

Employee Buyouts

Originally issued in July 1996 as a joint project by Price Waterhouse, the Co-operative Enterprise Project, the Registry of Co-operatives and the Australian Employee Ownership Association.

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The Mercury Centre
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1. Introduction to this document

The first edition of *Employee Buyouts* was launched in July 1996 by the then Minister for Fair Trading and Co-operatives, the Honourable Fay Lo Po MP. The content of this guide was the process for implementing an employee buyout.

The guide was funded by the New South Wales Registry of Co-operatives within the Department of Fair Trading. It was developed by a small team led by Price Waterhouse (now PricewaterhouseCoopers) with input from the Co-operative Enterprise Project, the Registry of Co-operatives and the Australian Employee Ownership Association.

There were 1000 copies of the guide printed and they are now in scare supply. There is still, however, a demand for *Employee Buyouts* as the user friendly structure of the guide and continuing currency of its content ensures its ongoing usefulness and relevance to this day. An electronic copy of the guide was not made available when it was first produced.

The first edition has recently been scanned and a PDF file created but the resultant file was large and unwieldy due to the number of photographs and the scanning process.

The Mercury Centre Co-operative decided that it was important that the content be available on line and has produced this second edition for electronic access. The photographs, cover pages and some of the more dated reference material from the first edition have been deleted. The educative content remains intact and although the two case studies provided have since moved on from employee ownership (both through sale), they are included as good examples of successful employee buyouts with both lasting 10 years or more under employee ownership.

The resultant document is more streamlined and now of a size that is easily available on an electronic basis.

Acknowledgement is made of the work of the main authors of *Employee Buyouts* from the then Co-operatives Education Project - Anthony Jensen and Susanne Haydon - for their efforts in producing a business guide that remains valuable in the mainstream of the advisory world today and for their continuing involvement in the promotion, research and support of employee buyout projects.

Although a large file, the scanned version of the first edition is available as a PDF file on request.

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2 March 2006

2. Introduction

The partial ownership of a business by employees is not a new development. Many of Australia's largest companies have employee share ownership plans. This reflects the belief that employee motivation and productivity can be increased by providing them with a stake in the business, which in turn will lead to greater profitability and a higher value of the business.

However, in Australia to date, the concept of employees owning a majority or 100% of a business has not been extensively embraced. We believe that majority or total employee ownership should be a natural progression, given the benefits of employee ownership.

In fact we believe that whenever a business is changing hands, whether due to an owner retiring, a divestment, privatisation or the realisation of an investment, the option of employee ownership should be considered.

Employee ownership of a business can be achieved through a process called an "employee buy-out". This booklet sets out what an employee buy-out is, when a buy-out is appropriate and why a buy-out should be considered. It also deals with the forms of buy-outs and the steps in performing a buy-out.

It includes two case studies of employee buy-outs that have taken place.

This booklet has been developed by Price Waterhouse, the Cooperative Enterprise Project, the Registry of Co-operatives and the Australian Employee Ownership Association.

Price Waterhouse contributes substantial world wide expertise in helping and advising on the purchase and sale of all types of businesses, and the associated requirements for valuations, taxation planning, business plans and finance structuring.

The Co-operative Enterprise Project brings together a wide range of consultants, academics and industry workers to promote research, discussion forums, conferences and workshops covering employee buy-outs and associated areas.

"Whenever a business is changing hands, employee ownership should be considered."

The Registry of Co-operatives provides and administers a legislative framework for co-operatives in NSW. It is also responsible for the growth and development of the co-operative sector and for protecting the public interest.

The Australian Employee Ownership Association meets regularly to discuss current issues, look at what assistance can be provided to member companies and individuals, and to review international trends and recent research. The association actively monitors the regulatory environment and provides submissions to governments on how changes can be made to best meet the needs of its members.

Together we can provide the support necessary to help ensure a successful buy-out. Our philosophy is for us to help manage your buy-out while you manage your business, and by co-operating together we can achieve a successful buy-out.

3. What is an employee buy-out?

Put simply, an employee buy-out is a transaction in which the employees of a business join with financing institutions to buy the business from its present owners.

The institutions put up most of the finance required in the form of debt and equity, with the intention of realising a significant return on their investment in a short period of time (typically five to seven years).

The employees retain a significant part of the equity, If the initial high levels of debt are repaid as planned, a significant part of the value of the business will accrue to the employees.

To date, management buy-outs have been more common in Australia than employee buy-outs. Management buy-outs usually only involve the top executive managers buying the business from the present owners. Recognition that there are potentially greater benefits from involving all employees in a buy-out can result in employee buy-outs becoming much more prevalent in the future.

Employee ownership makes sense commercially as real life examples point to substantial increases in motivation, productivity and profitability following an employee buy-out.

