Opinion

Employee ownership can be a successful alternative to consolidation

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Virginia's business-friendly policies are well-known. In fact, it recently ranked fourth in CNBC's "Best States for Business" analysis. But the state has another unique claim to fame: it is home to 299 businesses structured as employee stock ownership plans (ESOPs) — ranking Virginia sixth in the country. Only New York, California, Texas, Pennsylvania and Illinois have more ESOPs. This unusual ownership model is increasingly being leveraged to propel business growth, retain high-quality employees and operate independently within industries where consolidation is the norm.

In the last few months, several local businesses have announced or completed M&A deals: Bon Secours Health System moved forward with its merger to Mercy Health; Marsh & McLennan Agency acquired Insurance Associates; Citizens National Bank merged with Old Point Financial Corp., and Verizon Communications acquired Straight Path Communications. According to Deloitte, these industries — health care, technology and financial institutions — are among the hottest for consolidation.

But with the new corporate tax laws and tightening labor markets, many are considering the ESOP model to gain a competitive edge and achieve growth without consolidation. Our own firm, Graham Company, recently turned down acquisition offers to become a 100 percent employee-owned ESOP. Based on our professional and personal experience, here are some things to consider when determining if an ESOP model is right for your company:

Expect an ESOP to strengthen your culture – but not fix a broken system. It's true that giving employees full or partial ownership helps them to think like owners – and boosts their productivity, engagement, and spirits. Research studies show ESOPs typically promote a strong culture and company identity, leading employees to work harder. In our own experience, Graham colleagues feel even more pride in the company and are eager to make an impact and share their ideas. This was demonstrated recently when one of our long-time executive assistants asked how she could use her skills to help our expansion efforts.

While an ESOP can enhance a company that is already strong, it is not a band-aid — and it can fail. If the company has a poor culture to begin with, it is not likely that employees will suddenly feel pride and motivation with a new ownership structure. The most successful candidates for an ESOP are typically businesses that have a strong culture, high-value employees, low turnover, expert management teams and strong cash flow.

With the right culture and management, your company will grow. Numerous research studies have documented the surprising growth of ESOP businesses. A Rutgers University study found that companies grew about 2.4 percent more quickly after adopting an ESOP model than comparable businesses, and researchers out of the University of Iowa, Indiana University and Villanova University found that employee-owned businesses are about 4 percent more profitable. Additional research by Washington State found that individual employees at an ESOP earned anywhere from 5 to 12 percent more than peers in non-ESOP companies, and held nearly three times the amount of retirement assets.

Employee ownership gives you an advantage in retention and recruitment. Today's labor market is highly competitive, and an ESOP structure is a benefit that few other companies will be able to offer your recruits. We have found it to be incredibly enticing for potential hires, especially for people who work in industries with high consolidation, such as insurance. Many individuals are hoping to build longevity in their career, and an employee ownership structure is an assurance that the company won't be suddenly bought out next year.

And once those individuals join your company and see how their ESOP statement grows, they'll be reluctant to leave just to get a higher salary with a competitor. Their share of the company is essentially another retirement account, and it takes a lot to walk away from that. In fact, research out of the University of Pennsylvania's Wharton School of Business found that ESOPs contribute $14 billion in new savings annually to employees, above and beyond their income and benefits. Unsurprisingly, the study found that employees felt greater stability and satisfaction in their jobs because of this benefit.

Virginia has embraced ESOPs more quickly than all but five states — which means there is already a strong community of local organizations eager to share lessons learned and successful strategies. For the right company, the transition to an ESOP model can be a competitive advantage that benefits not just the employees, but the company's own bottom line and the satisfaction of its clients.

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