GBQ Consulting

VALUATION OBSERVATIONS

Is an ESOP Right for Your Company?

An Employee Stock Ownership Plan, or "ESOP", is a qualified retirement plan, similar to a 401(k), which allows the employees of a company to become owners of the stock of their employer, while at the same time providing an attractive business succession plan for selling shareholders. There are over 6,000 ESOPs in the United States, and the number of participants in ESOPs has grown in recent years (source: National Center for Employee Ownership, "NCEO"). The NCEO's most current data, coupled with the level of activity we are seeing in the market, confirms that ESOPs have become more popular than ever. Why are they so popular?

ESOP Companies are Thriving

Each business owner eventually reaches a point when it is time to sell, and millions of businesses have changed ownership since the turn of the century as "baby boomer" owners reach retirement age. As these business owners contemplate the ways to liquidate their investments, many are attracted to an ESOP's ability to provide a positive result for them, their company and their company's employees (a "triple win"). While the benefits of selling a business to an ESOP are briefly summarized later in this article, from the company perspective, many ESOP-owned businesses are thriving. The 2016 Economic Performance Survey, released by the ESOP Association in December 2016, reported that nearly two-thirds (64%) of responding companies reported profit growth year-over-year, while stock values increased for 73% of companies over the prior year (with a further 6% of responding companies yet to receive their valuation at the time of publishing). Why does the ESOP ownership model work? Along with certain tax benefits (for example, becoming an income tax-free entity), ESOPs provide a strong financial incentive for employees to invest the success of their company. 85% of respondents in the survey said their ESOP had a positive effect on corporate culture, while 90% said it was a good decision to implement an ESOP (only 2% said it was a bad decision).

ESOP Association 2016 Economic Performance Survey results:

64%
of companies grew profit last year

73%
of companies had stock value increase over the prior year

85%
said ESOP had positive effect on corporate culture

90%
said a good decision to implement an ESOP

Is an ESOP Right for Your Company? (continued)

Ideal Characteristics for an ESOP Company

Not every company is well-suited for ESOP ownership. Companies with the following characteristics typically make for the best ESOP candidates:

- ***Enterprise value of at least $1 million*** – There are transaction and ongoing administrative costs associated with ESOP ownership, and the smallest companies may not be able to afford them.
- ***Profitable*** – Likewise, companies that are struggling to achieve profitability may not be able to afford the ESOP, and possibly more importantly, may not command a value that is attractive to selling shareholders.
- ***Available borrowing capacity*** – Most companies take on leverage to enable the ESOP to purchase the companies' shares from selling shareholders.
- ***Strong leadership team*** – The ESOP ownership model is designed to last into perpetuity, so the business must have a succession plan in place as key managers retire.
- ***Stable and motivated employee base*** – ESOPs work best when employees recognize they benefit financially through the success of the company, and remain employed long enough to accumulate shares.
- ***Domestically-based employees*** – Foreign-domiciled employees may not be able to participate in the ESOP, although plans can be designed to give them comparable benefits.

Shareholder Considerations

If a company fits the criteria outlined above, and the shareholders are interested in transitioning ownership, an ESOP can be a true "triple-win" for the company, shareholders and employees. ESOPs can be an attractive option for selling shareholders when they:

(a) are ready to achieve liquidity for their ownership and diversify their wealth;
(b) are capable of realizing certain tax benefits not available through a third-party sale;
(c) wish to preserve the company's legacy as an independent company;
(d) wish to reward their employees who helped build the company; and/or
(e) desire to sell the company in a manner that typically provides greater certainty of closure, with less time and cost.

Is an ESOP Right for Your Company? (continued)

Conclusion

Does your company "check the boxes" above, and are your shareholders interested in succession planning, rewarding their employees, or monetizing their ownership? If so, please contact us to learn more about whether an ESOP may be the right fit for your company.

For more information, please contact:

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