Speaker 1:

All right. Hello everybody. And welcome to our follow-up to our Is an ESOP Right for You. Our webinar was very well attended. We had lots of great questions, many more so than our one hour could allot for answers. So we wanted to take a little extra time and make sure we respond to some of the questions you had. So my name is Tim Garbinsky. If you joined us last time. You would know that. I'm the communications director here at the end CEO and I am joined by executive director, Loren Rogers.

Loren Rodgers, NCEO:

Hello, Tim. Looking forward to it.

Tim Garbinsky, NCEO:

Fantastic. Well, thank you for the time today. I'm excited to get these questions answered. And I think we can just go ahead and dive right in.

Loren Rodgers, NCEO:

Sounds good.

Tim Garbinsky, NCEO:

So just to start out there was a question in the chat, not so much about the nature of ESOP's or how they work, but just a little bit about the current environment around them. In 2017 we had a graphic that showed around 6,700 ESOPs. And right now there has been a decrease. So there was, there was some interest in why there has been a decrease in the number of plans what's caused it. And maybe what we can expect from here.

Loren Rodgers, NCEO:

Sure, absolutely. So there has been a little bit of a decrease, but it's still a lot smaller than the person who originally asked that question saw. They saw that there used to be 60 to 700 ESOP's and in the webinar we were talking about 5,800 ESOP's that's comparing apples and oranges because those 6,700 ESOP's include both privately held companies and publicly traded ones. That second number is just privately held companies. So if you take that 6,700, bring it up to the present, there's still a bit of a decline, but it's down to 6,400 companies. If you look at the number of ESOP's that are created in a year, they tend to there are some created every year. Some that go that disappear every year, the rate of companiescreating ESOP's has actually been growing not dramatically, but gradually each year that we've got data for. There were about 226. ESOP's created in 2014 and about 274created in 2018. So the reason the number of ESOP's is shrinking is partly because more companies are terminating the ESOPs, which doesn't sound great, but in many cases it's actually good news for the ESOP participants by far, the number one reason that companies terminate an ESOP is they got an offer to buy the business, usually at a very substantial premium over their last appraised stock value. When that happens, the employees immediately have their ESOP accounts turned from stock into cash at a much higher value than what was in their accounts before. So they end up better off. It sad the, there it's no longer an employee owned company, but it's still a, in some senses, a good thing for the for the workers who get a real financial windfall from that. The other piece that looks like it's getting missed in these numbers is a lot of companies are now becoming employee owned, not by setting up their own ESOP's, but by being acquired by a company that already has an ESOP, a fair number of our member companies have that baked into their business model. And the topic of acquisitions is one of the most popular topics at our annual conference every year.

Tim Garbinsky, NCEO:

That's interesting. I'd love to actually see more data on that at some point, especially around mergers and acquisitions, because it has been such a sort of growing factor in the ESOP community, even in just the last three to four years. The number of acquisitions I hear about is astonishing, which also just means more ESOP participants. It's a really exciting thing, but also to Loren's point the numbers, then bear it out in ways that might not be obvious. Right. So, thanks for providing that clarity moving forward, we're going to move a little bit from the sort of scene setting. We're going to talk a little bit more about the nitty gritty of ESOP's and answer some of those questions now just around the sort of basics of how an ESOP functions, what happens to an employee's interest in the trust when they leave the company do employee owners get compensation with an exit event? How does, how does that work?

Loren Rodgers, NCEO:

Sure. So from a financial perspective, the ESOP is a retirement benefit. So it is designed for people to withdraw the assets from the ESOP account at retirement. And that is almost always what happens. And it does tend to really benefit employees. People have about 2.5 times as much assets, and if they have an ESOP then in company-sponsored plans, and if they just have a 401k plan and that's not counting that nearly that actually more than half of the US workforce doesn't have any company sponsored retirement plan. So ESOP's are you saw participants are a lot better off financially through retirement plans. They're also better off simply as employees, they've got dramatically lower turnover and turnover is really expensive. Changing jobs is really expensive for employees. You have to start again, you're off the growth path. You probably have some time between jobs.

Loren Rodgers, NCEO:

So there's that cost that also contributes to employee owners, households having about 92% greater household wealth and non-employee owners. And then I'd say, and, and Tim, you see this as we, as we conferences and things, I think employee owners really feel just personally more satisfied, you know work is a bit more interesting when you're working together with everybody at your company and you will all share the benefit. It's not just that I'm working to make my own account better. If I do something that's good for the company, everybody I work with is better off too.

Tim Garbinsky, NCEO:

I would agree with that a hundred percent, you know, the companies I talk to, whether it's from distance or in person at the conference, which feels like a long time ago, but hopefully it won't be so far in the future from now as well. The companies I talk to you're absolutely right, there is a more fulfilling aspect. They feel that sense of ownership, but they also receive a tangible benefit to that sense of ownership. And you really need both to create that sort of fulfillment. I would agree a hundred percent. I want to touch on something you mentioned, which is, you know you related ESOPs to a retirement plan, similar to a 401k. So speaking about that you know, the company pays for the shares, but is there a way for employees to contribute the same way they would to a 401k?

