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news on share based rewards

share plans in SMEs: marathon or sprint?

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Share plans in SMEs: marathon or sprint?

A survey of SMEs carried out by the accountancy and business advisory firm, PKF International[1], has revealed a startlingly low level of knowledge of share schemes among SME employers.

The survey also showed that, while SMEs continue to face difficulties in recruiting skilled and motivated staff, only a very small number of employers use tax-efficient share plans to motivate their staff.

Only 13% of the companies surveyed were using the Share Incentive Plan, and only 9% had an Employee Benefit Trust. Perhaps most surprisingly, only 7% of the companies surveyed had introduced the Enterprise Management Incentives (EMI) arrangement, the flexible option agreement designed specially for smaller, fast-growing businesses.

This seems to support a survey carried out by ProShare[2] in autumn 2001. This reported that 43% of companies which had received Inland Revenue approval for the SIP were unlisted, which sounds positive. However, of the companies that had not launched their SIP at the time of that survey, some 50% were privately owned.

On the face of it, these figures look like a big disappointment to the Chancellor, who introduced EMI and SIP in the Finance Act 2000 amid much fanfare, his aim being to "to double the number of firms in which all employees have the opportunity to own shares".

However, are these results truly as negative as they first appear? If share ownership is about the long term view, surely the development of share ownership should be equally long term?

Looking behind the numbers

1. In the beginning ...

Following the launch of the SAYE plan in 1980, the Inland Revenue approved just 22 plans in the first year.

However, this increased in the second year after launch to 137, with some 110,000 employees participating in an SAYE plan.

In comparison, 2 years after the introduction of SIP, the Inland Revenue has approved 350 SIPs, and estimates suggest that there are over 1 million employees participating in SIP in the UK.

This cannot be said to point to a failure of this plan. SIP (and EMI, for which figures are not so readily available) are still in the early stages, and the companies taking them up are the innovators. We anticipate that, like SAYE, as these products enter the next stage of the product lifecycle, the take up will increase significantly.

2. Flexibility / complexity: the double-edged sword

Flexibility was the keyword for SIP and EMI when they were introduced in 2000.

Equally key, but perhaps less widely mentioned, was the flipside - the complexity. Here are just some of the decisions and processes that companies will need to go through:

SIP:

- Free Shares, Matching Shares, Partnership Shares or Dividend Shares – or a mixture of all four?
- Accumulation periods or not?
- Performance targets for individuals, teams – or none at all?
- The importance of alerting employees to the financial risk they are taking by actually buying shares – including warnings about effects on benefits
- Complex tax issues will need explaining to participants

EMI:

- What exercise price?
- What type of shares to grant options over?
- Which employees to select?
- What level of reward?
- What performance targets?
- Vesting period and exercise period?
- Leaving provisions?

[1] Source: Recruitment, remuneration and regulation – the 3Rs for employers: The SME employers' survey 2002, PKF International
[2] Source: ProShare Share Incentive Plan Research, Autumn 2001

Designing and implementing a successful EMI arrangement is often underestimated by companies and advisers. Each of these issues can introduce a whole debate within a privately held company. The result can be a tailored plan, with considerable discretion on the part of the directors, but the process can take longer than might at first seem to be the case.

3. Economic uncertainty

Other findings in the PKF survey showed that around 1/3 of the companies surveyed made employees redundant towards the end of 2001. With more than 2/3 of those same companies now planning to recruit in the next 6 months, this might seem in retrospect to have been a short-term view, but for SME's the last 12 months have been a period of belt-tightening, rather than committing to high levels of remuneration for staff at any level.

From the employee's point of view, too, a volatile stock market does not sell the concept of share ownership. The experience of Marconi optionholders and the bursting of the dotcom bubble have been salutary reminders of the old warning that the value of your shares can go down as well as up.

Share plans: the New Generation

At Equity Incentives, there are signs that the uncertainty regarding share incentives of the last year is dissipating. Regardless of PKF's findings, there is an increasing interest in and understanding of share ownership generally, and the new generation of share plans in particular. Companies are prepared to introduce complex, carefully designed share plans and option plans for a variety of reasons, such as:

- recruiting key, experienced personnel
- rewarding past loyalty and performance
- maintaining the company's independence
- creating a strong company culture
- focusing on challenging performance targets for individuals, teams or the company as a whole
- tax efficiency

All grown up now

In the last few years, share plans have grown up. Until FA 2000, the choice was more limited: SAYE, seen by some as a glorified savings plan; CSOP, with its £30,000 limit looking increasingly outdated; PST, which had certain flaws such as leavers being able to retain their shares; and unapproved options, flexible but without the tax breaks.

Increasing awareness of share plans in the UK, and particularly their importance in the retention and motivation of staff, meant that companies wanted more out of their share plans – plans had to be tailored to a company's specific needs, and the needs of their staff.

The Inland Revenue figures show that the take up of EMI and SIP has been considerably greater than that of SAYE at its inception. Introducing these share plans does not happen overnight – for SMEs they require considerable thought and will sometimes even raise crucial issues about the future of the business itself.

PKF's findings may seem disappointing at first sight. However, at Equity Incentives we are confident that, as share plans become more of a "hygiene" factor in all companies, whether quoted or private, EMI and SIP will increase in popularity in the years to come.

Watch this space!

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