Comments from new employee owners

- “..you just put 150% in instead of 100%.”
- “..yeah, I mean you tried your hardest before because, I mean, that’s a job you got to do your best at your job. But now I suppose you just put that little bit extra in.”
- “I’m my boss and I don’t perform we don’t make extra money and I don’t get dividends, I don’t get bonuses.”
- “You know that it’s for you, not someone else, so you seem to have more pride, I suppose you’d say, in your work.”

4. When is an employee buy-out appropriate?

An employee buy-out will not be appropriate in every situation. The key to a successful employee buyout is proper planning in the initial stages, to ensure that your situation is compatible with an employee buy-out. Part of this planning will be an assessment of how your position satisfies the critical success factors for an employee buy-out.

There are three major critical success factors:

- a willing seller
- an effective employee team and capable management
- a financially viable proposition

Willing seller

Clearly, an employee buy-out will not succeed if the existing owners of the business are not willing to sell the business, or will only sell the business for an excessive price.

There are many situations where the owner of a business may want to sell the business:

1. Retirement

If a business is privately owned, the sole or principal shareholder may be nearing retirement and may want to sell their investment in the business. Private owners are normally concerned about whom they sell their business to, as they want to maintain the independence of the business and ensure it doesn't deteriorate and jeopardise employees' jobs. The sale of the business to employees protects the workforce and maintains its independence.

2. Realisation of investment

The current owners of a business may require their funds or may not want to continue with their investment in the business.

ABRASIFLEX - A Case Study

“Why don't we buy the company?” was the question posed by the Sales Manager, Mr John Sims, when it was discovered that the business of Abrasiflex was to be sold.

It is possibly a question which has been asked many times before, when staff find out that the business they have been working in is to be sold, and the fate of each employee, however skilled in their particular field, is suddenly unknown. Unfortunately the answer is more often than not ‘we just have to wait and see’.

But there is a solution. BUY THE BUSINESS!

The first thought which comes to mind is “How?”

Case study number one details how Abrasiflex was able to do this.

3. Divestment

A parent company may wish to sell a subsidiary, which is not part of its core business or part of its future plans, in order to obtain funds to reduce borrowings or make an investment elsewhere.

4. Business in distress

A poorly performing business may be threatened with closure by its current owners to prevent further losses. In order to save their jobs, the employees could buy the business from the current owners. This is a high risk situation and the comments on a financially viable business (page 8) should be noted.

5. Privatisation

It is common for governments to seek to sell public sector enterprises to the private sector, to reduce the burden on the public sector. An alternative option to a trade sale or a float is a sell off to the employees of the business.

Effective employee team

The optimum employee buy-out team is one which:

- is strong in each fundamental area of the business
- has a proven track record in the business
- has the required management capability
- is harmonious
- is ambitious

The employee team will need to convince financing institutions that it has the capability to manage the business in an independent environment, and to provide sufficient returns on the finance provided by the institutions.

It does not necessarily follow that an employee team which has been effective in running the operations of the business will have the motivation and ability to cope successfully with the strains of management and ownership following a buy-out.

It is essential to ensure the recognition by all people of a leader within the group to control the day to day operations of the business. This may involve re-training and the use of consultants to enhance leadership skills.

A change in work attitudes will also be required from the employees. The goal should be securing the future rather than making short term profits. There needs to be a readiness to accept the attitude that the survival of the business depends on all personnel, and not just the workers or the managers. It may also be necessary to develop a higher level of skills for many employees in order to prepare for future changes in the market and technological advances.

Financially viable proposition

A successful employee buy-out could be defined as the purchase of predictable cash flows at an economically reasonable price. This definition refers to two key factors which must be present for the buy-out to be a success:

1. Reasonable purchase price
2. Strong cash flows

It is obvious that a buy-out cannot succeed if the purchase price is excessive. An excessive purchase price will require an upfront cash outlay and subsequent interest payments which, if funding can be achieved at all, will place too much pressure on subsequent cash flows, with the result that the business will fail.

Critical Success Factors

The critical success factors for an employee buy-out are:

- Willing seller
This is likely to be due to:
 - ✦ Retirement of owner;
 - ✦ Realisation of personal investment;
 - ✦ Divestment of business by parent company;
 - ✦ Business in distress;
 - ✦ Privatisation by government.

- Effective employee team
Characterised by:
 - ✦ Management capability;
 - ✦ Strength in all areas of the operation;
 - ✦ Recognition of a leader;
 - ✦ Additional training;
 - ✦ Long term attitude.

- Financially viable proposition
A combination of:
 - ✦ Reasonable purchase price;
 - ✦ String and predictable cash flows.

