OWNERS AT WORK

THE NORTHEAST OHIO EMPLOYEE OWNERSHIP CENTER

Volume III, No. 1 **Spring 1991**

EMPLOYEE OWNERSHIP: A TOOL FOR BUSINESS SUCCESSION

Death, retirement, divorce, or just the yearning for a warmer climate can all threaten the survival of stable Ohio companies. If a transition has not been planned, any one of these events can leave an otherwise profitable firm vulnerable to closure. Retiring owners have limited choices in planning business succession, and many of these options have undesirable consequences.

In the absence of an heir who plans to continue the business, the departing owner's choices are frequently unattractive. Selling the enterprise as an ongoing business is the preferred choice: but too often the most likely candidates -- a competitor or an offshore corporation -- may be more interested in the market than in continuing to operate the business locally. The owner can always liquidate the company, but that generally yields a price far less than the business is worth. Liquidation is always unattractive to someone who has spent his life building a business.

Thinking about succession at Elwell-Parker

S. K. "Pete" Towson faced these options when he began to consider the future of family-owned Elwell-Parker Electric in Cleveland. For three generations, the Towson family had owned and operated the business. Although he was not certain where the company's future lay, Towson judged liquidation an unacceptable choice. "To build the world's best large lift trucks is something special," Towson commented. "Anyone can liquidate a business."

Yet Towson was nearing retirement age, some of the family shareholders were octogenarians, and the younger generation had interests other than running the family business. It was clear that the family needed a plan for exiting the business. While potential buyers approached Towson with regularity, some made no secret of their interest in moving production off shore.

As Towson considered the family's options in December 1987, he happened to attend the Employers' Resource Council Roundtable at the Union Club in Cleveland. The guest speaker that day was Cathy Ivancic, Associate Director of the Northeast Ohio Employee Ownership Center. Her topic was how Employee Stock Ownership Plans (ESOPs) can be used to help the owners of healthy ongoing businesses cash in their ownership without disrupting the operation of their companies. Employee ownership offered an almost perfect strategy for Elwell-Parker to avoid both liquidation and a sale to competitors.

Initial conversations with lenders ruled out a sale of the company to the employees in a single step. But employee ownership was viable financially if the sale was conducted in stages. After serious discussions inside the family and on the board of directors, Towson and other family shareholders chose that option. Approximately two years after Towson left the Employers' Resource Council session, the employees of Elwell-Parker became owners of 30 percent of the business through a leveraged ESOP. The family plans to sell its remaining shares after the initial loan is paid down. (For more about the Elwell-Parker story see *Owners at Work*, vol. ii, no. 1, pp. 9-11).

Why sell to an ESOP?

Selling to employees has a number of advantages. First, unlike many "buyers," who are competitors trying to satisfy their curiosity or who are simply shopping for a bargain, employees are serious buyers -- if financing is available. Second, employees are always interested in the survival of the business, which is psychologically rewarding for a retiring owner. Third, and certainly not least, are the tax advantages. The pre-tax repayment of the ESOP loan's principal and the lower interest rate that stems from the tax break for ESOP lenders make the sale to employees easier to finance. And, provided the employees own at least 30 percent of the shares at the conclusion of the transaction, the seller can defer income taxes on the capital gain from the sale, provided the sale proceeds are rolled over into qualified domestic securities. If these securities are subsequently sold within the owner's life, then the income tax on the gain falls due, but if the replacement securities pass into the owner's estate, the capital gain escapes income taxes altogether.

As a consequence of favorable tax treatment, selling to employees is frequently the best exit strategy for shareholders in a closely held company.

As a consequence of this favorable tax treatment, selling to employees is often the best exit strategy for a retiring owner or another shareholder who wants to sell his or her shares in a closely held company. If the company is profit-

Continued on page two

able and has additional debt capacity, a sale to employees is almost always a viable option if the owner is willing to sell, as Towson and his family were, over a period of years.

Business succession and job retention

Despite the hype about "high tech" being the wave of the future, the overwhelming majority of the jobs that will exist in the year 2000 in Ohio already exist today. The most significant source of avoidable job loss is the disappearance of successful small companies at or shortly after the retirement of the controlling owner.

Since its foundation in 1987, the Northeast Ohio Employee Ownership Center has argued that employee ownership has an important role to play as a strategy for business succession and job retention. One of the Center's earliest publications was Dan Bell's *Bringing Your Employees into the Business: An Employee Ownership Handbook for Small Business* (1988), which addresses issues of concern to owners of closely held businesses who are considering selling part or all of their shares to the employees. Much of the Center's subsequent outreach has focused on reaching owners of closely held business who are nearing retirement; Ivancic's speech at the Union Club was only one of scores of talks Center staff members have made to business audiences on the utility of employee ownership in closely held companies.

The outreach effort has paid off. According to an assessment prepared by the National Center for Employee Ownership for the Ohio Department of Development, recently presented to the legislature as part of the Department's annual report on employee ownership as mandated by the Employee Ownership Assistance Act, the portion of the national growth in employee ownership accounted for by Ohio increased by 18.5 percent since the NOEOC was established in 1987. Among closely held companies, the impact has been even greater: the rate of ESOP formation in Ohio since 1987 has increased by 45 percent relative to the national rate.

Copies of the report, "Employee Ownership in Ohio: A Status Report to the Ohio Legislature," are available from Tracy Bradford, Office of Labor-Management Cooperation, Ohio Department of Development, Box 1001, Columbus, OH 43266-0101.

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If you are interested in a brief presentation on ESOPs for yourself or your group, please call Cathy Ivancic of the NOEOC at 672-3028 for details.

