



# ESOPs in 2028

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What will happen with Employee Stock Ownership Plans and Trusts over the next 20 years? Many authorities estimate that as many as one out of every two businesses will change hands over that time period as baby boomers enter retirement age and look to transition their long held businesses. Where does that leave these owners? Most owners transitioning their businesses are surprised to learn that installing an ESOP keeps them in control of the process and they can structure their departure, involvement, successor management team, senior team retention programs and many other critical issues. As more owners are informed about the benefits and the advantageous tax incentives, we believe additional ESOPs will be created – not only more ESOPs, but many more high percentage ESOPs (70%–100%). In the same context, many current low percentage ESOPs will either be transitioned into high percentage ESOPs as owners sell their majority blocks or be phased out completely by selling to another company.

Of course, many people assume closely held businesses are transitioned from one generation to the next. However, it is more rare than one would imagine, and even more atypical for those transitions to succeed in the long term. Why not just sell to a third party? First, it can take time to find a buyer and

broker fees can be expensive. In addition, negotiations can be onerous. Finally, since owners are obligated to disclose confidential information about their business during the due diligence process, the risk of serious damage is real if the deal fails since often the potential buyer is a competitor. That's where an ESOP can be an attractive alternative.

Obviously, there are hard issues involved with ESOP transactions, e.g., what a business can sell for; but the success of any ESOP comes with a number of soft issues as well. The change in culture cannot be emphasized enough, as communicating the transition from employee to part owner via the ESOP is critical. This communication will require a champion from within, and possibly a change in leadership style from the past. Senior team retention programs, synthetic equity, and other compensation programs will become even more prevalent and complex in order to provide incentives to key people to grow the business. Isn't that counter-productive to the ESOP though? Not necessarily. If providing incentives to successfully manage the business provides increased value for everyone, then it is a win for the ESOP as well.

How do business owners proceed with selling their business to an ESOP? Obviously the financial

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engineering for these transactions has become more complex and will continue that way into the future. Front end C corporations transitioning to S corporations, especially high percentage S corporation ESOPs, have become the norm and will continue as long as the tax laws remain intact for the preferential treatment of the S corporation entity. Maintaining focus on pending ESOP legislation as well as long term capital gain rates is vital since tax consequences have a direct impact on the appeal of ESOP transactions. Multiple classes of stock, implications of tax laws, mezzanine financing, and S corporation election require educating all parties involved, thus professional advice will continue to be essential.

The ESOP Association recently recognized 130 companies with its Silver ESOP award and we believe that this number will increase over the next 20 years. Not only will there be more ESOPs, but more successful ones. The building of the many state chapters, educational opportunities, and peer groups to address ESOP culture and success stories are growing and available to assist companies. These factors help create a company culture and ESOP model that becomes sustainable.

One key challenge for ESOPs will be in the redistribution of stock. Many mature ESOPs have already confronted this challenge, making it less burdensome for those that will face it in the future. However, stock redistribution has also taught those professionals who structure ESOPs how to deal with

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this issue at the front end rather than years down the road when it is more difficult from an administrative and communications perspective.

So what lies ahead for ESOPs? Barring any devastating legislation, we believe it is almost certain that the number of ESOPs will rise dramatically. Several keys to ESOP survival and growth will be educating both owners and employees of the opportunities that employee ownership has to offer. Expert advice from professionals and reliance on a greater number of peer companies will assist future employee owners, guiding them to create a successful employee owned company. The shift to more employee ownership prompts changes in company culture where incentives to be successful ultimately benefits everyone. ☺

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