Three Models of Employee Ownership

Worker Cooperative, EOT and ESOP – Overcoming Barriers – Important Choices – Pros and Cons

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Three models of employee ownership: Worker Cooperative, EOT and ESOP – overcoming barriers – important choices - pros and cons

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Abstract

Purpose – The purpose of this paper is to compare three models of employee ownership and to identify pros and cons in relation to how they can overcome the barriers. Which choices are important when defining the overall rules around the models and the specific possibilities for variations and combinations and what are the pros and cons for these choices?

Design/methodology/approach – The comparison is based on the three main models of employee ownership identified from the country descriptions in this special issue.

Findings – The models do not exclude each other. They can all be promoted in a specific country leaving the choice of specific model to the stakeholders involved in the establishment of the employee-owned company. The article also shows the possibility of combining different models and in this way to adjust to specific preferences and conditions – e.g., whether employees and other stakeholders want collective or individual ownership and whether it concerns a startup or a succession company.

Originality/value – Identifying the key-differences and similarities of different models for employee ownership including pros and cons of worker cooperative vs the EOT and the ESOP models.

1. Introduction

The purpose of this article is to compare three models of employee ownership which can overcome or limit the main barriers for employee ownership as shown in this special issue including Mygind 2023. The three basic models are: the worker cooperative, the Employee Ownership Trust (EOT) as known from the UK and the Employee Stock Ownership Plan as known from the US. The implementation of the models is determined by the legislation in each country and the specific choices done in each company. There are a lot of choices to be made by politicians when writing the legislation and for the employee and other stakeholders when implementing the model at the firm level. The purpose of this article is to specify the main choices and to discuss the pros and cons of each choice including the overall political choice of promotion of each of the three models.

It must be stressed that the evaluation of pros and cons of each model and the connected variants is often based on different basic values. Individual stock ownership resulting in capital gains for the worker owner may be considered as a “pro” from the political center and the right wing, while the left wing may be more skeptical and prefer collective ownership where the capital value of the firm is indivisible. Still, a broad political spectrum considers that a more equal distribution of wealth is positive - a “pro”. It is not possible to avoid such judgements, but we will try to mention such perceived biases when relevant.

The prevalence and growth and some of the economic results are already presented in this special issue – the worker cooperatives in the July JPEO and EOTs and ESOPs in the October JPEO. The article by Mygind 2023 gives an overview, including how the specific model in each country overcomes the five barriers identified by Dow, 2003 and Mygind and Poulsen, 2023.

Figure 1 gives an overview over the three main models of employee ownership: the worker cooperative, the Employee Ownership Trust (EOT) and the Employee Stock Ownership Plan (ESOP). These models have proven successful in some countries and after some adjustments, they could be used for promotion of employee ownership in other countries. The three models do not exclude each other. If you have a spectrum of possibilities, it is possible for companies to adjust to their specific situation and goals. One size does not fit all.

Figure 1 and the following text includes three symbols to ease the overview:

A star: * indicates that there is an important choice to make,

+ indicates an advantage and therefore an argument for a positive recommendation,

- indicates a disadvantage and an argument for a not making the specific choice.

On the vertical axis figure 1 summarizes the key dimensions distinguishing the models starting with the growth potential based on the evidence of prevalence in the five countries analyzed in this special issue. This includes the spread over different industries, size, and capital- and knowledge intensity. Then follows the role of support organizations and consulting networks. The specific model is described by the key legislation and the determination of the three ownership rights of control, surplus and wealth. The rules for entry and exit of members is also an important element in the specific model. The main financing channels both from external and internal sources are emphasized. This is connected to the tax treatment of the company and the employee owners and the treatment of members in relation to wage earner status and connected benefits. Then follows the implications related to risk and finally, we analyze the choices and "pros" and "cons" in relation to startups and takeovers. Promoting one model or promoting a spectrum of possible models is one of the main *choices* to make when developing a new framework for employee ownership in a country. The purpose of this article is to give an overview over the main choices and list pros and cons related to these choices. We do that rather than directly recommending a specific solution – this must be a political choice.

We present first the worker-cooperative model based on the experience from France, Italy and Spain including the specific Mondragon model, and then the EOT-model from UK and the ESOP-model from US. How can these models overcome the barriers for employee ownership and what are the main choices to make when implementing the models in other countries? What are the pros and cons related to the different choices?

2. The cooperative model including the Mondragon variant

2.1 Growth potential and framework

The traditional model for a worker cooperative is well proven in many countries, but there are huge differences in relation to how widespread they are. In countries like the UK, the US, and Denmark they are in general quite small and quite few. In Italy and Spain, on the contrary, they make up a considerable share of all companies and have respectively around 500,000 and 250,000 employees. There are around 50,000 employed in worker cooperatives in France (Mygind, 2023).

In all three countries and especially in Mondragon in the Basque Country of Spain, there are strong cooperative support organizations that play a key role for promoting worker cooperatives by developing the model, supervision, monitoring and facilitating financing. In this way, they are important for starting new cooperatives from scratch or as conversions from conventionally owned companies and they support their further development as worker cooperatives (Arando, 2023).