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The Northeast Ohio Employee Ownership Center is a university-based outreach program which offers information and technical assistance to retiring owners, buyout committees, labor unions, managers and community development organizations interested in exploring employee ownership. Funded by a grant from the Ohio Department of Development's Office of Labor/Management Cooperation and contributions from both Kent State University and the companies that comprise Ohio's Employee Owned Network, the Center offers timely information and ongoing technical assistance in situations where there is a threat of job loss. Staff can help locate competent legal and financial advice, will perform prefeasibility assessments to determine whether employee ownership is a viable option, and can assist with financing efforts and business plans.

The NOEOC also develops resource materials on employee ownership and participation systems, sponsors workshops and conferences for the general public, holds training sessions for employee owners and facilitates cooperation among employee-owned firms throughout Ohio.

Owners at Work *(ISSN 1046-5049)* is published twice a year by the Northeast Ohio Employee Ownership Center. Letters, articles, requests for permission to reprint, and subscriptions (which are free) should be sent to NOEOC.

OTHER ORGANIZATIONS WHICH PROMOTE EMPLOYEE OWNERSHIP IN OHIO

Common Wealth
P.O. Box 6212
1221 Elm Street
Youngstown, OH 44505 (216) 744-2667

Common Wealth provides community education, organizing and technical assistance to facilitate the development of new, democratically owned and managed enterprises, to help such existing enterprises grow, and to assist with employee buyouts of closing enterprises.

Cooperative Work Relations Program
71 South Plains Road
The Plains, OH 45780 (614) 797-2535

The Cooperative Work Relations Program is one of seven state-supported Centers for Labor/Management Cooperation in Ohio. CWRP staff have expertise in employee-ownership theory and practice, prefeasibility studies, and training for existing employee-owned companies.

Jobs for People
1216 E. McMillan, Suite 304
Cincinnati, OH 45206 (513) 251-9111

Jobs for People provides technical, financial, and administrative assistance for establishing new firms to employ the unemployed and underemployed within the Cincinnati economy.

Worker Owned Network
50 South Court St.
Athens, OH 45701 (614) 592-3854

Worker Owned Network provides technical assistance and training for unemployed persons to establish businesses which will be part of a network of companies owned and managed by workers.

Printed by *Orange Blossom Press*, a worker-owned cooperative

GETTING INTO THE FLOW AT FLUID REGULATORS

When Fluid Regulators moved from being 37 to 100 percent employee owned, its 120 worker owners knew they were taking on an enormous challenge. As a 100 percent employee-owned company, they, and they alone, would be responsible for their firm's future. They accepted the responsibility three years ago. But, at that time, they may not have realized how challenging it is both to survive in a highly competitive market and to change corporate culture. Now they do; and they are working hard to surmount the obstacles to becoming a democratic worker-owned company.

A rough transition

Fluid Regulators' ESOP bought 63 percent of the firm's stock from departing owner Jack Hoye in a leveraged buyout in March 1988. The deal was done relatively quickly. Hoye wanted to get out of the business fast; the purchase took only three months to complete. There was little time for education about the ESOP or for preparing Fluid's worker owners for the challenges they would face as a 100 percent employee-owned company.

The first challenge was part of the buyout: the ESOP transaction saddled the new company with a heavy debt repayment burden. Soon after Hoye's departure, the firm encountered more obstacles to its success. Fluid completed a few major long-term contracts, lost some customers, and saw its primary market in defense-related production begin to soften. Its sales dropped sharply and paying off its debt became even more difficult. To help the firm survive the turbulent times, Fluid's employee owners accepted a wage freeze. Employee owners, naturally, began to associate these market-related events with the ESOP transaction, and some wondered whether being the owners, and responsible for their own fate, was the best position for themselves.

"The transition has been shaky. Business has been down," stated Rich Schreiner the company's president. "We had cash profit sharing before the ESOP, but [because of our debt service] we haven't shown a profit since. So it's been perceived as a bad deal. But the ESOP was the best way for us." The ESOP helps Fluid by allowing the firm to repay its debt in pre-tax dollars (see diagram on page five); and it has been a starting point for Fluid's effort to change its corporate culture. The company is struggling to evolve from a traditional, hierarchical structure to a participative, team-oriented decision-making approach.

As Fluid's employee owners have found, however, it is difficult to change historic perceptions and corporate culture overnight. Those attitudes go back to 1952 when the company was spun off from the Fluid Power Group and jointly owned by four people. When the ESOP was originally set up in 1981, it was implemented as a mechanism to provide a market for the departing owners' stock and to provide retirement benefits for Fluid's employees. From 1981 to 1988, the ESOP purchased 37 percent of the firm from the three minority shareholders. However, despite owning more than one third of the company's stock, the employees had almost no input in the way the enterprise was run.

PROFILE: FLUID REGULATORS
Products: Precision hydraulic components for the aerospace and defense industries.
Employment: 115.
Sales Range: $8-10 million.
ESOP: Formed in 1981, became 100 percent employee owned in March 1988.

As president, Hoye ran the show at Fluid Regulators. The firm did well under his stewardship, but the ESOP was basically a piece of paper and, for many employees, a far-off retirement benefit. Under Hoye, the firm was a long way from the participative structure it is currently trying to develop. "Before we became a 100 percent ESOP, we had a good-old-boy network. Hoye felt he had to control us. Sometimes, I still feel there's a little of the old network still around," said Wendy Baker, an assembler who has worked at the company for thirteen years. "Since we became a 100 percent ESOP, I feel we're trying to make it everyone's company."

Developing a culture of ownership

Trying to help Fluid's employee owners to take on more responsibility and truly own the company has been one of Schreiner's primary goals. "Our problem is we want a set of rules and regulations... [we want to do it] by the numbers, instead of having people take responsibility for getting the job done. We need to encourage people to participate," he said. Schreiner is working to make the ESOP more than a piece of paper. By doing both big and little things, he is trying to help worker owners develop a culture of ownership.

