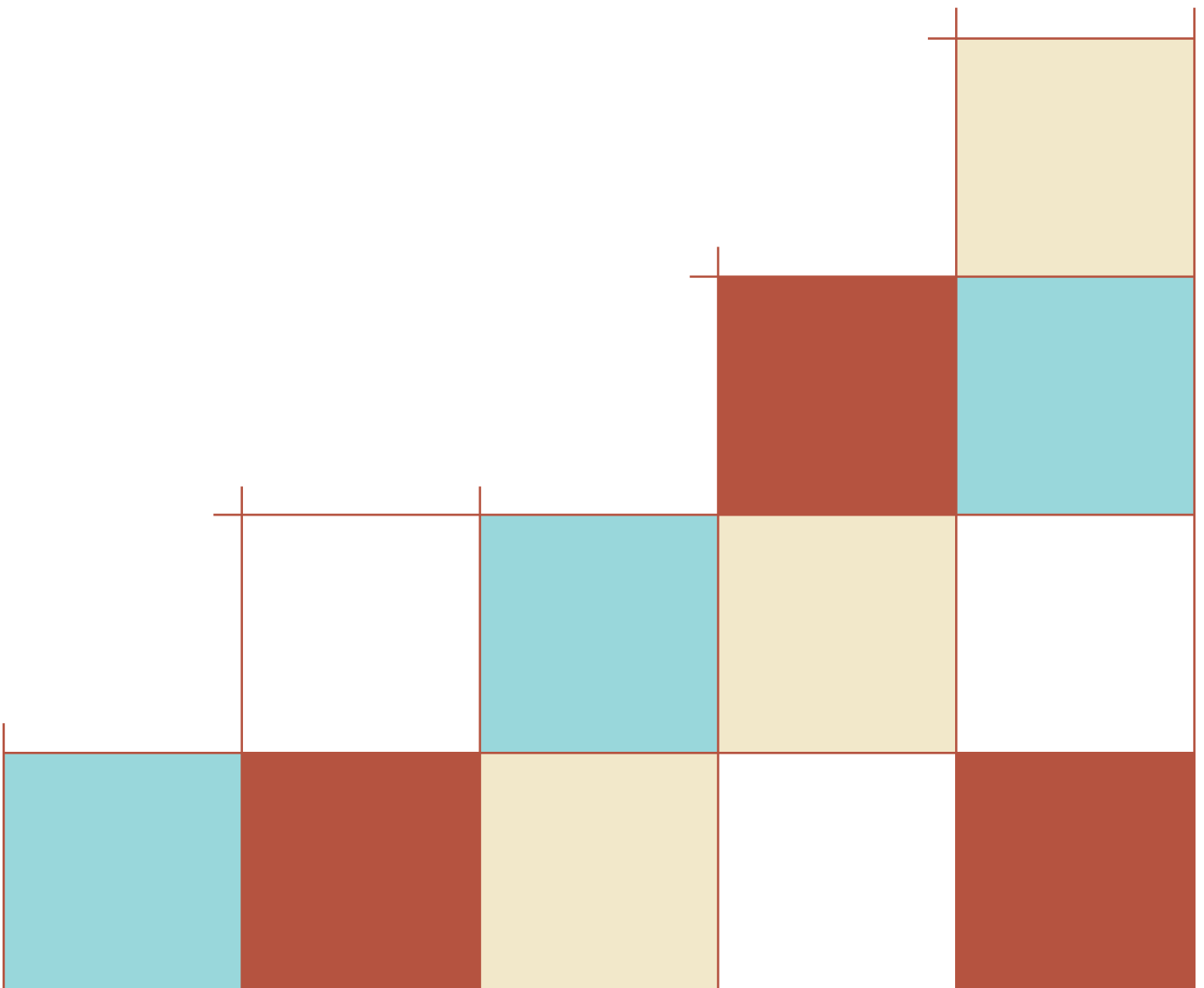


A Stake in the Post

Making employees stakeholders in Royal Mail



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Active Capital Strategies is dedicated to promoting employee ownership and employee financial involvement by providing advisory and management services to companies, ESOP Trustees, unions and employee owners.

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JOL is the association of employee owned and trust owned businesses. Founded in 1979 as Job Ownership Limited its member companies include the John Lewis Partnership, other long-established jointly owned companies such as Scott Bader and Swann-Morton, and a range of other employee owned businesses of all sizes from a wide variety of sectors. Wholly independent and not-for-profit, JOL is funded by its member companies.

Go to www.jol.org.uk for more information about:

- JOL membership, events and publications
- Employee ownership schemes and case studies
- Business succession and employee buy-outs

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Foreword

'A Stake in the Post' is a response to the current debate about the future ownership of Royal Mail and specifically to the speculation that the present management are actively considering giving employees a sizeable or even controlling stake in the business. In publishing this paper, JOL aims to make a constructive contribution to the discussion about whether and how this change could happen.

JOL has played an important role in the growth of the UK's employee owned business sector in the UK – producing evidence on the advantages and performance of the sector, and influencing and helping to shape the regulatory changes that have underpinned the sector's growth. The authors of this paper have practical experience of ownership restructuring designed to deliver increased employee stakeholding.

The experience of the John Lewis Partnership and many other jointly owned companies shows that employee ownership works. Companies where employees genuinely participate in the company, and hence feel like true stakeholders, tend to treat customers better, have better employment relations, handle change better, and hence be more competitive. Those are the kind of outcomes which Royal Mail can gain from employees having a sizeable or controlling stake in the company.