Italy has the strongest worker cooperative sector. There has been a long historical tradition with three support organization covering the whole political spectrum and there are strong clusters in Northern Italy, especially in Emilia Romagna, where worker cooperatives and consumer- and producer- cooperatives are an important part of local society with strong awareness about cooperative organizations as important players in the economy (Cori et al. 2023)

Figure 1: Worker Cooperative, EOT and ESOP: overcoming barriers; + pros, – cons, *choices

	Worker Cooperative	**EOT**	**ESOP**
Growth potential	* limited without strong supportive framework like Italy or Mondragon-if not, mostly quite small and labor-intensive, + knowledge intensive	+ strong potential if appropriate * tax incentives are implemented + also potential in capital-intensive and medium to large companies	+ strong potential if appropriate * tax incentives are implemented + also potential in capital-intensive and medium to large companies
Support organizations	+ support organizations key role *if not existing, some public support and finance may be relevant.	in UK: EOA and private network of consultants have key role * if not, some public initiative relevant	in US: NCEO, other organization and network of consultants have key role * if not, some public initiative relevant
Model = ICA	ICA principles, Mondragon way	ICA principles possible	ICA principles possible
Key Legislation	*specific law for worker cooperatives in countries with many worker coops + clear model, + easy to follow , - flex * tax legislation	* legislation on trusts, tax legislation on gifts/heritage and capital-gains + important driver in UK	* legislation on trusts, tax legislation on gifts/heritage, capital-gains, personal income, company profits + important driver in US
Right to control External owners	+ 100% employee members * but in recent years many countries open for some external ownership * < 25%? <33%? or <50%? often other coop, or former owner + more sources for finance * Mondragon group structure * coop can own subsidiary - non coop * France: Seed coop, mother majority for seven years + group competitiveness + startup of new coops - may compromise on democracy	* some minimum to EOT >50% like UK => tax incentives for conversions - employees control depends on the statutes for trustees including rules for appointment/election of trustees + democratic employee control possible if allowed in the trust deed * some mandatory control right for employees could be included, like US + former owners may have minority => higher incentives for conversions + possible hybrid: with ESOP or with individual employee shares	* some minimum to ESOP, 30% like in US => tax incentives for conversions - employee control depends on the statutes for trustees including rules for appointment/election of trustees + democratic employee control possible if allowed in the trust deed * some mandatory control right for employees could be included, like US + former owners may have minority => higher incentives for conversions + possible hybrid: combined with EOT or individual employee shares, KSOP
Right to surplus	* min % of profit to collective reserves * part of profit to individual accounts (this is quite high in Mondragon) * part of profit paid to members may go to individual non-voting shares	* profit-sharing bonus to employees * equally or based on hours or wages * tax-free, max amount per year + EOT gets its share of the surplus	+ yearly contributions go to ESOP => build up ESOP capital => + individual employee accounts + strong direct effect of ownership - complex individual share valuation
Right to wealth individual or collective reserves	* high priority to collective reserves + stability, + buffer, + no sell out * low priority to individual reserves * members' capital mostly like loans * Mondragon high individual savings - no individual capital gains	+ bonded in the collective trust + long run stability, + buffer + no incentive to sell the company - no capital gains to employees + hybrid with ind. shares or ESOP => possible capital gains to employees	+ ESOP capital gains value and individual accounts + possible individual capital gains to employees - some incentive to sell company + EOT hybrid: some collective reserves
Membership entry/exit	+ low entry fee => easy entry and exit + open membership, probation time + max proportion of non-members * Mondragon: high fee ^ installments	+ automatic membership no fee at entry, no pay-out at exit no employee contributions + broad ownership, all employees	+ No employee contributions + ESOP built by company contributions + broad ownership, all employees - complex individual share valuation
Financing	* special coop banks & credit unions * may be financed by coop tax * member loans, low interest rate * Mondragon: + individual accounts	+ loans with collateral in the company used for take-over bank and vendor loans - no employee accounts	+ loans with collateral in company used for employee buyout such as bank and/or seller loans + individual employee stock accounts
Tax benefits	* lower company tax for coops and savings into collective reserves * some to coop financial institutions * to former owner for conversions + levelled playing field in relation to succession by family or foundation	* for EOT, + employees: tax free bonus + profit-sharing + no capital gains tax for former owner + levelled playing field in relation to succession by family or foundation	* ESOP-gains only taxed when paid out * deferred gains tax for former owner if at least 30% ownership to ESOP * contributions to ESOP, installments and interest on loans deductible * ESOPs in S-corporation no corp. tax
Wage-earner benefits	* when? three or more employees?	+ wage-earner status not an issue	+ wage-earner status not an issue
Risk for individual employees	+ limited by high collective reserves - Mondragon high individual accounts + but diversified social security	+ no individual stakes, only collective reserves	+ often considerable individual stakes + no employee payment for the shares + rarely substitute to other pensions
Startup	* guidance by coop or public org.	- EOTs rarely used for new startups	- ESOPs rarely used for new startups
Takeover	* tax-incentives for former owners like for EOTs and ESOPs rarely used	+ Proven model in UK – high potential when combined with tax benefits	+ Proven model in US – high potential when combined with tax benefits

2.2 The worker cooperative model

In France, Italy, and Spain there is legislation defining the model of a worker cooperative – rules for the distribution of the ownership rights to control, surplus and wealth including the distribution on individual and collective reserves (Fakhfakh, 2023, Cori et. al. 2023, Marcuello, 2023). There are rules for entry and exit of employee-members. There are rules for taxation adjusted to the specific ownership structure, often including some special tax-benefits. This legislation has helped to overcome the different barriers.

