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Inquiry into the Tax Treatment of Employee Share Schemes

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Organisation: Succession Plus

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Submission

I have nearly completed Doctoral studies in the Utilisation of Employee Share Ownership Plans (ESOP) as a Business Succession and Exit planning tool for Australian SME's and my practice is a substantial provider of succession planning advice, products and services to business especially focusing on ESOP's. We were established in 2009, have 20 advisers nationally and work with mostly mid-market businesses to assist them maximise business value and achieve a successful exit. This often includes implementing an Employee Share Ownership Plan.

We implemented our first ESOP in 2006 (it is still operating and the business owners credit it at least partly with their success - especially in terms of attracting, retaining and motivating key staff which in their industry - real estate - is a key issue) and since then have implemented approx. 100. Our clients have won the Australian ESOP of the year award twice. Demand / inquiry is increasing in a tight labour market (for professional services employees especially) largely focused around staff recruitment and retention and even further as a result of COVID19.

The academic research https://successionplus.com.au/white-paper/academic-research-esops/ is overwhelmingly positive, providing the plan is properly designed (to match the business outcomes important to the business owner and key stakeholders) and implemented.

See https://successionplus.com.au/employee-engagement-share-plans/ for a case study video (featuring both founder and employees) on our client Umwelt, who has successfully implemented both Ownership Thinking and an ESOP as part of an overall succession plan to sell the business to its key employees. This option is common in both the USA and Europe as an exit option.

Unfortunately, in Australia, ESOP is not widely known, understood or utilised - my own research shows that business owners generally are unaware of ESOP as a strategy, believe it is expensive and / or complicated and perceived to be mainly for listed companies / larger corporates.

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In addition, both the ATO and ASIC work to make the implementation complicated and expensive - compliance documentation is lengthy, and the taxation provisions limit effectiveness in SME's - for example:

- The tax law limits each employee to owning less than 10 % of the equity in the business - in small businesses - for example a professional services firm with 4 key employees - each would necessarily own > 10 %. The use of ESOP's for succession has been widely recognised and was one of the recommendations of the 2004 Shared endeavours report. This limitation and focus on broad based plans limits the utility of these plans for succession.

- The deferred taxation rules (Div. 83A) serve to tax employees (on a deferred basis) without them having access to income /equity to fund the tax payment - we have several clients where this taxation impact will be far greater than the employees annual salary and may in fact force them to sell some shares to fund the taxation liability. The taxing point should be better matched to the realisation of value within the shares (and therefore access to cash to fund the taxation liability).

- The process of obtaining a Private Binding Ruling is slow and complicated - we have several instances where this process has taken longer than 6 months (the ATO default position seems to be that these plans are set up to avoid / minimise / defeat taxation).

- The taxation rules also favour broad based ESOP models (which are fine in some cases but not always) by requiring the plans be available to at least 75 % of employees with greater than 3 years' service. These are often not suitable in professional firms where ownership is typically focused on "key" employees.

In clients where the plans have been implemented, we generally see increases in staff retention, improved engagement (including ideas from employees to improve business processes), greater collaboration and overall, more profitable and valuable businesses. They are typically better prepared and equipped to grow and employ more people and contribute at a higher level to wider economic growth. Importantly, despite the taxation limits they do produce more viable succession outcomes.

Please see attached detailed supporting academic research including tax and legal issues.

Utilisation of Employee Share Ownership Plans (ESOPS) as a Business Succession and Exit Planning Tool for Australian Small to Medium Enterprises

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Abstract

This study seeks to examine the issue of business exit in Australia. The aim of this study is to determine which exit options are available to Australian business owners, and to examine the underlying reasons as to why owners choose to implement a particular exit strategy.

Ultimately, the goal of this study is to determine which options provide the best outcomes for a successful exit under various circumstances. In particular, this study will consider the potential use of employee share ownership plans (ESOPs) as a viable business succession and exit planning tool, with regard to better preparing the business for sale by reducing key person risk and by facilitating a potential sale of the entire business to the employees through the ESOP vehicle. The ESOP option can provide key outcomes related to financial reward/harvest for the owners and an ongoing legacy/stewardship outcome.

Therefore, this study seeks to identify and examine the effect of any potential barriers that might exist to restrict or prohibit the use of ESOPs. Accordingly, this research seeks to answer the following general research questions:

1. What are the succession methods currently being employed in Australian businesses?
2. Which exit options are preferred and what motivating factors are driving this choice?
3. What is preventing the take up of ESOPs as an exit option for Australian Small and Medium Enterprises (SME) business owners?

This work is significant given that the financial value of business assets, and wealth associated with those assets, held by ageing baby boomers is estimated to be approximately ten trillion dollars (Jackim & Christman, 2006).

Introduction

In line with underlying demographics, both in Australia and most of the developed world, a significant proportion of business owners in Australia are baby boomers and thus, are approaching retirement. According to the Australian Bureau of Statistics (2016), Australia's population aged over 65 years has increased by almost 20% since 2010. The ageing problem is particularly evident in the agricultural sector with the median age of Australian farmers increasing from 44 years in 1981 to 53 years in 2014 (Falkiner & Steen, 2016; Peel, Berry, & Schirmer, 2016). As a result, many of these people will need to transition the ownership of their small to medium enterprise (SME) to new owners. This change is not only crucial to the owners themselves, but also to Australia's economy and society. The collective value of the businesses involved represents many billions of dollars, and the ensuing change of ownership represents the most significant transfer of wealth in history (Keister & Deeb-Sossa, 2001). DeTienne, McKelvie and Chandler (2015) examined worldwide data on business succession and exit activity and concluded that wealth transfer is substantial in developed countries and warrants further scholarly examination. Lindsey, Mauck and Olsen (2017) reported that retiring business owners will sell or bequeath $10 trillion worth of assets over the next 20 years, we exit of millions of businesses.

Despite this, most business owners appear to give little thought to preparing for a successful exit from their business. According to the most recent State of Owner Readiness survey (Cooper, 2013), most business owners are seriously unprepared and ill-equipped to address business succession and exit planning issues, with the report finding that 48.6% of business owners aged between 50-59 years have no formal succession plan, and a further 34.6% have a non-documented (and not communicated) one. Unfortunately, this survey also highlighted that a high concentration of business owners' wealth is tied up in, or directly related to, their business. This survey estimated that, an average, 80% of a business owner's wealth was tied to their business. Of critical importance to this study, the survey also indicated that 67% of respondents were not able to identify all the various exit options available to them.

In examining the various exit options available to business owners in Australia, West (2013), as quoted by the Productivity Commission report into Business Setup, Transfer and Closure (Productivity Commission, 2015), proposed a model which outlines the various exit options in order of increasing complexity, cost and risk. The model also highlights the importance of selecting the most applicable exit option given the combined considerations of complexity and effort versus potential sale price or value. Figure 1 shows the various exit options that are available to business owners, and more importantly, the relationship between the chosen option and two dependent variables – the potential to maximise sale price/value and the level of complexity and effort involved.

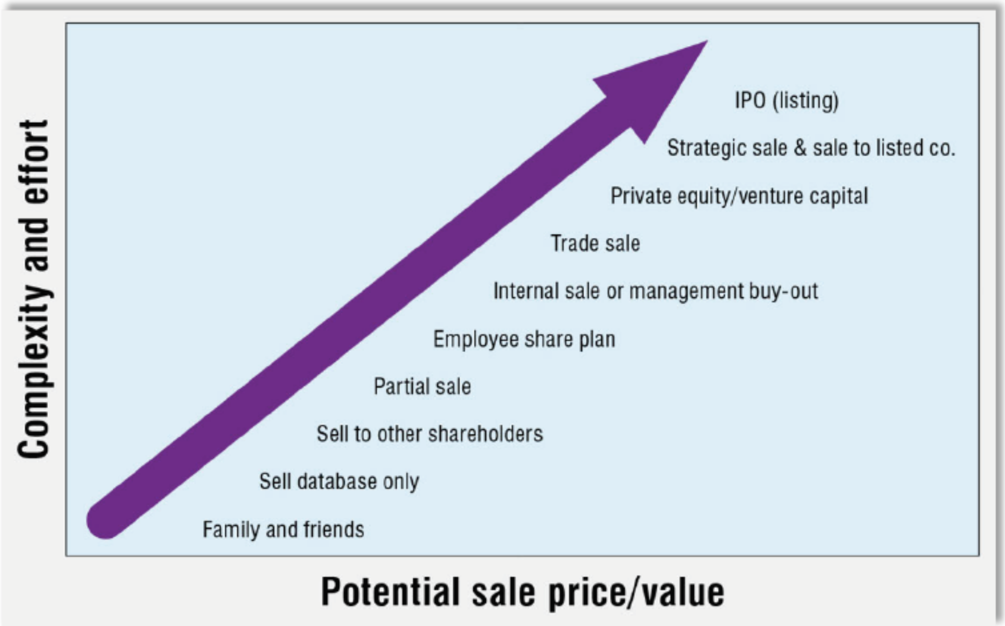


Figure 1. Business exit options: Complexity versus exit price. Note: extracted from Enjoy It – Business Succession and Exit planning, p. 40 (West, 2013).

Commentary in the Productivity Commission report (Productivity Commission, 2015) highlights the fact that the exit pathway chosen by businesses depends on many factors, including the ownership and management structure, the value of the business, its potential for growth and characteristics of the owner (such as age). The exit pathway chosen has implications for future business activity - whether business operations continue, and if so, in what form and how they are managed.

A survey by KPMG and Family Business Australia (KPMG and Family Business Australia, 2015) asked respondents which exit options they were considering and the likely timeframe for an exit. Interestingly, the results indicated that the majority were considering more than one exit option, with the most likely option being to pass management and ownership of the business to the next generation (see Table 1 below).

Table 1.. Exit pathways and timeframe of exit for family businesses

		Exit timeframe of businesses considering the exit strategy		
Exit strategy	Businesses considering strategy	Short term < 12 months	Medium term 1 to 3 years	Long-term 5 + years
	%	%	%	%
Passing senior management to next generation	67	18	25	57
Passing ownership to next generation	66	9	20	71
Sale to a competitor/trade sale	47	11	24	65
Sale to an independent third party	46	10	25	64
Appointment of non-family CEO or MD, but ownership and control remains within the family	42	14	24	62
Sale to a private equity consortium	23	14	20	66
Sale to current employees	21	11	14	75
Closure	18	11	13	76
Sale to family member	17	10	9	81
Initial public offering	16	3	14	83

Note: reprinted from KPMG and Family Business Australia - Family Business Survey, p. 29 (2013). CEO – Chief Executive Officer and MD – Managing Director.

The Productivity Commission report (Productivity Commission, 2015, p. 296) states that "although many business owners choose sale as the preferred business exit option, for the majority, this is not realised". The Productivity Commission noted that it is widely acknowledged within the business community that only around 40% of businesses listed by a business broker will be sold, and the remainder ultimately close.

While there is a paucity of research into Australian business succession planning, understanding business exit and succession planning issues is of critical importance to business owners, as their quality of life hinges on not only the amount they raise from the exit, but the legacy they leave behind.

Research into business succession can assist in understanding the various processes, motivators, behaviours, issues and trigger factors associated with succession. Given the vast amounts of money and people involved, research on these issues is essential to inform government policy in order to maintain economic productivity and foster growth.

Further, research into utilisation of super by the self-employed concludes that in the "run up to retirement (assumed to be ages 60-64 in this report), the self-employed have around half the superannuation of employees" (Clare & Craston, 2016, p. 5). This research suggests that there is a stronger dependence on sale proceeds from the business and related assets to fund retirement. The report goes on to highlight that for self-employed, business assets are also substantial contributors to non-housing wealth.

