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House of Representatives

Standing Committee on Employment, Education and Workplace Relations

The Australian Employee Ownership Association Survey

Background

This submission is further to discussions with Mr Andrew Brien of the Commission's staff about factual material on employee share plans in major Australian companies obtained from a survey that I am carrying out on behalf of the Australian Employee Ownership Association. This survey is confined to general plans as distinct from selective plans.

This submission is not related to the submission that I sent in May 1999 (number 25).

Summary

This submission covers three areas.

1. It sets out the nature of the AEOA survey and outlines factual material obtained from initial returns. This is covered in the appendix to the submission.
2. It draws six conclusions from this material (Part A).
3. It suggests a way of overcoming some major problems seen in the present employee share plan regimen (Part B).

The results in the Attachment are a matter of fact, but the suggestions in Part B are my personal views, and they have not been discussed with the Association.

Conclusions from the survey material.

With the best will in the world it is impossible to determine from the survey just how many companies have employee share plans, and how many employees are in those plans. Indeed many companies could not work it out without a lot of time and effort. This is particularly true of companies with plans that have been operating for some time.

What information is available is included in the Appendix.

I have drawn six key conclusions from the survey material analysed.

Conclusion 1

Scope of general employee share plans

Most companies with general employee share plans are happy to extend them to all employees except casual and short term employees, and no response suggested that companies found the present 75 per cent rule created a restriction. Even though this was not a specific question, a number of companies volunteered that part-time employees are included in their plans.

Of those companies that had a qualifying period only one company had a 36-month qualifying period. Most had a 12-month period.

Shortly put, the present eligibility requirements for qualifying plans create no problems, except for the provision relating to forfeiture of benefits (see below).

Conclusion 2

Why companies introduced plans.

The main reasons given for introducing plans were
“to increase employee identification with the interests of shareholders.” and
“To provide a benefit for employees”
Other important reasons given were
“Because it is a tax effective way of rewarding employees.” and
“To improve labour productivity.”

Some companies said that their plans were introduced to improve recruitment and retention, although this reason was not included as a specific question. Most of these companies were in the IT and related industries.

Aligning the interests of employees with those of shareholders, providing a benefit for employees and recruitment and retention are the principal reasons given for introducing employee share plans.

Conclusion 3

Changes in plan design and the effect of legislative changes

The earliest plan surveyed was introduced in 1982. Sixty-three per cent of companies responding had introduced their plans after 1995, in other words since Part III Division 13A was introduced.

In companies with plans, a quarter had varied an earlier plan to increase its effectiveness and to take advantage of changes in tax and regulatory provisions. For example, a number of plans were varied when Division 13A was introduced.

A number of companies that had conducted plans in the past did not intend to have one in the foreseeable future.

Not surprisingly, companies will vary plans to take advantage of “improvements” in the tax and regulatory environment.

Conclusion 4

Benefits of employee share plans

A quarter of the companies with plans saw an increase in employee understanding of the company and awareness of shareholder interests as a major benefit of their plan. An increased identification with the company and its interests was another major benefit.

The question on plan benefits was open ended, but a surprising number of companies used the words “understanding”, “awareness” and “identification”.

Different sorts of companies gained different benefits from employee share plans. A number could not specify any benefit, although most of these were companies which had introduced plans in the last year or two, so this is not surprising.

Companies saw the benefits of employee share plans in terms of increased awareness of business needs and identification with the goals of the company. If they thought that their plan led to improved productivity, they did not say so.

Conclusion 5

Introduction of plans and frequency of issues

Seventy per cent of companies with plans had an issue under the plan each year. A few had no set issue frequency and two issued shares each six months. Two of the companies in the sample had no further plans for issues at all.

Some companies related their issues under the plan to company profitability, or to similar factors.

Companies will issue shares or rights under their plans at times at times and with a frequency that suits their needs, and no frequency need be mandated.

Conclusion 6

Problems with employee share plans.

The main problem encountered in operating plans was the administration of the plan, including accounting for deductions, and the complexity of plans. These far outweighed any other hassle.