The laws on worker cooperatives are following the cooperative principles as defined by ICA, the *International Cooperative Alliance*. These principles emphasize the democracy of one vote per employee member, open membership, control not based on capital, and limited return to capital.

* The star in figure 1 indicates that there is an important choice about whether to have a specific law defining a worker cooperative and the different conditions it should fulfill.

+ The advantage of a specific law on worker cooperatives (marked with + in figure 1) is that it gives a clear model for the employees who want to start a worker cooperative. They do not need to start from scratch making a lot of complicated investigations and choices.

- On the other hand, a detailed and well-defined model may be less flexible to adjust to specific conditions and ideas of the founders. This is marked by – in figure 1.

The right to control belongs 100% to the employee members in the pure model. However, to open for broader supply of capital the model may allow for minority external ownership. The external investor could be another cooperative, or another investors including the former owner who wants to keep a minority share in the company (like in France and Spain).

* There is a choice of whether external ownership should be possible within the model, and if the maximum of votes in the general assembly or the board should be 25% (like EU's SCE-model) or 33% (like in Italy and France) or just less than 50%. Considering other legislation, the exact percentage could be related to whether the external investor shall be able to block key decisions, e.g., a merger, sale, or closure of the enterprise. Further pros+ and cons- worth mentioning are:

+ Supply of extra risk capital open for more capital-intensive startups and takeovers.

+ Smoothing a cooperative takeover of an existing enterprise by allowing the former owner to keep some minority ownership.

+ Open for capital support from another cooperative in the startup process.

+ The external ownership could open for another cooperative functioning as a mother company for some years, or it could be the base for long run mother-subsidiary relations like in the cooperative group structures in France or in Mondragon.

+ Connecting worker cooperatives into a group structure, like in Mondragon.

- A group structure may to some extent compromise direct democracy in the worker cooperative.

* As an alternative to a hierarchical group structure with mother-daughter relations there could be a structure of independent worker cooperatives cooperating through a federative structure like it is widespread in Norway.

The right to surplus concerns the distribution of profits to collective and individual reserves and/or paid out as cash to the employee members. *The right to wealth* concerns the collective indivisible reserves which cannot be distributed among the members. At the dissolution of the cooperative, remaining collective reserves are transferred to a cooperative support organization or to some public beneficial purpose.

* There may be rules for how much of the surplus should be allocated to collective reserves until these reserves reach a certain proportion of the equity in the cooperative (like in France).

Advantages of prioritizing accumulation of collective capital at the expense of the individual accounts:

+ Long run stability when collective capital is built up as a buffer.

+ A high proportion of collective capital is a barrier for selling the enterprise because this part of the wealth cannot be capitalized by the members.

+ Argument for tax deduction for savings into collective reserves.

But disadvantages of demanding a high proportion of collective capital include:

- Less flexibility for the employees to decide about the balance between collective and individual reserves and choosing a stronger weight on individual accounts like in the Mondragon model

- Less incentive for the individual worker members to support the accumulation of, which could lead to lower capital accumulation. The relatively large individual accounts have probably been important for the strong growth of the Mondragon cooperatives within quite capital-intensive industries.

- For worker cooperatives the individual accounts are like a loan to the enterprise - in the Mondragon variant with an element of profit sharing.

- Accumulation of capital into individual accounts based on contributions, interest and dividends give an effect on members' wealth and may influence the distribution of wealth in society. Collective reserves may also have some equalizing effects: The more capital being indivisible in society the less equity capital contributes to wealth inequality. However, in a society where indivisible reserves makes up only a minor part of the total company wealth the effect of a broader group of employees having an individual share, is probably the strongest.

2.3 Members' entry and exit

* According to the ICA principles of open membership, all employees should have the possibility to become members. However, there may be a certain probation period with a maximum length. Rules vary in the different national legislations, but often with a considerable scope for the bylaws of each worker cooperative. This also concerns a possible maximum proportion of non-member employees in relation to the number of employee-members.

+ Some flexibility for the cooperative bylaws to determine the length of a certain probation period before membership, possibly within a certain maximum.

+ A legal maximum for the proportion of non-member employees. This is an important safeguard against a degeneration of the cooperative with a small group of members benefiting from ownership and excluding a large group of employees functioning as hired labor.

- In industries with very high variation over the year and e.g. using a big group of short term employees in the high season, the rules may give too little flexibility.

* There is a choice for the regulation of a mandatory entry fee or a mandatory individual share when becoming a member of the cooperative (France: one share). Should there be a minimum and a maximum for such a fee? A high fee can, like in Mondragon and France, be smoothed by new members paying by installments over a period within a maximum proportion of the monthly wage.

+ A low fee makes entry easier.

- A legal maximum may exclude a Mondragon-type model with a high entry fee as part of financing.

