EMPLOYEE STOCK OWNERSHIP PLAN

Who gives what and why, and what effect might there be on the giver and the receiver?

An Employee Stock Ownership Plan (ESOP) is a financial arrangement whereby the ESOP, in behalf of the company's employees, borrows cash from a bank either to buy the stock of a retiring owner in a closely held company, to issue new shares, or to expand the company. The company then makes contributions to the ESOP out of cash flow, enabling the ESOP to pay off the loan. The loan repayment, vesting, forfeitures and distributions are up to the new owners – the employees themselves (Prodehl, 1998).

All parties, therefore, potentially benefit. The seller receives the agreed-upon price for the sale of the company to the ESOP, the lender receives profits from interest payments, the company may enjoy certain tax advantages, and employees are eligible to receive distributions based on tenure of service.

A simple analogy might be the purchase of a home by a newlywed couple ("employees"), secured by their parents ("ESOP"), and the mortgage of which is being paid by the accrued equity in the home ("cash flow"). So long as everyone remains a party to the transaction and the property continues to increase in value, everyone benefits. The longer the couple remains married and in the home, the more equity each will accrue ("vesting") and the more each will receive if the home is sold or one "retires" from the marriage ("distributions"), although early departure may mean "forfeiting" all or part of one's equity.

Why might traditionally owned businesses perform better?

Most of the companies sponsoring ESOPs, have at least 20 employees, or they are startup companies that plan to grow quickly and be sold or go public. The typical small business, like over 95% of all U.S. businesses, has fewer than 20 employees, most of which do not share ownership with their employees because existing employee ownership plans may seem too costly or complex, or their employees may be too impermanent, or their financial positions too uncertain to justify an employee ownership plan (NCEO, 2002). A traditionally-managed small business would most likely be more efficient than one with multi-dimensional management because it can make more rapid, centralized decisions, and retain more uniform control of operations.

As well, neither partnerships nor limited liability companies (LLCs) are commonly used for broad employee ownership. Because of potential liability problems, such as the ability of a single partner to obligate the entire partnership to a contract, as well as the usual tax and liability advantages of incorporation, it is probably best to use partnerships to share ownership among only a small number of people. Partnerships will generally be the cheapest way to share ownership among feweer than five or six employees. Similarly, in an LLC, rather than setting up an ESOP, partnership could be extended to additional employees by offering shares or by giving employees an option to purchase a partnership interest at a price fixed today for a number of years into the future (ibid).

Why might employee-owned businesses perform better, and would employee ownership or stock options influence you to be more productive?

I would agree with the observation of Dr. Douglas Kruse (2002) that "there is clearly no automatic improvement of attitudes and behavior associated with being simply an employee-owner", mainly because I may not directly associate my daily work with the eventual financial gain I stand to realize. Like myself, most employees are not likely to understand that they own a piece of the company and that their performance affects their own stock holdings unless the company implements a good communications program (Ashton, 1997), so potential improvements in employee productivity that an ESOP encourages can be best realized if the company communicates effectively with its employees about the advantages an ESOP offers them. This can be done by implementing simple, routine, ways of showing how everyday activities affect the company's value — whether it be production information, customer service feedback or financial results. That way, we would be more able to learn what affects the results and to adjust accordingly.

Further, performance can improve if the ESOP is combined with opportunities for employees to participate in decisions affecting their work. To that end, management must be genuinely committed to treating employees like owners. According to Loren Rodgers (1999), a partner at Ownership Associates, Inc., a firm specializing in ESOP consulting, employee ownership affects corporate performance only when combined with initiatives that create an environment in which employees are given the tools, training, and opportunities to take more active roles as owners — in other words, only when the company creates an "ownership culture."

A study of 167 Ohio firms (Logue, 2001) reports that among firms actively increasing information, training, and participation, 41 percent reported higher profits relative to industry peers. Of the firms not increasing informed participation, zero reported a positive change in profits relative to peers. Informed participation firms also reported a greater likelihood of stock appreciation over three years.

Additional recommendations for increasing productivity of employee-owned firms, as suggested by Jacquelyn Yates, assistant professor of political science at Kent State University Salem and an Associate of the Ohio Employee Ownership Center (Yates, 2000), include the following:

- “Develop an employee ownership committee that is involved in activities that promote problem solving and tracking of company’s performance, as well as providing constructive feedback to co-workers and company leaders on the things that happen in your company that encourage a "hired hand" mentality.
- “Connect the (daily work activities) to real-life experiences (such as) home budgeting, household resources, planning for children’s education, and directing their own retirement savings.
- “Build a line-of-sight from daily work to the big numbers. If you work in shipping, cost of goods sold (COGS) is too big to be a very meaningful number. Successful ship rate, however, isn't.”

In conclusion, the studies cited in this essay indicate that, in principle, if worker pay and benefits are closely tied to a firm’s overall performance, and if workers are involved in decision-making, employee ownership arrangements can help reduce inefficiencies in the workplace and increase profitability.

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