But employee ownership can't be successfully imposed without the assent of key stakeholders. Nor is there only one model or option for the kind of restructuring being debated for Royal Mail. Hence another aim of 'A Stake in the Post' is to help to generate a productive dialogue about Royal Mail's ownership, and help the respective stakeholders find enough common ground for genuine consultation about the company's ownership structure to start.

Royal Mail is too important a company for its prospects to be clouded by damaging speculation and controversy. I hope that 'A Stake in the Post' will help all Royal Mail's stakeholders to arrive at a shared vision of its future.

Sir Stuart Hampson
Chairman, John Lewis Partnership plc
President, JOL

1. Policy Summary

‘A Stake in the Post’ is about Royal Mail’s reported intention to create a large employee stakeholding in the company, possibly involving a transfer of ownership to the workforce, or a combination of workforce and government. In the absence of definitive or confirmed plans from the company or the Government, ‘A Stake in the Post’ addresses the straightforward issue of how and why Royal Mail ownership could be restructured.

The importance of Royal Mail means that there needs to be a serious, constructive debate about its future, instead of the exchange of attributed views in the media. There is no one blueprint of how the ownership of Royal Mail could successfully be restructured. ‘A Stake in the Post’ discusses the options.

As the issue of privatising Royal Mail is so politically problematic, there may be scope for an innovative approach to the ownership issue, such as a hybrid ownership structure which creates a new form of public interest company. Such an arrangement would acknowledge Royal Mail’s public service role by retaining a significant Government stake, impose public service obligations, but deliver a sizeable or majority employee ownership stake, preferably held in a trust structure.

Transforming Royal Mail into a new breed of public interest company – retaining a public service ethos, continued Government shareholding in some form, and real employee stakeholding possibly including employee ownership – would radically redefine the concept of privatisation, and arguably provide an innovative model for synthesising competing public service and commercial imperatives.

Whether Royal Mail becomes substantially employee owned or acquires a new form of public interest company status, it is essential that the company is set challenging targets for commercial success and competitiveness. The company must retain and attract talented managers at all levels, and empower them to make decisions that will drive that commercial success.

The strengths of the employee owned business model mean that Royal Mail’s customers, the company itself, its employees and unions, and the Government all have much to gain, potentially, from giving staff a major or controlling stake in the business:

- Customers should benefit from using a postal service whose industrial relations are better, where staff feel truly involved in the company, and where commercial imperatives and public service obligations have been clarified.
- A successful transition to major employee stakeholding in Royal Mail should be part of a wider corporate strategy that will equip it to face ever increasing competition with improved employee relations, and an ability to embrace change. It also offers Royal Mail the prospect – judging by the performance of other employee owned businesses – of improved productivity based on real engagement of the workforce.
- Employees would gain a real rather than nominal stake in the business and hence a strong incentive to see it succeed; along with the prospect of emulating staff in other employee owned companies by having a meaningful, democratic voice in the way the company is run.

1. Policy Summary

- The unions stand to gain by delivering real benefits to their members over time and, with employees becoming stakeholders in the business, having enhanced input into the strategic decision-making processes of the business as representatives of the workforce.
- The Government has a real opportunity to create an innovative and dynamic form of public interest company where a mix of public service ethos and true employee stakeholding produce an enterprise capable of meeting the demands of customers and competition.

Attractive as the prospect of a major employee stakeholding in Royal Mail is, no solution is likely to work, or last, unless all the key stakeholders are involved in designing and implementing what would be a massive restructuring. This should include involving the Communication Workers Union (CWU) in meaningful consultation on the restructuring options at the earliest opportunity.

That phase of consultation with key stakeholders will be the most fruitful time to take a strategic view on vital technical aspects of ownership restructuring such as:

- The size of the employee stake
- The structure of the employee stake
- Timescale for restructuring
- Price allocated to shares
- How the restructuring would be financed
- Methods and standards of corporate governance

An employee stakeholding – whether in the form of individual or collective ownership – won't be enough on its own to create the harmonious, productive industrial relations and employee engagement that the main stakeholders all want to achieve. Research evidence shows that this impact is only achieved when a meaningful equity share is coupled with far-reaching employee involvement and participation. Successful implementation of ownership restructuring will require an intensive, long-term communication, awareness and education programme among staff and management.

For reasons explained in this paper, a form of collective ownership using one or more trusts with elements of the John Lewis Partnership model – as opposed to widespread individual shareholdings by staff – is more likely to create a stable, sustainable basis for a jointly owned Royal Mail.

Any ownership restructuring of Royal Mail should draw on the wealth of experience in the UK and elsewhere on making employee ownership work. This should include companies who have long experience in making a success of employee ownership; companies who have managed the transition from either public or private ownership; and specialist advisers with actual experience of working with the employee owned business sector.

2. Reforming Royal Mail

The British media have rightly made much of the remarkable turnaround in the fortunes of Royal Mail. Under the stewardship of Allan Leighton and his colleagues, the business has moved from a deficit of £318 million three years ago to a profit of £537 million in 2005. This success has allowed Leighton to reward the 200,000 or so employees with a cash bonus of over £1000 each in the 'Share in Success' initiative; a direct cash benefit in the form of a profit share for those operating the business.