2.4 Financing

Lack of financing for the start and expansion of a worker cooperative could be an important barrier but is seems to have been eased in the countries with a high number of cooperatives and prevalence even in quite capital-intensive sectors like in Mondragon.

In Mondragon, the capital base comes to high degree from the individual contributions linked to the individual capital accounts, which plays a much smaller role in worker cooperatives elsewhere. In Mondragon, the individual accounts can grow both by adding interest and by profit related dividends being added every year. The capital inputs from members in Italy, France, and the rest of Spain function to an even higher degree as member-loans to the cooperatives. These loans have strict limits for the possible returns, like in Italy with a regulated maximum interest following the Central Bank.

To keep the basic principle of dominant employee control there must be strong limitations of the weight of *external equity capital* in relation to the right to control, surplus and wealth.

Concerning *external loan capital,* the awareness and understanding of this special type of ownership are important. When worker cooperatives are rare, they are probably considered a strange animal not fitting to the usual pattern of banking including estimation of risk. However, when employee ownership reaches a critical mass, some of these barriers may disappear.

* Financial institutions specialized in democratic firms including employee-owned enterprises play an important role in countries with many worker cooperatives. This role would be even more important in countries where the number of worker cooperatives have not reached the critical mass of general recognition. If there are no strong cooperative banks dedicated to worker cooperatives loans from public owned institutions could be relevant. They could be based on initial public funding and then function like revolving funds. Further funding could over time be built by special contributions from the worker cooperatives like in Italy with a 3% profit contribution from worker cooperatives refunded through the tax system.

The pros and cons of specialized financial institutions with some state support as starting capital:

+ They know the special problems and opportunities of worker cooperatives.

- Instead spread the knowledge and let conventional banks including cooperative banks do the job.

Finance the specialized funds by a special tax, like the 3% tax used in Italy.

- It would take many years before it reaches a size to make a difference.

- It should be counter-balanced by a tax relief on the company tax for cooperatives.

2.5 Tax benefits

The arguments for special tax-benefits to worker cooperatives relate both to making a level playing field to other ownership types, especially to the treatment of family-owned businesses in cases of company succession, or to the treatment of foundation owned companies. There are also arguments related to the development of company democracy, to solve the generation problem related to a large group of retiring business owners, and to push for a more equal wealth distribution.

In France, Italy and Spain promotion of cooperatives have been an important political goal for many years and there are some tax benefits for worker cooperatives, though the tax levels of cooperatives are in general comparable to conventional firms. In the UK and especially the US, tax incentives have been a strong driver for conversions to democratic firms. It is worth noting that in the US, some tax-advantages related to takeovers also apply to worker cooperatives, though the number of ESOP buy-outs of successful conventional firms are much higher than for takeovers by cooperatives.

* In Denmark, succession of family-owned companies to close family members, is taxed quite favorably compared to conversions to employee ownership. This relates to taxation of the accumulated capital gains and the tax on gifts and inheritance. It can be argued that conversion of a majority share to broad employee ownership in the format of a worker cooperative, an EOT or an ESOP should have the same treatment as family successions. The argument of saving jobs counts also strongly for employee ownership. In the case of transfer to a worker cooperative or an EOT it can be argued that the values go into collective indivisible reserves and helps to secure the long run survival of the company. This is about the same situation as when a beneficial foundation takes over the

company. This point in the direction of similar conditions for worker cooperatives and EOTs. In the case of an ESOP buyout, the employees will eventually capitalize the transferred values. However, these values are taxed when the employees exit the company and cash in their individual accounts. In the US Internal Revenue Code Section. 1042 allows the family business sellers to defer and reduce their capital gains taxes on the sale to an ESOP if more than 30% of the firm is sold to the workers.

+ Giving the same tax conditions for succession takeovers by worker cooperatives, EOTs and ESOPs as for family successions and foundation takeovers will make a level playing field.

+ Employee takeovers means a more equal distribution of wealth than family successions.

+ Cooperative savings into collective reserves should be deductible from the company tax base. It is not payment to the employees, but long run investment into the company, which cannot be capitalized by the employees.

- Compared to a takeover by a non-family external investor there will be a fall in tax-revenue.

* There should be no uncertainty for worker cooperative members whether they are treated as self-employed owners or wage earners in relation to their rights to unemployment benefits and social security. Therefore, it should be clarified that employee-members are considered wage earners, given a minimum size of the cooperative, e.g., three employees, and given that an employee-member does not have controlling influence.

2.6 Startups and takeovers

The barriers for forming a group of employees starting up a worker cooperative can be rather high compared to a situation where one or a few persons start a new company. Often the entrepreneur will not give new employees a share of ownership without high compensation for the costs already incurred and therefore, the newcomers become ordinary employees. Some kind of incubator system and some coordination mechanism connecting like-minded people may be a possibility. The cooperative support organizations play a key role in countries with many worker cooperatives. These organizations not only help startups from scratch. They also work as promotors and consultants for conversions of successful companies to worker cooperatives.

* The incubator function starting up new worker cooperatives could be done by cooperative support organizations or by public entrepreneurial centers.