Taxation was a problem for many companies, but just as many companies were concerned with the complexity of the tax system and with the number of changes to it as with the inadequacy of the tax benefits provided.

Prospectus requirements were also an issue for a significant number of companies.

Two particular irritants were

- (a) the taxation of unrealised gains through the operation of the Capital Gains Tax system and
- (b) the provision in Section 139BA of the Income Tax Assessment Act that a plan seeking concessional tax treatment cannot have a provision that could result in any participant in a plan forfeiting shares or rights.

The first of these is a longstanding concern, and the second makes a joke of using this sort of plan for recruitment and retention.

The companies, that responded to the survey and, it, would seem, their employees thought it ludicrous and inequitable that employees who resigned or who left a company for the good of the company, including those dismissed for cause, could be treated more generously than the valuable employees who remained.

In an open-ended question, companies identified administrative problems, plan complexity and frequency of change as major problems with plan operation. This affected both these companies' ability to operate employee share plans in a cost-effective way and their ability to explain their plans to their employees.

Although the sample of companies with no plan was too small to draw firm conclusions, there are indications that these factors militate against the introduction of employee share plans by increasing the costs in the cost-benefit equation.

Taxation of employee share plans is important, but based on the sample of survey forms analysed, the problems identified above are even more significant than perceived inadequacies of the present taxation of employee share plans. The problems can be addressed without tax concessions.

A Simple General Employee Share Plan

From the responses to the AEOA survey, it seems that if the smaller and some of the medium sized enterprises are to adopt an employee share plan they need one with five elements.

1. Simple eligibility provisions.
2. Clear rules.
3. A clear and unequivocal tax position.
4. No prospectus requirement.
5. Ease of implementation, and simple administrative provisions.

A “vanilla flavoured” plan will not meet the needs of most large companies. They will continue to obtain advice on the best plan to suit their particular needs. However such a plan should encourage companies that have decided not to introduce an employee share plan because they do not think that the benefits justify the costs.

A possible “vanilla flavoured” plan is the UK savings-related share option plan.

Under this sort of plan employees enter into a contract to save with either the Department of National Savings, or an approved building society or bank. In broad terms individuals contract to save for three, five or seven years, but can withdraw from the contract if the need arises.

At the time that they enter into the contract, employees are granted an option to take ordinary shares in their company at a discount of up to twenty per cent on the market price.

Employees do not pay interest on their savings, irrespective of whether or not the savings are used to purchase shares, so some people use the plans to save for holidays or to purchase consumer durables. (This is probably the real reason that the plans are not popular in government circles, although the reason is stated to be because many employees sell off the shares. The fact of the matter is that some individuals will dispose of their shares as soon as possible, irrespective of the type of employee share plan.)

The problem is easily rectified because all that is needed is to provide that interest used to purchase shares is not taxable. If the principle and interest is not applied in this way the interest will be taxable in the year when it is drawn down from the savings account.

No prospectus should be required for this sort of plan because employees have at least three years to consider their company and its progress; however the plan needs to specify that

- 1 employees entering into a contract under the plan must receive the annual report and similar statements,

- 2 issues under the plan must open within four weeks of the Annual General Meeting,
- 3 employees must be provided with a copy of the Chairman's address to the AGM and
- 4 employees must be provided with a statement of any significant developments since the AGM.

Downside risk is effectively taken care of by the three-year period between the grant of options and the exercise date. Given the attractiveness of a regular and predictable flow of savings, providers might be expected to develop the necessary systems to administer plans of this nature and to develop suitable reports to employees.

The problem of employees who leave can be readily resolved.

Employees who are dismissed for cause must receive back their contributions plus (taxable) interest. Other employees who leave may also be allowed to receive back their contributions plus (taxable) interest. They should also be allowed to leave their money in the savings account until the exercise date but not to add to it, although it should continue to accrue interest. On the exercise date they may then exercise their option to the extent of the extent of the money in their account.

Additional details of a suitable savings-related employee share plan can be provided if required.

Appendix

The Australian Employee Share Ownership Survey

Conduct of the survey.

The AEOA Survey covers most of the Australian Stock Exchange's top 500 companies by market capitalisation.