Sometimes symbolic things are the most difficult to change. For example, Schreiner eliminated the parking space reserved for the company's president. But, even if he comes to work late, people still will not use the space. In other aspects, however, employees are thinking more like owners. Schreiner related a story of how employee owners are thinking more about costs. "The burring department told me they were out of hand soap. I said I was going out, so I'd get some. They said 'we're paying for it,

Continued on page four

get generic.'" The company is now considering the elimination of the time clock and making every employee a salaried worker. "People need to work hard, but they need to be comfortable. It cannot be a stiff working environment," Schreiner noted.

A few people aren't pulling their weight, but if you gave them a gold brick they'd say it's too heavy.

One way the company has tried to involve its employee owners has been by creating a series of work teams. Getting people to adjust to work teams has been a growing process. "If we change anything, it doesn't matter if it's for the good or the bad, people are reluctant," commented Tom Hribar, an assembly supervisor who has been at Fluid for fourteen years. Fluid received an Ohio Development Grant to help it set up the program which stresses total quality management (TQM). Employee owners have different perspectives on whether or not the team concept has been working. "You put ten people together as a team and 60 percent will stand around not doing anything," said Ray Penhollow, an assembler who has been with the company since 1987. Quality Control Inspector, Pat Karel felt the dimension-control team he participated on had solved some vexing problems. "We found out why our parts' dimensions went out of tolerance [range]. We've been meeting once a week and solving most of our problems," he said. Schreiner believes that the work team idea fits well with being an ESOP company. "Any benefits we get from the work teams will go to the ESOP participants." And since everyone is an ESOP participant, they all share in the gains made by the teams. The company is now evaluating the team process to see its results and how it can be improved.

Learning what it means to be an owner and that ownership carries new responsibilities is an important part of Fluid's changing corporate culture. "We're trying to create a situation where people are willing to go forward and take responsibility, but it's a slow change," said Schreiner. The team concept is giving more people input into the work process and control over their working environment. "You get to voice your opinion quite a bit," said Tom Pete, a machinist at Fluid since 1986. "You're not just stuck in the corner. You get a lot of input." Fluid's employee owners are encouraged to speak up about the company that they own and how it can be improved. "Here you can communicate with all the bosses. You can make an appointment and speak with them privately if you like. They take the time to talk to you," said Edith Hester from her seat behind a grinding wheel that removes burrs off the hydraulic regulators that the company produces. Even though the doors are open, not everyone is excited about being a participative owner. "I think it's great being an owner," said George Schlauch a machinist, who has worked for seventeen years at Fluid. "A few people aren't pulling their weight, but if you gave them a gold brick they'd say it's too heavy."

Fluid's reputation for excellence in production and for being able to engineer difficult products is the gold plating the firm's worker owners put on the company's products. Supplier excellence awards from General Electric, Sundstrand, Rockwell International, and Texas Instruments, among others, are proudly displayed in the company's lobby. Being an owner provides an added incentive to maintain the company's reputation for top-notch product quality. "If you work for yourself, you'll do a better job and take more pride in your work," said Karel. Being an owner also means taking on more responsibility for seeing that the job is done right. "If one person wants to be negative and screw around, it rips everyone off," commented Penhollow. "I try to raise questions as a concerned owner and some people think I'm wasting their time."

The Painesville-based ESOP is not a typical manufacturing operation. In its sparklingly clean facility it produces high-tech hydraulic valves for the aerospace and defense industries. Its valves are designed to provide technical precision and dependability beyond commercial industrial standards. Fluid Regulators' reputation for quality manufacturing and its ability to design difficult components -- it has an in-house engineering department -- enables it to compete in a crowded market place. Under a microscope lens, employee owners scrutinize parts that, for example, will become integral components of the F-15s streaking