3. The EOT and ESOP models

3.1 Growth potential and framework

Since the new legislation in 2014, the EOT has spread very fast in the UK. In a few years, it has become the dominating format of employee ownership for medium sized and large companies (Pendleton et al. 2023). Many ESOP types and direct individually employee-owned companies have changed format to an EOT. This proven success of the EOT makes this model a relevant option for other countries.

The ESOP model is also a well-proven success in US now covering 6,700 medium and large enterprises with around 14 million employees. In large listed enterprises, the ESOPs own typically a small part of the shares while in non-listed medium to large firms they most often own 50-100% (Rose 2023; Blasi and Kruse 2023).

3.2 The EOT and ESOP models

The EOT model has similarities with the worker cooperative model in relation to the collective reserves. In the pure format, the EOT has no direct individual employee ownership.

However, the *indirect* EOT ownership through a trust makes an important difference to the cooperative model. The trustees administer the ownership rights. They perform *the right to control* on behalf of the employees. The precise relation between the employees and the trustees are determined in the trust deed. There are possibilities for varying degrees of influence of the employees. You may get close to the democratic format of a worker cooperative where the employees elect the trustees, and where the employees can be trustees themselves. However, you may also have a model where the trustees are self-appointed by the board of trustees and the employees have limited influence. In relation to the control rights and the role of trustees, EOTs and ESOPs are quite similar.

+ Possibility for a democratic governance structure in both EOTs and ESOPs, but also

+ possibility for the former owners to form the model according to their preferences within the given framework. It can be assumed, that this possibility makes the former owners more favorable to the model and this promotes more conversions to EOTs and ESOPs.

- However, this may mean a long distance from the employee to the controlling top of the enterprise.

In this way, there may be a trade-off between the direct democratic control of the employees and the willingness of former owners to transfer/sell their company to the EOT or ESOP.

According to Pendleton et al. (2023), the statutory ESOP in UK was not a success because the criteria for democratic control to the employees were too ambitious. This scared away the former owners from using this model for business succession.

Rosen (2023) also argues that there is a trade-off between more strict conditions for democratic employee governance of the ESOP trust and the number of new conversions to the ESOP format. Therefore, the model should make it possible to form a fully democratic EOT or ESOP, but it should also be possible to make a trust deed with more distance between the employees and the trustees and possibility for the former owner to keep some control.

* In the US-type ESOP, the employees have mandatory rights in relation to strategic decisions like sale or merger of the company. In listed companies, the ESOP employees can directly instruct the

voting of the shares belonging to the ESOP. This type of rights may also be attributed to the EOT, but it could be argued that especially in the ESOP case, the employees have their individual accounts at stake, and therefore they should have mandatory control rights for key strategic decisions.

* The share of ownership to be eligible for tax-relief is an important choice. Should it be on the level given to family conversions or higher? In UK, the EOT shall buyout more than 50% to open up for tax-relief. In US, the demanded threshold for ownership converted to the ESOP is 30%.

+ The argument for more than 50% is to make a clear shift of ownership control. Still, the employee control can be softened by the trust deed.

+ A lower threshold, like 30%, also means a significant shift of ownership. In the US, 30% would often imply a controlling stake for many medium and large companies.

+ The conversion can be increased over time all the way up to a 100% buyout.

If there are no tax benefits connected to the transfer, there is no reason to define a legal threshold.

If the 100% conversion was the rule, it would not be possible for the former owners or other external risk capital-suppliers to have a minority position. This would be an unnecessary restriction.

* *The ownership rights to profit and wealth* are quite simple in the EOT case. The right follows the EOT in relation to its share of ownership. The individual employee has no rights to wealth – no right to withdraw an individual share of the accumulated capital. It is indivisible. However, the UK model includes an optional tax-free bonus to the employees. It could be formed as profit-sharing with a given maximum value like in UK, or a maximum percentage of wages. It could also take the format of individual shares in the company if the goal is a hybrid model – see below.

In the ESOP model, companies make annual contributions to the trust to fund the purchase of shares. The contributions normally come out of profits but are not directly linked to them. A company can contribute even if it does not make a profit. The value of the shares is determined by an outside independent appraisal. The ESOP company may pay dividends on the shares as well.

When the employee leaves the company, the accumulated capital value depends on the value of the shares at that time. Employees need to work for a period to gain the right to their shares.

+ In the ESOP there is a strong link between the economic performance of the company and the capital gains for the individual employee – strengthening the employee identification with the company.

- The calculation of the value of the individual shares includes a yearly valuation of the company, which implies some costs. Because of their greater complexity than other plans, the legal and administrative costs of ESOPs are higher. This makes them inappropriate for very small companies The company should have a certain size to make it worth the effort. Rosen (2023) suggests more than 20 employees, Blasi and Kruse (2023) even higher.

- There may be an incentive for the ESOP employees to sell the company to realize a substantial capital gain. If the trust deed instructs the trustees to seek the maximum value of the ESOP, it could be an obligation for them to sell the company, if there is a favorable takeover offer. This may happen, if a strategic investor finds synergies (market, scale of production, technology etc.) and offers a takeover price with a premium on top of the normal market value. In this case, the employee shall vote on the possible sale. Such a takeover gives the employees an extra capital gain and would often be accepted as it happened for New Belgium Brewing in US, and Unimerco in Denmark (Mygind and Poulsen, 2021). This may be efficient seen from a traditional economic point of view, but it would end the employee ownership.

