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Spread The Wealth

At some point, if your company is succeeding, you'll look around at the employees who've helped you make it and ask yourself: "Should I cut them in on the action?"

Steve Sarowitz asked the question early. The president of Paylocity Corporation in Elk Grove Village is already thinking about the employee stock ownership plan (ESOP) he hopes to set up in several years.

Bruce Haines waited until the last minute. Mr. Haines, the former president of Sternberg Lighting Inc. in Niles, had agreed to sell his company to a competitor. Instead he sold the then 74-year-old manufacturer to employees.

Whatever the timing, most entrepreneurs who dole out equity see it as a reward for employees. But there are plenty of benefits for owners as well.

Retiring owners can cash out without selling and ease into retirement instead of just walking away. Plus, so long as they follow certain rules, the proceeds are tax-deferred. Other companies use ESOPs to get low-cost loans for capital improvements or acquisitions — money they also can deduct from their taxes. Owners can sell as much or as little as they want, so they don't have to give up control.

Mr. Sarowitz, the Paylocity owner, wants to give his 80 employees a stake in the company they helped build, but he wants to keep majority ownership in the family. "My mom had a dream that my daughter is going to run the company," he says. "So I won't sell it all, just in case."

OWNERS WORK HARDER

Perhaps the best argument for employee ownership is that it strengthens the bottom line. A definitive study by a pair of Rutgers University professors in 2000 found that, projected over 10 years, an employee-owned company could end up a third larger in sales and employment than its non-ESOP counterpart. And the ESOP Assn., a trade group in Washington, D.C., reports that 75% of its members (both companies and employee owners) believe motivation and productivity have increased as a result of employee ownership.

"The owner of a company always works the hardest, and we're all owners," says Joe Waldau, who became president of Sternberg Lighting in 1999, two years after employees bought 40% of the company from Mr. Haines.

Employees — there are now 130 — bought the remaining 60% in 2001.

ESOPs are grounded in wildly complicated corporate and tax law, but the basic concept is simple: The plan, managed by trustees, borrows money to buy company stock. The company repays the loan. Employees vest in the plan gradually and cash out when they leave or retire.

Selling equity to the staff is especially attractive to small business owners who don't have the option of taking their company public.

"A small private company that would never dream of doing an IPO can gain liquidity by doing an ESOP," says David Ackerman, an ESOP specialist and partner with Morgan Lewis & Bockius LLP in Chicago.

A COMPETITIVE EDGE

When Campbell & Co. became 90% employee-owned in 1985, the Chicago philanthropic-consulting firm had about a dozen employees, and founder Don Campbell hoped employee ownership would ensure that the company survived him. Mr. Campbell sold his remaining 10% to the ESOP in 2000, and now serves as chairman.

These days, the 33-employee company uses the ESOP as a bargaining chip with new hires. "This is a competitive edge that the other companies we're competing with don't have," says Susan Lindahl, director of finance.

Yes, there is a downside. The non-profit National Center for Employee Ownership in Oakland, Calif., reports that ESOPs generally cost $20,000 or more to set up.

Then there are annual administrative and valuation costs, although tax benefits often make up for that. Still, ESOPs require stringent record keeping and put heightened importance on communication with employees.

Ms. Lindahl’s best advice: Talk to people with ESOP experience. “You’re not smart enough to know the questions to ask until you’ve had the plan for several years.”

Other smart moves: Hire the best consultants you can find, and make sure they’re up-to-date on the rules. Also develop a succession plan that covers transition in management as well as in ownership.