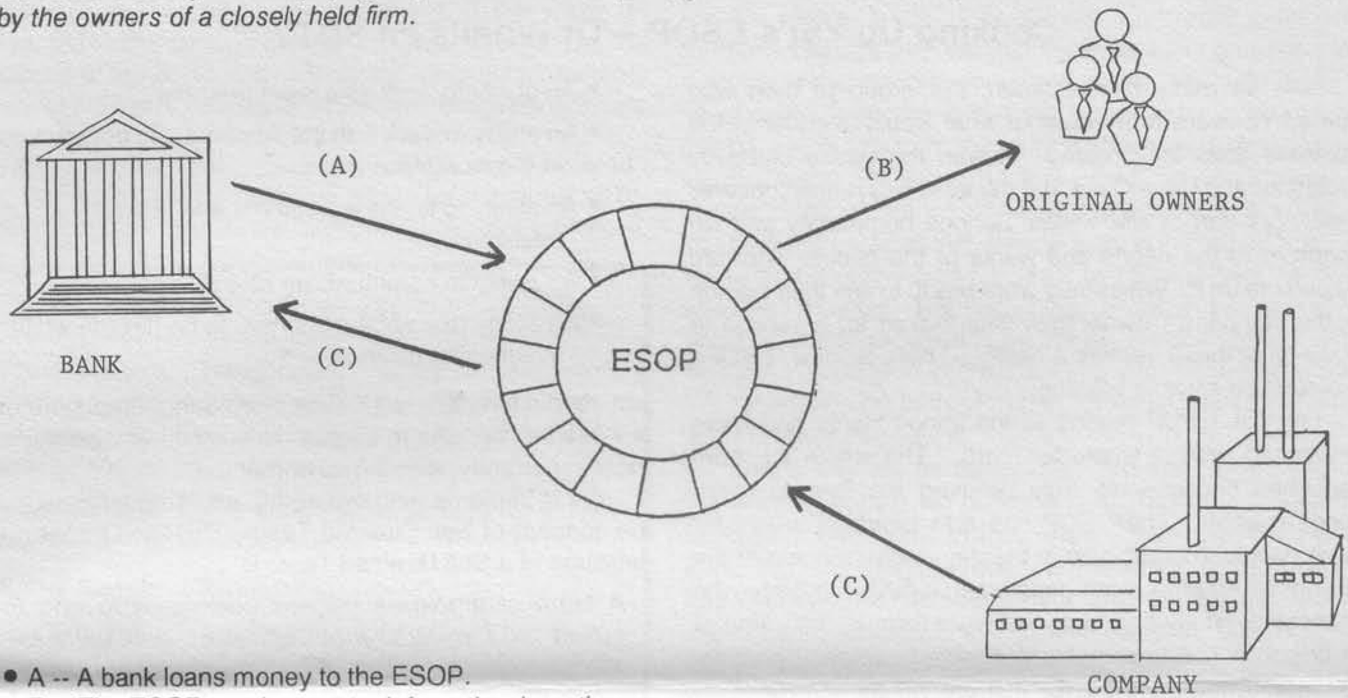
In Memorium

Louis Kelso

December 4, 1913 - February 17, 1991

Using an ESOP to Sustain a Closely Held Company

An Employee Stock Ownership Plan (ESOP) can be used by the owners of closely held companies to sustain their businesses when they retire. Owners who sell to an ESOP can rollover the sale's proceeds into another qualified domestic security without paying any taxes on the capital gain. Below is an example of how an ESOP can be used by the owners of a closely held firm.



- A -- A bank loans money to the ESOP.
- B -- The ESOP purchases stock from the departing owners.
- C -- Repayment of debt is made through the ESOP in a tax deductible contribution.

across the Saudi desert sky and the Boeing 767s landing at Cleveland Hopkins Airport. Fluid's employee owners take quality very seriously. All the firm's products are inspected or tested at least three times before they leave Fluid's facility.

Fluid Regulators' transitional growing pains are all part of a firm trying to make itself and its product better. "It's been hard to get both management and worker philosophies changed," said Roger Waterman, the firm's sales manager. One thing that has helped the company has been its ability to adapt to the changing market place. It has moved into the commercial market to replace lost defense contracts, and has been booking more orders. The increased business has kept Fluid's worker owners busy, but it also makes it more difficult to take some time away from production. Time, unfortunately, is often needed for the education necessary to change corporate culture. "We are really busy," stated Hribar. "We are looking at a major increase in business. No one has the time to talk."

Heading toward the honeymoon

Nevertheless, the company is committed to turning itself into a more participative one. Fluid has monthly and quarterly meetings where the company's financial statements are explained to its employee owners. As owners, employees need to understand the company because they directly elect its board of directors. Fluid is one of the few ESOP companies where the worker owners elect *all* the board members. Full voting rights for the board are part of Fluid's commitment to workplace democracy. Workplace democracy is also part of the company's effort to encourage people to participate and force them into situations where they have to make decisions. "Our biggest problem is that the majority of the population doesn't understand that other ESOP companies have gone through the same problems we have," said Penhollow.

At many employee-owned companies, becoming a 100 percent ESOP is followed by a honeymoon period. At Fluid Regulators, due to changing market conditions and the drop in business, worker owners missed their honeymoon. But the firm is moving forward and continually pushing itself to be a better company. More employee involvement and a more democratic workplace has been its focus since it became 100 percent employee owned. With orders up and its outstanding debt going down, Fluid Regulators is moving in the right direction. Its employee owners are heading toward the honeymoon that they missed, but have not forgotten about.

EMPLOYEE-OWNER FORUM

Nan Harshaw and Basil Zabek of YSI Speak Out

Cooking Up YSI's ESOP -- Or What's an SDT?

Like so many businessmen, the group of men who started YSI were worried about what would become of the business after they retired. It was the desire of Hardy Trolander and Dave Case that the business remain not only intact, but part of the Yellow Springs community and responsive to the needs and wants of the people who had helped create it. When they were ready to sell their portion of the company's ownership, they looked for a vehicle to make all of these desires a reality. Then, as now, ESOPs represented a viable solution.

For YSI, ESOP means all the things Hardy and Dave envisioned, plus a whole lot more. The whole lot more happened because we truly believed that people make things happen. The ESOP has also provided a way for more people to participate in the day-to-day running of the business. And the more people participate, the better the chances of timely and high-quality decisions. This kind of participation has become a recognized company philosophy; it sets the pace for the cultural values and management style that exist today.

The reality is that at YSI the employee owner is different from any other person who owns stock in a company. In describing this difference, two words come to mind: empowerment and responsibility. Empowerment probably means a host of things to the business community. But at YSI we have some pretty clear ideas about what it means. Of course, we believe that it means sharing power. But we also believe it means that every employee owner must understand that he or she can't have power without a responsibility for its use.

Employee owners must have a clear understanding of the vision and goals of the company and how their personal mission and goals fit into it. This is easier said than done, and it takes a lot of effort and time to develop and communicate a clear understanding of the company's mission. But, we learned that having the understanding and the power is still inadequate; to act responsibly you need a few more things. You need some tools; in this instance tools mean skills such as:

- An ability to work as a team member
- An ability to work with the systems and equipment in the workplace
- An ability to analyze problems and make decisions
- An ability to communicate effectively
- An ability to embrace change, to be flexible while maintaining balance

Not such a long list, is it? One more thing, employee owners need to be able to empathize with other owners, and, most importantly, with the customer.

YSI is implementing ownership and empowerment with the concept of Self Directed Teams (SDT). Our visionary definition of a Self Directed Team is:

A team of employee owners committed to and focused on a mission that capitalizes and enhances YSI's competitive advantage in the global market.

The employee owners within the SDTs interpreted this to mean, "a team of highly skilled individuals fully responsible for a specific task or segment of work." Their definition was taken from a book on self-directed work teams (Jack Orsburn, Linda Moran, Ed Musselwhite, and John Zenger, *Self-Directed Work Teams -- The New American Challenge)*, and most team members feel it clarifies their decision-making roles.

