FIND THE RIGHT FIT FOR YOUR COMPANY

EMPLOYEE OWNERSHIP OPTIONS

Employee ownership is increasingly becoming the best succession plan for companies wanting to sustain their legacy and receive fair value for the business they worked hard to build. There are several paths that lead to employee ownership, and choosing the best one will depend on your company size and ultimately your business goals.

Broad-based employee ownership sustains quality jobs, creates stronger businesses, and preserves your company's legacy. Employee Stock Ownership Plans (ESOPs), worker cooperatives, and Employee Ownership Trusts have been around for decades. Each path—or model—of employee ownership has some key characteristics that can help you decide what will work best for your company.

Employee Stock Ownership Plans

Employee Stock Ownership Plans (ESOPs) are a popular choice. They are qualified retirement plans—in the same way a 401(K) is—and are used to transfer all or part of the company's shares to a trust, administered on behalf of the employees. ESOP's are:

Size-dependent: generally advisable for companies with more than 20 employees and $2M in revenue

Tax positive: potentially significant federal tax benefits to the seller (at >30% of stock held by the ESOP), to the business, and to the employees

Highly regulated: part of a qualified defined-contribution employee benefit plan designed to invest primarily in the stock of the sponsoring employer, and overseen by ERISA / DOL

More expensive: the high setup costs and ongoing administrative costs are far outweighed by tax benefits for companies above a certain size

Free to employees: employees don't pay for their shares, instead shares are gifted as a retirement benefit

ESOPs are a highly tax-advantaged structure that makes them a fit for companies over a certain threshold size (generally 20 employees and $2M in revenue), given the need to comply with regulatory requirements. ESOP ownership can be anywhere from a small percent of the company stock up to 100%. Tax benefits to the seller kick in at 30 percent sale to the ESOP (potential lifetime deferral of capital gains), and the myriad of tax benefits to the business increases with the percent ownership. For example, a 100 percent S-Corp ESOP pays no federal income tax. The value of the stock is determined based on an annual valuation.

The benefits of employee ownership that research has demonstrated—improved company performance and employee wellbeing—require participatory culture and are deepened by 100% employee ownership. Democratic ESOPs build this into the business structure by incorporating employee participation in electing Plan Trustees, on Trustee Committees, or on the Board of Directors.

Worker-Owned Cooperatives

Worker-owned cooperatives are 100 percent employee-owned and are a popular choice because of the many benefits, the lower cost to set up and the full range of democratic values. Worker-owned cooperatives are:

Democratic: one person, one vote among employee-owners (to elect board members and vote on major strategic decisions as defined in the bylaws), with employee-owners making up the majority of the board

Equitable: employee-owners earn profit-sharing via patronage, based on hours worked

Less expensive: lower set up and ongoing administration costs

Tax positive: profits shared as patronage are tax deductible to the business; also some sellers may qualify for lifetime deferral of capital gains tax

Equity stake: employees pay a small equity buy-in

Universal: appropriate for companies of all sizes

A worker-owned cooperative is a company that is owned and controlled by the people who work there. The Board of Directors is made up of a majority of employee-owners who are elected by the full membership on a one-person, one-vote basis, and profits are shared based on hours worked. Their hallmarks are a highly participatory culture with most having traditional management structures and 'representative' democracy through the Board and the Annual General Meeting.

Employees purchase their single voting share, and their buy-in price is set relative to their earnings so that becoming an owner is a financial stretch, but still within reach of the entire employee base. Share value does not appreciate; this is one of the ways that worker cooperatives are designed to perpetuate employee ownership over the long term.

Worker coops have lower set up and ongoing administration costs, and qualify for some tax benefits (but fewer than ESOPs). In some circumstances, the seller can qualify for lifetime deferral of capital gains tax, and the profit that is paid out as patronage is tax deductible to the worker cooperative business.

Employee Ownership Trusts

Employee Ownership Trusts (EOTs), sometimes called Perpetual Employee Trusts, offer an option that safeguards the ownership over the long term by blending the trust structure with some of the democratic qualities of the worker-owned cooperatives. EOT's are:

Perpetual: safeguards the ownership of the business by its employees

Flexible: offers more ability to design the trust structure to meet the goals and needs of the business

Lower cost: lower set up and administration costs

Free to employees: employees don't pay for their ownership benefits

EOTs preserve the business over the long term for the benefit of the employees – not just their financial benefit, but also the preservation of their jobs and ownership. This contrasts to ESOPs, which, if faced with an acquisition offer, have a fiduciary responsibility to maximize the financial benefits to the shareholders. In an EOT, the employees benefit financially by receiving a share of the company's annual profits, rather than by owning an asset that changes in value based on an annual valuation. Company shares don't circulate, as they stay in the trust.

Democratic voting by employees can be built in (through the power to direct the trustee), enabling strategic decisions to be in the hands of employees (for example, electing the Board of Directors). EOTs have lower set up costs and negligible ongoing maintenance costs, but they are not eligible for the significant tax benefits of an ESOP.

One of the major benefits of the perpetual trust structure is its flexibility for companies that want to design the trust to fit their specific goals. For example, there's a new twist on the Perpetual Employee Trust that is being used by mission-driven companies to keep their mission at the center: a Perpetual Purpose Trust.

Compare employee ownership options

	Employee Stock Ownership Plan	Employee Ownership Trust	Worker Cooperative
Suitable company size	Large 20-40+ employees	Any size	Any size
Tax benefits	✔✔✔	No	✔
Setup and ongoing costs	High but offset by tax benefits	Lower	Lowest
Flexibility of model	✔ Within ESOP parameters	✔✔✔ Highly flexible	✔✔ Within coop parameters
Employees buy their shares	No	No	✔
Employees role in strategic decision-making	Optional	Optional	✔✔✔ Democratic governance
Percentage of company owned by employees	Any percent	Any percent	100%*
Profit sharing built in	No	✔	✔
Designed to stay employee-owned and avoid acquisition	No	✔	✔

** Worker-owned cooperatives can have preferred shareholders who hold non-voting stock in the company.*

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