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The Employee Ownership Option

When companies fail or look to move out of state in order to maintain financial gain, states may endure the hardships associated with plant closures, layoffs, and large job loss. One option that can be explored in order to revive the struggling company is a transition to employee ownership. The most prevalent method in executing this type of takeover is through the establishment of an Employee Stock Option Plan (ESOP). By transferring company assets or individual owners stock shares into the hands of company employees using a tax deductible contribution plan, ESOPs enable employees to effectively assume control. An ESOP is different from other pension plans because an ESOP allows for the borrowing of money in order to buy-out or expand a company. By securing a loan based on the assets of the company, an ESOP can provide employees with the funds necessary to takeover a business.

By utilizing this option, a distressed company is effectively transitioned or bought out by its employees through stock option plans. In many cases the stock option plan offers benefits to the employee in order to make the transition smoothly as well as maintain the productivity of the company in the future. Some states have offered programs and financial support in order to ensure that a company is eligible for employee ownership as well as provided technical and financial support to support its future. This option allows these states to maintain the benefits of successful business practices as well as job security. It is important to consider that employee ownership is not a feasible option for all companies and must be carefully examined in order to determine whether ESOPs are a feasible option for the future.

State Programs

The possibility of employee ownership plans in the United States have been assisted by employee ownership experts and grant assistance programs in states such as Wisconsin, Michigan, Ohio and New York. Through these programs the feasibility of Employee Ownership takeover options can be assessed and advised, making sure that the transition is in the best interest of the company as well as the employees. Once the feasibility study is complete and eligibility for employee takeover is approved, grant assistance programs can be utilized in order to support the transition.

Wisconsin's Department of Commerce runs the Employee Ownership Assistance Grant Program (EOP). EOP is a program designed to assist Wisconsin businesses that have experiencing substantial layoffs or plant closings. The program helps assist by offering professional advice

upon the feasibility of an employee takeover. The company must then operate in Wisconsin and hold a comprehensive employee stock option plan. The amount of grant assistance given is determined by company size, the management capability of the group and the economic impact of the closing to the community or state.¹

The **Ohio** Employee Ownership Center is another program that provides services to companies interested in the possibility of employee ownership and employee stock option plans. This non-profit University-based program runs out of Kent State and is funded by the Department of Development, private foundation, and dues from participating firms. The program provides significant advice to companies interested in employee stock option plans through a large database of lawyers, investment bankers, valuers, and other professionals who specialize in ESOP services. Through these professionals, the OEOC is able to provide advice on company structure as well as specialized training programs for employee owned companies.²

In **New York**, the Center for Economic Growth provides a Pre-feasibility Study Consulting Program sponsored by the New York State Department of Labor. The program allows for a no-cost restructuring plan advised by personnel with expertise in the area in order to provide assistance to companies with the possibility of selling to employees. Assistance includes consultants working with employee buyout groups working toward developing ESOPs and making a smooth transition to employee owned businesses that will benefit the state of New York.³

Michigan's Department of Labor and Growth also offers assistance and benefits to companies looking toward employee takeover options. Holding more than 300 employee owned companies, Michigan's program provides assistance through consultation work and access to specialists who can provide important information regarding financing options and other useful resources for ESOP companies. While Michigan finds that companies with over 25 employees and a 500,000 payroll are best suited for ESOP plans, smaller firms may also be appropriate for employee ownership.⁴

ESOP Performance

Aside from anecdotal evidence, it is difficult to assess the success of employee takeovers of closed plants using ESOPs. There is research that evaluates the performance of ESOPs overall, but it is important to note that although there are nearly 11,000 ESOP companies in the country, only one percent grew out of company closures (according to the National Center for Employee Ownership). In a paper presented to the U.S House of Representatives for testimony, it was concluded that employee ownership is linked to 4-5% greater productivity levels, greater

¹ Employee Ownership Assistance Grant Program. Wisconsin Department of Commerce. <http://commerce.state.wi.us/MT/MT-FAX-0804.html>, accessed January 26, 2006.

² The Ohio Employee Ownership Center. Kent State. <http://dept.kent.edu/oec/>, accessed January 24, 2006.

³ Partners, Grants and Assistance. New York Center for Economic Growth. <http://www.ceg.org/services/grants.htm>, accessed January 26, 2006.

⁴ Employee Ownership. Michigan Department of Labor and Growth. http://www.michigan.gov/mdcd/0,1607,7-122-1678_2665-5965--,00.html, accessed January 31, 2006.

employment stability, and even firm survival.⁵ Numbers pulled from papers that were conducted on companies “post adoption” reveal that after instituting ESOPs, employment growth was more pronounced. It was also apparent in many studies that while the effects of ESOPs are positive they are similarly small, and tend to only last for a short period of time. There may be nothing to suggest that ESOPs result in permanent improvement in company performance.⁶

Vermont Cases

A Burlington Free Press report in January 2006 shows that the use of employee ownership plans, mainly through ESOPs, can show varied effects upon the company performance. In December 2006, Carris Reels Inc. became 100% employee owned when employees assumed control from Bill Carris. Seeking to keep jobs in the company’s home of Rutland, the company transferred ownership into the hands of its employees over 11 years, a slow but beneficial change which human resource director Karin McGrath says changed the culture of their company.

Although Carris Reels found success and smooth transition with employee ownership, woodworkers of Ethan Allen Inc. in Island Pond found hardship in association with their transition. Faced with plant closure in 2001, Ethan Allen Inc. became Island Pond Woodworkers with the financial backing of the Vermont Development Authority and the Community Development Block Grant program, according to the Burlington Free Press. Although funding wasn’t a problem, logistical problems left the company struggling to survive. In the end, all of the investing employees lost their 2,000 dollars and Don Maiolo, the chief investor and former maintenance supervisor of Ethan Allen Inc. lost over 70,000 dollars in materials and investments. Although the customers of Island Pond Woodworkers were satisfied with their products, the company’s employees were unable to run the company setting the stage for its closure in less than three years after opening.

These cases can show the varied results that employee owned companies have had in Vermont and can illustrate that while employee ownership plans are feasible to reconstruct some businesses, they can also prove to be detrimental to companies that experience lack of planning and a clearly directed business plan, a mistake that Don Maiolo says proved fatal for Island Pond Woodworkers.

Compiled at the request of Representative Ira Trombley by Ryan Whalen and Stephanie Manosh under the Supervision of Professor Anthony Gierzynski on February 9, 2006.

Disclaimer: This report has been prepared by the undergraduate students at the University of Vermont under the supervision of Professor Anthony Gierzynski. The material contained in the reports does not reflect official policy of the University of Vermont.

⁵ Research Evidence on the Prevalence and Effects of Employee Ownership. The Subcommittee on Employer-Employee Relations, Committee on Education and the Workforce, U.S. House of Representatives. February 2002. <http://enzi.senate.gov/owner.pdf>, accessed February 7, 2006.

⁶ William N. Pugh, Sharon L. Oswald, John S. Jahera Jr. “The Effect of ESOP Adoptions on Corporate Performance: Are There Really Performance Changes?” *Managerial and Decision Economics* (2000).