The business must have the ability to generate cash flows sufficient to enable the repayment of debt, and provide a satisfactory return on equity. The need to reduce the initial high level of borrowings inherent in buy-outs means that the generation of a strong cash flow is of paramount importance.

The cash flow should be reasonably predictable and not immediately absorbed into providing working capital finance (ie. finance for day to day activities) due to the cyclical nature of the business or an uncontrolled rate of expansion. A high level of fixed asset expenditure due to a lack of investment before the buy-out can also place pressure on the cash flow.

5. Why have an employee buy-out?

Employee ownership improves performance

A United States study by the National Centre for Employee Ownership matched companies with Employee Share Ownership Plans (ESOPs) against non-ESOP companies. ESOP companies significantly outperformed non-ESOP companies by 40% in sales and 46% in employment growth. Also, ESOP companies with well established systems for participative decision making performed better than ESOP companies without participation.

There are many arguments in favour of employee buy-outs. These include:

- employees have a share in the companies success, which will improve the motivation and morale of employees;
- the existing owner of the business will be happier selling the business to people who know the business and will continue its traditions;
- the workforce and status quo of the company is maintained, eliminating the uncertainty arising from selling the business to an outside party;
- an employee buy-out can be more attractive than a management buy-out as it spreads the wealth across a larger number of people; and
- an employee buy-out may be more stable than a management buy-out in that it may raise more equity. This would result in the transaction being less dependant on external debt financing.

6. Forms of employee buy-outs

There are several different forms of employee buy-outs, which provides the flexibility to adapt a buy-out to a particular situation. In this booklet we will only cover the major forms of employee buy-outs, as these will probably be the forms you choose to use in your own buy-out. Every business and group of employees is different, and professional advice will need to be obtained to ensure the form of buy-out that you select is appropriate to your situation.

The main structures used for employee buy-outs are:

- Co-operatives
- Employee Share Ownership Plans (ESOPs)

Co-operatives

A co-operative is a form of business organisation similar to that of a company. Like a company, the members of a co-operative have limited liability. A co-operative is a democratic organisation and is formed when a group of people get together to work towards a common objective. A co-operative may be formed to supply goods and services to the general public or to its members. In an employee buyout, the common objectives can include preserving employees' jobs and generating an additional income for members by sharing profits.

Underlying all co-operative enterprises are the seven basic co-operative principles adopted by the International Co-operative Alliance (ICA). These are:

1. Voluntary association and open membership
2. Democratic member control
3. Member economic participation
4. Autonomy and independence
5. Education, training and information
6. Co-operation among co-operatives
7. Concern for community

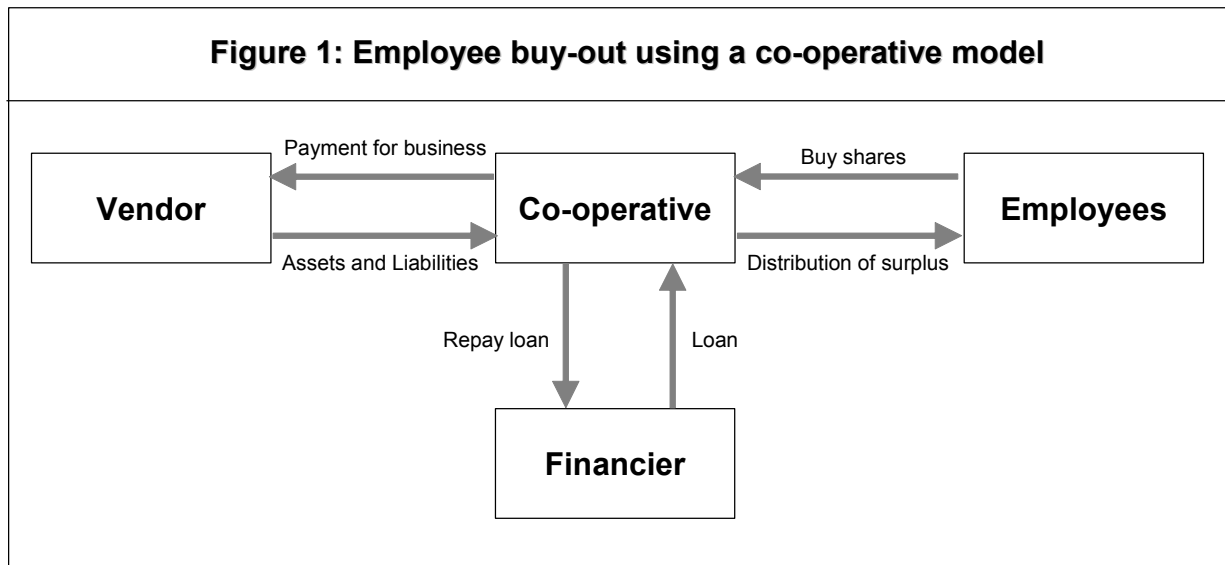
Traditionally, agricultural and consumer type co-operatives have been very popular. However, in many parts of the world, workers have got together and formed worker co-operatives. In Australia, we have a number of examples of successful worker co-operatives (now commonly known as Employee Owned Co-operative Enterprises). Two of these are discussed in the case studies.