We chose to use SDTs as a means of implementation for several reasons. In the beginning we thought of them as work centers, and there were really two principal reasons for their creation. The first had to do with the fact that YSI was already an ESOP and we needed a way to structure ourselves so that all of the owners had a way to participate in the business. The more traditional organizational structure just didn't allow for this.

The second was that our company's manufacturing operations are very complicated. We have hundreds of products comprised of multiple technologies and used by customers in many different market niches. We had no easy way to satisfy the unique needs and expectations of these customers because we could not focus our manufacturing efforts on some targeted market niche. We needed to be more flexible.

Self Directed Teams seemed to promise the right kind of structure. Teams could be formed that were small enough to work together effectively, and they could be focused on particular niches by building selected products in

Nan Harshaw is Corporate Secretary for YSI and a member of the company's ESOP Administrative Committee. *Basil P. Zabek* is the firm's Executive Vice President and is responsible for the concept of SDT's at YSI.

some particular way: from one of a kind to continuous flow. We made mistakes; we've learned from things that went well and those that didn't go so well. We could try to write a book but it might not show things as clearly as an illustration can. Perhaps one of our most important breakthroughs was to realize that we couldn't do everything simultaneously; we had to be mindful of all the areas represented in the diagram below. The illustration shows the structure of the SDTs and reflects the various components to assist the team: strategies which are necessary to insure team success.

Another breakthrough was to recognize that we couldn't buy, borrow, or steal a definitive recipe for bringing it all together. We had to write our own cookbook. We learned

PROFILE: YSI

Products: Temperature probes, electronic thermometers, industrial temperature probes, chemical analyzers, dissolved oxygen measurement, and marine and oceanographic instruments.

Employment: 370 (300 in Yellow Springs, 40 in New Mexico, and 30 in Massachusetts).

Sales Range: $30 million

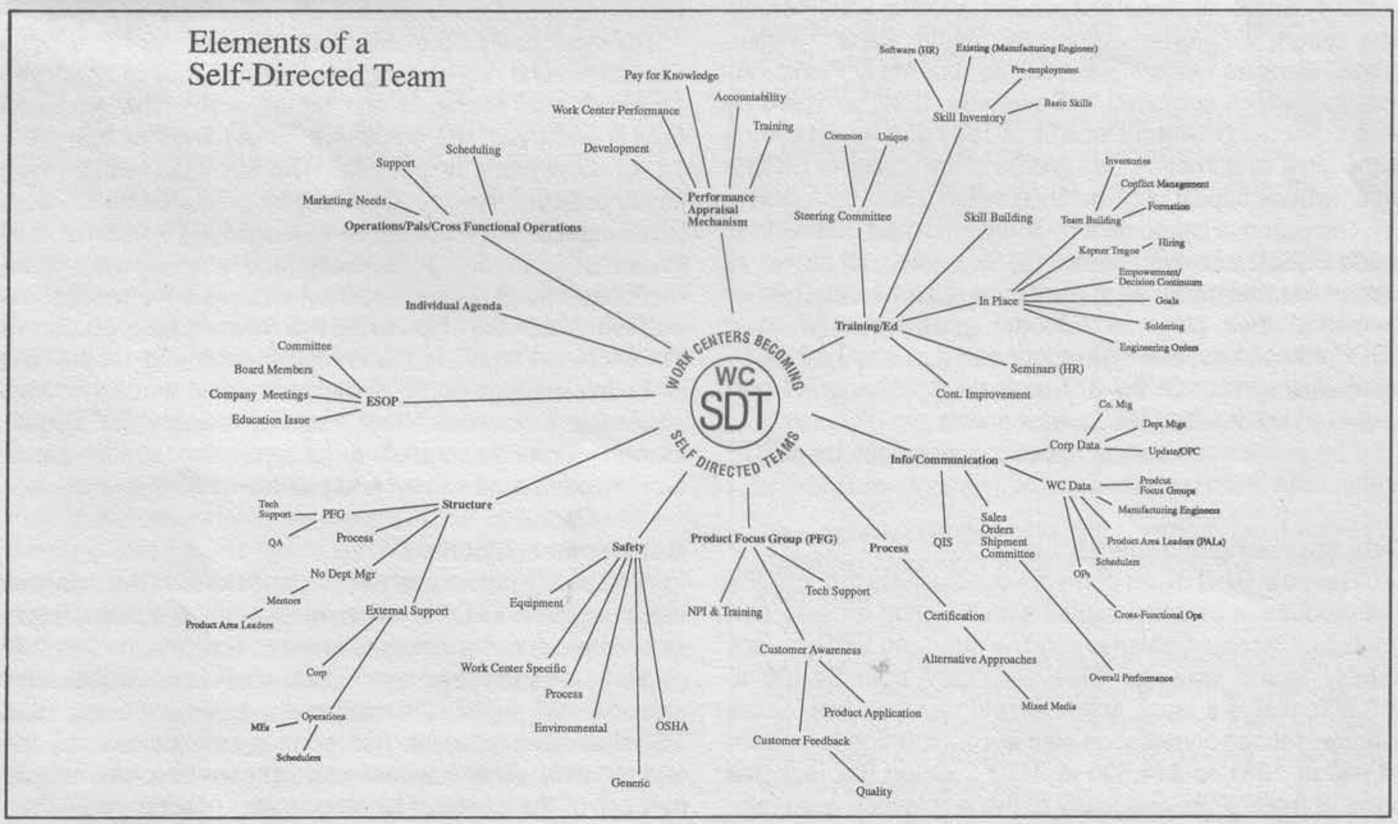
ESOP: Formed in 1983, leveraged in 1987 to buy additional shares from owner-founders, 37 percent employee owned.

some other things too. We learned that the investment in SDTs paid handsome dividends in improved quality of product and services, and overall efficiency of the company. People at YSI take pride in what they do. SDTs are working for us; and they can be everywhere within YSI, not just on the factory floor.

