BridgeBank

EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs)

What is an ESOP?

An ESOP is a unique corporate finance tool that allows business owners to gain liquidity, often on a tax-advantaged basis, while passing along ownership to the company's employees. In an ESOP, the sponsoring company provides their employees with stock ownership through annual contributions on behalf of the employees. Shares are allocated to employees' accounts annually and are held in an ESOP trust until the employee vests in the plan and retires or leaves the company. Typically, the shares are then sold.

An ESOP is a qualified retirement plan. It's regulated by the Internal Revenue Service and the Department of Labor and came into being with the passage of the Employee Retirement Income Security Act (ERISA) in the 1970s. The regulation is meant to ensure that the ESOP is used for the benefit of employees and that it's not just a tool where a business owner can sell at an inflated price.

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What are the benefits?

An ESOP can be an effective way to create liquidity for a business owner as well as serve as a means to transition a business to new ownership while providing an ownership benefit to employees. The issue with other alternatives such as selling to a strategic buyer or private equity firm, or even conducting an initial public offering, is that each option typically forces the owner to sell 100 percent of his or her stake in the business. A significant additional benefit of selling stock to an ESOP is that the seller controls the process.

What types of companies can benefit from an ESOP?

Any privately held company which has an owner who is at some point thinking about transitioning ownership. ESOPs are best suited to companies that have high employee participation and dedication to the success of the company.

Usually, companies with at least $10 million in annual revenues and at least 25 employees are the best candidates for ESOPs. There is no upper limit on the size of company that might adopt an ESOP, and about 10% of all ESOPs are found in publicly traded companies.

The most prevalent industries that favor ESOPs include:

- Manufacturing
- Financial services
- Construction
- Professional services
- Wholesale trade/distribution

ESOP transactions are afforded significant tax benefits to the selling shareholder and the sponsoring company. This makes for improved cash flow to repay an ESOP term loan that the bank may structure to these companies. Further, the seller may be able to pledge securities as additional collateral to the bank loan in certain circumstances.