Co-operatives provide a basis for the mutual achievement of economic and social needs which may be unavailable to the individual in the private or public sectors. It is a form of enterprise suited to small and medium sized business, and is relatively less complex and costly to incorporate and administer than most forms of corporate entities.

Table 1 is a summary of the differences between co-operatives, companies and partnerships.

The legislation governing co-operative enterprises in NSW is the Co-operatives Act 1992. This legislation offers a great deal of flexibility in the formation of employee owned co-operative enterprises.

In an employee owned co-operative enterprise, the employees or workers own and control the business; they own shares in the business and receive a dividend on their shares; they control the business by electing a Board of Directors to run the business; and employees perform the same tasks as if outsiders owned the business. An employee buyout using a co-operative model is illustrated in Figure 1 below.



The operations of a registered co-operative are governed by the rules of the individual co-operative. Rules regarding membership of the co-operative will require a number of issues to be discussed before the co-operative is formed. These issues should include:

- capital and other contributions required from members;
- membership policy;
- procedures for members who wish to leave the co-operative enterprise;
- the creation of an internal market for shares;
- new employees and the probationary time for membership;
- resolution of disputes between members; and
- reward/bonus arrangements for members.

Table 1: Differences between partnerships, companies and co-operatives

	Partnership	Company	Co-operative
Ownership and management	Partners are owners and managers	Shareholders are owners and separate from management	Members are owners and managers
Control	Partners control on the basis of interest specified in the partnership agreement	Shareholders control on the basis of shareholding	Democratic control, namely one member one vote
Profits	Partners share profits in proportion to their interest in the partnership	A portion of the profits is distributed as dividends to shareholders	A portion of the profits distributed to members as dividends, bonuses or rebates
Liability	Partners are exposed to unlimited liability	Liability of shareholders is limited	Liability of members is limited
Legal status	Not a separate legal entity	Separate legal entity	Separate legal entity
Governing document	Partnership agreement	Constitution	Constitution
Applicable legislation	Partnership Act	Corporations Act	Co-operatives Act

Employee Share Ownership Plans (ESOPs)

An Employee Share Ownership Plan (ESOP) is not only a plan to enable employees to own shares in their employer's business, but is also an important financing vehicle for the company. An ESOP can be one of the most flexible ways of purchasing shares in a company on behalf of employees. ESOPs are flexible because employees can collectively own anywhere from 1% to 100% of the company.

ESOPs have useful tax advantages. For example, contributions made to the ESOP by the company are tax deductible (note however, that employee share schemes qualifying for such tax concessions are subject to the rule that no one employee may receive more than 5% of the capital of the issuing firm).

ESOPs have not been common as a financing structure for employee buy-outs in Australia. However, in North America and Europe they have been widely utilised.