So, where do we go next? We don't really know. It's kind of an adventure. We just know we can't go back. We also know that people working in teams, who feel a sense of empowerment and ownership around their work and behavior, can outperform the more traditional organizations.

But we're not done. As we've said, we don't have any recipe to follow, but we do know that decisions need to be made in the company where the work is actually done. To make that a reality takes at least two things that we have identified thus far. The first is a lot of training so that skills and knowledge required to do the job are possessed. The second is access to information and information networks. We're working on both of these; we have been for a while and probably always will.

That's why it's an adventure. We don't exactly know the end target, but we do know the direction: satisfy the customer. We don't exactly know the recipe, but we do know the major ingredients: people and information. We know that by themselves, owning stock and profit sharing are not enough for YSI's employee owners. ESOP at YSI will be what we make of it -- empowerment, ownership with responsibility, and employee owners writing their own cookbook.



NEW GAO STUDY RAISES PROVOCATIVE QUESTIONS

In the last decade, most surveys of employee-owned companies have uniformly yielded positive results. Employee Stock Ownership Plans (ESOPs) have been found to improve company productivity, profitability, job retention and creation, likelihood of firms staying in business during recessions, and work satisfaction. About the only thing that ESOPs do not seem to improve is the weather in Northeast Ohio.

The serpent in this paradise of studies is the General Accounting Office (GAO), the Congressional watchdog agency. To the embarrassment of the ESOP community, the major GAO study done in 1985 found that ESOPs had no demonstrable impact on company profitability or productivity, did not increase capital formation, and did not lead to much employee participation in corporate management. (The GAO did find that the combination of employee ownership and participation, which was relatively rare, had a favorable impact on company performance.) While there is some argument about the GAO's methods in the study, there is no question that that study was both the most broadly based survey of ESOPs and also the only one with a genuinely good response rate (81 percent). What seems to account for the difference between the GAO's findings and those of earlier studies is that the GAO got responses not only from enthusiastic ESOP companies but also from the unenthusiastic and indifferent ones.

Hence special interest has been focused on the results of the most recent General Accounting Office ESOP study. The report, *Employee Stock Ownership Plans: Participants' Benefits Generally Increased, but Many Plans Terminated*, which appeared in December 1990, is based on data collected between December 1989 and April 1990. It is the most systematic study to date of the impact of ESOPs on employee capital accumulation within ESOP companies.

The report is based on a re-survey of all the 606 non-tax credit ESOPs surveyed by the GAO in 1985. Of these, 45 companies had gone out of existence, 20 others had either converted their plans or become subsidiaries of other ESOP companies, and 164 responded that they had terminated their plans. Of the 377 remaining, 156 -- or 41 percent -- answered the GAO questionnaire.

The resulting report provides nourishment for ESOP enthusiasts and skeptics alike.

Genuine financial benefits

The new GAO study confirms conclusively that ESOPs can produce substantial capital accumulation for plan participants. Account balances in the surviving ESOP plans roughly tripled between 1981 and 1987 from $4,400 to $13,000; that is a much faster growth rate than that for the average defined contribution plan account, which grew from $8,900 in 1981 to $14,300 in 1987. Given the fact that some of the ESOPs and many of the employees were relatively new, a more meaningful indication of the financial benefits from ESOPs is the fact that the average vested participant's account grew to almost $23,000. This average conceals substantial discrepancies: the average vested account for highly compensated participants in 1987 was $73,500 as compared to $16,400 for the rest of the vested participants. (Fully 98 percent of the plans allocated on the basis of wages and salaries.)

Given the fact that the median ESOP plan was nine years old, the GAO numbers seem to confirm the projections made by Corey Rosen and Jonathan Feldman in 1985 that the average ESOP employee account would be worth $21,000 - 31,000 with ten years in the plan.

While it should not be surprising that there is a good bit of churning in establishing and terminating plans, the GAO number of plan terminations is shockingly high.

Also worth noting is the fact that the average plan in the sample increased its ownership from 8 percent of the sponsoring company in 1981 to 23 percent in 1987. One qualification: unlike the high response rate in the 1985 GAO survey, the 41 percent response rate of the current study may well skew the results in a positive direction, because enthusiastic ESOP companies are more likely to answer.

Coincidentally, the Michigan Center for Employee Ownership and Gainsharing released its *Study of Employee Ownership in Michigan* last fall as well. The Michigan Center surveyed 169 employee-owned firms in the state; 72, or 43 percent, responded. The Michigan results were highly positive: employee ownership produced better work performance, improved labor-management relations, and increases in profits, productivity, and employment. (The response rate of 43 percent may also skew the results in a positive direction.) However, the most striking portion of the Michigan report is the finding that among responding companies, "democratic" firms (defined as those with high employee involvement and majority ownership) outperformed "non-democratic" firms systematically in sales, employment, productivity, and profits.

But also financial risks

The GAO report expresses concern with the financial risk involved in ESOPs. While employees in some companies have done spectacularly well, employees in other plans have seen their stock become worthless (as was probably also the case in many of the 7 percent of the 1985 ESOP companies which had gone out of business by the end of 1989). This is a particular concern because fully *59 percent of the companies responding had no other pension plan than the ESOP*. This makes the degree to which employees nearing retirement actually diversify their holdings significant.

Another risk for those without other pension plans is ESOP termination. The most surprising outcome of the study is that of the 541 companies which were still in business in 1989, 164 (30 percent) had terminated their plans. This rate of ESOP plan termination was about three times the rate of other defined contribution plans, and the proportion of plans terminated between 1985 and 1989 (30 percent) was substantially higher than the 15 percent rate of plans terminated between 1979 and 1985, as determined by the previous GAO study.