A comprehensive study (Foo & Ernest, 2010) explored the preparation and execution of business exits undertaken by SME business owners, and identified the processes that owners undertook to complete a successful exit, looking at preparation and execution. Successful exits were characterised by the likelihood of the business continuing to operate post-transition, the financial outcome for the exiting shareholders/founder and the continued employment of the workforce. Further work has also examined business exits and reviewed the issues surrounding exit planning and timing (Kotey, 2016), exit strategies, exit options via succession and exit intentions (DeTienne et al., 2015).

This study seeks to determine what exit options are currently used in Australia, and to explore the reasons why those options are being employed, as well as why other available options are not being used. Ultimately, the aim is to determine which options provide the best outcomes for a successful exit under which circumstances. Importantly, research on the drivers of exit option choices seems to support a combined strategy which merges the financial/harvest driver with legacy/stewardship drivers. In particular, this study will consider the potential use of employee share ownership plans (ESOPs) as a viable business succession and exit planning tool, both in terms of better preparing the business for sale by reducing key person risk and by facilitating the potential sale of the entire business to the employees through the ESOP vehicle. ESOPs are in everyday use in other jurisdictions such as the United States of America, but are not commonly used in Australia (Blaszczyk, 2014). One informative finding would be to determine why this is the case.

Limited research has also examined the increasing trend whereby private company baby boomer business owners are no longer confidently passing their business to the next generation within their family, and therefore need to consider other exit options, such as management buyout (Johnston, 2005). Johnston (2005, p. 56) states that this is mostly caused by "the stark reality that they do not have adult offspring or extended family members who are both willing and capable of taking over the reins". Johnston (2005) draws interesting comparisons with the United Kingdom

(UK) business market where approximately 30% of all business sales include management buyouts or similar structures, whereas in Australia, this is less than 5% (Brown, Rowan; O'Connell, Ann; Ramsay, Ian, 2012, p. 3). Johnston (2005) also notes two key factors directly related to the current research Firstly, owners refuse to talk to their employees about succession or exit due to the very private and personal nature of this conversation, and secondly, owners believe (rightly or wrongly) that the management team does not have the financial capacity nor the resources to purchase the business.

Scholes, Westhead and Burrows (2008) provided fresh insight into the ownership transfer of private family firms through internal management buyout (MBO) and external management buy-in (MBI) succession options. Their paper included an examination of the nature of succession planning and its impact on the business sale negotiation process. They analysed the results of a structured survey conducted in several European countries that investigated private family firms that had completed MBO or MBI deals. Scholes et al. (2008) found that management buyouts were associated with lower information asymmetry, highlighting the importance of information sharing and suggesting that family owners were not always in the most influential position, due to a long-term bias towards keeping information "within the family". This study also reported that internal managers with greater access to information were able to influence the negotiation process, and therefore, determine who was more likely to benefit from the price to be paid for the firm.

New Zealand research by Battisti and Okamuro (2010) highlights the lack of research attention previously paid to entrepreneurial exits. Their study employed a survey of small businesses to examine the determinants of intended exit modes between sale, succession or closure. The authors concluded that intention to sell a business is significantly affected by both the performance and size of the firm as well as the involvement of the family and the method of entry of the founder or owner. The authors examined various exit options, including an examination of MBOs, on the basis that recent evidence suggests that owners of private firms are increasingly considering MBOs, ESOPs and similar structures as viable exit options. While this research was undertaken in New Zealand, this market has apparent similarities to the Australian business environment, economy and legal framework.

There is substantially more acceptance and greater numbers of ESOPs in the USA. They also receive more generous taxation treatment. Thus, it is worth examining the effect this type of legislation might have on the take-up rate of ESOPs in Australia.

Background and literature review

Small to medium enterprises (SMEs) in Australia

According to the Australian Bureau of Statistics (ABS, 2016), there were 2,121,235 active businesses in Australia as of June 2015, and 12.4% or 263,000 exited in the 2014-15 financial year. Approximately 827,000 of those businesses had between 1 and 200 employees, and are therefore classified as SMEs. Approximately 60.5% had no employees. SMEs contributed 57.7% of total industry value added, representing approximately $29.6 billion (Department of Innovation Industry Science and Research, 2011).These businesses employed approximately 4.8 million people and were estimated to be valued more than $4.5 trillion (Green, 2015; KPMG and Family Business Australia, 2015).

Many of these businesses were founded in the late 1950's and 1960's by people who are now approaching retirement age, when business exit becomes unavoidable (DeTienne & Cardon, 2006; Hayes & Schervish, 2003; PWC, 2014). About 70% of privately owned businesses in Australia are owned by families (KPMG and Family Business Australia, 2015), and baby boomers own the majority. Baby boomers are those people who were born following World War 2, between 1946 and 1964.

Table 2. Australia's generational profile

Generation	Birth years	Number and %	% of workforce
Builders	1930-1946	2.56 m (11%)	1%
Boomers	1946-1964	5.21 m (22%)	34%
Gen X	1964-1980	4.75 m (20%)	42%
Gen Y	1980–1995	4.95 m (21%)	27%
Gen Z	1995–2010	4.35 m (19%)	2%

Note: table based on Australia's Generational Profile Infographic by McCrindle Research (2014).

Whilst the first baby boomers turned 65 in 2011(Australian Bureau of Statistics, 2016), many delayed retirement and will continue to constitute the dominant age group in Australia's population until 2029. According to the Productivity Commission (2015), the majority (57%) of business owners in 2015 were older than 45 years. Figure 2 illustrates this age demographic particularly well.

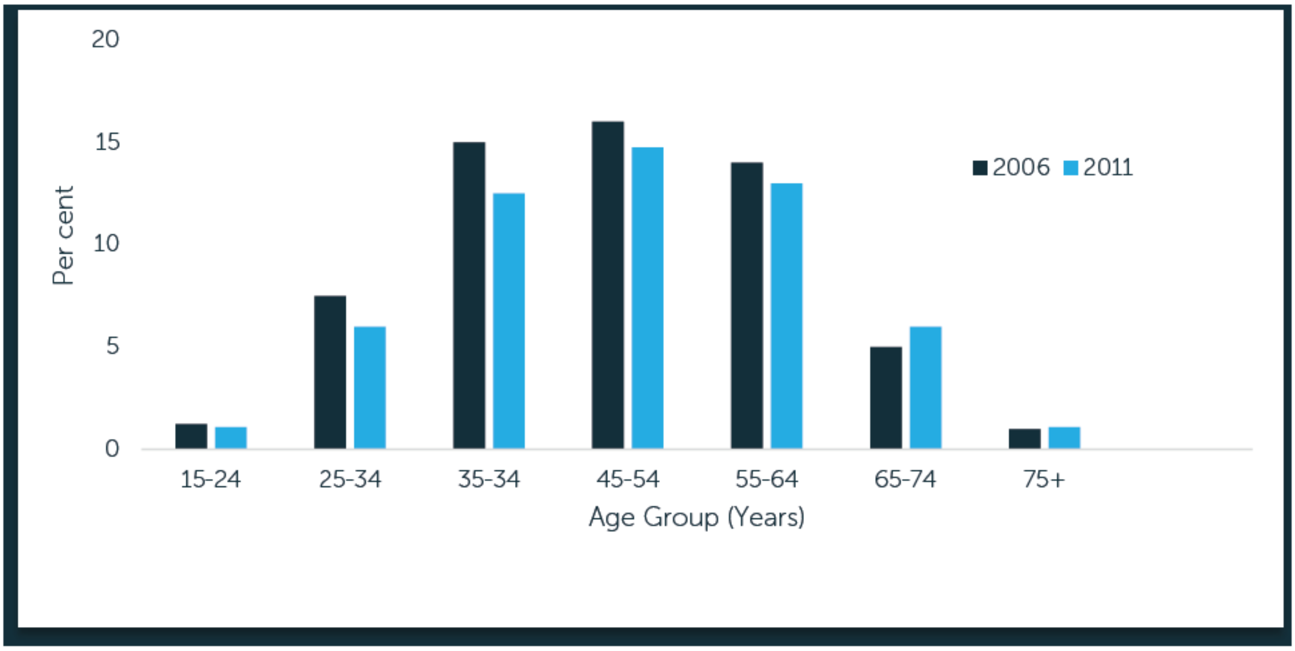


Figure 2. Business operators by age. Note: Source, Australian Bureau of Statistics (2016).

As business owners approach retirement, most will cease to own their businesses; however, up to 83% have no defined or documented business succession or exit plan (Cooper, 2013). The KPMG report on family business states that 76% of family businesses intend to appoint a new Chief Executive Officer in the next five years, and further, 72% expect to have some transfer of ownership in the next five years (KPMG and Family Business Australia, 2015). This represents a large number of transitions over the next ten years and a large amount of wealth to be 'transferred'. The transfer of ownership represents a significant stage in entrepreneurial activity. It is through this transition that founders remove themselves from the business they own, in terms of both ownership and decision making, and importantly, most plan to generate a capital surplus for their efforts (DeTienne, 2010).

Baby boomers are expected to turn 65 at a rate of 5,000 people per week, and this will continue for the next 19 years. In the USA, a similar situation exists, where it is estimated that due to the retirement of baby boomers, businesses with a total aggregate value of over $10 trillion US dollars will be passed down by 2025. Also, an estimated 65-75% of US family businesses (approximately 10 million in total) will likely be up for sale within the next five years (Doerksen, 2014).

Business succession and exit planning

Exit has been described as the full or majority transfer of ownership, shares and control from the owner to a successor; however, it is important to view exit as a process and not an event. Burlingham (2013) described it as a continuum of experience that begins long before the sale or transfer of the business. Burlingham (2013) proposed four main phases: a) exploratory, b) strategic, c) execution and d) transition.

Foo (2010 completed an empirical study of SME exits to identify and determine the processes that owners take to enable a successful exit. Foo (2010) stated that there is available literature devoted to, or focused on, business exits (or "harvesting" in his terminology) that does not include business cessation. Foo's research focused on the different results and impacts of two exit scenarios, that is, reactive (unsolicited offers from buyers) and proactive preparation and planning, as well as the different driving motivators of the owners. Whilst Foo's work only examined a small number of businesses (and all were successful exits), he stated that further study of exits, explicitly focusing on identifying and integrating buyer activities and approaches to the overall exit process, and including a more detailed study of comparative costs and resources associated with respective exit activities, would add significantly to the understanding of exit options.

Further research undertaken by DeTienne et al. (2015) examined worldwide data on business succession and exit activity, and concluded that the transfer of resulting wealth is substantial and warrants scholarly examination. The authors identified various exit strategies and condensed them into three higher-order exit options: financial harvest, stewardship and voluntary cessation.

Financial harvest refers to the ability of the owners to "harvest" the equity value in the business and successfully extract that value upon exit, such as by IPO or sale to an independent external buyer. On the other hand, stewardship does not involve any harvesting of value, but instead focuses on an ongoing role for the owners to have influence over the future and long-term viability of the firm, often via family succession or employee buyout. Voluntary cessation, typically liquidation or discontinuance, is primarily adopted when the business fulfils its original purpose or when the primary activity changes substantially.

DeTienne et al. (2015) study goes on to identify relevant predictor variables at the individual and firm level. The work includes a detailed examination of previous studies related to various exit routes and strategies. Interestingly, DeTienne et al. (2015) research classifies employee buyout (which can consist of ESOPs) as a stewardship exit strategy, as distinct from harvest; though, practical experience indicates that this does not necessarily need to be the case. Unfortunately, DeTienne et al. (2015, p. 263) focused on stewardship exit strategies and excluded ESOPs from their hypothesis and findings "due to the paucity of existing literature".