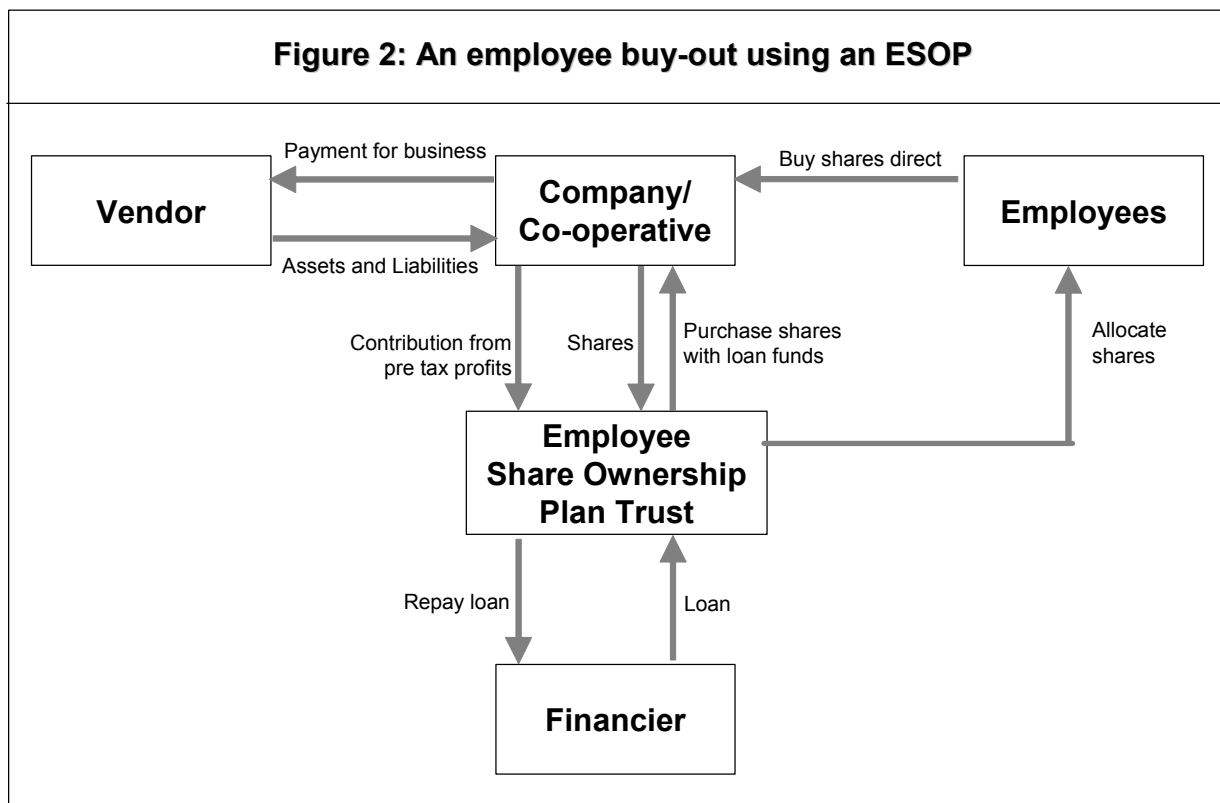
To effect an employee buy-out using an ESOP, an ESOP Trust is established. The trust borrows money from a lender to buy an interest in the company. Depending on the ownership structure proposed for the company (which is usually related to the ability to finance the buy-out), this interest may be a minority interest, a majority interest or, in a few cases, a 100% interest. The purchase may be effected as a single transaction (usually when a division of a business is being divested by a company) or over a period of years (as may be the case in the sale of a family owned firm). Refer to Figure 3 for an illustration of a progressive buy-out.

The ESOP Trust repays the loan from contributions made into the trust by the ESOP company. As the loan is repaid, shares may be released by the lender, in which case they would be allocated to employees.

A leveraged ESOP transaction, such as this, is accomplished predominately out of future business earnings, rather than out of employees' current savings. In Australia, it is possible, in some small businesses, for conversion to majority employee ownership to occur without the employees outlaying any of their own funds. However, financiers will generally prefer to see employees putting some of their own money at risk as evidence of their commitment to the buy-out.

The buy-out company needs to develop a mechanism through which employees leaving the company can sell their shares to employees remaining in the company. Often this is done through the ESOP Trust purchasing the shares and reallocating them.

The use of an ESOP to effect an employee buy-out is demonstrated in Figure 2 below.



Comparison of co-operatives and ESOPs

In comparing co-operative ownership with ESOPs, there are benefits to each form of ownership. Cooperatives are likely to be less expensive legal structures given the "standardised" model rules available under the Co-operatives Act 1992 (NSW). ESOPs, because they can be set up to suit all sorts of circumstances, may be more expensive to install and administer. ESOPs may have easier access to traditional sources of finance than co-operatives and the ESOP may have some important tax advantages. Co-operatives are automatically democratic: an ESOP will have to be deliberately designed to be so.