It is undeniably true that Royal Mail will face challenges from ever increasing competition in the postal services sector which will necessitate changes across a wide section of its organisation and business, including implementing the company's stated intention to be a "great place to work". In September 2005 Deutsche Post signalled a move to increase its presence in the United Kingdom by announcing its intention to acquire Exel ahead of full deregulation of the German postal market in 2007, having already received a licence to operate from Postcomm from 2006.

While a financial turnaround of this magnitude is highly newsworthy, reports that the Government might consider selling a stake in Royal Mail to its employees have equally grabbed the headlines. In May 2004, it was reported in *The Times* that Royal Mail was planning some form of employee buy-out or large employee owned stake, to pre-empt the possibility of any full privatisation. The company has also reportedly considered transferring a 20% stake to employees, with 31% to be offered to the open market. A May 2005 report claimed that Royal Mail might transfer a 51% stake in Royal Mail to employees to be held in some form of trust structure similar to that adopted in the retail and supermarket group the John Lewis Partnership.

The John Lewis Partnership example

Anyone who knows the John Lewis Partnership with its 60,000 employee 'partners' will recognise that it is a successful and efficient business with low staff turnover, high productivity and healthy profits. Entirely owned by its workforce through a trust, it is a successful business by any measure. Like other successful employee owned businesses, it is managed in a highly professional manner, but with a participative style, so that employees are involved in operations at all levels from the shop floor to the boardroom. It is a business model that works in its Waitrose supermarkets as well as in the John Lewis department stores.

It was particularly interesting that John Armitt, chief executive of Network Rail, picked up on reports of Royal Mail's intentions – stating that "If Royal Mail can do it, then why can't we?" In an article in *The Independent* on 27 May, Mr Armitt said that "If we had 30,000 people out there who knew that what they took home would be driven by the performance of the company that would be a powerful incentive. You can do it with staff bonuses but having actual ownership of the business is much better. I am attracted to that idea".

Could such an employee trust model work for businesses like Network Rail and Royal Mail? Certainly, but it would require a more considered and serious debate than it has generated up to now, along with acknowledgment of the scale of preparation needed to make it happen. The success of the John Lewis Partnership and other employee owned businesses did not happen overnight, but has taken years to develop and mature.

2. Reforming Royal Mail

Establishing an employee ownership culture in Royal Mail need not take the decades over which the John Lewis Partnership has matured, but it would take unprecedented co-operation and long term planning from key players inside and outside Royal Mail to lay and build on the foundations.

Aims

A core aim of restructuring Royal Mail ownership should be to bring its employees into a meaningful and, hopefully, financially rewarding partnership with government and the company; with the added incentive that, collectively, the employees themselves would potentially be the single biggest shareholder. A substantial measure of employee ownership should allow Royal Mail to become a more efficient and profitable business, better prepared for the challenges of the future and capable of providing a rewarding and stimulating place to work. We discuss below why there are good reasons to think this will be the case.

Sir Stuart Hampson, chairman of the John Lewis Partnership, quoted in *The Observer* on 22 May 2005, says that he knows Allan Leighton well but that he has not discussed the matter of a partnership-style mechanism for Royal Mail directly with him. Sir Stuart, who is the President of JOL, noted that as long as such a mechanism was set up correctly, it could be an effective model providing something between a conventional public limited company (plc) and a state-owned business.

A trust structure?

A key component of any such joint ownership structure would be the use of one or more trusts. The aim behind the trust structure is to ensure that the employee ownership model is stable and enduring. All of the John Lewis Partnership shares, for example, are held in perpetuity by trustees and it would require an Act of Parliament in order for the mechanism to be changed, thus stabilising the business and allowing all concerned to focus consistently on improving how the company operates.

3. The debate so far

One problem is that the debate so far has been patchy and conducted through the press. Comments from the various interested parties have tended to be in 'headline' style, perhaps reflecting the lack of a detailed proposal on which to focus. Oddly there has been almost no response to Mr Armitt's comments.

Following the hint of privatisation of Royal Mail in May 2004, Labour Party affiliated trade unions, including the Communication Workers Union (CWU), secured a commitment from the Government at the Labour Party's National Policy Forum at Warwick University in July 2004 that there were "no plans to privatise Royal Mail". The text also contains the now oft quoted line that the Government's "...ambition is to see a publicly owned Royal Mail fully restored to good health...".

During the debate on the Queen's Speech in May this year Lord Sawyer, who declared that he had been working with Royal Mail, the CWU and the Communication Managers Association for four years in the area of industrial relations, noted that 33,000 Royal Mail jobs had gone and 2,500 post offices closed. He thought that the culture of Royal Mail had not changed and that there was still an "us and them" culture between management and workers. Lord Sawyer, referring to the Labour Party Manifesto and the Warwick agreement, noted the Government said it had "no plans to privatise" Royal Mail.

Government view

Later in the same debate, Lord Sainsbury, for the Government, stated: "In case there is any doubt, I make it absolutely clear that privatisation of the Royal Mail is not on the Government's agenda. There are no plans to dispose of the Government's shareholding in the Royal Mail". In the Commons in March this year, the Prime Minister himself reiterated his commitment to the Warwick agreement. There was no mention, however, that an employee owned Royal Mail might just address the "us and them" culture Lord Sawyer referred to and might not amount to abandonment of Government policy.