Further study on the issue of small business exit provided a detailed review of the research, and importantly, positioned the topic as a multidimensional and multidisciplinary process. DeTienne & Wennberg (2013) proposed three key theoretical perspectives on the issue of exit: career choice economics (individual exit); entrepreneurship (individual-firm interface is important); and strategy and organisational theory (firm exit - often as a failure). They analysed 28 prior studies of small business exits over the last 20 years, and categorised those studies according to the three perspectives outlined above, thereby creating a comprehensive matrix of the studies as well as the underlying theoretical perspectives. These perspectives may help to explain the various exit drivers and issues, including successful "harvest" exits and also exits as a result of failure; several of these aspects are linked to both firm and employee behaviour, and this links directly with some of the key aspects of employee buyout as an exit strategy.

The issue of entrepreneurial exit is often argued to be an important part of the entrepreneurial process (DeTienne, 2010). Value creation affects the ability to harvest the value of the business at some point in the future, and entrepreneurial exit has a significant effect on firms, industries and the general wider economy. DeTienne (2010) outlined various phases of the entrepreneurial process and examined each phase by exploring the development of an exit strategy, the reasons for exit and the various options available. DeTienne and Wennberg (2013) proposed that ownership structure affects the decision to enter the development of an exit strategy and further impacts the options for exit. This article included an attempt to link the decision to exit and varying exit options with ownership structures, and included a limited discussion of the potential to utilise an employee buyout or stock option as an exit strategy.

In terms of family business continuity and succession, Dana, Smyrnios and Bi (2015) examined management and governance practices utilised by family businesses and the relationship to multigenerational continuity of those businesses, including an examination of both family harmony and firm performance. Based on a national survey of Australian family business owner-managers, Dana and colleagues examined levels of awareness, acceptance and implementation of 35 main practices that can be used as tools for understanding and explaining continuity of family firms. The research included an examination of succession and exit options, and the level of preparation and education required to achieve a successful succession outcome.

This study was somewhat limited in that it only examined family-owned businesses and concentrated on multigenerational succession as the only potential successful outcome. However, it did classify seven key attributes – stewardship, governance, communication, professionalisation, education and development, continuity planning and corporate citizenship - which contribute to success. Further, they included continuity planning – succession, exit options, succession planning, timely retirement of incumbents - as a critical strategic planning and management issue to be addressed (Dana et al., 2015).

Iqbal (2015) investigated the idea of triggering the exit process with the concept of exit contemplation by a business owner, and examined the extent to which an SME owner's human capital, entrepreneurial orientation, firm performance and psychological ownership are related to their exit. Iqbal (2015) proposed that specific trigger events (and the underlying behavioural drivers) create different exit outcomes for business owners, depending on individual circumstances. Included in Iqbal's (2015) analysis was an examination of the various exit options available to business owners, and the potential drivers behind each, including the utilisation of ESOPs. This study was limited in geography and focused on Indonesian businesses only; therefore, it may have significant cultural bias. Nevertheless, the examination of the initial trigger and process upon which the owner decides to exit, and the effect that may have on the choice of exit option, is undoubtedly relevant to the current study.

Kang and Uhlenbruck (2006, p. 62) proposed that an important factor in determining "the stock of entrepreneurship at any point in time is the number of and quality of exit options available" to the entrepreneur. In other words, the decision to invest in an opportunity is partly dependent upon the likelihood of being able to exit and realise returns voluntarily. Wiklund, Nordqvist, Hellerstedt and Bird (2013) note that very little attention has been given to external ownership transitions in the literature; they state the following: "given that so many firms transition from the family business category, the choice of transition mode is worthy of more conceptual and empirical attention". Given the large volume and value of businesses to be sold, the capital required, and the lack of other baby boomers or family members to assume control, it is likely that professional financial buyers will play an increasing role.

The psychology of succession and exit

Popular literature highlights the key challenges owners face in transitioning from their role as owners and exiting their business (Burlingham, 2013; Peters, 2009; Prisciotta & Weber, 2005; PWC, 2014). Several of these studies identified lack of any documented exit strategy as a significant risk to continuity of the business, yet 63% of the owners had made no preparation for this inevitable event (Prisciotta & Weber, 2005).

The ultimate impact of failing to plan is that 70-80% of businesses fail to sell on the first attempt (West, 2015), and of those that do, the vast majority of sellers regret their sale within 12 months, and very few are satisfied with the price and terms (Burlingham, 2013).

Exit failure is most often attributable to the psychology of business owners (Peters, 2012). Peters (2012) asserted that the single greatest barrier is believed to be the owners inability to overcome psychological impediments. Several authors have argued that founder-owners experience a unique emotional attachment to their business which makes exit psychologically challenging (Akhter, Chirico, & Nordqvist, 2013; Hammer & Khelil, 2014; Iqbal, 2015; Sharma, Chrisman, & Chua, 2003b).

According to the available literature, for the majority of owners who fail to consider their exit strategy until they decide to actually exit, the strategic phase is likely to be hastily engaged (DeTienne & Cardon, 2006) mainly because they have not formed robust goals and answered critical, self-reflective and existential questions (Burlingham, 2013). As a result, these owners limit their potential or available exit options, and also lessen the opportunity to maximise wealth and legacy; at worst, some owners will fail to move through the strategic phase altogether.

A PWC study, reported by the Exit Planning Institute (Cooper, 2013), agreed with Burlingham's assertion that the transition phase is challenging for owners who do exit through a transaction, and found that 75% regretted their exit within 12 months. According to researchers at INSEAD (Kets de Vries, Carlock, & Florent-Treacy, 2007), the characteristics, behaviours and experiences of owners and entrepreneurs are the core of who they are and how they experience the world. Their attachment to the business and letting go of the business creates profound emotional challenges (Akhter et al., 2013; Burlingham, 2013; Forster-Holt, 2013; Iqbal, 2015; Kets de Vries et al., 2007; Weesie & Teeffelen, 2013).

Multiple studies have examined the common characteristics of successful entrepreneurship: 1. Tolerance for ambiguity; 2. Propensity for risk; 3. High innovation bias; 4. Need for goal achievement; and 5. Desire for control (Rauch & Frese, 2000; Shane, Locke, & Collins, 2003; Yusof, Sandhu, & Jain, 2007). However, there is little examination of how these characteristics, normally viewed as strengths, may become less desirable at the point of exit, and how they shape the self-image and identity of the owner.

Several researchers (Burlingham, 2013; Peters, 2009; Sharma et al., 2003b; Van Teeffelen, 2012) have determined that the psychological attributes of the owner are the primary contributing factor to failed business owner exits. Some authors (Burlingham, 2013; Noble & Walker, 1997) assert that failure to exit arises because owners fail to complete psychological tasks that are required during the early exploratory phase – exit is simply unnatural to the composition of most entrepreneurs. Weesie and Teeffelen (2013) suggested that owners' self-identity is strongly tied to their role, and claimed that it is the critical reason owners fail to exit. On the other hand, those entrepreneurs (typically serial entrepreneurs) who do view successful exit as a goal are typically intrinsically motivated to exit their role and harvest the fruits of their labour (Kets de Vries et al., 2007; Rauch & Frese, 2000; Waight, 2006).

Owners with a strong balance between work and non-work lives are able to find fulfilment and satisfaction in each domain (Gropel, 2005; Olson-Buchanan & Boswell, 2006). Business owners with a strong work life balance are likely to experience lower dissonance with the exit process than those whose balance is strongly work focused. The loss of the dominant focus – work as owner – is expected to create greater tension and may lead to avoidance of exit (Gropel, 2005; Olson-Buchanan & Boswell, 2006).

Additionally, while considerable work has been done in an effort to understand the unique characteristics of entrepreneurial exit (DeTienne & Cardon, 2006; DeTienne et al., 2015; Kaplan, Klebanov, & Sorenson, 2012; Wennberg, Wiklund, DeTienne, & Cardon, 2010) and the issue of emotional attachment with regard to exit (Akhter et al., 2013; Waight, 2006), several gaps in the literature remain. Researchers, owners, advisers and brokers all report that exit is a profoundly emotional experience (Burlingham, 2013; Peters, 2009; Weesie & Teeffelen, 2013)

Likewise, as noted by Hammond, Pearson and Holt (2016), there is "widespread acknowledgement that controlling families value many non-financial and family-related outcomes." Similarly, the PWC (2016) survey of family businesses noted that 72% of respondents measured success in more than just economic terms. Hernandez (2012) defined a stewardship-based exit strategy in which a selling owner recognises an "ongoing sense of obligation or duty to others". Miller, Le Breton-Miller and Scholnick (2008) noted that exiting owners under the stewardship-based exit strategy are willing to sacrifice financial gains for the welfare of other stakeholders.

Of particular relevance is the employee stakeholder group. This is an obvious choice given that the PWC (2016) survey indicated that 74% of family business owners believe that they do a better job of "looking after staff" relative to larger and publicly traded businesses.

Employee share ownership plans (ESOPs)

An employee share scheme (ESS), also referred to as an employee share option plan, employee share ownership scheme or an employee equity scheme, is a remuneration scheme under which firms offer their employees shares, stapled securities or rights to acquire them (options) (Department of Parliamentary Services, 2015). ESSs should not be confused with cooperative, mutual and member-owned firms (Senate Economics Reference Commitee, 2016), which may or may not have an ESS.

ESOPs are a means of enhancing enterprise performance through promoting worker productivity (Department of Empoloyment and Workplace Relations, 2000). There have also been studies related to use of ESOPs as a means of reducing agency costs through directly monitoring employees and through adopting incentive-based forms of remuneration (Pendleton, 2006). Principal–agent behavioural theory argues that employee logical self-interest, aversion to risk and effort creates costs for an organisation. In the absence of complete information, the principal (business owner) has to increase productivity through a mixture of compensation and monitoring of agents (employees). ESOPs are a way to align principal and agents efforts to improve productivity; however, a free rider effect is expected to diminish the effect of ESOPs in larger firms (Sesil & Lin, 2011). ESOP's have also been argued to reduce wealth inequality and improve firm and aggregate economic outcomes (Kozlowski, 2013). ESOPs are also considered by policymakers and advocates to be an important mechanism to encourage start-up activity by enabling Australian employers to improve cash flow and attract and retain talented staff at lower rates of wage compensation (when supplemented with shares or options) (Department of Prime Minister and Cabinet, 2014).

The Shared Endeavours Majority report identified three key interrelated objectives: ownership objectives – whereby plans are used to transfer all or part ownership of a company; remuneration objectives – whereby shares are used as an incentive for employees; and workplace change objectives – whereby shares are used to change the culture of the company (Department of Empoloyment and Workplace Relations , 2000, p. 30).

According to Landau, Mitchell, O'Connell and Ramsey (2007), employee share ownership "has enjoyed bipartisan support in Australia". Obviously, ESOPs can take many different forms and use many different structures to implement what is broadly described as an employee ownership model. There are two key models which vary primarily in the amount of equity they offer for employee ownership. "One category provides benefits to executives, while the other is aimed at general employees" (Brown & Lau, 1997, p. 34). The first category, majority employee-owned firms, are characterized by active employee involvement and a strong sense of ownership; employees are more involved in the corporate governance and decision-making processes. The secondly category, minority plans, are those typically found in larger companies; these offer a far smaller amount of equity for employee ownership, and are often a component of the company's overall remuneration and incentive planning; employees have little interest in governance or management participation. Accordingly, French (1987) argues that the orientation of minority plans is primarily focused on being part of a remuneration strategy.