Loren Rodgers, NCEO:

That's a great question. So there are two, well, you can divide this up a few ways, but there are two ways of setting up an ESOP. One is to make a standalone ESOP where it's just a pure ESOP plan. And in that case, no, it's not possible for an employee to make a contribution to it. You can however, make a combined plan, which is both a 401k and an ESOP. That's called a KSOP. If you have a case up, then what a lot of companies do is if an employee makes an employee contribution to the KSOP then the company matches that contribution with company stock. So they, they make a matching contribution into the ESOP part of the KSOP. So that's a way that employees can sort of indirectly contribute to increasing the amount of shares they have. Now ESOP and KSOP combinations are complicated, we've got a whole book about how to do it well, and there are a lot of options and alternatives. I just covered one of them, but there, there are a fair number of our companies, both publicly traded and privately held that, see the combination of an ESOP and a 401k is a really good fit for their workforces and their cultures.

Tim Garbinsky, NCEO:

Gotcha. Gotcha. And just to get to a really basic question that I know is going to be on a lot of companies minds how, how much does it generally cost to really execute an ESOP? How much does it cost to become an ESOP?

Loren Rodgers, NCEO:

Sure. Yeah, so the cost to create an ESOP, the transaction cost of setting up one has a really big range. And I, I'm almost tempted to say you shouldn't even think of an ESOP transaction, but instead think about variety of visa transactions and kind of try to price each one you can do. The cheapest possible transaction is a really simple non leveraged where the company makes contributions from year to year, uses those contributions to buy shares a more complicated one might be where the ESOP borrows a bunch of money and does a bigger transaction, maybe buys 50 or 70 or a hundred percent of the shares all in a single transaction. And then a really complicated one might be where you've got a big transaction that involves more than one source of debt. Like maybe you've got a bank doing some lending, you've got some mezzanine financing.

Loren Rodgers, NCEO:

Maybe you've got a seller note. Maybe you've got more than one buyer. Maybe you've got a complicated ESOP structure, but if you, but we don't have data on each of those types of ESOPs. What I can tell you is that in 2016, we did a survey of transactions of ESOP transactions. And we asked people how much they paid for their ESOPs and in the mid-teens; I think it's fair to say all of the people who responded to our survey, roughly one third of them paid less than $75,000 to set up an ESOP roughly one third of them paid more than $200,000 to set up their ESOP and the other, the third was somewhere in between, of course. So there's a big range in how much an ESOP costs.

Tim Garbinsky, NCEO:

Yeah, no foolin' that is a big range. So, you know, if there's a lesson there it's that there's no such thing as one- size-fits-all, right? So...

Loren Rodgers, NCEO:

That's right. [Both] Yeah.

Tim Garbinsky, NCEO:

And speaking of no size or no, no such thing as one-size-fits-all. There was a question in the chat from our webinar, we did allude to the chance of these things not working out. There was a mention of

United Airlines and sort of what happened there and what lessons may have been learned from what happened at United Airlines. So maybe you can elaborate a little bit on that.

Loren Rodgers, NCEO:

Yeah, sure. United airlines was the biggest most public ESOP ever. It was a 55% of the shares were owned by the heats up. It was a dramatic union-led,transaction, but there was a lot of excitement. They were on the cover of magazines. It was a, it was a really impressive event. And then of course it flamed out people ended up with,the value of their shares in their ESOP account being far less than at the end of the ESOP than it was at the beginning of the ESOP. I'd say there are four takeaways from that. And there are lots more people write about about United Airlines in a really sophisticated way. But for four, maybe four things to highlight one is that it didn't cover everybody. The flight attendant's union was originally part of the ESOP, but as part of putting it together, they opted out.

Loren Rodgers, NCEO:

And that ended up being a really big problem because the flight attendants are often to the people that have the most chance to really affect the customer experience. They're the people you'd really want to have in the ESOP and caring about the fate of the ESOP. So that was one problem. Another big problem was the executive resistance, the top two executives, the CEO and the COO at United airlines were chosen by the union(s) as part in order to be the two chief executives as part of the original transaction. So they were bought in, but the rest of the executive team and at United Airlines, it's an 800 person executive and management team wasn't involved in setting up the ESOP. They weren't particularly excited about it and they didn't feel any real reason to support it. And many of them actively resisted the fulfillment of the ESOP, trying to make it a real thing.

Loren Rodgers, NCEO:

So there was a lot of, a lot of resistance to making a employee ownership all it could be at United Airlines. A third problem was union politics. The the head of the pilot's union; the pilot's union had originally led the effort to create the ESOP but there was a change in leadership. The new leadership of the pilot's union was not that excited about employee ownership focused instead, purely on base compensation for pilots had a very conflictual style. I don't want to place blame on this person. There are lots of motivations for someone who runs a union, but that ended up being bad for employee ownership at United [Airlines]. The fourth thing was 9/11. The attacks of 9/11, September 11th happened that was terrible for the airline industry. It devastated the airline industry, including United Airlines.