Alan Johnson's arrival as the new Secretary of State for Trade and Industry is interesting since, as was noted recently, he successfully opposed privatisation of Royal Mail while he was leader of the CWU. The Secretary of State clearly thinks, however, that some form of stake for Royal Mail's employees is not out of tune with the union tradition. Recently, he stated in an interview in *The Daily Telegraph* on 18 June 2005 that: "The guild socialists, who formed the union of post office workers, believed in giving workers a stake in the organisation. I was looking for ways to do that when I was in the union and I'll be doing that as a minister".

Even more recently, on 21 July this year, Mr Johnson said that the Government would not privatise Royal Mail. However, he also said, in answering a question on the possibility of an employee trust model for Royal Mail, "I am not ruling that out...I do not think that the House should rule it out. It is certainly something that we should look at on the basis of seeking to restore Royal Mail to full health...".

3. The debate so far

Union view

The CWU has been consistent to date in its opposition to any form of privatisation of Royal Mail. In its consultation paper 'Delivering Quality: The Post Office in the Public Sector', the CWU considers that "privatisation or some form of employee buyout would be a disaster for our members and for postal users".

The paper addresses the prospect of ownership restructuring and possible privatisation in these terms: "Dressing up a share-sale as an extension of ownership is simply an ideological game...Dressing privatisation up as a gimmick is a diversion from the industry's needs and leaves management open to the accusation of promoting self-interest". On share plans more generally, the paper offers the following observation: "Share schemes undermine the principle of collective pay bargaining and detract from the need for a significant uplift in basic pay rates. Unilateral imposition of a share scheme not only negates national pay negotiations but runs counter to the Board's 'partnership' approach".

The CWU continued to keep the pressure on the Government when Billy Hayes, General Secretary, stated at the most recent CWU Annual Conference: "Today we are making our position very clear. We will fight any attempt to sell off or screw up Royal Mail. The CWU values its links to the Labour Party. But I have no illusions about how that link will crumble if the Government breaks its promise". More recently more than 100 Labour MPs signed a Parliamentary motion calling on Ministers to ensure that Royal Mail remains publicly owned with all shares continuing to be owned by the Government. As recently as the September 2005 TUC conference, he maintained a fierce opposition to any "John Lewis style" stake, referring to the "nonsense about a partial share sale" which is privatisation.

The Industry Minister, Barry Gardiner, in a recent written answer to the House, stated that "neither do we [the Government] have plans to issue shares [in Royal Mail] to employees or others". And, as the exchanges in the House have continued, in late July 2005, Mr Gardiner, in response to a question from Barry Sheerman, the Labour/Co-operative member for Huddersfield, agreed with him that "the enterprise that works best is the one in which every member of the workforce has a share".

The CWU, for example, has pointed out that there are no actual shares in Royal Mail available to buy and that any value given to them would be entirely arbitrary. This is true if by Royal Mail we mean its regulated products and services. There is, however, already a corporate structure with Royal Mail Holdings plc as the parent company of a group which includes Royal Mail Group plc (the Postcomm licence holder), Post Office Limited and General Logistics Systems International Holdings B.V. ('GLS'). The creation of legal, taxation and accounting mechanisms to introduce a measure of employee ownership will need to be worked through, but these challenges can be met if the political will exists.

Complexity?

So far, there has been no detailed consideration of how a part-employee owned Royal Mail could be made to work. Despite the recent successes of Royal Mail, the formidable challenges the business still faces are set out clearly in its 2005 Report and Accounts

3. The debate so far

and elsewhere. The Chief Executive's Statement explains:

“Not only will Royal Mail have to generate sufficient profit to pay off the £2.5 bn pension fund deficit, it currently makes losses of over £200m on nearly 90% of its price controlled volumes which it has to provide under its universal service obligation. Also, the 14,609 strong network of Post Offices branches made a loss on its operations last year of £110m. The rural network of 8,000 branches is uneconomic and needs an injection of £3m a week to survive. The current annual Government funding of £150m is due to end in 2008 and Post Office Limited cannot be expected to absorb extra costs at this level. Meanwhile, Royal Mail also lags behind its major rivals on automated sorting technologies...”.

This is in addition to the opening of the mails market to full competition in January 2006 together with other changes. Undoubtedly, it would be complex to make ownership restructuring work – but not necessarily more complex than any large and significant corporate restructuring, merger or acquisition of public companies of similar size. The John Lewis Partnership has 60,000 employees; Royal Mail has more than three times that. The strategy for transition to an ownership culture in Royal Mail would have to be thoroughly planned and then actively managed in a sustained way.

Timing

This paper is about introducing employee ownership now to help build on the recent turnaround of Royal Mail and create a long lasting ownership structure that fits in with Royal Mail's business objectives. The John Lewis Partnership has developed its unique style of industrial democracy over a very long period and Royal Mail under the same mechanism could also take years to mature.

The strategy for transition to an ownership culture in Royal Mail would have to be thoroughly planned and then actively managed in a sustained way. This is no reason to postpone a discussion on employee ownership. However one analyses Royal Mail, it is clear that employees are key to the success of the business.

4. The feasibility factor

How feasible would it be to restructure Royal Mail ownership to give employees a large and even controlling stake? Certainly the notion of giving 200,000 employees a stake worth more than £2bn in part of the nation's 'family silver' would be new ground for the Government. There is, however, useful experience on which the Government can draw.