This would probably not happen for an EOT where the long run survival of the company to the benefit of current and future employees are in focus. The same issues could be discussed for Danish Foundation-owned companies like Novo Nordic, Lego, and Carlsberg, where the long run survival of the company and its main products are part of the deed of the foundation.

In the pure model the ownership right to wealth belongs to the EOT. There are no individual rights. In contrast to this, the ESOP distributes the wealth to the individual accounts and during their period of employment the employees get a share of the accumulated wealth, which they can realize at the market value when exiting the company.

+ The accumulation of individual share capital for all employees in the ESOP contributes to a more equal distribution of wealth.

+ The collective reserves in the EOT can as earlier argued also give a more equal distribution of wealth by neutralizing some of the very unequal distribution of company wealth. However, the effect is probably much weaker than the effect from the accumulation of employee wealth in the ESOP.

3.3 Membership entry and exit

The easy *entry and exit of employee-members is a strong advantage for both EOTs and ESOPs*. In the EOT the employees are automatically members when they are employed in the company. There is no entry fee. However, there is some employment conditions for getting the tax-free bonus and possible control rights if the trust deed opens for employees voting for trustees or directly for members of the company board. The ESOP-model is quite similar.

+ Both EOTs and ESOPs are broad *all-employee models* with no entry fee. It makes entry very easy.

* The specific definition of when you are an employee in relation to tenure, number of hours, may vary a bit, but should be adjusted to the labor market regulations.

* Concerning *exit*, the EOT is much simpler than the ESOP because the EOT has no obligations to the leaving employees. In the ESOP case, the value of the individual share should be paid out to leaving workers. To avoid a fast drain of capital, there is up to six years payback period. The length of this period should balance the two considerations: not to make the payback period too short to pressure

the company and not to make it too long for employees having to wait for a long time for their money after they have left the company. Six years seems to be a reasonable and well-proven maximum. The company can pay back faster if preferred.

+ Since there is no individual capital to pay back in the EOT, exit is just like exit from the job.

- There is an administrative burden for the ESOP to administer the individual shares including the pay back of the fair market value of the individual shares to leaving members. Therefore, as earlier noted, the ESOP is not appropriate for small companies.

3.4 Finance and tax benefits

The payment for the takeover of the company is an important issue for both the EOT and the ESOP model. This could be a mix of gifts/contributions from the company, vendor loan from the former owner and external bank loans with collateral in the company.

+ There are no contributions from the employees in the EOT and ESOP models.

* A key question is whether the contributions from the company are tax-free for the receiving trust, and if they can be deducted from company profits before tax. This is the case in US, including the interest and installments paid by the company for a possible loan used for financing the takeover.

A driving element has both in the UK and the US been that the former owner can avoid or defer capital gains tax for the revenue from the sale to the EOT or ESOP - in the UK under the condition that the EOT takes over more than 50% and in the US that the ESOP gets at least 30%.

Furthermore, for so-called S-corporations in the US there is no corporate taxes. Persons or companies finally receiving the profits pay the tax. For the ESOP it means that the employee-owners are taxable, but only when they receive the money at exit. They can rollover the money into pension savings and in this way further postpone the tax.

* These benefits could also be options in other countries implementing ESOPs with adjustments to their specific tax-system.

Since both interest and installments are tax-free, it has also eased the access to bank loans. The so-called “leveraged ESOP” mainly financed by bank-loans are the most used model for ESOP takeovers.

- Widening the group for tax-exempt means lower tax-revenue in the short run. However, in the ESOP model, the capital gains are taxed later when the employee cash out the capital. In the EOT case, the money goes into collective reserves and there is no capital gains to the employees. Takeovers by worker cooperatives could be treated in the same way. This is in fact the case in US.

* In the specific Danish case, it would be relevant to give employee takeovers at least the same preferential treatment as family takeovers in relation to gift/inheritance tax and capital-gains tax.

Like in the case of family takeovers, the conversion to employee ownership could consider the company as a tax-succession enterprise, deferring the tax that might have to be paid at the takeover.

* Like in US, the tax on the money paid out to employees should have the possibility for being rolled over to pension-savings and not taxed before it is finally paid out.

There is no issue on wage-earner benefits in relation to EOTs and ESOPs. They are normally quite large companies, and their employees are treated as wage earners with the usual benefits.

3.5 Risk

With the possibility of accumulation of wealth in individual accounts in the ESOP also follows a risk of losing the money. However, it can be argued that the accumulated individual wealth in the ESOP have happened without contributions from the employees. They only risk losing the extra money accumulated in their individual accounts. In the EOT case, no individual money is accumulated, thus nothing to lose or gain. There is the risk of losing the job, but there is strong evidence that employee-owned companies have more stable employment than conventionally owned firms (Mygind and Poulsen, 2021).

3.6 Startups and takeovers

The EOT and the ESOP models are rarely used for starting new companies. The advantage of these models lies in the takeover of conventionally owned companies. The former owner is a key player in this process, and tax-incentives play an important role in both the UK and the US.