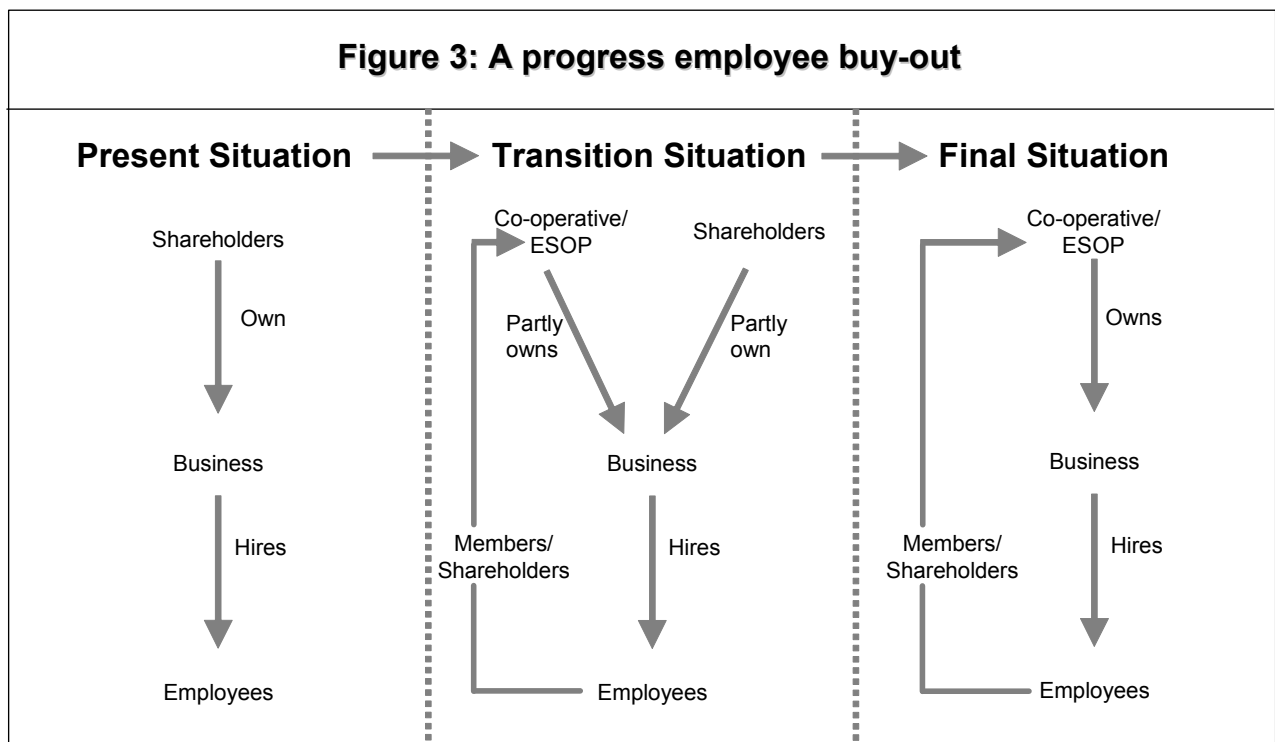
Employee-owned co-operative enterprises typically provide 100% employee ownership at the outset, whereas ESOPs are generally used for a progressive buy-out. It is possible to use both for either a progressive or complete buy-out as shown in Figure 3.

An ESOP Trust can also be used as a mechanism to buy and sell shares when a co-operative is buying a company. In this case an employee buy-out can be facilitated using a combination of a cooperative structure and an ESOP Trust as shown in Figure 2.

To ensure that productivity benefits arise from employee ownership, it is important for the new owners to feel that they are participating in the control of the company regardless of whether it has adopted a co-operative or an ESOP legal structure.

Progressive employee buy-outs

An employee buy-out can be either a single transaction at the outset or a progressive buy-out over a period of time.



In a progressive employee buy-out process:

- employees form a buy-out structure;
- they contribute funds for equity in the buy-out vehicle, and the remainder of funds are provided by external financier's over a period of time. The combined funds are used to progressively purchase the shares in the business from the existing owners; and
- the ultimate goal is to completely buy-out the existing owners. In the interim period, the ownership of the business and its profits are shared by the original shareholders and the buy-out vehicle in proportion to their respective shareholdings.

7. Steps in performing an employee buy-out

Once it has been established that the existing owners of a business are willing to sell the business and the employees are willing to buy the business, the buy-out process can proceed. The buy-out process will usually encompass the following steps:

<i>The Buy-out Process</i>	
A.	Establishing the buy-out team
B.	Valuing the business
C.	Preparing the business plan
D.	Raising finance
E.	Structuring the buy-out
F.	Negotiating with the existing owners
G.	Operating after the buy-out
H.	Repurchase obligations

It should be noted that often these steps may not be performed in this order or may be performed at the same time, and often will be revisited many times during the buy-out process.

A. Establishing the buy-out team

The starting point in the process will be the election of a committee and chairperson, representing the employees' interests in the buy-out process and co-ordinating the process.

To ascertain whether the employee team has the ability to manage the business after the buy-out, a skills inventory will need to be undertaken. This will involve a critical self assessment of the buy-out team and will be the first test of their ability to work as a team. If the group is cohesive this process may go smoothly but often a team building program will be required.

The buy-out team will establish a vision or mission statement for the business, to reflect a shared understanding and commitment to the team's purpose for undertaking the buyout. Without this shared understanding and commitment, a buy-out is unlikely to succeed.

It is essential that the team can show financing institutions that it has an acceptable track record and has sufficient experience to face the future as an independent enterprise.

B. Valuing the business

Conducting an early assessment of the value of the business will assist in developing the various options and financing arrangements. The valuation will also provide a starting point for negotiations for the purchase price of the business.

Valuing a business is a complicated matter and is subject to many uncertainties. As a result, the valuation of the business should only be undertaken by an independent accountant with the relevant expertise and experience.

C. Preparing the business plan

A business plan looking several years into the future will assist employees in planning the company's strategic directions. As well as providing strategic direction to the employees, this business plan will form part of a submission to financing institutions for the purpose of arranging finance for the buy-out.