The use of ESOPs varies internationally, as does the numbers of employee participants. The USA is seen as the leader of employee ownership with ESOPs emerging as early as the 1920's (Blair, 2000). The most recent wave of use commenced in the mid-1970s when specific ESOP legislation was introduced. According to the National Centre for Employee Ownership in the USA, 11,500 companies use an ESOP, encompassing 13.5 million employees and US$213 billions of ownership capital. The total of the various ESOP structures is estimated to involve about 20% of the US private sector workforce in share ownership (Blasi, Kruse, & Bernstein, 2003).

It is notable that ESOPs are most common in the Anglo-American economies, or what Hall calls the "liberal market economies" (Hall, 2001). This appears to be largely as a result of those governments having legislated to promote the plans and offer tax incentives. Various studies, such as that by Poutsma, Ligthart, Pendleton and Brewster (2013), have shown that regulation and fiscal concessions are key influences on the incidence of financial participation schemes (such as ESOPs). Though, according to the Shared Endeavours report, "very little of a substantive nature is known about employee share plans in Australia at all" (Standing Commitee on Employment Education and Workplace Relations, 2000, p. 41-42). According to the Office of the Chief Economist (2017), the percentage of Australian firms with ESSs grew from 0.23% in 2006-07 to 0.57% in 2014-15, and the average total ESS expenditure per firm per annum was $1.58 million; the average ESS payments per employee per annum were $10,200.

In simple terms, employee ownership provides employees with additional rights to those normally expected; a right to share in the company's profits, access to information on company finances and operations, and rights to participate in management (Rousseau & Shperling, 2003). However, there are multiple types of plans and multiple parameters within those plans; the extent to which employees are entitled to profits, information, management and participation rights varies considerably (Ben-Ner & Jones, 1995). "This variety means generalisations about employee share ownership have to be made with caution" (Kaarsemaker, Pendleton, & Poutsma, 2010, p. 316). According to survey data, the main reason for Australian firms introducing ESOPs is to motivate, attract and retain competitive and valuable employees (Landau, O'Connell, & Ramsey, 2013).

Legislative framework and issues

There is no single legislative framework for ESOPs – these schemes are covered by various aspects of corporations and taxation law. The Corporations Act 2001 (Cth) contains many of the general requirements concerning disclosure, fundraising and licensing that are relevant to both the initial implementation and ongoing management of ESOPs. While the legislation contains specific provisions relating to ESSs, it does not provide for separate or different treatment of employee-owned shares. An Australian Securities and Investments Commission class order does provide some conditional relief for companies that introduce complying schemes.

The most significant issues arise when dealing with smaller privately held entities – for example, the prospectus requirement may not be onerous for companies associating an ESOP as part of an IPO; however, "they are very significant and often insurmountable for small/medium unlisted companies" (Young, 1999).

In reviewing the various issues regarding disclosure, fundraising and licensing, a 2006 government issued consultation paper noted that "the discouragement of employee share schemes in unlisted companies...does not accord with the general policy of supporting the introduction of employee share schemes" (Commonwealth Treasury, 2006).

A company may elect to operate an ESOP through a trust for several reasons, including to administer the various performance, qualifying and vesting conditions, to manage the orderly and cost-effective acquisition and disposal of small shareholdings, and to enable a company to control and efficiently manage its share registry costs – this is a widely used structure for SME's.

The corporate regulatory regime is commonly criticised for imposing compliance costs that may effectively deny unlisted companies access to ESOPs (Australian Employee Ownership Association, 2007). A government report (Employee Share Ownership Development Unit) in 2004 found that "burdensome corporations law requirements" were imposing a "significant barrier" to businesses taking up an ESOP (TNS Social Research, 2004).

Landau et al. (2013) show company views on regulatory reform highlight several critical concerns, including the strong suggestion (64%) to introduce a single piece of legislation to clarify the multiple overlapping legislative issues, an increase in the $1000 concession (77%) and improvements to tax-deferred plans (Div. 83A), as shown by Figure 3 below.

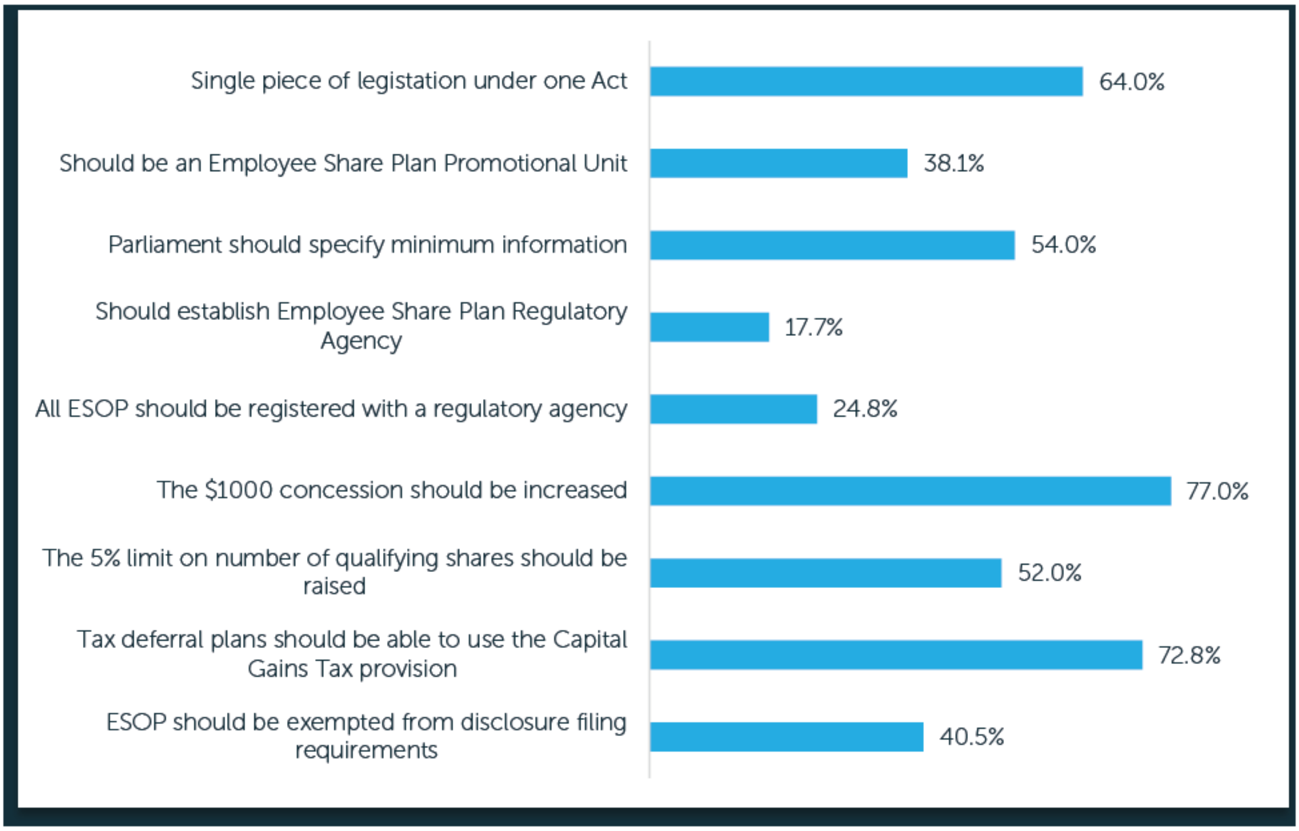


Figure 3..(Landau et al., 2013, p. 73).

Taxation law and treatment

In July 2015, the Australian government introduced several changes to the legislation covering the taxation of employee share plans; these changes apply to ESS interests (shares, stapled securities and rights to acquire them) issued on or after that date. There were changes to some existing rules as well as new concessions for employees of start-up companies. The main changes introduced were:

1. to the timing of the deferred taxing point for ESS interests acquired under tax-deferred schemes, including increasing the maximum deferral to 15 years;
2. the test for significant ownership and voting rights limitations was eased so that an individual may own up to 10%; and
3. that a tax refund is possible in some circumstances where an employee acquires rights but chooses not to exercise them.

In addition, for eligible start-up companies, where the company cannot be listed, they must have been incorporated for less than 10 years and they must have an aggregated turnover of less than $50 million; new concessions were introduced which provided for no upfront taxation on discount to market value and for any gain (or loss) to be assessed under the capital gains tax regime.

Several of the taxation concessions provided to employee share plans are dependent upon meeting several conditions, some of which are contrary to the business aims of those implementing the plan. For example, the concessions available through the rules in Div. 83A are based upon the scheme being non-discriminatory – this is defined as being offered to at least 75% of employees with more than three years' service. Often in an SME, employers are looking to incentivise only key/senior employees, typically far less than 75% of the employees.

The newly introduced Div. 83A has in fact made the conditions for accessing the concessions more demanding and costly for SMEs. Landau, O'Connell and Ramsay (2013) state that this is mainly because, whilst the government is seeking to encourage employee share ownership, it is overly concerned that the concessions may be subject to abuse Mong, (2000). In fact, Mong argues that the rules are too strict and have restricted the growth of employee share ownership in Australia. In the dissenting report to Shared Endeavours, the minority argued that the concessions have led to plans becoming "vehicles for aggressive tax planning for the benefit of company executives" (Rider, 2005). Further, wariness of ongoing reform has been attributed, at least in part, to fear of taxation abuse on the part of the Treasury (Price, 2003).

The 10% limit on shareholdings by individuals can serve to prevent SMEs from accessing the taxation concessions. It also prevents employee or management buyouts from occurring under Div. 83AA (Department of Empoloyment and Workplace Relations , 2000).

The graph below (Figure 4) highlights the influence taxation law and treatment has on business owners.

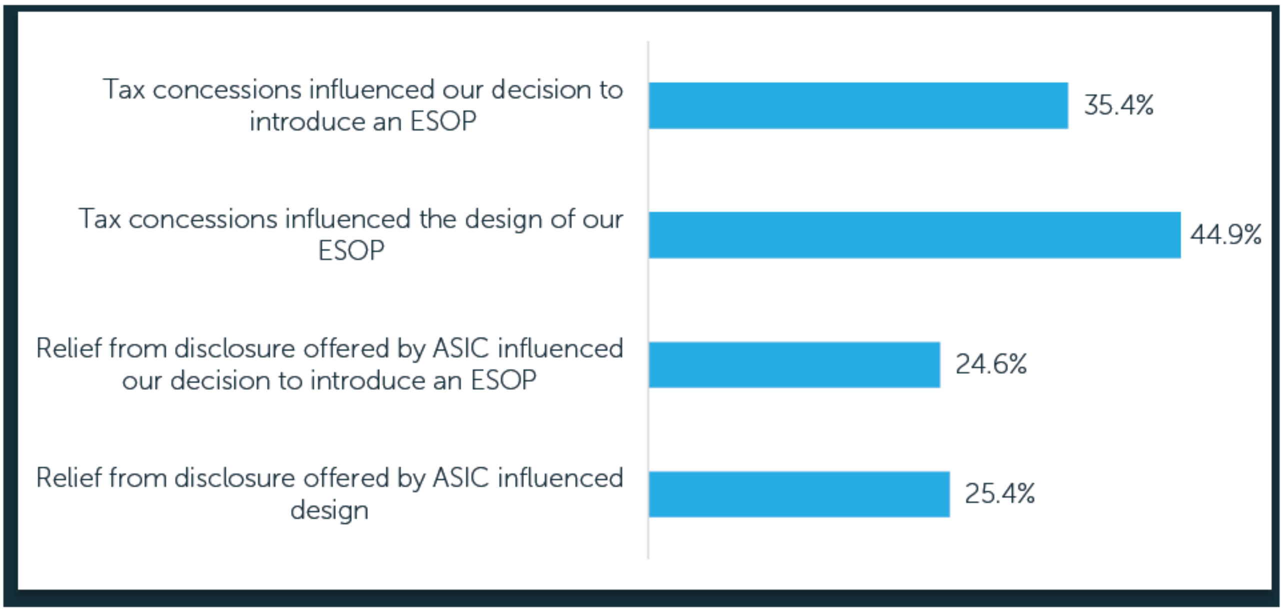


Figure 4 Influence of tax incentives and disclosure relief. Note: taken from Landau et al. (2013, p. 72).