Since the GAO counted a plan as terminated only if the company responded that it had been terminated, the GAO termination figures surely understate the actual rate of termination; some of the 221 companies which did not respond to the survey probably also had terminated their plans.

This suggests two conclusions. First, ESOPs have much less permanence than generally assumed. Second, the numbers of ESOPs may well be overestimated. The data collection that Michael Conte is undertaking for the ESOP Association will surely in time provide more accurate figures.

Terminations... and successes

The rapid growth in number of ESOPs clearly reflects their flexibility and the variety of uses to which they can be put. Not all sponsoring companies have an equal commitment to the concept of employee ownership. Some, in fact, have no commitment whatsoever, and terminate their plans promptly. While it should not be surprising that there is a good bit of churning in establishing and terminating plans, the GAO number of plan terminations is shockingly high. Obviously, further research is needed in this area.

One cannot help being intrigued by the questions the GAO termination data raises. Why are plans terminated? Were the terminated plans established primarily for tax purposes and terminated when those purposes were no longer served? Did companies abandon plans because of increased regulatory requirements? Did plans terminate themselves by selling stock at appreciated prices to outside buyers? Or does the large number of terminations reflect intrinsic problems in employee ownership? And what was the value of the terminated plans for their participants?

On the other hand, the weight of the accumulating evidence is that ESOPs which survive both the vicissitudes of business and temptations of plan termination really do yield substantial benefits for employees. The 40 percent of ESOP companies most likely to respond to surveys may have larger account balances than the 60 percent which do not respond, but in those companies at least ESOPs really do have a significant impact in spreading ownership of capital and achieving substantial financial benefits for individual employees.

NETWORK NEWS

Ohio Employee-Owned Firms Find Purchasing Power in Numbers

How does the CEO of a company with less than 130 employees convince a nationally recognized consultant to sell him a cutting-edge computer software program for less than a third of its $30,000 price? Erv Howard of Plymouth Locomotive did it with help from Ohio's Employee Owned Network.

When Merri Ash, Vice President of Qualified Employee Benefit Systems (QEBS) and Chairperson of the Administration Advisory Committee of the ESOP Association, was invited to Kent to discuss ESOP recordkeeping issues with employees from eighteen of Ohio's employee-owned firms, she certainly had the opportunity to address an audience of potential customers. But what made this group of possible clients different was that they had the advantage of a structure which could organize their buying power.

Some of the participants at the May 31, 1990, forum had seen a demonstration of QEBS's ESOP administration software at the ESOP Association's conference in Washington, DC. While they were very interested in the software, none of them found the large corporation price tag realistic for their companies. Thirty thousand dollars may be feasible for a 6000 employee company, but that price is not attractive to firms employing 50, 100 or even 600. Nevertheless, members of Ohio's Employee Owned Network that had already experienced the cost effectiveness of multi-company training programs for their employee owners, suggested that Ms. Ash discuss a reduced group price for Ohio companies that would buy the software as part of an Ohio consortium. QEBS representatives returned on October 11 to demonstrate their product to eight interested companies. These companies formed a committee to work out a pricing proposal for the group which QEBS subsequently accepted.

Interest in the Network grows

Established in 1989, Ohio's Employee Owned Network now has nineteen dues-paying members; and it has involved close to 70 Ohio-based, employee-owned firms in its activities. Although its focus is on Ohio companies, the Network has attracted attention from firms outside the state's borders.

Companies have not been the only organizations interested in Ohio's Network. Its success has inspired other states, such as Washington, California, and Massachusetts to begin developing their own networks. With these organizations starting up, Ohio's Employee Owned Network can no longer claim to be the only state organization of employee-owned firms. Ohio's Network, however, continues to set the pace for what a group of employee-owned companies can achieve when they cooperate with each other.

Because Ohio's Employee Owned Network's membership is limited to employee-owned companies, it can pursue a targeted agenda which the companies themselves define at an annual CEO meeting. To date, this agenda includes three components: training, sharing experiences, and joint ventures. The economies of scale the Network provides enable member companies jointly to pay for programs that would be difficult to afford on an individual company basis.

The software purchase was one of three Network-sponsored joint ventures that has been undertaken. The first was the publication of the catalog *Products & Services of Ohio's Employee-Owned Companies* in 1989. Company representatives felt that it made sense for employee-owned companies to buy from and sell to each other since they had first-hand experience of the superior quality of the products and services of employee owners. Unfortunately, there was no way for them to easily learn what other firms had for sale.

The catalog fills that void. It compiles one-page descriptions of Ohio-based employee-owned companies and what they are selling. Updated every year, and distributed for free, the 1991 edition will highlight about fifty firms with everything from golf clubs, furniture, and insurance to steel bars, lift trucks, and rolling-mill equipment. This year's edition will also include an index.

The second joint venture was the publication of a 1990 calendar highlighting employee ownership and twenty-five Ohio companies. The calendar was an inexpensive item which allowed companies to show their employees that they are part of a larger employee ownership community. While the calendar was well-received, the Network CEOs recommended at their 1990 annual meeting that the NOEOC direct its limited resources into the areas of training programs and multi-company forums.

CEOs discuss common concerns

While seeing the names and descriptions of other employee-owned firms on the calendar and in the catalog is interesting, there is nothing like a face-to-face encounter with worker owners from other employee-owned enterprises. This is why the Network organizes so many multi-company forums. CEOs recently had the chance to discuss an open agenda with each other at the March 7 CEO roundtable. The priority topic was how to balance the internal, ESOP-related activities with external, customer-related pressures. In some of the companies where employee participation is starting to mature, CEOs thought that taking employees away from production and putting them in meetings was actually *increasing productivity,* not to mention job satisfaction. They thought that educated, involved employee owners were working both harder and smarter because of the meetings.

