



The ESOP option

Can be beneficial for owners, employees and the business

UNLESS YOU HAVE the genetic makeup of Steve Jobs or Elon Musk as a business leader, you need to rely on your employees to generate many creative and innovative ways to grow revenue and improve operations.

There is sound management theory to support this concept. Douglas McGregor, professor at MIT and Harvard, as early as the 1950s argued for a management approach called Theory Y, which emphasized participatory management. Recognizing the importance of workers taking ownership and pride in their work, he argued that it will lead to more creative and innovative solutions to any company's problems.

This was echoed by the famous Dr. Edwards Deming, the American statistician who taught the Japanese how to empower employees to be innovative. We have paid the price and loss of leadership to them in electronics and the automotive industry.

Locally, Lisa Reardon, CEO of OwnersEdge, came into an ESOP company when she was hired in 2005 by CC&N, a local wired and wireless infrastructure company. At that time, CC&N was having a hard time growing beyond \$25 million. In order to grow the ESOP and increase share value, OwnersEdge was created in 2014 as an ESOP holding company. The holding company currently has four diversified businesses in its portfolio that allow for continued share value growth and protection in times of industry downturns.

The government recognized the advantages of employee ownership when it took action to create ERISA, which provides major tax advantages to owners who sell their companies to their employees. You do not have to be a raging capitalist to know that ownership leads to more motivated decision-making and pride in workmanship.

There are other champions of ESOPs, and that includes highly successful business leaders such as Bob Hillis of Direct Supply, who said, "I once owned a large part of a small company, and I now own a small part of a very large compa-

ny." The growth of his company exploded after conversion to an ESOP.

If you are a business owner contemplating a sale to a private equity firm, you might want to think about the alternative of selling to your employees both for the tax advantages and for the potential to continue to guide your legacy company.

Reardon listed many of the advantages of moving forward with an ESOP aside from the obvious tax advantage:

1. The owner or owners receive a competitive pay day for selling their shares. There is no evidence that the valuation for an ESOP conversion is less than what a private equity firm or a strategic buyer would pay for the firm.
2. The owners can stay involved to ensure their long-term vision is implemented because of the continuing involvement.
3. It is not turning over the company's leadership to employees. That's only a myth. There is no evidence of that ever happening. Employees are vested in having management succeed and not overthrowing it.
4. ESOPs offer tax advantages, which translate into a competitive advantage when it comes to pricing products and services, and having more cash available to compete head-on in their industries.
5. There have been examples of spectacular failures such as United Airlines' conversion to an ESOP, but those can be mitigated by good strategic planning.

Clearly, this is worth a serious look if an owner is at the point of wanting to sell the company.

Reardon listed several critical stepping blocks to make sure the conversion was thought through and would achieve success.

Begin by hiring a lawyer with experience in doing ESOPs who can lay out a step-by-step pro-

cess. That should include an accountant skilled in the process as well.

Obviously, the owners will want to be assured they get a fair valuation of the stock, and therefore selecting an outside valuation firm is critical.

There are other ways of financing this than traditional bank financing. That could include a seller's note, which provides the owners with a higher rate of interest and another way to leverage continued family involvement in the business after the sale to the employees.

Lastly, a trustee will be appointed to represent the employee-owners. They have a fiduciary duty to those employees to make sure the business functions in their best interest. Reardon's advice is to make sure that the trustee has a background as a successful business leader who understands the complexities and challenges of your business.

As an owner, you have an opportunity to help your organization continue to thrive and grow long after the sale and drive innovative solutions to your company's challenges. It's certainly worth a look. ■



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