

Life is interdependent. Transition to Employee Ownership. Bring work to life.



Your weekly blog on all things EO
with Barry Horner

Episode 16 | Series 1

EO Unvarnished – What They Don't Tell You About EO: The Challenging Debt Repayment Years

“Becoming an EO business is a journey of 1,000 miles, and the first few miles are often the steepest.”

I'm delighted to introduce a new sub-series of my 'EO Know Hows', called 'EO Unvarnished', where I'll tackle the real-world challenges of Employee Ownership head-on, from surviving the debt years to navigating hybrid ownership structures.

This special series will step away from the gloss to unpack the practical realities of Employee Ownership. We are pulling back the curtain on the complexities of the EO model so that every business is aware of the inherent challenges in the model and what might be done to overcome these challenges.

Over the coming weeks, we will explore the 'home truths' of the transition-examining the complexities, the challenges, and the strategic manoeuvres required to navigate them successfully.

This episode is designed to help navigate the challenging debt years, the period where the business is technically owned by the Trust, but a significant portion of cash flow is earmarked to pay back the former owners (and later, the minority shareholders in a hybrid EO business).

Paying Off the Vendors: Whichever Way You Cut It, It Is Just Tough

It requires a shift from short-term profit to long-term enterprise value. While the excitement of becoming owners is high, the reality of the first few years involves balancing the books while paying off the Deferred Consideration (DC) – the debt owed to the founders for the sale of the business.

Here is how we battle through this phase to reach the prize of a debt-free, fully owned firm.

In a hybrid EO business, (partly owned by the EOT and partly owned by minority shareholders) there are multiple demands on cash, especially in the early years:

- Keeping the lights on and paying salaries and operating expenses.
- Ensuring all corporate tax obligations are met.
- Scheduled payments to the selling founders, the payment of the deferred consideration.
- In a hybrid model, the minority stakeholders are repaid after (or alongside) the primary EOT debt. The repayment of the DC can feel a bit like a false summit when minority shareholders are still in the picture, so you need language that distinguishes between external liabilities (the bank or the founders or both) and internal equity alignment (the minority holders). The oft-used expression of ‘debt free day’ is unhelpful and misleading in a hybrid EO business where the minority have yet to be bought out.
- Surplus profit for internal reinvestment and employee-owner bonuses. We would always advocate the payment of a modest EO bonus at the same time as the DC is being repaid.

It can be frustrating to see strong profits disappear into debt repayment. However, the mindset shift is this: Every payment made to a founder or minority shareholder is an act of ‘buying back’ your company.

- Think of it rather like a mortgage. You are living in the house while you pay for it. Once the mortgage is gone, the equity belongs entirely to the residents (the employee-owners).
- You do need to be very mindful of the period over which you plan to repay the deferred consideration, an issue that HMRC are looking more closely at. Basing a business valuation off an EBITDA multiple is one thing, being able to repay the debt within a reasonable period in terms of available cash flow is another. Take a long hard look at the proposed debt repayment period. Does it look reasonable and 'doable'?
- The 2025 Budget Factor. Recent tax changes* emphasise that these payments must be made from surplus trading profits. This means the healthier the business, the faster the debt clears.
- Often the final years of the DC repayment schedule are 'back ended'. Be realistic when financially modelling the likely repayment profile. A massive balloon payment of the DC in say eight years' time can be a real challenge to the new leadership team who are looking to build and grow the business for the benefit of the beneficiary owners.
- Don't forget too that there will be months when targets are hit but the bank account feels somewhat dry because a large DC payment just went out. This is the hardest part of the journey. Feeling 'rich' on paper but 'lean' in the office. This isn't a sign of failure, but rather it's a sign of a mortgage being paid off ahead of schedule.

In a hybrid model, think of paying off the DC as arriving at Base Camp. If the EOT debt was the first peak, the minority shareholders are the final ascent. This acknowledges that you have achieved something massive, but the summit (100% EO) is still ahead.

A comprehensive and well-articulated repayment strategy – covering the repayment of the DC, the buyout of minority shareholders through a hybrid model, and the potential buyback of EMI-awarded shares – gives all employee-owners clear visibility of the stark realities ahead.

Once the summit is reached, the capacity for internal investment and profit distribution effectively doubles.

Strategies to Battle Through – How Do We Accelerate the Journey to the Summit?

- **Keep an eye on waste** – In a traditional firm, a wasted £1,000 is the “company’s money.” In an EO firm under debt, that £1,000 is a direct delay to your future bonus. Efficiency becomes a collective effort.
- **Sustainable growth** – We need to make sure the business remains healthy while we repay the debt. Continuing to invest in our people and our technology is essential – without it, we risk reaching the end of the repayment period with a company that hasn’t benefitted from an ability to grow or thrive.
- **Transparency as fuel** – Regular updates on the remaining debt balance can be incredibly motivating. Watching that number tick down creates a shared sense of purpose.

Don’t forget that during the debt years, there is often a confusing overlap of power. It is the Board that runs the business, whilst the Trustees (including employee-representatives) are the ones monitoring the debt repayment to ensure the ‘mortgage’ is paid without starving the business.

Try and view the DC repayment years as the price of independence. By battling through these payments with discipline, we ensure that our EO businesses remain independent firms for the next generation.

Once the debt is cleared, the ‘Ownership Dividend’ changes from a future promise to a monthly reality.

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

Contact **Barry Horner** at bhorner@pnfp.co.uk.

This article is distributed for educational purposes and should not be considered investment advice or a recommendation of any particular security, strategy, or investment product. Tax Planning is not regulated by the Financial Conduct Authority.

Paradigm Norton Financial Planning Ltd is authorised and regulated by the Financial Conduct Authority. FCA register number is 455083. Registered address: Paradigm House, Macrae Road, Ham Green, BS20 0DD.