The CEOs also shared strategies for dealing with technical issues like repurchase liability and stock valuations. It seems that all those attending saw the interaction as valuable. In fact, when one CEO from a more recently formed ESOP commented that he was getting more from the meeting than other, more experienced leaders, a seasoned CEO pointed out that these discussions helped reaffirm what he was already doing at his company.

Joint training programs continue

With guidance from the Network members, the Northeast Ohio Employee Ownership Center has been developing training programs for general employee owners, employee owner leaders, and employee owner supervisors. (See *Owners at Work*, vol. ii, no. 2 for more details about the Employee Owner Leadership Development Program.)

On December 6, 1990, thirty-one supervisors from thirteen companies attended Ohio's first employee owner supervisor workshop. The training program was based on recommendations from participants in a forum about employee owner supervisors held in January 1990. Exercises and discussions dealt with the pros and cons of alternative leadership styles when managing employee owners, the role of frontline supervisors in participative companies, and toning up communication skills. Comments from participants were very positive. As one supervisor wrote on his feedback form, the supervisor workshop was a "very good program to get people thinking."

Those dealing with ESOP administration issues also had the opportunity to meet with their counterparts at the January 31 ESOP administration forum on valuations. Idelle Howitt, Director of ESOP Services for American Appraisal, gave an excellent presentation of the numerous considerations which go into valuing ESOP stock. More importantly, she was able to respond to concrete questions from the participants regarding concerns about their own valuations. While the forums do not take the place of a private consulting session, they do allow Network members to pick the brains of nationally recognized consultants in a small group setting. Furthermore, listening to the questions of other participants highlights ESOP administration issues which might have otherwise been ignored.

Human resource managers and other employee owners responsible for employee involvement met on March 28 at the sixth participation and communication forum. This series of meetings has allowed employee owners to meet with national experts to discuss labor-management committees, autonomous work groups, gainsharing, and employee training. They have also been able to bring up issues which they are dealing with at their own companies and get feedback from a group of peers who can relate to their situation.

Ohio's Employee Owned Network has many employee owners thinking about ways to get the most mileage out of cooperation among their companies. Lower prices on software, the opportunity to get concrete answers from people at other employee-owned companies, and a cost-effective leadership training program are just a few of the thoughts that have become a reality over the past two years.

Upcoming Events

April 9-12, 1991, Boston, Massachusetts

"The NCEO's 10th Annual Conference," for more information call the NCEO at (415) 272-9461.

April 26, 1991, Columbus

"Employee Ownership: Strengthening Ohio's Economy," the NOEOC's 6th Annual Conference. For more information call Jim Bado at (216) 672-3028.

May 15-17, 1991, Washington, D.C.

The ESOP Association's annual convention. For more information call the ESOP Association (202) 293-2971.

May 23, 1991, Kent

"Employee-Owner Board Training and Forum," a training session of Ohio's Employee-Owned Network. For more information call Dan Bell at (216) 672-3028.

June 20, 1991, Kent

"ESOP Administration Forum," a one-day educational seminar of Ohio's Employee-Owned Network. For more information call Dan Bell at (216) 672-3028.

1991 Catalog of Products of Employee-Owned Firms Available

Whether you are in the market for golf equipment or rolling mills, insurance or weld fasteners, vending machine services or automatic guided vehicles, gym lockers or clay extrusion machines, you can buy what you need from Ohio's employee-owned companies. Request your free catalog *Products and Services of Ohio's Employee-Owned Companies* from the NOEOC today.

NOEOC HOLDS SIXTH ANNUAL EMPLOYEE OWNERSHIP CONFERENCE APRIL 26

The Northeast Ohio Employee Ownership Center (NOEOC) will hold its Sixth Annual Employee Ownership Conference on Friday, April 26, 1991 at the Park Hotel, 900 Morse Road, Columbus, Ohio, from 8:30 to 5:00.

As more than 275 employee-owned, Ohio-based firms demonstrate, employee ownership can be a valuable tool for strengthening Ohio's economy on the local, regional, and state-wide levels. Setting up an employee owned firm is a cost-effective way to maintain good jobs and tax dollars in Ohio.

The conference offers something for everyone -- from the ABC's of ESOPs to advanced sessions for those familiar with employee ownership. It has separate tracks designed for those who want to explore employee ownership and for managers and shop-floor employees from ESOP enterprises. The day is full of panels and workshops about employee ownership. Among the topics featured are

- Tax advantages of ESOPs.
- Case studies of firms that set up ESOPs.
- How-to-do-it advice from ESOP experts.
- Interactive workshops for worker owners.
- Managing the employee-owned firm
- An insider's perspective on how being an employee owner makes a difference.
- A roundtable discussion of employee ownership for salaried and hourly employees of ESOP firms.

Conference speakers include **Scott Crooks**, attorney, Thompson Hine & Flory; **Lowell Marshall**, President, Republic Storage Systems; **John Meyer**, Vice President, Republic Engineered Steels; **Corey Rosen**, Director, National Center for Employee Ownership; **John Smith**, manager of pension plan coordination, Procter and Gamble; and **Steve Walko**, President, Textileather. The conference's co-sponsors include *Ameritrust, the Columbus Area Chamber of Commerce, the Ohio Council of Churches, the Ohio Department of Development, Office of Labor-Management Cooperation, the Ohio Manufacturers Association, Society National Bank, the United Steelworkers of America, District 27, and the United Paperworkers International Union, Region 8.*

The conference fee is $45 pre-registered by phone or mail by April 15 or $80 at the door. Registration includes lunch, refreshments, parking, and all conference materials. Group discounts are offered and some scholarships are available for low-income or unemployed persons.

For more information on the conference, contact Jim Bado, NOEOC, Department of Political Science, Kent State University, Kent, OH 44242, (216) 672-3028.

Owners at Work

Vol. III, No.1
(Spring 1991)

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