1. Determinants of employee share ownership

In general terms, small, minority equity stakes are often acquired by employees of larger listed entities (Pendleton, 2001). The literature here is substantial and tends to focus on agency theory, that is, on the principal-agent framework and the issue of how the principal gets the agent to do what the principal wants (Jensen, 1976). Agency theory states that optimal employee arrangements will be a trade-off between incentives and risk. There is a substantial volume of material in the remuneration literature that suggests that higher risk facing firms are less likely to use incentive-based pay arrangements, possibly due to employee risk aversion (Bloom & Milkovich, 1998). Some additional key factors that have been identified as being related to the use of ESOPs include size, employment/workplace characteristics, risk and liquidity.

a. Size

Many studies (Festing et al., 1999; Kruse, 1996; Pendleton et al., 2001; Landau et al., 2007) have reported that size is widely associated with the adoption and use of ESOPs. ESOPs appear to be more suitable for larger firms primarily because of their lower transaction costs (Lenne, Mitchell, & Ramsay, 2006). As noted above, this is one of the key variables proposed to inhibit the adoption of ESOPs in Australia.

According to the ESODU research, whilst 30% of large businesses (those with more than 100 employees), 39% of companies with more than 50 offices in Australia, and 32% of companies with an annual turnover of $50 million had ESOPs, only 8% of private companies had ESOPs and 9% of small businesses (5-19 employees) had ESOPs (Department of Empoloyment and Workplace Relations (2000) . The Shared Endeavours report recognised that the adoption rate of ESOPs in the unlisted sector, since their introduction in Australia in the 1970's, has been significantly lower than in the listed sector (Department of Empoloyment and Workplace Relations , 2000, p. 21-22).

b. Employment/workplace characteristics

The research in this space appears to be uncertain and often contradictory. There is some evidence to suggest that ESOPs are most prevalent in professional sectors, such as professional services and IT (Kruse, Blasi, & Park, 2007). Other studies suggest that ESOPs are most likely to be used when production is human capital intensive, on the basis that there is a more extensive, often less skilled workforce that is more difficult to monitor (Jones, 2006). While other studies again have reported that workforce composition is not related to use of share plans (Pendleton, 2001). One study found negative relationships between share plans and teamwork on the basis of the free rider problem, whereby benefits are distributed amongst a large number of employees, and therefore, individual incentives become diluted (Kruse, 1996).

c. Risk

Agency theory states that optimal contracts between employees and owners consist of a delicate balance between incentives and risk. However, a 2002 study (Prendergast, 2002) suggested a positive relationship between risk and incentives based on the theory that, in more uncertain settings, the principal is better off delegating responsibility, and this requires the use of incentives such as ESOPs.

An additional consideration is the increased risk because of concentration – both incomes from employment and investment in the same business create a concentration of risk in one asset. If the business fails, then both income and investment are at risk, and in many cases, are lost. A 1996 US study (Kruse, 1996) suggested that employee-owners have superior retirement provisions, even excluding their ESOP stake, mainly because their firms are more likely to have defined benefit pension plans.

d. Liquidity

Firms with cash flow constraints and a high need for capital, which can often only be sourced at higher costs externally, may substitute equity compensation for cash payments to employees to reduce the cash required. While this usually is not succession related, it does highlight the funding aspect (and hence, perceived cost) of ESOPs (Core & Guay, 2001). An additional perspective is that share plans signal to employees that investment in human capital will be protected; the analysis completed by Robinsons (2005) , reveals that an ESOP is more likely to be engaged "in a workplace that depends upon and encourages employees to make valuable investments in their human capital...the evidence confirms the influential and independent role that employee share ownership plays in supporting human capital" (Robinsons, 2005, p. 484). The lower liquidity of unlisted firms and the difficulty in determining objectively the fair market value, both at the time of take-up and the time of employees exit, are fundamental difficulties in implementing broad-based employee share plans in unlisted firms (Landau et al., 2013, p. 55).

2. Employee participation

The issue of employee participation in ESOPs, while relevant, has been mostly disregarded until recently. This is because much of the early work was focused on majority-owned plans, and thus, the issue was mostly irrelevant as all employees typically received shares. Newer work focuses on the predominantly financial orientation of employees, and that income, and therefore, employees' capacity to participate, is a key influencer (Dewe, 1998). A recent European study based on the European Working Conditions survey of 2005 (Blaszczyk, 2014) found that employees in managerial/senior positions were more than four times more likely to participate actively with in the workplace as compared to unskilled workers. Accordingly, employee interest in participation is one of the factors identified as potentially impacting ESOP adoption in Australia. Consistent with previous work (Stradwick, 2000) and overseas research (Pendleton, 2002), participants in a Melbourne study (Landau & Ramsay, 2013) cited employee recruitment and retention as one of the most critical goals for the implementation of ESOPs in practice for unlisted entities. Australian ESS policy may benefit from additional incentives that encourage collective shareholding by employees (e.g., trusts) in order to limit the 'free rider' problem or incentivise complementary management practices (e.g., high level of information sharing) so as to encourage an innovative, cooperative culture (Conyon & Freeman, 2001; Kruse, 1996; Sesil & Lin, 2011).

3. Impact on employee attitudes and performance.

There exists a large volume of academic research, beginning as early as 1987, that is almost overwhelmingly positive in terms of the impact of an ESOP on employee attitude and performance (Klein, 1987). The study by Klein (1987) identified three key aspects of employee ownership affecting attitudes and behavioural change – intrinsic satisfaction, where ownership per se is sufficient to bring about attitudinal and behavioural change; extrinsic satisfaction, when ownership leads to attitudinal and behavioural change because it is financially rewarding; and instrumental satisfaction, where ownership brings about change by facilitating other outcomes that are desired by employees, such as more involvement and participation in decision making (Klein, 1987). This work was further developed by Brown, Pierce and Crossley (2014) who proposed that employee share ownership leads to a change in employee mindset, and ultimately, attitudinal and behavioural change. Although the results of all prior studies have been equally positive, several gaps in the research appear. For example, the question of what level of share ownership results in real attitudinal change has not yet been examined. The relationship between the level of employee share ownership and the level of performance is also strongly linked to culture and employee involvement (Beyster, 2007). Ownership alone does not necessarily lead to performance improvements, but employee involvement (Kato & Morishima, 2002) and company culture combined with ownership tend to lead to improved performance (Sengupta, Whitfield, & McNabb, 2007).

Further, several studies have focused on employee wealth and wages relating to ESOPs. For example, Blair (2000) found 8% higher compensation levels in public companies where broad-based ESOP plans held at least 5% of company stock. Kardas, Scharf, Keogh and Rodrick (1998) confirmed that the levels of pay and other benefits were similar between ESOP and non-ESOP firms in companies in Washington State in the US. They proposed that this was an indicator of the fact that ownership wealth from ESOPs does not substitute for present-day income, but instead, comes in addition to worker pay and benefits; thus, this results in far greater overall compensation packages in ESOP companies, and potentially more significant employee loyalty and engagement.

Regarding employment stability, Blair (2000) also found substantial evidence of increased job stability in US public companies with broad-based employee ownership plans, as compared to otherwise similar firms. ESOPs typically lead to a reduction in employee turnover, which may result in increases in productivity (Sesil & Lin, 2011). Employee turnover is also a reasonable measure of employee satisfaction, and is highly correlated to both firm and employee performance (Park & Shaw, 2013).

Rosen, Klein and Young (1986) used a scale to test for satisfaction with ESOP participation. They reported that 80.4% of respondents were "proud" to own shares in their company and 51.7% reported that it was "very important" to them that their company had an ESOP. Only 4.5% of shareholders "didn't care" about their company's ESOP.

4. Impact on workplace and company performance

Several studies have emphasised the capacity of ESOPs to retain valuable employees, either by signalling the firms commitment to their employees (Robinsons, 2005) by locking in employees through the deferred nature of share plans (Sengupta et al., 2007), or by linking employee rewards to the business cycle (Oyer, 2004). In addition, there are multiple studies (Beyster, 2007; Doucouliagos, 1995; Kaarsemaker et al., 2010; Kato & Morishima, 2002) on the financial, productivity and profitability effects of an ESOP, which are almost all positive. Most of these studies indicate that the improvements are often individually small but undoubtedly more significant when two things are combined – majority employee ownership (Doucouliagos, 1995) and employee participation and involvement in decision making (Kato & Morishima, 2002). Significantly, Sengupta et al. (2007, p. 152) concluded that "a substantial part of the explanation of this positive association with labour productivity and financial performance is due to the promotion of lower labour turnover in share ownership workplaces".

Kruse (1996) summarised the results of 11 studies evaluating performance before and after the adoption of an ESOP, comparing ESOP to non-ESOP firms and comparing post-adoption performance to matched non-ESOP firms. The study concluded that on average, for all the performance categories, ESOP companies did better per year than non-ESOP companies, and companies did better post-adoption than pre-adoption. They estimated the average increase in performance across tests and across studies was 4% annually (Kruse, 1996).

In a project report sponsored by the National Centre for Employee Ownership (NCEO), Kruse et al. (2007) examined all privately held companies with ESOPs in 1988, and found that they had a much higher survival rate than closely matched firms without ESOPs. Of the 1,176 private companies with ESOPs in 1988, 69.6% survived through to 1999, compared to only 54.8% of non-ESOP companies in the same industry and of the same size.

In a more detailed study, Blasi, Freeman and Kruse (2016) concluded that shared capitalist forms of pay are associated with high-trust supervision, participation in decisions, information sharing, and with a variety of positive perceptions of company culture. At the firm level, shared capitalist forms of pay are associated with lower voluntary turnover and higher Return on Equity.

Further, Blasi (2003) analysed 70 empirical studies on the effects of employee stock ownership, broad-based stock options, profit sharing and employee participation (which they describe as the four key aspects of "partnership capitalism"). They found that adoption of any of the four forms of partnership capitalism resulted, on average, in the gains listed in Table 3 (below).

Table 3. Investor Gains from Sharing Ownership (Blasi et al., 2003)

Performance measure	Gain from employee ownership
Average employee ownership	8% -- after dilution
Productivity	4%
Return on equity	14%
Return on assets	12%
Profit margins	11%
Total shareholder returns	2% -- after dilution!

In other words, the studies examined by Blasi show that, on average, companies and their investors made a profit on partnership approaches, including stock options, over and above other incentives offered to employees. They gave workers an 8% ownership stake, and in return, enjoyed an average of a 2% point higher return, even after considering the dilution of equity after 8% of the equity was allocated to employees.