The case of eircom

The current administration would not be the first government to transfer part of a holding in a state-owned company to its employees. The Irish Government, for instance, did so prior to divesting itself of Telecom Eireann (now eircom), the incumbent telecommunications company. There, the 14,500 or so employees bought a 14.9% stake in the business through an employee share ownership plan or ESOP, which is considered in some detail below. The eircom model is useful in that it was relatively large scale, involved a highly unionised workforce and has already delivered significant benefit through shares worth €390 million tax free for the employees in the six years it has been operating. So, it is feasible, provided there is a political will from all parties and the Government develops policy which contemplates employee ownership structures.

The return on investment by employees in eircom, by any measure, must be considered a success and Royal Mail and the Government would need to look closely at how and what made that programme operationally and economically successful.

Eaga for change

Employee owned business Eaga Partnership Ltd provides products, services and solutions which address the energy efficiency, environmental and social needs of central and local government, housing associations and the private sector. The company started life as a governmental agency tackling the social problem of fuel poverty but was later set up as a not-for-profit business, becoming employee owned in 2000. Today the company has over 1,400 employees, a turnover of around £300 million per annum and operates in eight different countries.

In converting the business from a not-for-profit to a limited company Eaga drew heavily on the John Lewis Partnership model – incorporating trust structures along with a similarly democratic structure. All of the surplus profit generated by the business is shared between partners and the independent Eaga Partnership charitable trust, a charity dedicated to researching into fuel poverty.

Critically, the switch to employee ownership was prompted partly by chief executive John Clough's belief that a not-for-profit structure was unsuited to the more commercial environment Eaga operated in, and by a desire for an 'ethical' solution to the requirement that Eaga change its structure.

This year Eaga's employees ranked the company in the top 40 of The Sunday Times 'Top 100 Companies to Work for' index for the second year running. Employees also rated Eaga second in the whole of the UK for "making the world a better place".

4. The feasibility factor

Employee owned business

There are no reliable statistics on the size of the employee owned sector in the UK. JOL estimates that companies with full or significant employee ownership have a combined total turnover of not less than £20 billion annually. The sector is significantly larger in the USA, but in both economies joint ownership is still the exception – so why would a major corporation consider such a step?

JOL recently staged a national conference in the UK for employee owned companies. The experiences employee owners shared at the conference ranged from long-established co-owned companies like Swann-Morton and Scott Bader, to newer and smaller employee owned businesses such as Loch Fyne Oysters, Sunderland Home Care, Learning IT, School Trends and St Luke's Communications. One common factor to emerge was the shared drive of these employee owners to be part of and directly influence the financial performance of their companies.

International research consistently shows that the combination of extensive employee stakeholding with real workforce involvement produces superior productivity and profitability compared with other companies.

A forthcoming literature survey, commissioned by JOL and carried out by Professor Jonathan Michie, director of Birmingham University Business School, will report this evidence in depth. The study will show elements present in companies that make use of some degree of employee ownership which predispose them to outperform 'classic' business models. Research from the UK, US and Japan – the study shows – demonstrates that firms with employee ownership, or significant levels of employee financial participation, have:

- Higher productivity and financial performance
- Greater innovation
- Higher levels of customer loyalty
- Lower staff turnover, and
- Increased shareholder returns.

In the US, researchers and academics such as Cory Rosen (of the National Centre for Employee Ownership) – along with Beom-cheol Cin and Stephen Smith, who studied experience in Korea, and Kato Geniichi in Japan – show the productivity gains that can be achieved where employee participation in ownership of a business is part of the structure.

In the USA the 'Employee Ownership Index' created in 1992 by Douglas Kruse and Joseph Blasi of Rutgers University, with Michael Conte of the University of Baltimore, outperformed comparable indicators. Between 1992 and 1997 EOI, based on the stock price of publicly traded companies with a public record of 10% or more of employee ownership, rose by 193%. In that time, the Dow went up by 145% and the S&P index 500 by 140%.

The UK equivalent index is the UK Employee Ownership Index ('UK EOI') produced by Equity Incentives Limited. This covers only 25 or so companies but shows a similar impressive difference. For those who dislike percentages, a £100 investment in the UK

4. The feasibility factor

EOI in January 1992 was worth £453 at the end of March 2005. The same amount invested in the FTSE All-Share or the FTSE SmallCap Index would only have been worth £201 or £148 respectively at the end of March 2005.

Not just an ownership issue

The research tends to suggest that even a substantial employee stakeholding is not enough in itself to lift productivity dramatically. The biggest impact is produced when that stakeholding is coupled with employee owner participation in the decision-making process of the business.

It is exactly as John Spedan Lewis, the founder of the experiment in industrial democracy that is the John Lewis Partnership, suggested – it's the sharing of the fruits of ownership that is critical. Those benefits are clearly spelt out at the John Lewis Partnership as being the sharing of gain, knowledge and power and that the purpose of that 'experiment' is to make the happiness of its workers a paramount objective. That purpose has driven the building of one of the most productive retail companies in the world.

5. How could ownership restructuring work?

It's worth remembering that whatever size of stake is transferred to the employees, by whichever mechanism, the prospect of restructuring the ownership of Royal Mail would be a major corporate transaction in its own right – though as we've pointed out, not necessarily bigger or more complex than other large-scale corporate restructurings. For any business planning such a transaction, an early step must be to engage specialist legal, tax, financial and other advisers with experience relevant to this specific type of transaction.

Size

The size of the employee owned stake is also an important issue. The Daily Telegraph reported on 15 May 2005 that Royal Mail chairman Allan Leighton had told Ministers he proposed to purchase a 51% stake on behalf of its workers. Such a stake would present its own challenges. If we consider that the Government would still retain 49%, due consideration would need to be given to shareholder and governance issues, for example the balance of main board representation.