The survey was posted to specific executives where they were known to be involved with employee share plans, but in most companies it was sent to the employee who was the company secretary.

Surveys were not sent to a number of companies in three classes.

- Exploration companies with very few employees.
- Investment companies with very few employees.
- Companies with overseas head offices and few employees in Australia.

In addition, a few companies could not be reached for one reason or another.

The survey sample.

The survey results quoted in this submission are drawn from the first fifty returns received. This analysis was carried out as the basis for formatting the final analysis. It contains returns from all states, but

- New South Wales is over-represented because of the order in which returns were sent out,
- companies with employee share plans are greatly over-represented because they are the ones interested in the topic and complete the survey forms and
- although a few of the companies surveyed had two plans, we only included one at this preliminary stage.

None of this invalidates the survey results, and the numbers analysed are more than ten per cent of the total survey population.

In analysing the findings we have ignored any event where there were less than two responses.

Summary of findings.

Numbers of companies with plans

Of the sample of 50 companies

41 (82%) had a plan

three (6%) did not have a plan and were proposing to introduce one and

six (12%) did not have a plan and were not proposing to introduce one.

Numbers of employees covered.

We had hoped to find out roughly how many employees were covered by employee share plans, but this was not possible. Many companies knew how many employees had taken up a particular offer, but did not know how many employees in total held shares issued under a plan.

Types of employees covered.

Most companies with a plan included all employees, and twenty per cent of companies with plans mentioned that part-timers were eligible, although this was not a specific question.

More than half the companies with plans had employees overseas and included them in the plan.

Types of plans.

Of the 41 companies that had a share plan

11 (27%) had a loan plan, and all but one of these were plans where the loan was paid off by dividends,

12 (29%) had an option plan,

5 (12%) had a salary sacrifice plan, and

14 (34%) gave free shares,

Most loan plans gave discounts, and these ranged from five per cent to 20 per cent.

Dates plans were introduced

Plans were introduced in the following years

1982	1
1983	1
1984	0
1985	0
1986	1
1987	2
1988	2
1989	1
1990	0
1991	0
1992	0
1993	3
1994	3
1995	1
1996	10
1997	5
1998	5
1999	6

Overseas employees.

Sixty three per cent of companies with plans had Australian employees stationed overseas, and all but two companies included these employees in their plans.

Reasons for introducing plans.

Respondents identified four main reasons for introducing plans.

“To increase employee identification with the interests of shareholders.” (90%)

“To provide a benefit for employees.” (80%)

“Because it is a tax-effective way of rewarding employees” (40%)

“To improve labour productivity” ((29%)

Although “recruitment and retention” were not included in the choices given, seven per cent of companies added this reason amongst “other reasons”.

Benefits of employee share plans.

This was an open-ended question, but “identification” and “awareness” were the words often used to describe the benefits of the plans, as were “commitment” and “loyalty”.

A number of companies saw unique benefits, but we need to analyse more returns before putting weight on them.

Five per cent of companies listed recruitment and retention benefits.

Only one company mentioned increased productivity as a benefit of introducing a plan, although this may well be a by-product of improved commitment and the other benefits mentioned above.

Problems with employee share plans.

By far and away the biggest hassles with plans were seen to be administrative (29% of companies with plans). A lot of this had to do with tracking deductions, and some similar bookkeeping functions.

Complexity was also seen as a factor, and this was not only a problem for the participating companies themselves, but it was also a problem when companies were explaining their plans to employees.

Tax issues were also seen as problems and, although a number of companies referred to discount-related issues, just as many were concerned with complexity and the number and frequency of changes to the conditions covering income tax.

Two companies specifically mentioned payroll tax, although I am aware of two other companies in the survey that also have concerns with this State tax.

Two companies were concerned saw the burden imposed by prospectus requirements as a major problem and some other companies mentioned it as a minor one.

The other concern was the way in which the provision relating to non-forfeiture of shares or options worked in practice.

Some companies felt that this provision meant that employees resigning or leaving the company for the company's good were treated more generously than those who stayed, and this caused resentment amongst management and staff.