Based on the ABS (2015) Economic Activity Survey, SMEs with an ESS had a 94% growth rate in sales and a 56% growth rate in value added per employee over a three year period, as compared to 62% and 29%, respectively, for SME's without an ESS (Office of the Cheif Economist, 2017). Further, 75% of 139 firms surveyed by the University of Melbourne either agreed or strongly agreed that having a broad-based ESS encouraged increased productivity (Landau and Ramsay, 2013).

5. Participation

It has been regularly argued that employee participation in decision making is a key contributing factor to the likelihood of ESOPs being able to secure attitudinal change and achieve improvements in company productivity; these arguments have been accepted mainly by policymakers (Blaszczyk, 2014).

In a relatively recent study, Brown, O'Connell and Ramsay (2012) reported results from a survey of a group of employees who were asked to rank the essential elements of an ESOP. Below are the factors ranked by percentage of employees who found them to be significant.

1. Financial payoff (68%)
2. Fair treatment (67%)
3. A sense of community (59%)
4. Employee influence on management of the company (42%)
5. Individual influence on decisions affecting daily work (38%)

While the first factor is financial and relatively obvious, the other factors are not related to financial issues and are more focused on employee involvement, engagement and influence. This indicates that while financial payoff was the most significant issue, the combination of other issues appear to be important to most employees.

Further research among companies who had an ESOP in place strongly supports the focus on alignment of interests, shared financial success and attracting and retaining key employees. The graph from this study Figure 5 below (Landau et al., 2013, p. 159) shows that a very high percentage of employers are looking to attract and retain key employees, as well as to align staff interests and share financial success; they are also using ESOPs as a mechanism to show the company values its employees. It is clear that the predominant objectives are based on workplace relations or human resource management rationales.

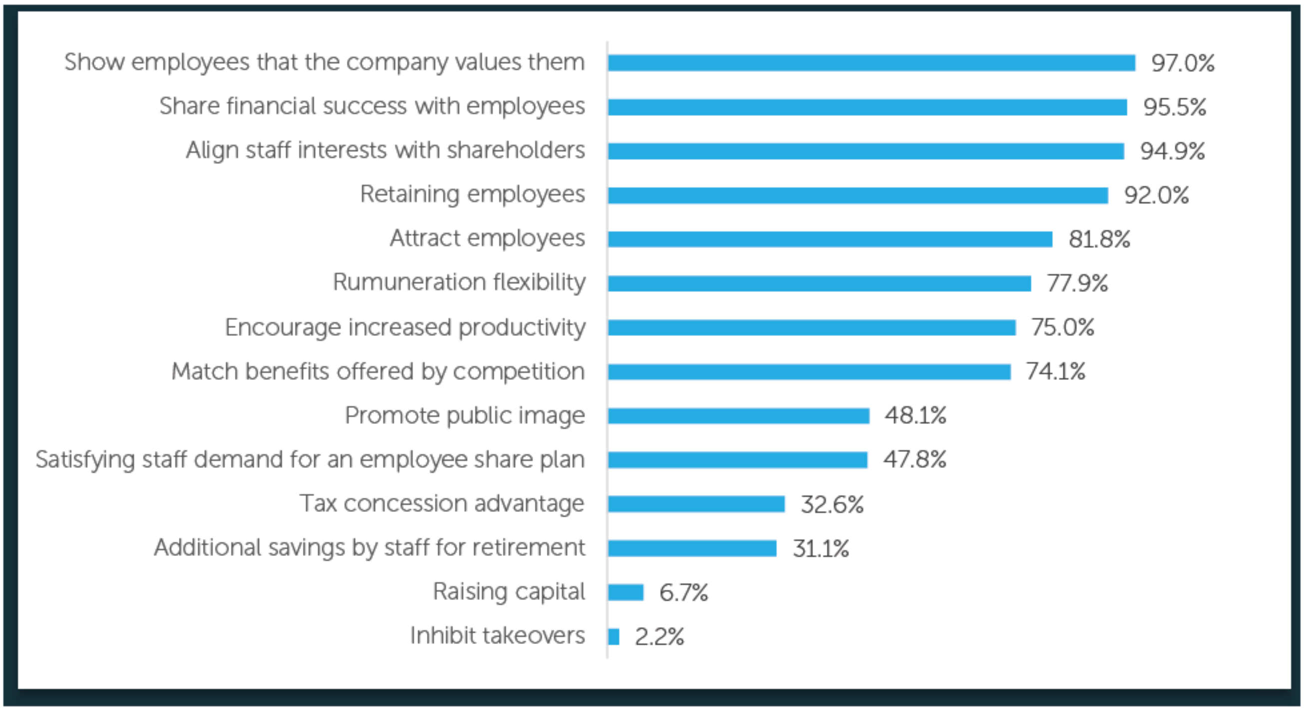


Figure 5.. Employer drivers for ESOP adoption Note from Landau et al. (2013)

In the same study, Landau et al. (2013, p. 161) provided a detailed list of potential barriers that were identified by companies who did not have an ESOP. This list was broad and diverse, with no individual item achieving higher than 40%. "This may suggest that many respondents have simply not considered ever having an ESOP or were apathetic towards the practice" (Landau et al., 2013, p. 162).

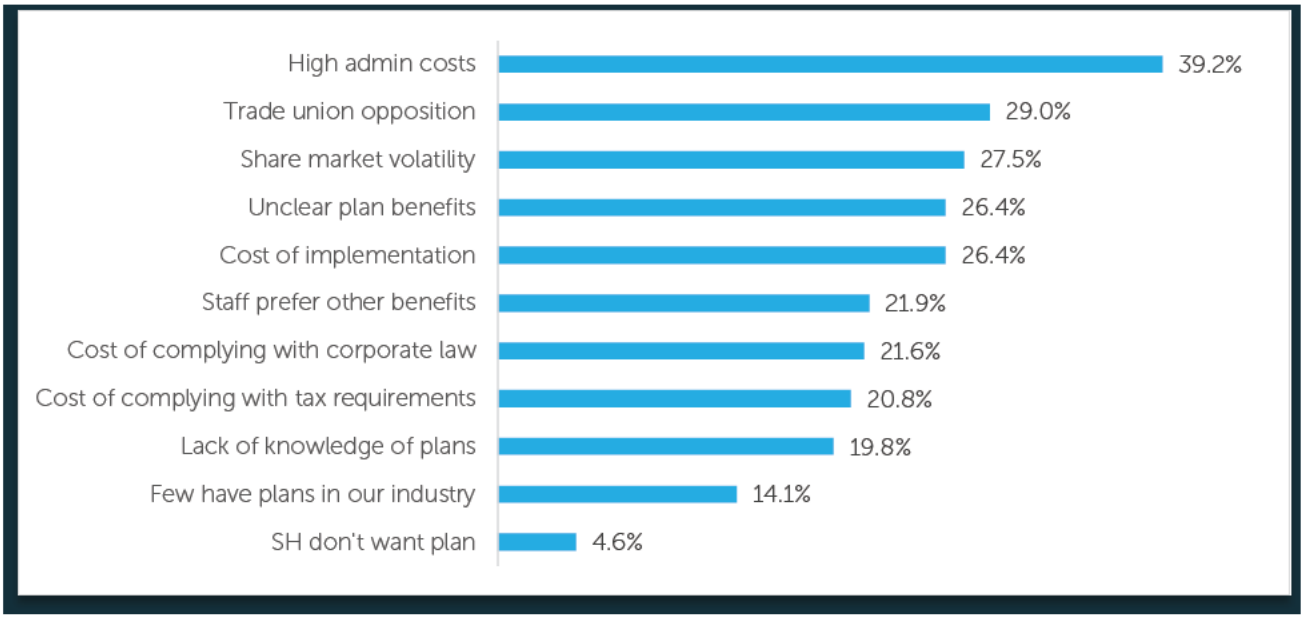


Figure 6.. Potential Barriers to ESOP adoption Note from Landau et al. (2013)

These findings are remarkably similar to the ESODU research (Department of Employment and Workplace Relations, 2004) which asked a similar question and reported four main barriers: a perception of lack of relevance of employee share ownership to the business, practical issues regarding tax and legal complexities, employee resistance and expensive set-up and maintenance costs.

Blasi (2003) summarised 10 different studies, as provided in the table below (Table 4), which analysed the relationships between employee ownership and satisfaction.

Table 5. Key employee owner satisfaction studies

Comparison	Authors	Source of data	Explanatory variables	Main results
Between employee owners and non-owners	Greenberg (1980)	Surveys of 550 employees in 4 US plywood coops and large non-employee owned firms	Co-op member-ship	Higher work satisfaction for co-op members
	Hammer, Stern & Gurdon (1982)	Surveys of 233 employees in 2 firms saved by employee buyouts, 1-2 years later	Owner-ship status, stake	Lower alienation from work among owners in both firms; Satisfaction similar for owners and non-owners in one firm; higher for some owners in other; Not linked to ownership stake
	Long (1978a, b; 1980)	Survey of 87 employees 6 months after 70% bought trucking co., and at knitting mill w/30% owners	Owner-ship status	Higher satisfaction for owners, but due to perceived participation rather than simple ownership status
Pre-ESOP/ Post - ESOP	Pendleton, Wilson & Wright (1998)	Three surveys of 234 employees in UK Bus Co, ESOP adopters.	Perceptions of ownership, process participation	Opportunities for participating in decision-making are more important than ownership per se in generating feelings of ownership, which are significantly associated with higher levels of commitment and satisfaction
	Long (1982)	Three surveys of 147, 184, and 248 employees, first one prior to employe purchase of Canadian electronics firm	Employee buy-out after first survey, Ownership stake	Satisfaction up for those perceiving increased participation, but down for those perceiving no change in participation. No relation to ownership stake
	Tucker, Nock & Toscano (1989)	Two surveys of 38 & 39 employees at small, fast growing US firm	ESOP adoption after first survey	Satisfaction up (but sample too small for significant results)
Between groups of employee-owners	Buchko (1993)	Survey of 218 employees in an ESOP company, 1987	ESOP account value, perceived influence	Perceived influence had positive effect on satisfaction, while ESOP account value had no significant effect.
	French & Rosenstein (1984)	Survey of 560 employees in firm with direct ownership	Ownership stake, perceived influence in job & co.	

While no link was found between the size of ownership stake or the dollar value of those stakes and satisfaction levels, the studies did, however, indicate that satisfaction and motivation were derived not from the size of ownership, but rather from increased participation and involvement.

In terms of direct benefit (Akerlof, 1982), the model of "gift of exchange" proposes that workers respond to the gift of employee share ownership or profit sharing with a reciprocal 'gift' of higher effort, co-operation and work standards.

Further, a recent meta-analysis of 102 samples covering 56,984 firms found a small but positive relationship between employee share ownership and firm performance (Boyle, Patel, & Gonzalez-Mule, 2016).

International comparison

"The incidence of ESOPs in Australian firms is growing, but appears low relative to European and US firms" (Office of the Chief Economist, 2017, p. 14). The depth and breadth of employee share ownership appear to be higher in the UK than in Australia. In 2000, 23% of UK workplaces surveyed had some form of ESOP (Gill & Krieger, 2000). Based on Australian Tax Office records, the number of employees receiving ESS payments increased from 227,000 in 2009-10 to 335,000 in 2013-14; this represents 2.91% of the labour force (Australian Bureau of Statistics, 2016).