The eircom experience is instructive and shows how a much smaller (currently 20.9%) but significant employee owned stake in a quoted company can be highly effective. Again, main board representation for the ESOP was crucial in the development of that arrangement.

Finance

Clearly finance is an issue. Any employee shareholding in Royal Mail would represent a long term investment and would not be in the form of tax-free pay or incentive, such as provided by a typical share option plan. Any stake acquired by a trust for the employees would probably be bought at a market price and would have to be paid for. The method of financing of any employee owned stake in Royal Mail would be an important consideration.

The value of up to a 51% stake would be a significant sum and could be funded in a number of ways. The approximately £2bn sum, if borrowed from the City, (it was suggested in The Daily Telegraph on 15 May 2005) could be partially repaid by selling assets such as the European parcels business, GLS. However, other financing structures, or a combination of structures, are possible. A method successfully used in the USA and UK, for example, is so-called 'vendor' finance – where the vendor (or selling shareholder – in this case the UK Government) receives part or all of their money over time, usually receiving interest until the debt is paid.

The role of a trust

It is likely that such a stake would be bought by and held in one or more employee benefit trusts on behalf of all the employees participating in the employee share ownership plan or ESOP. A key aspect of employee owned stakes in the John Lewis Partnership, eircom and other companies such as Tullis Russell is the utilisation of trust structures. There is a variety of options for restructuring. For example, the John Lewis Partnership trust structure is designed to be perpetual or 'evergreen'. The eircom ESOP

5. How could ownership restructuring work?

was designed to be ‘sunset’ in the sense that all shares in the ESOP will eventually be distributed to the participants as individuals over the next ten or so years and the trust will ultimately be wound up.

A new ownership structure for Royal Mail could use a combination of these ideas. It is possible to have a stable core trust holding while at the same time distributing shares to each individual employee. These individually owned shares can be sold on an internal market kept ‘liquid’ by a share plan, such as the HM Revenue and Customs approved share incentive plan (SIP) launched by the Chancellor in 2000. This is the approach used by Tullis Russell, and in the management-led all-employee buy-outs funded by the Baxi Partnership.

The Baxi Partnership, when investing in employee owned businesses, insists that 50% of the shares in any business Baxi invests in be held in a trust to ensure the longevity and security of the business. Such a mechanism is also employed in Tullis Russell to protect the independent nature of the company.

Might putting a large share of the equity into an employee trust deter investors in the capital markets? It will ultimately be for Ministers to decide how much equity, if any, is held outside of employees and the Government. The existence of an employee trust stake would not in itself prevent external equity being traded. In September 2005, eircom launched a rights issue to raise €420 million to acquire the third largest mobile company in Ireland. The fact that the ESOP Trustee, which is regarded as an insider, has indicated that it will accept the rights at a cost of €88 million has been well received by the market. The John Lewis Partnership, for example, for historical reasons, still has non-voting cumulative preference stocks which are quoted on the London Stock Exchange.

A company’s size, profitability and liquidity, rather than the proportion of shares on the market, are some of the main determinants of tradeability. As far as share price is concerned, should this arise, the key factors in both the medium and long term will be the true performance of the business.

Corporate governance

The trustees’ or corporate trustee’s role would be to acquire the shares and manage the trust on behalf of participants and provide the strategic and corporate governance elements. Care would be needed in designing and drafting the governing documents, the corporate governance structures, financing and borrowing provisions, employee participation and mechanisms to allow for the enduring nature of the trust. The eircom ESOP has a corporate trustee with a board of seven directors and its composition is interesting: two of the seven directors are nominated by the company itself, the unions (as the elected employee representatives) nominate four and the seventh is an independent professional trustee director. The UK Government has recognised a ‘paritarian’ arrangement for trustee directors in UK employee share trusts legislation (under which there is at least one independent professional director with parity between the number of management and workforce elected directors).

5. How could ownership restructuring work?

It is important that all concerned recognise that the decisions in which the trustee or trustees are involved are ownership decisions – they don't interfere in the day-to-day management or industrial relations of the company. Instead, the existence of the employee trust stake creates a positive background which allows management to foster true employee commitment through a participative management style.

Employee participation

If Royal Mail ownership is restructured to create significant employee stakeholding, it would be important to ensure that employees have genuine participation in decision making. It would also be vital that the committees and councils who may elect appointees are transparent and effective. Mechanisms for the conduct of ballots and elections are critical to employees' involvement.

Attention should be given to educating management and employees in employee share ownership issues and the particular structures to be used. Successful employee owned companies tend to invest large amounts of resources in training, educating and communicating with their employees. With potentially 200,000 participants in a Royal Mail plan, the administrative and planning functions of the scheme would need to be on a large scale.

It is only by involving the employees in the ideas, the vision and the sharing of information that they will embrace the wider ambitions of the plan. Businesses with large scale employee owned stakes should be consulted to gain a much better understanding of how training, culture change and management accountability can work under an employee owned structure.

Communications are also a key component of participation. In eircom, an ESOP Unit was set up at the outset with a dedicated manager and support teams to handle the communication with and administration for the 14,500 or so participants. There, a wide range of communication tools is used; from a regularly updated intranet site where participants can log on and keep up to date with developments and access vital information to a country-wide network of 'key communicators' who are often union branch officials. This network means that the ESOP Trustee can ensure that every piece of information sent out is timely, accurate and delivered correctly.

