



How Employee Share Ownership Is the Spur to Economic Growth and Lower Taxation

David Craddock is a recognised authority in the UK and worldwide on employee share schemes and the author of *Tolley's Guide to Employee Share Schemes*. In this article, David identifies the role that employee share schemes can fulfil in making a significant contribution to economic growth while at the same time guarding against excessive tax rates.

The Track Record of Employee Share Ownership

Since the introduction in the UK of the first tax-approved employee share scheme in 1978 - the profit-sharing employee share scheme, at the behest of the Lib-Lab Pact – the subject of employee share ownership has enjoyed cross-party support in the British Parliament. In a curious way, it appeals to the political ideologies of all the major political parties and persuasions. Yet despite this general political consensus employee share ownership has a very precise functional identity within British companies of all sizes which is to deliver individual reward via team effort and company-wide commercial success, an approach that appeals to the human spirit as a matter of enlightened self-interest, aligning the employee's interest with existing shareholders around the unifying totem of the developing share value.

The evidence to support that this principle works in practice is formidable. It ranges from the significant body of work produced over the decades by Rutgers University in the USA to the more recent studies of consequence undertaken by Cass Business School in conjunction with the British Government Department for Business, Innovation and Skills. Add to these the many other studies covering some 40 years from an array of prestigious universities and institutes in the UK and the USA together with numerous case study examples drawn from companies that have embraced the subject, and the overall picture emerges that, when applied with proper communication and proper implementation, employee share schemes can produce outstanding commercial results.

The Linkage of Employee Share Schemes to Tax Policy and Commercial Intent

The attraction of employee share schemes to businesses and their advisors has always been in the first instance through the inclusion of tax reliefs and exemptions for employee share schemes by successive Chancellors of the Exchequer in their Budget Day speeches. Although it is the tax bait that draws the attention to employee share schemes, the companies that succeed in maximising the potential of employee share schemes in their businesses are those whose directors embrace the employee share ownership ethic of employee involvement and participation through the introduction of compatible sister policies. For example, a company may choose to introduce a cash profit-sharing scheme or give emphasis to employee training and development or establish quality circle type forums and committees for employee consultation or utilise the performance review process for the proactive employee buy-in of key corporate objectives.

The irony is that if a company chooses to restrict the focus to the tax bait, then that measure alone will not guarantee the success of the employee share scheme initiative, valuable though the tax reliefs are in giving quantum to the employee reward and incentive and providing the first attraction for the company to the subject. The point is that it is in embracing the full commercial substance of the impact that employee share schemes have on the inner inventive qualities of the human spirit that the company benefits from the encouragement of the entrepreneurial spirit within its workforce. ►



The Opening Up of the Tax Debate

The question arises: why impose taxes upon successful businesses that are contributing with strength to the gross national product, whose trade is enabling other businesses that are in their orbit to thrive also and enabling employees from their own businesses and others to receive just rewards from their employing companies? In other words, surely the intuitive response is to encourage more of the same success which can only be hampered by punitive tax burdens. By increasing their disposable income employees are better able to take charge of their own lives and those of their families, thereby in time lessening the burdens on the state in the provision of health care and social benefits. There are indeed ample studies that support the position that the healthier families live in the more prosperous areas. There must be a move towards this policy.

Furthermore, the increased tax burden on companies that arises through corporate taxes leads to undermining the country's competitive position with its international competitors, notably China and other supplier nations in the Far East, ultimately leading to an increase in unemployment as internal investment is sacrificed through a diversion of funds to pay the corporate taxes. In this scenario, for those employees who retain their jobs, either

their wage increases fail to keep up with inflation or, alternatively, excessive wage demands create a cost-push inflation of its own. A policy of not levying excessive taxes, maintaining the buoyancy of the economy, and upholding the dignity of both work and the worker generates a spiral of ever-increasing success for the nation, as opposed to the "tax-and-spend" spiral of the 1960s and 1970s in the UK that was demonstrated to produce ever-increasing decline in production and in competitiveness.