The UK offers four employee share schemes with government sponsored taxation concessions. The two most common are share incentive plans (which utilise a trust structure to provide shares to employees, and can be free of initial taxation and tax free on disposal providing certain conditions are met, including the maximum total share value per annum not exceeding £9,000) and save as you earn schemes (a contractual arrangement with a bank to save to fund purchase of shares in the employer). These are both broad-based plans and so must be offered to all employees. The other two schemes, company share option plans (whereby an employer can grant options to employees up to £30,000 per employee, as long as no employee exceeds 25%) and enterprise management incentives (a scheme targeted at start-up companies where each employee can be granted up to £120,000 worth of options in the first round, as long as the total does not exceed £3 million per company – on this basis there is no tax liability on granting or exercise, but capital gains tax will apply on sale of the shares) may be offered to selected employees.

In 2014, additional changes were made to UK tax law which provided new benefits. Specifically, employee ownership trusts work as follows: company owners who sell a controlling interest to an employee ownership trust can claim full exemption from Capiatl Gains Tax, and a company controlled by an employee ownership trust may pay annual bonuses to employees, free of income tax. Some conditions apply, mainly to ensure broad-based benefits to all employees, though some variation is allowed under the rules, for example, based on salary and length of service and/or hours worked. Postelthwaite (2014, p. 46) states that these recent improvements have "the potential to make employee share plans attractive to more private companies".

Interestingly, in Japan, where ESOPs were introduced by the government back in 1967, primarily as a mechanism to prevent foreign takeover, growth in ESOPs has been strong and consistent over many years. One cultural explanation for the apparent popularity, especially given the complete lack of any taxation incentives, is that the Japanese have managed to substantially reduce the adversarial relationship between labour and management that has been traditional in Western economies (Benelli, Loderer, & Lys, 1987).

It is well known that the USA has the highest rate of employee share ownership. As of 2010, it was estimated that 36% of the USA workforce owned equity in their employer through one kind of ESOP or another (National Centre for Employee Ownership, 2010). Combined, they controlled assets worth more than $US 1200 billion (National Centre for Employee Ownership, 2010). Interestingly, in dramatic contrast to Australia, the vast majority of ESOPs in the USA are found in unlisted companies. Private companies are more likely to offer ESOPs than public companies. Public companies account for only 12% of all companies with employee share ownership (Blasi, 2003).

The taxation treatment of ESOPs (and similar plans) is vastly different in the US; three significant tax concessions are available (Landau et al., 2013). First, the employee stock ownership plan (US ESOP) is the principal legal vehicle for meaningful (i.e., greater than 5%) employee stock ownership in the US. Company stock is not purchased but instead granted to workers. Second, the employee stock purchase plan (ESPP) is a scheme that offers stock or options, and must be offered to all employees, but can take different forms. Third, the incentive stock option plan (ISO) provides options that can be granted on a discretionary basis. In general, if the ISO or ESPP requirements are met, the taxpayer is not taxed on receipt or exercise of the option. Instead, the employee is taxed on disposal under the capital gains tax regime. However, the employer does not get a tax deduction for contributions to the tax-advantaged schemes. By contrast with Australian rules, "the US ESOPs offer much more generous tax incentives" (Landau et al., 2013, p. 210), but corporations must be fair and equitable in distributing benefits to most workers.

The US ESOPs provide "very generous deductions for employers" (Landau et al., 2013, p. 214) and are often seen as a tax effective exit strategy by SME business owners. Finnell (2011) has published an article highlighting the clear taxation advantages in the US for business owners looking to use an ESOP as a succession tool. The author encouraged advisers to understand these benefits and to explain them to their baby boomer clients.

A review of taxation incentives, which are substantially stronger in both the US and the UK, consideration of the regulatory framework, which is far less conducive in Australia, recognition ofthe more burdensome disclosure requirements and a cost comparison leads to the conclusion that the "framework in which Australian employee share schemes operate does not create an incentive to establish such schemes compared to the US and UK" (Landau et al., 2013, p. 229).

ESOP performance

Lenne et al. (2006) highlighted the increasing interest in the use of ESOPs and explored the various policy rationales for these schemes. The author noted both broad bipartisan political support and a limited conception of the fundamental purpose of such schemes. Their paper focused on corporate governance issues, particularly in light of the increased employee participation which is typical post-introduction of an ESOP. They also attempted to outline the various types of ESOPs and the incidence of those plans within the business environment.

In examining the potential to utilise an ESOP, a key consideration is the effect it might have on the employees. To that end, McElvaney (2011) examined whether ESOPs are a viable method of providing employee incentives by comparing overseas and local business experiences. Significantly, the study concluded that struggling companies with ESOPs delivered improved economic value to both shareholders and employees. The study strongly supported the notion that ESOPs can achieve improvements in performance and profitability. However, the study was limited by its focus on only ASX listed entities.

Data taken from the Australian Workplace Industrial Relations survey of 1995, by Brown and Lau (1997), demonstrated a negative correlation between lower rates of absenteeism and higher productivity in companies with ESOPs (especially those with broad-based participative practices). Significantly, the participation theme was noted in several other studies (Pendleton 2001 , Brown & Lau 1997, Peetz, McNabb & Whitfield) whom all concluded that corporate performance is only improved where increased participation in decision-making accompanies the adoption of an ESOP. Bagchi (2008) also reported that "those interested in enhancing firm performance should expand opportunities for employee influence in the firm".

As noted by both Pendleton and Lenne and Mitchell and Ramsay, one of the key benefits of an ESOP is that it provides employee shareholders with additional rights to those they ordinarily possess as workers, without infringing upon the principles of existing company law. Importantly, in terms of business performance, employee shareholders are likely to have a considerably longer time horizon and are likely to have additional objectives further to short-term profit maximisation, including but not limited to long-term job security (Pendleton, 1997).

A study by Blaszczyk (2014) examined a staged approach to introducing employee share ownership. The research worked through three stages of employee profit-sharing: income based profit sharing, a mixed system, which included both profit-sharing and equity, and finally an ESOP which involves pure equity. Blaszczyk (2014) concluded that further examination of the vast differences in scale and scope of financial participation and incidence of employee share style plans in varying international economies, including an examination of the motivators and performance effects of ESOPs, is needed.

There is increasing international evidence that broad-based ESSs generate greater benefits to firm performance if regularly offered to employees (Sesil & Lin, 2011).

Employee engagement and psychological ownership

When employees are also owners, their relationship with the organisation is changed, and this affects the way they think and behave (Druskat & Pescosolido, 2002; Duncan, 2001; Gamble, Culpepper, & Blubagh, 2001).

Implicit to the discussion of psychological ownership as a group-level phenomenon is that it involves both shared beliefs and norms of behaviour that are aligned with the long-term interests of the organisation (Wagner, Parker, & Christiansen, 2003; Long 1978). Theory and research on employee ownership suggests that employee owners exhibit behaviours that are intended to enhance the financial status of the organisation. This can include improving their job performance, finding ways to cut costs and suggesting innovative ways to increase revenue (Druskat & Pescosolido, 2002; Duncan, 2001; Long, 1978). This suggests that participation in employee ownership is associated with employees believing that they have shared interests with the organisation that employs them and employees acting in a manner that promotes those interests. Thus, employee ownership plans encourage employees to think and act like owners, and this enhances organisational performance (Wagner et al., 2003).

ESOP as a business succession and exit planning tool

A small amount of research has also examined the increasing trend whereby private company baby boomer business owners are no longer confidently passing their business onto the next generation within their family, and therefore, need to consider other exit options, such as MBO. Johnston (2005) draws interesting comparisons with the UK business market, where approximately 30% of all business sales include MBOs or similar structures, whereas in Australia, only 10% of all businesses have some form of ESO, and only 4% have a broad-based plan (Department of Employment and Workplace Relations, 2004). The paper continues by proposing two key factors that are directly related to the hypothesis in my research topic. That is, firstly, owners refuse to talk to their employees in relation to succession or exit due to the very private and personal nature of this conversation, and secondly, owners believe (rightly or wrongly) that the management team does not have the financial capacity nor the resources to allow them to purchase the business.

Scholes et al. (2008) provided fresh insight into the ownership transfer of private family firms through internal MBO and external MBI succession options. Their study examined the nature of succession planning and its impact on the business sale negotiation process by conducting a structured survey of private family firms in several European countries that had completed MBO or MBI deals (Scholes et al., 2008). They found that family firms that had achieved MBOs reported lower information asymmetry, highlighting the importance of information sharing. They further concluded that often family owners are not always in the most influential position to make a decision regarding exit options. They also proposed that internal managers with greater access to information were able to influence the negotiation process, and therefore, determine who was more likely to benefit from the price to be paid for the firm.

Burke (2015) undertook a detailed examination of the use of employee stock ownership plans in succession; though, their study was entirely focused on the US market, where significant tax and legal benefits are attached to employee share plans (the US has a vastly different tax and legislative regime to that of Australia). Burke's study (2015) supports the utilisation of ESOPs as a succession tool, and notes other advantages of ESOPs in terms of continuity of management and control and reductions in key person (employee) risk.

Other studies have examined potential legal and policy issues that might limit or prevent utilisation of ESOPs, especially in smaller privately held businesses. These issues include concern around imposing costs for non-employee shareholders and dilution of the capital base, therefore disadvantaging non-employee shareholders and resulting in a potential loss or reduction in control when the business is small and privately held. In addition, some managers may be wary of the potential for ESOPs to lead to greater control by employees due to block voting. Stradwick (1996)dismissed this fear as "so remote as to be almost nil". Finally, concerns are often raised as to the perception of ESO as a tax avoidance vehicle and its potential use as a means of avoiding tax (Department of Employment and Workplace Relations , 2000, p. 251).

Both Pendleton (1997) and also Michie and Oughton (2001) have suggested that the use of trust structures (often used as the vehicle to manage an ESOP) may enable employees to take a more proactive role in corporate governance, as the trustee may canvass employee opinion and vote employee shares "as a block". Moreover, the use of a trust serves to maintain confidentiality of employee participants (Michie & Oughton, 2001).

In a 2006 KPMG family business survey, respondents were asked a series of succession-based questions. Respondents indicated that selling the business to employees, management and other owners was the second most popular choice for succession and exit after sale of the business on the open market. This succession option ranked above passing the business on to other family members, and significantly higher than publicly listing the company (KPMG and Family Business Australia, 2006). Therefore, there is "a great potential for the use of ESOPs as a vehicle for transferring ownership to facilitate smooth exit of current owners" (Landau, Mitchell, O'Connell & Ramsay 2007, p. 165-166). This mechanism is prevalent in the US, where ESOPs are most commonly used by employees in private firms to buy out an owner (National Centre for Employee Ownership, 2010).

Scott Miller, a well-known advocate of ESOPs in the US, examined several critical issues involving the adoption of ESOPs for small businesses (Miller, 2010). Miller (2010) stated that there is a significant amount of research and empirical evidence that shows that ESOP companies generally outperform their non-ESOP closely owned counterparts. He goes on to acknowledge that the "studies reinforce what is already generally known amongst business writers and consultants: the open sharing of information is a superior organisational structure that typically contributes to longer-term financial success" (Miller, 2010, p. 33). Miller (2010) also examined the tax incentives and advantages available, though again, these relate entirely to US law and are not relevant to Australian SMEs. However, Miller (2010) does also refer to the fact that governments, including the Australian government, have made recent moves to support the implementation of ESOPs.

In more recent research, Pendleton & Robinson (2017) look into the increasing incidence of an ESOP for the purposes of faicliatting business succession, which they claim has ioncreased from sixteen percent in the late 1990's to thirty-nine percent in the 2017 White Rose Employee Ownership Centre survey results. They further attribute this increase as a desire by owners to exit but not sell the company to a competitor or family member, whilst "protecting the company and the interests of the company's workforce as the owner exits." They also note that in instances were succession was the predominate driver the average lev el of employee ownership was 85 percent and that the vast majority, 95 percent were held indirectly, i.e. in a trust.

