EO Know how

Your weekly blog on all things EO
with Barry Horner

Episode 8 | Series 1

Transaction, Transition & Transformation

Transitioning a business to employee ownership is a journey often mistaken for a one-off event. However, this journey is best understood as having three distinct parts:

The **Transaction**, the **Transition** and the **Transformation**.

While the transaction is the legal and financial process, the transition is the cultural and operational shift that follows. Focusing on the transaction without planning for the transition is a mistake that can undermine the entire process.

The Transaction: The Easy Part

The Transaction is the 'what.' It's the legal, financial, and administrative work of transferring ownership from the founder to the employees. This is the part that lawyers, accountants, and financial planners are experts in. It involves:

- **The business valuation.** Getting a professional valuation of the business.
- **Legal structure.** Deciding on the appropriate ownership model, typically in the UK being an Employee Ownership Trust (EOT).
- **Funding.** Securing the financing to buy the owner's shares, which may involve a combination of bank loans and deferred payments from the business's future profits.

- **Financial Planning.** Helping the seller/vendor navigate the risk issues associated with the deferred consideration [DC] payments. What happens if the DC payments slow down or stop for a period? Designing a 'plan B' for example.
- **Documentation:** Drafting and signing all the legal agreements and corporate documents.

This part of the journey is well-defined, with a clear beginning and end. The goal is to get the deal done, often culminating in celebrating a key milestone when eventually the deferred consideration is fully repaid. While complex, it's a predictable process with a set playbook. The challenges are technical and can be overcome with the right professional guidance.

The Transition: The River of Change

The **Transition** is the 'how' and 'why.' It's the far more nuanced and challenging journey of potentially shifting from a traditional command-and-control culture to one where employees truly think and act like owners. This is a continuous process that doesn't end when the transaction is complete. In fact, the transition process, if well planned can start before the transaction completes.

- **The Cultural Shift.** The most significant challenge is changing the mindset from 'I work for the business' to 'I am the business.' This requires empowering employees with a sense of ownership, not just a financial stake. It involves fostering transparency, collaboration, and a willingness for all employees to take on new levels of responsibility.
- **Governance and Leadership.** The role of the leadership team, and even the Trust Board, must be redefined. The Trust Board acts as a guardian of the company's culture and values, while the operational board must learn to lead by influence and consensus rather than authority. This requires a new approach to decision-making that involves seeking input from all levels of the business.
- **Communication and Education.** Communication becomes a vital tool. The new employee owners need to be appropriately educated on the financial performance of the business, how their actions impact the bottom line, and what their rights and responsibilities are as owners. This requires transparent and regular communication about both the good and the not-so-good news. A lack of understanding can lead to disengagement and a feeling that nothing has truly changed.

Transformation in an employee-owned business is the ultimate, and most rewarding, outcome of getting both the Transaction and the Transition right.

It's the point where the company's new structure and its cultural evolution converge to create a truly superior business model. This transformation is not just about a change in ownership, but rather it's about a fundamental and sustained shift in performance, culture, and long-term viability. When transformation is achieved, the business operates at a higher level, characterised by a unique sense of shared purpose and collective responsibility.

It's the transformation that delivers on the promise of employee ownership. It manifests as a tangible and measurable improvement in the business's key performance indicators.

For example, a transformed EO business typically sees significant increases in productivity and profitability, driven by a workforce that is genuinely invested in the company's success. It's also evident in improved employee retention and attraction, as the company's culture becomes a powerful recruitment tool. The business is more resilient and adaptable to market changes because every employee is an owner with a stake in its future, contributing to innovation and problem-solving. This isn't just about sharing profits; it's about sharing a destiny.

Ultimately, transformation is what a 'EO CEO' (The subject of another EO Know How) should be aiming for from day one. It's what differentiates a successful employee-owned company from one that merely went through the motions of a transaction. A business that achieves this level of transformation becomes more than just a place to work; it becomes a legacy - a self-sustaining, long-term enterprise that secures jobs, empowers people, and creates a more equitable and prosperous future for all of its employee-owners.

If an EO CEO is asking the question as to why his or her team haven't really pursued 'owner mindset' thinking, then maybe they haven't grasped the need for a real cultural transformation, and the question is a clear indication that the journey has stalled at 'transition' and has not yet reached its transformative potential.

Ultimately, the true success of an employee-owned business is a testament to its **transformation**. It's not a metric found in legal documents or a quick win celebrated on a single day. Instead, it is the living result of a well-executed transition - a thriving, innovative, and engaged culture that delivers on the promise of employee ownership. When a business achieves this level of transformation, it evolves into a more resilient, dynamic, and purposeful enterprise, proving that shared ownership isn't just an exit strategy, but a superior model for long-term growth and success.

The transition to employee ownership (EO) in the UK has evolved through distinct phases, moving from initial adoption to true cultural transformation.

EO 1.0: The First Wave

This phase began with the Finance Act 2014, which introduced the Employee Ownership Trust (EOT) and its attractive tax benefits. For many businesses, the primary motivation for transitioning to an EOT was the significant 100% capital gains tax exemption for selling shareholders. This made it a highly tax-efficient succession plan, leading to a "first wave" of companies adopting the model. The focus was primarily on the legal and financial aspects of the transaction itself.

EO 2.0: The Transition Phase

As more companies adopted the EOT model, they entered the "2.0" phase. While the transaction was complete, these firms face the practical challenges of operating as an employee-owned business. The key hurdles they are trying to overcome include:

- **Paying down deferred consideration.** Most companies are focused on a multi-year effort to pay down this debt.
- **Embedding the owner mindset.** It's a challenge to shift the mentality of employee owners from being a wage earner to an owner. This requires a deeper cultural change.
- **Getting the governance structure 'right'.** While the EOT requires a board of directors and trustees, many companies struggle to find the right balance of power and representation.
- **Establishing an effective employee voice.** Creating and empowering a governing council or 'Partner Voice' group is crucial, but many organisations haven't yet unlocked its full potential.

EO 3.0: The Transformation

A small number of established and well recognised EO companies have moved beyond these challenges and are fully reaping the benefits. They have learned that true success lies in cultural transformation, not just financial engineering. The key lessons and what I have observed from these EO 3.0 firms are:

- **Financial transparency and literacy.** They make financial information accessible and understandable to all employees. By sharing real-time data on performance and deferred consideration, they turn debt repayment into a shared mission.
- **True empowerment.** They don't just 'talk' about an owner mindset; they empower employees to make decisions, innovate, and take risks at all levels of the organisation. They have really thought it through and are leading from the front.
- **Inclusive governance.** They have built multi-tiered governance structures that genuinely involve employees, often with employee representatives on the board of directors and a highly engaged employee council. This ensures that decisions reflect the interests of all stakeholders.
- **Shared purpose.** These companies have a strong sense of purpose beyond profit. This shared mission becomes the driving force behind the culture, fostering a deep sense of commitment and collective pride.

By successfully addressing these challenges, EO 3.0 firms have moved from simply being a tax-efficient business model to a powerful engine for employee engagement, innovation, and long-term success.

For more information or to discuss anything in this latest Know-How;
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