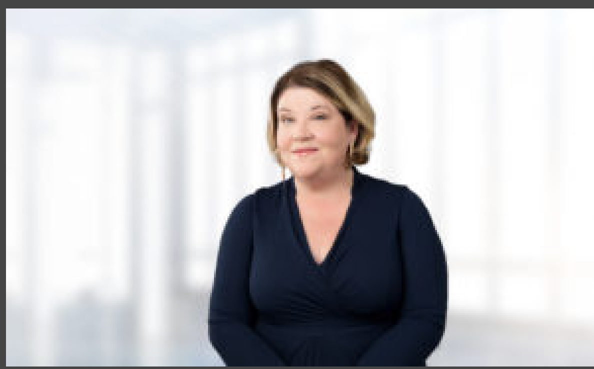

Catherine Gannon, Founder of Gannons Solicitors reviews the option of share schemes as an employee incentive

A recent UK Hospitality[2] briefing highlighted some of the consequences of the UK leaving the European Union. There is a general expectation that net migration will shrink, particularly affecting those working in the hospitality sector. The current low levels of unemployment allied to the large number of EU nationals working on short term contracts within this unstable economy is likely to create further gaps in the labour market.

Therefore, casual dining operators should already be aware of the growing importance of the domestic workforce and have plans to position themselves as an employer of choice, rewarding and recognising excellent customer service and providing a clear and fulfilling career path.

An appropriate remuneration package to achieve this can include a range of options, such as regular employee recognition, discounts, childcare vouchers, bonuses, leave incentives, health service provision and access to employee perks.

But are these enough to make your business stand out in such a competitive environment for staff recruitment and retention? Bennett Hay is one of a growing number of companies that offers a colleague ownership programme, giving employees the opportunity to own shares, encouraging motivation and loyalty to drive long-term success. Is this an option you should consider?

Awarding shares to employees is a big step which requires some forethought and considerations including the right scheme. There are several ways that private companies can provide shares for employees in the UK including a gift of shares or growth shares, options- including the popular Enterprise Management Incentive (EMI), Long term incentive plans and Phantom shares.

Before making any decision, the key facts to consider include:

1. **Extent of participation**

The directors of the employer awarding shares must decide who they want to provide the benefit to? Many HMRC approved plans, e.g. EMI, can be granted on a selective basis

2. **How much equity to give away**

Shareholders decide on how much to give away. Share capital tables will show the dilution under the share scheme. If employees leave, they will usually lose entitlement and surrendered shares can be returned to the pool to provide for new awards

3. **Performance conditions (if any) that will apply to the employee share incentives**

There is plenty of discretion on this point and no legislative requirements

4. **When options convert into shares**

You need to decide what happens on:

- Reaching milestones: e.g. years of service and financial targets
- Sale of the business
- Demerger or reconstruction of a business stream
- Voluntary arrangement/administration order

5. **What happens if an employee ceases to be employed?**

Directors usually decide whether special provision should be made for death, injury, disability or redundancy.

6. **Are employees paying for the share award?**

There are no fixed rules. Shares can be gifted for free but other considerations are whether employees should enjoy inherent value accumulated pre-award and whether you plan for a tax charge for your employees upon the award of shares?

7. **How will the shares be sourced for the employee share incentive?**

Newly issued will dilute existing shareholders, or existing shares can be used if shareholders are prepared to allow for a transfer.

For new share issues, directors must have the requisite shareholder approvals to issue shares pursuant to the option/share awards. If existing shares are used it is usually necessary to consider the tax position of the transferors. Some companies link equity awards to share buy backs under which existing shares are cancelled.

8. **Are existing articles and/or shareholders agreement adequate?**

The articles and shareholders agreement should cater for employee shareholders as they may present different risks than that of the existing shareholder base.

- For example, what will happen if an employee leaves? Do you need good/bad leaver provisions?
- The employment contract is quite separate from any equity contract. Unless the shareholders agreement expressly covers the point, you could fire an employee but find they remain a shareholder.
- How will shares be valued if a transfer of shares is forced on cessation of employment, valuation by accountants or appointment of an independent expert?
- Will employee shareholders be treated the same as investors and founders? Setting up a new class of shares for employee shareholders is often an answer.

Risks when awarding shares to employees – poor design

A badly designed share award gives away more equity than intended and doesn't enhance shareholder value. You risk demotivating employees and driving them into to competitors if you fail to meet their expectations and directors can expect a backlash from investors.

Known disaster areas which can be avoided:

Poor documentation supporting the award of shares to employees

Common problems arise when the drafting of the terms of the award of shares is not clear; poorly drafted performance criteria and vesting schedule, for example can lead to unintended consequences.

Failing to issue the shares correctly

Employers sometimes fail to review the articles and shareholders' agreement to obtain the requisite shareholder approvals. They can also overlook the various requirements which have to be met under the Companies Act when an issue of shares is made.

Missing the commercial driver behind the award of shares to employees

With unclear objectives the bigger picture may be overlooked. The usual end game is what benefit should the employees receive under the award of shares if the business is sold.

Tax on awards of shares for employees

There are various time limits for reporting and payment of tax on the award of shares to employees. If these are missed so can the tax benefits be lost. And, or, a charge to interest and penalties is imposed by HMRC for failure to report or failure to pay tax on time.

Managed correctly, issuing employee shares could help reward your team and futureproof your business. For further information and advice, please visit Gannons.co.uk, or contact Catherine Gannon at cg@gannons.co.uk or call 0207 438 1060.