A further significant gap in the research is the lack of any detailed examination of the effects on ESOPs upon owners who lead the transition (Freeman, 2007). The decision on whether to adopt an ESOP at all, and the various design and implementation parameters, all rest with the existing owner, and there is little work on the impact of adoption on him or her. A detailed examination of this issue could provide a firm basis for assisting other owners to make these decisions.

In addition, the government sponsored Shared Endeavours report (Standing Commitee on Employment Education and Workplace Relations, 2000) included in its recommendations that "public policy be formulated to promote employee share plans for the following purposes:
to better align the interests of employees and employers;
to develop national savings;
to facilitate the development of sunrise enterprises; and
to facilitate employee buyouts and succession planning" (Standing Commitee on Employment Education and Workplace Relations, 2000, p. 54).

One potential barrier which is highlighted in several studies (Pendleton, 2001; Pendleton & Robinson, 2010; Robinson & Wilson, 1992) is the lower liquidity of unlisted, privately held firms and the difficulty in objectively determining the fair market value, both at the time of take-up and the time of exit of employees. Additionally, Dewe (1998) argues that employees adopt ESSs when they are more positive to ESSs in general, as opposed to their specific attitudes towards their employer. This cultural aspect may explain the relatively low incidence of ESSs in Australia compared with other countries such as the US.

Conceptual model

Entrepreneurship researchers have only recently begun to examine the influence of determining factors on entrepreneurial exit route decisions (DeTienne & Cardon, 2012). In family business studies, variation in the choice of exit options is mainly ascribed to the presence of several individual, relational, financial and contextual factors that impede the preferred internal succession model (De Massis, Chua, & Chrisman, 2008). Family business research also highlights that an owners attachment to his or her firm is particularly rooted in non-economic reasons, such as legacy concerns, which grow stronger over time (Zellweger, Kellermanns, Chrisman, & Chua, 2012).

Based on the review of the literature, it appears that there are two broad types of motivators driving business succession and exit planning projects – financial / harvest and legacy /stewardship,in addition to voluntary cessation (a failure to successfully exit) (DeTienne et al., 2015). These two types produce very different outcomes and are driven by very different motivating factors.

Financial/harvest motivators for exit are more widely covered in the literature (DeTienne et al., 2015; Foo & Ernest, 2010). Much of the literature in this area focuses on financial payout and harvest in terms of owners' ability to harvest the equity value, typically through exit to an IPO or sale to an external buyer – strategic sale, private equity, and sale to larger, often listed, entities.

Recent research shows that owners of privately held businesses care about the company's post-succession prosperity, indicating that the outlook for the firms future affects their exit decisions (DeTienne & Cardon, 2006; DeTienne, 2010; Graebner & Eisenhardt, 2004). Several family business researchers (Sharma, Chrisman, & Chua, 2003) also acknowledge the intertwinement of owners and businesses and their subsequent concern about the future wellbeing of the organisation and its stakeholders. Dehlen, Zellweger, Kammerlander and Halter (2014) concluded that owners' concerns regarding the prosperity of their firm may continue well beyond the period of ownership.

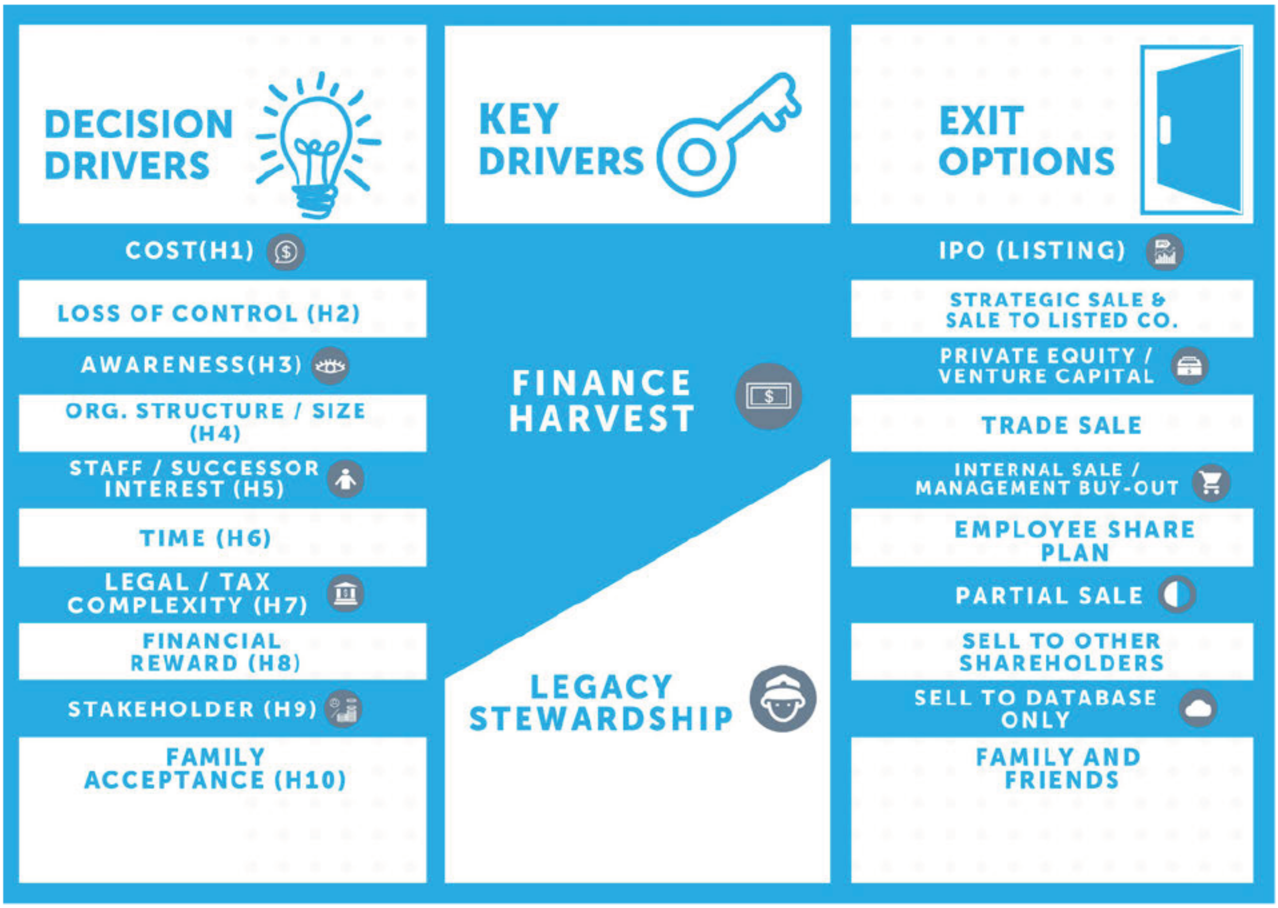
The literature on stewardship and legacy focuses on the psychology of succession, and the issue of role identity fusion, that is, the owners inability to separate their role as an owner from their identity as an individual, leading to blurred boundaries (Taylor, 2017). Weesie and Teeffelen (2013) described owners' self-identity as being strongly tied to their role, stating that this is the critical reason owners fail to exit. Role identity fusion is described by Swann and Buhrmester (2015) as the concept of self-identity being tied to a role. Byrnes (2010) asserted that founding entrepreneurs with a significant ownership share and management responsibility frequently have a heightened psychological connection to the firm.

For these owners, their attachment and inability to let go of their business creates profound emotional challenges (Burlingham, 2013; Iqbal, 2015; Kets de Vries et al., 2007). The research outlines the very strong "understanding that in these cases, time is a salient factor"(Taylor, 2017, p. 80), and supports the work of Burlingham (2013) that suggests that owners who engage in a more robust exploratory process can make time a competitive advantage by starting years not months prior to the intended transition.

Tantalo, Caterina and Priem (2016) proposed a model that considers a combination of external interests – shareholders, customers, suppliers, employees and community - in the value creation formula. However, Jensen (2001) suggests that for owners looking for wealth maximisation (harvest) only, then none of the terms of other stakeholders should be of concern. Lindsey, Mauck and Olsen (2016) focused on the PwC 2016 survey (PWC, 2016), which indicated that up to 72% of business owners measure success beyond just financial profit and 74% of family business owners believe they do a better job of looking after staff than larger businesses. Importantly, Lindsey, Mauck and Olsen concluded that the owner/manager does not need to sacrifice wealth to benefit employees (Lindsey et al., 2017)

Work by Sund, Melin and Haag (2015) outlined the various antecedents and preparatory requirements for successful intergenerational ownership succession. The antecedents are grouped in terms of family culture and support arenas. The preparatory requirements are grouped into psychological factors and legal/financial factors; this grouping is indicative of the conceptual model groupings around legacy/stewardship and financial/harvest, though the authors do not match their antecedents and preparatory requirements in the model with exit choice.

This research conceptual model proposes that the two key focus areas or drivers of exit outcomes – financial/harvest and legacy/stewardship - drive very different processes and timelines. This is of significance to the use of an ESOP as a succession tool, as ESOP succession is normally a long-term gradual process, far more closely aligned with stewardship, and provides rewards for both shareholders (stewardship) and employees (legacy), whilst also providing a financial outcome for the owners. Thus, it is a combination strategy that can overlap both drivers and include factors of both drivers – financial / harvest and legacy/stewardship.



Research question and hypotheses

In addition to determining which methods for business succession are commonly used in Australia, and why they are used, this study will examine the use of ESOPs. As indicated above, the utilisation of ESOPs in both the US and UK is far more common than here in Australia (Brown, Rowan, O'Connell & Ramsay, 2012). Anecdotally at least, there is no financial or practical reason why ESOPs should not be more widely used in Australia for business succession. Therefore, this study seeks to identify and examine the effect of any potential barriers that might exist to restrict or prohibit the use of ESOPs. Accordingly, this research will answer the following general research questions:

1. What are the succession methods currently being employed in Australian businesses?
2. Which exit options are preferred, and what motivating factors are driving this choice?
3. What is preventing the take up of ESOPs as an exit option for Australian SME business owners?

The literature described in the preceding sections indicates that several barriers may limit or prevent the adoption of ESOPs as an exit strategy for Australian SME business owners. These barriers present a series of testable hypotheses:

H_1 There is an inverse relationship between the cost of an exit option and its adoption. Exit option choices with lower cost will be preferred.

H_2 There is an inverse relationship between business owners' perceptions of loss of control and exit option choice. Exit option choices with a greater degree of owner control will be preferred.

H_3 There is a positive relationship between the awareness of an exit option and its adoption. Exit options of which owners are more aware will be preferred.

H_4 Exit option choice is determined by its perceived relevance to an organisational structure. There is a perception that some exit options are only relevant to larger listed corporations.

H_5 There is a positive relationship between staff interest in an exit option and its adoption. Exit option choices with a greater degree of staff interest will be preferred.

H_6 There is an inverse relationship between the length of time required to implement an exit option and its adoption. Exit options which require less time to implement are preferred.

H_7 There is an inverse relationship between the complexity of the legal and taxation arrangements of an exit option choice and its adoption. Exit options which have less complex legal and taxation arrangements are preferred.

H_8 There is a positive relationship between the financial reward provided by an exit option choice and its adoption. Exit options which provide greater financial reward will be preferred.

H_9 There is a positive relationship between stakeholder and family acceptance of an exit option and its adoption. Exit options which provide greater stakeholder and family acceptance will be preferred.

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