Leadership

Finally, each ESOP needs its champions. At eircom, among the many dedicated people involved in delivering that plan, it was arguably the then general secretary of the Irish CWU, Con Scanlon, who best understood that the company, the Irish Government, employees, unions and the capital markets could work together in partnership for the success of the business, the employees and the shareholders in the company. Mr Scanlon saw that the unions' members, through their representation on the boards of both eircom and the ESOP Trustee, could gain significant influence over the strategic direction of the company. That influence was negotiated and hard fought over a period

5. How could ownership restructuring work?

of time and increased through a number of major corporate transactions.

The wide variety of employee ownership models demonstrate that there are different options available when considering how to restructure ownership of Royal Mail. There has to be a political will and, critically, strong visionary and influential individuals involved in the process to make employee ownership happen.

6. Getting the mechanics right

Creating a new co-owned structure for Royal Mail should involve building a consensus between the Government as shareholder, Royal Mail's board and management, the unions and the employees.

Reaching such consensus would involve much negotiation and agreement between all the parties on issues such as the value of the company, the size of the stake to be purchased, the price to be paid for that stake (bearing in mind that it might or might not be a controlling stake), how the purchase would be financed, how the ESOP would be structured and governed, and associated corporate governance rights. A first step would be to bring stakeholders together to recognise and debate their aims and objectives, and find common ground from which consensus can be built.

Transfer options

In designing a template for Royal Mail there are a number of approaches to weigh up. In the UK there have been several transfers to trust ownership financed by the company involved. Valuations have ranged from a tiny fraction of market value in the case of Baxi Partnership to full market price at Tullis Russell, with the John Lewis Partnership falling somewhere between.

By contrast, at eircom, the 14.9% stake was bought by and transferred to the employees at market value in three tranches without the company taking on any net liability to pay. Firstly, 5% was acquired by the ESOP through an Economic Value Added (EVA) transaction – in return for 'transformation' which involved significant changes in work practices and cost savings. This was negotiated with the company, the government and the unions. A further 5% was acquired by way of a tax-deductible contribution from the company, in return for increased employee pension contributions and bonus savings. The final 4.9% was funded by a commercial loan of €121million from a third party lender, which was not secured in any way by the company. Instead, security was taken over the shares, with interest payments and debt repayments met through dividend income.

Tax

Tax planning is also critical to the perceived benefit of trust ownership to the employees. The Government has a number of tax efficient plans which encourage employee participation, but has abolished other tax breaks to stamp down on the misuse of offshore trusts as tax shelters.

In Ireland, the model is highly tax efficient and involves an approved profit sharing scheme (the UK equivalent is the SIP) which allows shares worth up to €12,700 to be distributed to participants each year tax free provided they have been participants and the shares have been held in the ESOP for a minimum of three years. Therefore, in the case of the eircom, the 14,500 or so participants will derive a tax-free distribution of shares for as many years as the trust has assets to distribute.

6. Getting the mechanics right

The tax reliefs are justified as the ESOP is a captive shareholder in the company and cannot diversify its risk by investing in alternative securities. The available tax relief goes some way, therefore, towards reducing the risk carried by the ESOP and employees.

Implementation

Putting a new co-ownership structure in place in Royal Mail would require a strong implementation team to complete the transaction, set up the employee ownership structures and ensure it operates smoothly for the long term. In addition, the whole executive board would have to be actively involved in and designing the strategy for participative management, and committed to its implementation. Advisers should include practitioners with previous experience and understanding of a wide range of employee ownership structures.

Finally, it is essential that any transition to joint ownership is an integral part of an overall corporate strategy to prepare for increased competition; and does not dilute the commercial imperatives on Royal Mail to be competitive and profitable, and deliver better service to its customers. This will mean, among other things, ensuring that a restructured Royal Mail is fully capable of retaining and attracting exceptional management talent.

7. Can union concerns be met?

How justified are union fears about the possibility of ownership restructuring, and is there any hope of addressing these fears and still delivering a more competitive Royal Mail, more satisfied customers, unprecedented employee engagement and an entirely new ownership structure?

The CWU's prime concerns about ownership restructuring are that:

- They won't be consulted or involved in a meaningful way in planning for and implementing ownership restructuring;
- Unionisation and union membership may prove incompatible with partial or extensive employee ownership;
- Ownership restructuring will amount to privatisation of a public service;
- Offering shares to employees undermines the principle of national pay bargaining and dilutes the security of pay.

Consultation

On the first count, there seem to be reasonable grounds for concern. Neither Royal Mail nor the DTI, on the face of it, appear to be engaging with or consulting the CWU although it does appear that significant restructuring plans are under consideration. On the other hand, Royal Mail and the DTI may arguably have been deterred from taking this step by the union's implacable public opposition to getting involved in discussing what they regard as privatisation.

However, a project on this scale could not progress far or successfully without the serious involvement of all the key stakeholders. Unions and their members are an integral part of Royal Mail, and successful partial or extensive employee ownership is inconceivable without their active participation in the process.

Union future

On the second count, there is nothing inherent in employee ownership that makes it incompatible with strong effective unions. JOL supports trade unions, many employee owned companies are unionised or work constructively with unions, and unions can make a highly positive contribution to the development of the UK's employee owned business sector. The John Lewis Partnership is sometimes cited as an example of unions' difficulty with employee owned companies. But staff at the company can belong to any union they wish, and there is a small but significant number of union members in the company.

