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# Employee Stock Plans Show Increase Locally

## **FINANCE:** Owners Can Sell; Workers Profit from Profits

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**Darren Hofstra, accounting director at the Welk Hospitality Group, says the creation of an employee stock ownership plan has been a great motivator for employees.**

Attorney **Marc Schechter** specializes in helping business owners sell their companies, not to competitors or family members, but to their own employees. Schechter's firm, **Butterfield Schechter LLP**, is one of the largest in Southern California to focus on employee stock ownership plans (ESOP) and has seen a spike this year.

The firm typically creates a dozen ESOPs a year, but will have already completed 10 by the end of the month and met with 12 more companies to discuss the feasibility of an ESOP.

"I don't want to jinx it, but it's been busy by our standards," Schechter said. "There seems to be a big bubble of interest right now."

Federal data on ESOPs, which are regulated by the **U.S. Department of Labor** as retirement plans, only runs through 2012. But an analysis of the information by the **National Center for Employee Ownership** showed that even as the number of ESOPs nationwide fell from roughly 8,900 to 6,900 between 2002 and 2012, they grew in California from 413 to 881. San Diego-area ESOPs rose as well, from 45 to 102 during the same period.

ESOPs allow owners to sell a piece of their company, or even all of their stock, to a trust for the benefit of their employees. Workers don't own the stock directly and can't vote their shares, but slowly accrue interest in the trust based on their wages. When they leave, the ESOP buys back the value of their shares, giving the employees cash that can be rolled over into a retirement account.

### Funding the Plan

Companies with ESOPs claim the plans lead to better performance, as employees have a more direct connection to the success of the company. But there are potential risks, including the debt required to buy an owner's shares in the first place. Employees don't pitch in to fund the ESOP, so a company often takes out a bank loan to fund the plan and uses future profits to pay down the debt.

"Four years ago, it was really slow because the banks weren't really lending any money and business valuations were very low, so owners weren't really motivated to sell," Schechter said.

A San Diego institute dedicated to ESOP advocacy has also seen increased interest in the past few years for its consulting services. The **Beyster Institute** began its work in 1986 as part of a separate nonprofit launched by J. Robert Beyster, the founder of defense contractor **SAIC** and a fierce proponent of ESOPs. The institute became a part of the **University of California, San Diego** in 2004.

SAIC was employee-owned for decades, before Beyster retired and the company went public. Beyster Institute Executive Director **Martin Staubus** said Beyster, who died last year, viewed ESOPs as matter of worker fairness.

"He felt they were going out and winning contracts, delivering high-quality work," Staubus said. "To not share that value with them was just immoral to him."

Most owners seeking the institute's advice are in search of a succession plan that avoids giving up control of their company to outsiders. It's also a way for them to translate a closely held company into cash without selling their entire stake. Owners can give any percentage of their shares to an ESOP, while most other buyers would only be satisfied by a majority share.

"The motivation is really not typically because they want to set up a retirement plan," Staubus said. "The bigger driver is that it's a very attractive way for owners to liquidate ownership and cash it in. An owner may be told they have a $10 million company, but that's just a number on paper."

### Setting Up the Plan

ESOPs cost about $100,000 to set up due to legal and other service fees, though several tax benefits, such as the ability to permanently defer capital gains taxes on the proceeds in some circumstances, can offset the charge, according to Staubus. He recommends companies have annual revenues of at least $5 million before considering an ESOP.

**Active participants in employee stock ownership plans**

| | |
|---|---|
| 2002 | 7,946,000 |
| 2003 | 7,570,000 |
| 2004 | 7,826,000 |
| 2005 | 9,448,000 |
| 2006 | 9,850,000 |
| 2007 | 10,174,000 |
| 2008 | 10,055,000 |
| 2009 | 10,015,000 |
| 2010 | 10,307,000 |
| 2011 | 10,288,000 |
| 2012 | 10,603,000 |

*Source: National Center for Employee Ownership*

Even as the number of ESOPs has leveled off, the number of employees participating in the plans had grown to 10.6 million three years ago, up from 7.9 million in 2002. National Center for Employee Ownership Executive Director **Loren Rodgers** expected continued increases as baby boomers retire in droves. They are more philosophically inclined to share ownership than past generations, he said.

"It's not a story about the decline of ESOPs, but about their consolidation," Rodgers said. "A fair number have been acquiring other businesses and some of them would have adopted an ESOP otherwise."

Another hurdle for companies with ESOPs is added regulatory scrutiny. Companies must undergo annual independent valuations to ensure the stock is being sold to the ESOP at a fair price.

The **Department of Labor** has averaged between four and five lawsuits a year against ESOP trustees since 2009, compared with about one every two years prior. Last year, the agency reached a $5.4 million settlement with **GreatBanc Trust Co.**, a trustee for hundreds of plans, which allegedly failed to vet valuations used to set the stock price for a company whose ESOP GreatBanc managed.

**Welk Hospitality Group**, founded by TV host Lawrence Welk in 1964, created an ESOP three years ago after the family member with the largest block of shares wanted to sell some for estate planning. The ESOP bought 12 percent of the company and currently has assets of $24.4 million.

The change has added some paperwork for management as they coordinate with auditors for annual inspections. But the work has paid off. Welk is on track to exceed last year's revenues of slightly less than $200 million and accounting director **Darren Hofstra** said the company's ESOP is a big contributor towards the past few years of growth.

"You don't have to be as creative with ways to motivate employees," he said. "They're all motivated by the bottom line."