Checklist for Successful ESOPs

If some form of ESOP is to be established, here is a checklist of key issues that the implementing agency should ensure are being followed.

Participation Issues

- All employees should be able to participate, subject to a qualifying length of service such as 12 months.
- There should be no great discrepancy between management's stake and that of the rest of the work force.
- There should be similar voting rights.
- There should be similar dividend rights.
- Use of an employee trust aids flexibility and helps sustain the plan for the longer term.
- Transparency—particularly regarding the first allocation, where it is important that everyone knows broadly who is getting what.
- A "free share" allocation, even quite modest, is usually essential to get everyone in as a shareholder.
- Wages and other benefits (for example, pensions) should not be sacrificed for a share scheme.
- It is usual for employees leaving or retiring to have to sell their shares to the trust.
- The trust will be run by trustees and a balanced make-up of the trustees avoids its being dominated by any one faction—for example, two management representatives, two work force representatives, and one independent trustee agreed on by the other trustees would strike a good balance.

Management Issues

- The engagement of a specialist adviser, familiar with ESOPs, trust law, and taxation, will be essential.
- A participative style of management is adopted to make the best of the plan.
- Communicating with the work force before, during, and after the plan has been implemented is vital to gaining their initial and ongoing support, thereby creating the necessary long-term enthusiasm.
- Plans should be subject to full consultation with the work force.
- There is a need for culture change on both sides (that is, management and the work force), but it should be led by management.
- Employees need to understand the difference between their rights and duties as employees and their more limited rights as shareholders—an important part of the communications process, particularly around the time that the deal is completed.
- In all of the concerns about the work force, it is important to ensure that management has adequate incentives and that these arrangements are transparent. Often, an appropriate share option plan is one that allows employees to acquire additional shares when they achieve agreed targets, both corporate and individual, over, say, a three-year period.
- Management also still has the right to manage.

Structural and Technical Issues

- What is the source of the shares (existing government shares, newly issued shares)?
- What are the eligibility rules (how many shares to offer, when, and at what price)?
- What constitutes compliance with national legislation?
- Wages and conditions of employment should be kept separate from share ownership.
- Employee representatives (including trade unionists) should have access to independent professional advice about the plans.
- It is important to build in features that will promote the sustainability of the plan, such as leavers must sell their shares, use of trust.
- There is nothing wrong in principle with employees being asked to put their own money in—some employees will be more focused on their jobs if they have their own money at risk.
- For distribution of shares it is best to use tax-efficient share plans where available.
- Internal market: some of the work force will want to buy or sell some shares, and this is usually allowed in private companies, on a "matched" basis when the scheme has been running for a while.
- Depending on the size of the stake the employees have, they may be entitled to look at having a representative on the company's main board—as a rule of thumb, a holding in excess of 25 percent?
- If the ESOP is put in place before PPI, should the ESOP offer existing employees the possibility to cash in at the time of privatization or should it be structured as a long-term, performance-related incentive plan for the employees who best respond to the transition to private management? (The answer is probably both, and this will have implications for how the ESOP is eventually put in place.)