There are other employee owned companies, such as the Tullis Russell Group, that are more fully unionised. As we have seen in eircom, the unions (led by the CWU of Ireland) are an intrinsic part of the ESOP Trustee structure and wield serious influence on the company's strategy and development, along with the right to nominate directors to the main board. Here, management, employees and unions are working together in partnership to ensure the well being of the company in a highly regulated and competitive environment.

7. Can union concerns be met?

The key to maintaining a strong union role is to keep the industrial relations and share ownership domains separate. The Tullis Russell Group, the Scottish-based paper and coating business, is 100% employee owned and has a clear separation of function between union matters and those matters which fall into the realm of shareholders and which are decided upon by the Share Council, a body mainly elected by the employees, with the remaining positions appointed by the board. These decision-making and HR and industrial relation mechanisms work together as an organic whole. They are not without tensions, but there seems to be general commitment all round.

Fred Bowden, chief executive of Tullis Russell Group, said at a seminar in Dublin recently that “the very fact that employees had a say in the decisions which affected their working lives and equally importantly had access to management information and accounts was a hugely positive aspect of employee ownership”. Responsibility and accountability of management and workers alike was the key to making the venture a success. Experience shows that employees generally come to understand their business much better, and so are able – and motivated – to engage constructively in improving how things are done in the company.

This paper suggests that the reasons for the difficulties between unions and employee owned businesses are the product of history rather than any inherent mutual incompatibility. Tullis Russell shows that unions can operate successfully within an employee owned environment. And co-ownership, as Alan Johnson’s remark [quoted above] signals, can give employees precisely the kind of stake in business that most unions were founded to achieve. The unions have much to gain from a dialogue, from which they can always withdraw later, to co-design a meaningful union role in a mutually owned business in which their members have a literally unprecedented say and stake in Royal Mail.

Privatisation?

Union concern number three is that ownership restructuring amounts to the privatisation of a public service, hence guaranteeing union, and substantial Labour Party opposition. This paper has already cited DTI Secretary Alan Johnson’s reminder that the postal union’s founders believed its members deserved a stake in the postal service. And it is possible to think of a compromise ownership solution that could be acceptable to all the parties. Imagine for the sake of argument that the Government assents to an arrangement where the state retains 49% of Royal Mail, and employees acquire a 51% stake.

It would be hard to see ownership restructuring as ‘traditional’ privatisation if the result was the deliberate creation of a new form of public interest company which combined:

- A large but minority government stake, including a mechanism to allow reversion to the current ownership structure in specified circumstances;
- A majority or very substantial employee stakeholding, in the form of the kind of trust arrangement described above;
- Clear public service obligations which take account of Royal Mail’s need to operate commercially, profitably and competitively.

7. Can union concerns be met?

It would be naïve to think that the public interest company solution could remove the tension between Royal Mail's public service and commercial imperatives at a stroke. But the formula might at least provide a workable foundation for the Government, company and unions to address that critical issue.

Any ownership restructuring needs to take into account Royal Mail's business diversity. It's possible to imagine the 'public interest' formula proving more applicable to parts of the business delivering a more obviously essential public service, and less so where Royal Mail is simply delivering a routine commercial service in competition with other providers. It would be important, for instance, not to put the Royal Mail at a competitive disadvantage with the likes of DHL, a wholly owned subsidiary of Deutsche Post.

Shares undermine bargaining?

The CWU's 'Delivering Quality' report says: "Share schemes undermine the principle of collective pay bargaining and detract from the need for a significant uplift in basic pay rates". The report also says such schemes can breed resentment if senior executives gain disproportionate bonuses or share options from them. On the question of share ownership undermining national pay bargaining, it seems premature for the CWU to predict that this is an inevitable outcome. This seems more likely to depend on the strategic direction a restructured Royal Mail decides to take. But by then it could be a Royal Mail where employees have an unprecedented say in what the company does. In eircom, for example, employees have received all the pay rises due under the social partnership programmes.

As 'A Stake in the Post' has shown, ownership restructuring need not involve giving staff actual shares at all and could instead be based on collective ownership through some form of trust. In any event, the union should have some confidence that the Royal Mail's pay strategy – if its ownership is restructured to give employees a large stake – has a higher chance of reflecting their members' wishes than now.

8. Conclusion

This paper has discussed and advocated a new ownership model including a substantial employee stake as part of a strategy to deliver a new and crucial competitive edge for Royal Mail. Such a step would create a very significant employee owned business – one of the largest outside the United States – which if successfully implemented, could potentially be the pathfinder for a new approach to the development of other state companies.

The central theme of ‘A Stake in the Post’ is that a major and even majority employee stakeholding in Royal Mail can deliver what the management of the business, the Government, customers, employees and unions ultimately want – better service for customers, greater profitability, better employee relations, more employee involvement.

The approach has worked elsewhere and offers a good solution to the challenge of increasing competition in the postal market and the need to create a greater sense of cohesion and commitment within the company. However, progress of this kind won’t come without extensive informed debate about how ownership restructuring could be achieved, and a determined effort to learn from the accumulated experience of what it takes to make employee ownership work.

This paper is designed to make a constructive contribution to the debate. It is time to think creatively and innovatively about the future of not only Royal Mail but other state businesses like Network Rail. Now could be the time for employee ownership to take a major role in the wider business landscape.



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