The State of Texas as a Case Study in Financial Management

So on to examine a government that operates without state income taxes. The state of Texas in the USA, from which important lessons can be learnt, appears to thrive while at

the same time balancing its budget without any form of state income tax. In broad terms, the state is funded by a combination of federal funding and sales taxes. The federal monies contribute to the funding of Medicaid and Medicare, education, and transportation costs. While the revenues from sales taxes are typically regarded in economic theory as a regressive tax that affects the poorest people the worst, if there is no burden of a state income tax then employees have higher disposable income anyway, free to spend or save or give as they choose. Additionally, the Texas state government receives revenues from lottery proceeds, income from state lands, and returns on its own investments that have been carefully managed for decades, thereby positioning the state government as an astute market player in its own right, operating in the interest of its citizens, minimising the dependency culture often associated with European governments and allowing businesses to allocate their profits between reinvestment and rewarding their employees. Any additional financial requirements are funded by local government authorities through a local sales tax of up to 2% and property taxes, recognising that in a democracy fund raising powers are best decided and exercised at the unit level closest to the citizens.

The Nature of Wealth Creation and the Employee Ownership Culture

The imposition of excessive taxes assumes that wealth creation is a zero-sum game based on the distribution of finite resources. Yet in practice wealth creation is anything but a zero-sum game. The human species has been endowed with a mind that has the capacity to produce an infinite blend of ideas that can apply both art and science to the formation of a business and the generation of wealth. The testimony of history is that new inventions and new discoveries are always there waiting to be unearthed, each with its own wealth generating capacity in the provision of goods and services. The wonder of employee share ownership, when introduced





alongside the wider ownership ethic and supported by compatible sister policies, is that it ignites both the rights and responsibilities that are bestowed upon humans to produce their best in the furtherance of their own well-being and the betterment of their families. Wealth creation is absolutely core to the progression of life of the human species, central to the development of character and the capacity to accept the responsibility. Employee share ownership, properly implemented and maximised for its business potential, ignites personal responsibility in the employee to create wealth in the interest of both individual return and overall business success.

The Role of Employee Share Ownership in the Economic Growth Dynamic of Lower Taxation

The American economist, Art Laffer, contended that if tax rates increase

beyond a certain level, then total tax revenues fall. The reason is that higher tax rates discourage people from working. The implication of the so-called Laffer Curve is that cutting tax rates could lead to an increase in tax revenues. The theory is predicated on recognition that the extremities are: (1) if the tax rate is 0% then tax revenues are zero and (2) if the tax rate is 100% then the purpose of working becomes redundant and again tax revenues are zero. The question that arises, therefore, is to determine the optimum tax rate.

So, if tax rates are too high then a reduction will create the incentive for companies to expand their productive capacity, seek out new markets, increase the size of the workforce with new employment opportunities and become more competitive at home and in the export market. On top of all that, existing employees will be incentivised to work longer hours! What an ideal

business environment for employee share ownership to thrive in, given the renowned capability of employee share schemes, when properly introduced, to provide the incentive for an increase in productivity, the containment of inflation as wage increases are matched by productivity increases and the developing ethos of an incentive economy with capital returns delivering to employees their true return on their business endeavours. The impact of employee share ownership, properly implemented, on total tax revenues will more than compensate for the fall in tax rates.

David Craddock has been advising on employee share schemes and employee share trust arrangements for over 35 years. He advises on every aspect of the implementation process, working personally with the client at each stage, and offering solutions and expertise in all the technical questions that require clarification during the consultation. As an expert share valuer, David is the Technical Secretary and Advisor to the Share Valuation Worked Examples Group that meets quarterly with HMRC. He is also a member of the Steering Committee of The ESOP Centre, Economics Policy Adviser to The Employee Shares Policy Forum and the Educational Director of The ESOP Institute.

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