The plan should set out the justification for a buy-out and provide concise information about the key areas on which a financing institution will ultimately make an investment decision.

The plan is essentially a selling document conveying the buy-out team's commitment and understanding of the business and the market in which it operates. The style of presentation must be as brief as possible, cover all essentials and hold the reader's attention.

Avoid excessive optimism where possible, and address areas of uncertainty or sensitivity.

The contents of the plan should cover the following areas:

Executive summary:	brief description of the business and key features; summary of historic performance and financial projections; broad details of finance being sought.
Industry:	history of business; size of industry; industry trends.
Product:	full description of product; planned developments, competitive products
Market:	market share; opportunities available; customer base; competitors
Operations:	production processes; raw materials required; major suppliers

Employees:	details of buy-out team; organisational structure
Financial information:	historic trading performance; future profit, cash flow and balance sheet projections, with underlying assumptions
Finance:	amount required; forms of finance; repayment schedule

The plan should reflect the buy-out team's style, character and business philosophy and it is recommended preparation be done by the team rather than by employing professional advisors.

However, an accountant with the relevant expertise and experience can assist in the following areas:

- structure of the document;
- financial projections;
- weaknesses and inconsistencies; and
- investor expectations.

D. Raising finance

During the process of preparing the business plan, your professional advisers can be assessing the alternative financing arrangements which may be available for the buy-out.

The main forms of finance include:

- secured bank debt;
- unsecured bank debt;
- redeemable preference shares;
- convertible preference shares; and
- ordinary shares.

The assessment of the alternative forms of finance is one of the crucial stages of the buyout. After the buy-out, the team will want to maximise their percentage of the ordinary share capital without making the business over dependent on borrowings.

Based on the outcome of this assessment, the appropriate financing institutions can be selected. The selection of financing institutions will normally depend on the:

- size of the transaction;
- industry concerned; and
- timescale.

Approach several institutions with a view to obtaining more than one offer of terms.

In addition, the buy-out team will require funds to finance their own share of the equity capital. The institutions financing the buy-out will want a sufficient financial contribution from the buy-out team to evidence their commitment. Few employees will have the necessary funds available without resorting to borrowing. The employees can either decide to raise the finance individually or perhaps collectively approach a bank. This has the advantage of limiting the time spent on arranging finance and achieving terms which are similar for all members of the team.

The team will decide how their equity should be split between individual team members. Ideally the equity should be apportioned having regard to each individual's probable contribution to the future success of the business rather than to their ability to make financial contributions. The split of equity will be affected by the type of buy-out structure.

E. Structuring the buy-out

The objectives of the parties will determine the design of the buy-out structure. This step will probably be the most time consuming, involving the detailed analysis of a number of options, including co-operatives and ESOPs and the possible variations of these.

This detailed analysis will require the employee buy-out team to obtain competent legal and taxation advice from lawyers and accountants with the relevant experience and expertise. The buy-out legal structure may be simple, as in the case of small companies, or it may be complex for larger ones. Considerable experience is emerging worldwide on hybrid buy-out models.

F. Negotiating with the existing owners

The negotiation of a buy-out with the existing owner is a delicate process because the employees are negotiating with their employer. Stress frequently arises in this situation and this can jeopardise the goal of reaching a mutually acceptable outcome.

If the buy-out team has little negotiating experience, the institution financing the buy-out may be prepared, or indeed insist, on being involved in the negotiations. Alternatively, negotiations may be conducted by the team's financial adviser.

It is easier for the financiers providing the majority of the funds for the buy-out, or financial advisers, to insist that the normal level of warranties and indemnities are given by the existing owners. If negotiating with the buy-out team, the existing owner may decline to provide these warranties on the basis that the buy-out team should themselves be aware of any potential problem areas.

In addition to agreements relating to the purchase price, negotiations might cover:

- clarification as to whether it is the company or its underlying business (ie. assets, including patents and other intellectual property, and liabilities) that is being purchased;
- identification, of any significant assets or liabilities not to be acquired;
- discussion of arrangements on the transfer of employee contracts and pension entitlements;
- specification of contracts, rights or property leases to be assigned;
- consideration of arrangements to settle intra-group balances and dividends;
- agreements regarding any adjustments to the purchase price depending on net assets at completion or profits earned to that date; and
- determination of warranties and indemnities.

The outcome of these negotiations should be agreed in writing between the two parties, subject to contract and any other preconditions, such as the results of a detailed acquisition review, any necessary tax clearances, and vendor shareholder approval.

