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By **Larry Myler,** Forbes Contributor

An Employee Stock Ownership Plan (ESOP) Could Increase Employee Engagement And Promote Intrapreneurship -- Here's How

Why try to persuade employees to *act like* owners when you could just *make* them owners?

In case you didn't know, October is Employee Ownership Month. According to the ESOP Association, there are about 10,000 ESOPs in place in the U.S. covering 10.3 million employees, so this phenomenon should at least be on the radar of business owners. But does an ESOP strategy (whereby employees gain equity ownership in the company for which they work) make the company more valuable and the employees more productive? If so, we should take a closer look at this approach.

Through our research into the similarities and differences between intrapreneurs and entrepreneurs, we find that intrapreneurs lack much of the basic risk/reward motivation experienced by entrepreneurs simply because intrapreneurs are not owners, but employees. Thus, intrapreneurs have a smaller personal upside if the company they work for performs well financially. Could the ESOP model remove this pervasive roadblock to increased engagement and innovation? The answer appears to be *yes*. Multiple studies conducted on the business results of ESOP companies versus their traditionally owned counterparts show an advantage for ESOPs (National Center for Employee Ownership). Are these increased results attributable to greater employee engagement?

According to Larry Kaplan, managing partner of CSG Partners, an investment banking firm specializing in ESOPs, “Employee engagement increases with an ESOP, but is often destroyed in a traditional buy-out.” Kaplan explains that in the vast majority of conventional deals, there is an immediate reduction in the workforce of the acquired entity due to operational redundancies. Further, the culture of the purchased company is almost always negatively affected when the acquiring company begins to impose its will. “These are two of the biggest reasons why morale and motivation go down in connection with the traditional sale of a company,” observes Kaplan. “But these two negatives are completely absent in an ESOP.”

What’s in it for the founder?

Selling to an ESOP could be the best exit strategy for many founders. CSG’s experience shows that the sales price for a given company is the same with an ESOP as it would be with a more common deal structure because the valuation process is the same, but there are tax advantages with the ESOP. As an example, IRS code 1042 allows an owner who sells to an ESOP to reduce the capital gains tax liability to zero (in qualifying cases) by investing sales proceeds, within a specified period of time, into stocks and bonds of public and private companies operating in the U.S. There are several other tax advantages that come with the ESOP transaction structure, and business owners should work with an experienced advisor to capture all of them.

Beyond the financial benefits, the thing many owners find most gratifying about selling to an ESOP is the fact that they are able to preserve their legacy and pass it on to those who worked along side them to create it. Todd Carroll, CFO of Marlin Network, Inc. and past ESOP client of CSG, put it this way, “The people who helped us build our company would ultimately be the beneficiaries of its success, so we opted for the ESOP exit strategy.” Jimmy Kirchdorfer, CEO of ISCO Industries (another CSG ESOP client) remembers, “We were able to control the trajectory of the business and create the best long-term opportunity for our people. They are the true asset of the company, and the biggest reason for our success.”

Regarding the effect an ESOP can have on employee engagement and intrapreneurship, Todd Carroll said it best. “It’s been pretty amazing to watch how people have stepped up and started acting like owners.”

Well, that’s because they *are* owners.

If you know of an organization that has profitably engaged its workforce, let me know at lmyler@bymonday.com. I’d like to share the story.