+ Both EOTs and ESOPs are well-proven models for employee takeovers for succession and the reason for widespread employee ownership both in the UK and the US.

+ Compared to family-successions, employee takeovers mean spreading the wealth to more persons implying a more equal distribution of wealth in society.

4. Overall comparison and combinations

As already noted, the three models can exist side by side in a country and as discussed below, they can be combined in different ways. Promotion and tax-benefits can vary the support to different models. Therefore, this section starts with an overall comparison of the pros and cons of the models.

Figure 2 gives an overview of the three models and a fourth based on *directly owned individual shares* in the upper right corner. This fourth "model" is quite widespread in many countries, but the employees have normally only a very small part of the total shares and the employee shares are very unequally distributed. To build employee ownership based on individual employee shares there must be rules to secure majority control and to secure a quite equal distribution on the broad group of employees. However, as an extra element in combination with another majority employee ownership model it gives some extra possibilities, see below. In France, the UK and the US, such systems are widespread. However, in contrast to EOTs and ESOPs, direct individual employee ownership has very rarely been used to give the employees a significant part of the ownership.

The relevant models for this report are all employee schemes like SAYE and SIP in the UK, while most other models in UK are incentives for managers and key employees, which do not contribute to a more equal distribution of share ownership (See Pendleton et al. 2023). In the US, the so-called 401(k) plans are relevant and quite often it is combined with an ESOP forming a so-called KSOP.

Figure 2. Models of employee ownership: direct/indirect and collective/individual

Employee ownership	**Collective** based on indivisible reserves	**Individual** capital can be paid to employees
Direct employee stakes	**Worker cooperative** **Dominant collective ownership** At start, individual contributions make up a high proportion of capital, often as loans. Over time collective reserves accumulates **+ Employee democracy** Mondragon: strong weight on individual accounts adding interest and dividends	**Individual employee shares** Most often **small minority** share. Often **very unequal distribution**. May be open for all employees, but mostly high wage employees get shares **=>Not broad employee ownership** **- Often unequal among owners** **- No democratic control** + Employees can after some years sell their shares => possible levelling effect on distribution of wealth
Indirect through a trust	**EOT** Employee Ownership Trust **Indirect democracy by trustees** **+** possibility for democratic model **-** but often long distance from employees to trustees **+ All employee** scheme **+** The capital stays in company as **collective reserves** **+** no sale of company **-** no capital gains to employees	**ESOP** Employee Stock Ownership Plan **Indirect democracy by trustees** **+** possibility for democratic model, **-** but often long distance from employees to trustees **+ All employee** scheme => **+** quite equal distribution of **individual shares** with capital gains paid to employees at exit => **+ more equal wealth distribution**

The *worker cooperative model* is illustrated in the upper left corner of Figure 2. On the one hand, the worker cooperative has direct ownership through the individual employee stakes. These contributions make an important part of the start-capital. On the other hand, these stakes have the character of loans with limited returns - maximum interest rates. In the Mondragon model the individual contribution and loans have a higher weight. These individual accounts accumulate interest and dividends, but the money paid out to exiting employees does not include capital gains based on a fair market valuation like in the US ESOP. *The classical worker cooperative* is mainly based on accumulating collective reserves. Therefore, it is placed as a collective type of ownership in Figure 2.

The main strength of the worker cooperative model is the democratic governance and the stability of the collective employee ownership. Broad employee ownership is secured by smooth entry and exit of employee-members and of rules limiting the number of non-member employees. However, there are no strong incentives for the employee to build up capital in the company. The individual capital stakes function most often as low interest loans to the cooperative. Therefore, access to external capital is crucial if they shall develop in more capital-intensive sectors.

The *EOT model* is like the classical worker cooperative based on *collective* reserves. There is no individual accounts and the employees do not get any capital gains over their work-life. Ownership is *indirect* performed through a trust. The trust deed defines the framework for how the trustees shall administer the ownership rights in relation to the employees. There can be quite a long distance from the employees to the trustees. However, it is also possible to format the rules so that they secure democratic governance by the employees.

The EOT is well fit for company successions. The former owner is a key player in this process, and it can be expected to be more widespread if the rules for governance and the direct influence of the employees are flexible like in the UK. Similar arguments are relevant for the ESOP model based on the experience in the US. To become eligible for relief of capital gains tax the EOT must take over more than 50% of the ownership. That still leaves a possibility for the former owner to own a considerable minority position. These conditions have in UK been considered so favorable for the former owners that the number of EOTs have increased very fast in the later years. In contrast to the ESOP model, there are no possibilities for the employees to capitalize the reserves by a sale to another company.

The EOT has the easiest entry and exit of employees of the three models, because the indirect format and the collective ownership means that there is no fee to pay at entrance and no values to take out at exit. The current employees of the company share the advantages of the EOT.

The ESOP has indirect trust ownership like the EOT, but instead of having collective reserves, the values of the ESOP trust are divisible. When the employees leave the company, they can take out the value of their individual shares. There is no entry fee, no contributions to pay for the employees. The market values on their individual accounts develop during the period they are employed in the company and they can take the accumulated values out when they leave, with a possible lag of a few years to avoid liquidity problems for the company. The valuation of the individual shares and the administration in relation to exit imply some cost for the company, which demands a certain size of the company to cover these costs.

