PNC ESOP SOLUTIONS

ESOP INSIGHTS

ATTRACT. RETAIN. MOTIVATE AND BUILD VALUE: THE EFFECT OF ESOPS ON THE WORKFORCE

By Julie Williams, Managing Director, National Lead of ESOP Solutions, PNC Bank

> "Even as they forecast a brighter future for the working class, economists also worry that the new age of tight labor markets and rising wages will create a different sort of challenge. As Alan B. Krueger, a Princeton University economist who was the chief economic adviser to President Barack Obama, put it, 'We are heading for a labor shortage.'"[1]

ESOPS THROUGH THE LENS OF THE EMPLOYEE

Employee Stock Ownership Plans (ESOPs) are often described and explored from the perspective of the business owner. They address ownership transition goals, provide flexibility and offer attractive tax benefits. Beyond the economic benefits, they may also appeal to an owner's desire to protect employees and provide opportunities for employees to participate in the financial rewards of ownership. In fact, the belief that ownership improves outcomes for both companies and employees underlies the support for employee ownership among lawmakers, which continues today on a bi-partisan basis, decades after ESOPs were passed into law.

According to the Department of Labor, there are nearly 7,000 ESOPs across every major industry. ESOP-owned companies employ more than 13 million workers and hold more than $270 billion of employer stock for the benefit of the participants.[2] Of these 7,000 ESOPs, approximately 4,000 are 100% ESOP owned.

In a competitive labor market where attracting and retaining talent is a mounting challenge, the benefits of employee ownership can be a significant differentiator.

Many studies corroborate the notion that employee ownership yields positive outcomes for the company and benefits that employees can readily recognize.

FIVE REASONS THAT ESOPS ENHANCE OUTCOMES FOR EMPLOYEES

1. ESOPs provide employees access to financial ownership as a company benefit.
ESOPs are broad-based employee benefit plans. All employees participate. Hourly workers, administrative staff, middle management and senior leadership can gain ownership and create wealth that may have been out of their reach due to lack of access to capital.

2. ESOPs typically improve job stability.
ESOPs perform better in economic downturns and frequently experience less turnover and fewer layoffs. The General Social Survey (GSS), an analysis by the National Center for Employee Ownership (NCEO), showed that employees in the U.S. who were employee owners were ***four times less likely to be laid off during the Great Recession than employees without employee stock ownership***.[3]

The 2014 GSS, performed by the NCEO in partnership with the Employee Ownership Foundation, provides evidence that ESOP-owned companies reduced unemployment costs to the federal government by more than $17 billion in 2014. Specifically, ESOP-owned companies alone resulted in estimated savings of approximately $8 billion.

3. ESOPs may improve the success of the business and job satisfaction.
ESOPs can result in higher productivity and wages. Employee owners' decisions often reflect their awareness of their ownership stake. It is widely believed that job satisfaction is a result of ownership (and improved fortunes) and contributes to stability in the workforce, efficiencies and continuity for the business.

A great majority of ESOP-owned firms agree that employee ownership positively affects overall productivity of employee owners and that it increases financial performance (revenue and profitability) of their businesses.[4] Many attribute the improved corporate performance to "the ownership mentality" — greater attachment, loyalty and willingness to work hard; lower turnover; and more frequent suggestions for innovations by employees. Ownership by employees is most effective when combined with worker empowerment through participatory management and other techniques.[5]

4. ESOPs can provide superior retirement benefits.
Employers have traditionally offered defined benefit plans to their employees, but the high costs associated with these plans have caused many employers to switch to alternate retirement plan options. ESOP companies tend to contribute higher levels to the ESOP vs. the average for other defined contribution benefit plans. Furthermore, ESOP companies are more likely than non-employee owned companies to offer their employees more than one qualified retirement plan.[6]

In addition, the stock in the employees' ESOP accounts may experience greater appreciation because the company does not pay income taxes. The combined effect of higher contribution levels and the potential for strong equity returns on the stock is one reason ESOPs can provide greater retirement assets for employees compared to the alternatives. In practice, ESOP participants are actually better off by a considerable margin in terms of retirement assets. Moreover, by their design, ESOPs are particularly better for lower income and younger employees than typical 401(k) plans.[7]

5. ESOPs often preserve jobs and perpetuate culture and legacy.
Owners who choose to transfer their businesses to their employees often do so out of a desire to protect employees from drastic changes or from job eliminations under new ownership. An ESOP structure allows the company to continue to operate the business independently and consistent with the current strategy. This is a benefit to not only the owner, who is optimizing a key objective to perpetuate legacy and culture, but also to the employees whose jobs depend on it.

ADDITIONAL CONSIDERATIONS

While ESOPs can have significant benefits for owners, management and employees, they are not the best strategy in every situation. As you consider an ESOP, ask yourself the following questions:

- Does your company have consistent earnings? ESOPs tend to be best suited for businesses with consistent and predictable earnings so that they are well-positioned to service the transaction debt and future repurchase obligation requirements.

- Are you anticipating compelling strategic offers? ESOPs can pay no more than fair market value for the stock. If the selling shareholder is seeking to maximize his or her sale price, then an ESOP may not be the best means to achieve this goal.

- Do you require upfront liquidity? When selling to an ESOP, a meaningful portion of the total sale proceeds may be deferred and paid to the seller over a period of time.

ABOUT JULIE WILLIAMS

Julie Williams is Managing Director and the National Lead of ESOP Solutions for PNC Bank. She has more than 15 years of experience advising companies and business owners on various aspects of ESOP transactions.

Clients and prospects of PNC Bank leverage her knowledge and experience as they evaluate the benefits and considerations of using an ESOP as an ownership transition and liquidity solution. Williams also serves as a resource for PNC clients as they execute their corporate strategy with the added complexity of ESOP ownership. Prior to joining PNC, Williams held senior positions with major financial institutions in the Midwest, focusing on ESOPs.

Williams earned a bachelor's degree in business administration from the University of Michigan and a master's degree in business administration from the University of Chicago, Booth School of Business. She is licensed by FINRA with a Series 79 and Series 63.

FOR MORE INFORMATION

Ask how PNC's ESOP Solutions group helps companies transition to an ESOP structure and assists existing ESOP clients in maximizing performance. Contact Julie Williams at **julie.williams@pnc.com** or **616-771-8864**.

1 https://www.nytimes.com/2017/09/19/business/economy/labor-shortage.html

2 Joint report issued by ESCA and NCEO: Economic Growth Through Employee Ownership, How states can save jobs and address the wealth inequality gap through ESOPs. August 2016.

3 Great Recession defined by the National Bureau of Economic Research, December 2007 – June 2009.

4 Employee Ownership Foundation 23rd Annual Economic Performance Survey (EPS) of ESOP companies. September 2014.

5 *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-Based Stock Options*, edited by Douglas L. Kruse, Richard B. Freeman, and Joseph R. Blasi, The University of Chicago Press, National Bureau of Economic Research, 2010. Page 12.

6 NCEO Survey; 2010 NCEO project funded by the Employee Ownership Foundation found that 56% of the ESOP companies have at least one additional employee retirement plan. By contrast, only about 44% of all companies otherwise comparable to ESOPs have any retirement plan, and many of these are funded entirely by employees. In a survey by PlanSponsor Magazine in 2013, 95% of ESOP companies offered 401(k) plans compared to 86% for respondents overall. ESOPs were also slightly more likely to offer defined benefit plans and profit sharing plans.

7 https://www.nceo.org/articles/esops-too-risky-be-good-retirement-plans

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