G. *Operating after the buy-out*

It is important for the employee buy-out to be supported after the buy-out has occurred, ensuring that the transition from employees to owners is smooth and that the business can operate to its full potential under its new ownership. This may involve the accountants, who advised on the buy-out process, providing ongoing professional services such as taxation advice, accounting advice and other services as required. It could also involve post buy-out support from the previous owner. In some buy-outs, the previous owner retains a stake in the business (often land, buildings or machinery which the employees cannot buy immediately) and/or is retained as a consultant to the business for a number of years. This is an important consideration for a supportive previous owner who may not want to leave the business immediately.

H *Repurchase obligations*

As employees leave, it will be important for both employee owned companies and co-operative enterprises to have funds set aside to meet their repurchase obligations for shares. If the employee owned company does not plan adequately to buy back these shares, they may have to be sold to outside interests resulting in existing employees losing partial control of the company.

8. Conclusion

The employee buy-out process outlined in this booklet is intended to provide prospective employee buy-out teams with an overview of the process and the potential benefits of employee ownership. This booklet has only contained an outline of the employee buy-out process. It is a demanding process and is unlikely to be achieved without the support of experienced professional advisors. The business and its future prospects, will suffer if excessive employee time is devoted to a buy-out.

9. Case Studies

Case Study No. 1: Abrasiflex Workers Co-operative Limited

In December 1990, the owners of Abrasiflex announced that the business, which manufactures abrasive grinding wheels, will be sold. The employees, with a total of 240 years invested in a unique industry, decided that they should make an offer to buy the business.

This decision was arrived at after only one meeting of the 30 employees. The reason for such an "instant" decision was quite simple: there were people who knew how to run and manage a small business, there were people who were the most knowledgeable in the industry in terms of technical expertise, there was an accountant conversant with the day to day financial operations of the business and there were the skilled workers who knew how to make world quality grinding wheels. More importantly, all employees knew that the business was a profitable business and that the monthly drain of corporate charges reduced the business to a mere "cash cow".

There was the concern on exactly how to structure the proposed new business and how to fund the purchase. Both concerns were relatively easy to address but not so easy to put in place.

Due to the need for every employee to have a fair and equal stake in the business the best form of incorporation was a co-operative. The finance was by way of secured bank loan where each employee/member was asked to sign a joint and several bank guarantees.

The process of incorporation and securing the bank loan, involved 4 months of planning and documentation; seeking assistance from the Registry of Co-operatives; and sound financial advice.

Between December 1990 and July 1991 each member showed their commitment by taking a 15% cut in wages, exercising thrifty economic management and committing personal funds to assist working capital.

In March 1991 the final agreements were signed and the co-operative enterprise was officially owned by the employees.

Between March 1991 and June 1995, the company has increased production output and product diversity to a level never thought possible in December 1990. Restrictions on capita expenditure by the previous owner have been reversed with new products and increased profits.

The members have maintained employment, gained increased benefits, enjoyed regular dividends and still enjoy the real feeling of working for themselves.

In July 1995, Abrasiflex announced its plan to purchase a local manufacturing company specialising in consumer abrasive cutting wheels and grinding discs. This purchase was completed in August 1995 and should increase output by 47%.

The members look back at December 1990 and proudly say their decision to purchase the company was the turning point of their working lives.

Case Study No. 2: Budge-Ellis Staff Co-operative Limited

The Budge-Ellis Staff Co-operative came into being when Dairy Farmers Co-operative Limited (now known as Australian Co-operative Foods Limited) decided in 1988 to sell off their non core operations and concentrate on milk and milk products.

The Budge-Ellis organisation had been in existence since 1974 when two companies, one in industrial refrigeration and the other in commercial refrigeration and air conditioning, were merged after being separately acquired.

A firm of accountants was contracted to prepare financial statements and a company profile for presentation to prospective buyers. It soon became clear that the business success would depend on the buyer retaining all of the existing 10 staff including the then general manager.

Contact was made with the Registry of Co-operatives and advice sought on the employees purchasing the business. A finance package was proposed which included a \$200,000 low interest loan over 5 years plus a further \$200,000 overdraft facility. This was subject to employees contributing \$100,000.

A meeting was then called of all employees to explain:

- the concept of a co-operative;
- the divestiture proposal from Dairy Farmers;
- sale to a proposed outside party was not an option; and
- the need to contribute \$10,000 each.

The employees were already running the business very successfully for someone else, so the question was if the employees owned the business would it be less successful?

It was considered that if the historical profits were any indication of the future then future success was almost assured, especially with the extra effort and continued commitment you would expect from employees who have invested their own money in the business.

The individual employee loans were raised from a credit union with minimum security. Then the offer was made to Dairy Farmers - net assets plus \$ 20,000 for goodwill. The offer was successful.

The new entity Budge-Ellis Staff Co-operative Limited was incorporated in early 1989 and has been trading successfully since then.