The indirect trust ownership results in the same pros and cons as for the EOT in relation to democratic governance and the trade off in relation to incentives for the former owner to sell to the ESOP. The strength of the ESOP is the link between company performance and the value of the individual shares, Combined with the broad *all employee* ownership the ESOPs may have a strong effect on the distribution of wealth. If there are high capital gains on the individual shares there is also a risk of losing the money, but the values of the individual accounts come on top of normal wages. The ESOP is not based on savings paid from wages.

In contrast to the EOT model, the ESOP employees may have an incentive to sell the enterprise if an outside strategic investor offers to buy with a high premium. In the US case, the employees shall vote on such an offer. Such ESOP sales can be expected to be more frequent than similar exits of EOTs, where it is questionable if a sale would be in the employees' best interest.

4.2 Hybrid forms - combining EOT or ESOP with some direct individual ownership models

While direct individual share ownership is not a strong candidate for majority employee ownership, it could be a supplement to the other models, a way to balance the individual and collective elements.

For worker cooperatives, the Mondragon model is a well-proven model, with a stronger weight on individual accounts, even though it excludes accumulation of capital gains over the worklife of the worker. This is probably one of the key elements behind the success of the Mondragon cooperatives connected to its growth in quite capital-intensive sectors.

The EOT has a strong collective element. However, EOT covers 50-100% of ownership and there is often room for minority owners. It could be the former owners continuing some minority position, it could be other external investors, but it could also be the employees in the form of *individual employee shares*. Such individual shares could complement the collective ownership of the trust with some direct individual ownership elements. This could give the employees some direct ownership and possibility for capital gains. The majority position would still belong to the EOT. An unequal distribution of the individual shares need not compromise a possible democratic organization of the EOT and it would not be necessary to have strict regulation of the distribution of individual shares.

Pendleton et al. (2023) find this type of overlap in 9% of the surveyed cases. It opens for employees to have some direct ownership with possible capital gains with positive impact on wealth distribution and incentives, though with the risk for the individual employees to lose these assets.

The ESOP combined with direct individual share ownership like the KSOP is quite widespread in US. KSOPs are often in listed companies controlling 1-3% of the total shares outstanding of a corporation. It is a combination of an ESOP and a 401k retirement saving plan. Typically, the free ESOP shares granted to the worker are used to match worker cash contributions to their 401k retirement saving plan. Another hybrid is the so-called ESOPerative combining the democratic governance structure of a cooperative and the tax benefits of an ESOP (https://medium.com/fifty-by-fifty/the-esop-erative-daaa98c1174f).

It is also a possibility to combine an EOT and an ESOP. Following the UK model, the EOT could have the majority and the ESOP the remaining ownership. The combined group of trustees could control the company board, and the ESOP-part could give the employees possibility for some individual shares. The legislation could allow a full integration with one trust, which within certain limits could split the right to surplus and wealth into a collective part and an individual part. A model with a dominant EOT element could combine the advantages of long run stability for employee ownership and at the same time give the employees the possibility for capital gains and increasing wealth, but not the possibility of selling the company and capitalizing the collective reserves.

4.3 Concluding remarks

There is a long list of choices to be made when adjusting the legal framework around employee ownership. The choices can be viewed from the perspective of the politicians or from the perspective of the involved stakeholders, primarily the employees, but also including the selling owners and external capital providers.

Which model shall politicians promote and how shall each model be calibrated? If the priority goals are democratic governance and to build up a worker cooperative movement while accumulation of capital and creating workers ownership of the wealth of companies is considered less beneficial, worker cooperatives would be preferred. If the goal is to satisfy retiring business owners who wants to pass their enterprise to a trust for the long run survival of the company, the EOT would be the solution. It could be combined with considerable control to the employees, but it would not imply a strong effect on equalizing ownership of company wealth. If the goal is spreading the company wealth to build up the working middle class and using the capital gains as an important driver the ESOP model would be preferred.

There would be different political goals and it would be necessary to make compromises. It is interesting to note that in the countries covered here, much of the legislation has been decided by broad political majorities. Most ESOP legislation had bipartisan support from both Republicans and Democrats and in the UK a broad majority was behind the EOT legislation.

However, you can have the three models existing side by side in a given country, and as shown, you can even combine the different models. Therefore, the politicians should make broad long run compromises and promote all the three models at the same time.

Seen from the group of stakeholders, including the employees and owners who want to secure the succession of their companies the preferred situation would be a broad spectrum of possible models. It should be possible to choose between all three models and even make some combinations if relevant. In this way, you can adjust to different preferences of the employee and different ideas of current owners who find that transfer of their enterprise to the employees is an interesting option.

Theoretical models of the performance employee ownership usually have narrow assumption about the objectives of the owners. However, people are different and the important issue concerning performance is that there is a good fit between the ownership structure, whether individual or collective, and the goals of the employee owners – whether individual or collective, (Mygind 1992).

Furthermore, it is important to be able to adjust the ownership model to different types of enterprises with varying size, technology, knowledge base, capital intensity, need of capital, etc.

For all these choices, there is not one ideal model – a spectrum of models can secure the best solutions.

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