Loren Rodgers, NCEO:

And that's something, of course that has nothing to do with employee ownership. And unfortunately, that's one of the lessons too, that employee ownership doesn't inoculate a company from the outside economy. So looking back at all of it, United [Airlines] did a bunch of smart things. There were some flaws in the structure of their plan, but basically when they first put it in place, they had some amazing results. Grievances filed by the union fell by 92% in the first 18 months of the plan. They came up with lots of great ideas to make the company better. Everything was working as it should, and as you'd want it to for the first 18 months. It was only after that, that these four factors kind of stepped in and made things tougher at United.

Tim Garbinsky, NCEO:

Gotcha. I guess if there's another global lesson, it might be that, you know, there's no silver bullet. There's no one thing that's going to work for every company and there's no guarantee that the outside world isn't going to interfere in some way with the best laid plans. Right. And so I think that's one lesson to learn. And then also for what it's worth there are, there are still ESOPs and other airlines Southwest, I believe still has one Cape Air, a smaller airline. It's a really wonderful ESOP company. So, you know, it's, it's, it's specific to a single situation here with United, for sure.

Loren Rodgers, NCEO:

Yeah, that's a, that's a good point, Tim. I think, I think one thing that was so sad for, for you and for me and all the people in the field was that United airlines got so much press that it sort of became associated with employee ownership overall, but most employee ownership is in the, in smaller companies that, that aren't household names. And, you know, there are all these stories of just quiet nondramatic success all over the place. And this one company with all this publicity could undo so much of the good that all these smaller companies were doing.

Tim Garbinsky, NCEO:

Yeah. I think that's another lesson for us in the field, perhaps, but a lesson for people at large, but also, you know, your mileage may vary, but also there's no one, there's no one company that represents all employee ownership can be right. Like we said, at the very beginning ESOP businesses, like any other business are beholden to sort of the general life cycles of the business world. Some persist for a long time, some are born and then die eventually, or what have you. And it's, it's a part of the way businesses run ESOPs are at the end of the day, a business. So I think that's, that's a really good lesson to learn. And also you stop sending isn't or terminating. Isn't always a bad thing, like you had mentioned as well, and that's also just sort of a natural lifecycle of it. So I think not placing undue importance on any one ESOP story is also a really good lesson to learn there. So thank you for providing that color and that background. I think that's important for people to hear can moving a little bit forward to the sort of setting up in the structure behind it, talking a little bit about S-corporations, C-corporations, et cetera, can ESOPs be set up as, as corporations, C corporations. What's the, what sort of in general, the practice there around how ESOP's are then incorporated?

Loren Rodgers, NCEO:

Sure. So ESOPs can be set up in both S-corporations and C-corporations when ESOPs, were first created back in 74, it could, it was just C corporations, but in 1997, a new law was passed. It took effect in '98 that allowedan S-corporation to have an ESOP. And since then there's been a, just a huge, transformation in the field. More and more of our member companies are S-corporations, a number of companies converted from S corporation to an S corporation, ESOP, some C corporations with ESOPs can converted to S-corporations. So, yeah, it's possible to do both there. The tax implications are different for us corporations and C-corporations, but the incentives are pretty powerful for, for both.

Tim Garbinsky, NCEO:

Gotcha. Gotcha. Gotcha. And what about LLCs? What about an LLC is say for instance, taxed as S-corporation, can they do an ESOP?

Loren Rodgers, NCEO:

Yeah. Yeah. That's a good distinction. An LLC cannot do an ESOP unless, it is taxed as an S-corporation, but if it is, there's no barrier to them having an ESOP.

Tim Garbinsky, NCEO:

Okay, Good. All right. So there you have it, there's still the flexibility there. Getting a little bit back to just the nuts and bolts of how it works. So how, how does it, the ESOP get the funds to pay the purchase price?

Speaker 2:

The ESOP gets the funds through company contributions. So the company is always the source of the funds that are used by the ESOP to acquire shares. Always is maybe a little too strong. There are a couple examples here and there of companies using allowing employees to use their 401k assets to purchase here through an ESOP, but in general, in almost every case and almost all shares, it's originally a company contribution that goes to the ESOP. The ESOP uses that contribution to buy shares.

Tim Garbinsky, NCEO:

Understood. Understood. You had mentioned a little earlier about some of the sort of positive aspects of the ESOP and the sort of win-win-win nature of it and about sort of employee turnover. Are there any statistics on how much employee turnover is reduced after the implementation of an ESOP?

Loren Rodgers, NCEO:

Yeah, there are some really compelling ones. The general social survey is a representative sample of the whole US workforce. That gets asked every every four years and it's got a question that asks the people who respond if they're a participant in an ESOP. So they were able to look at a whole bunch of different variables. And one of the most amazing outcomes was, was what you just raised him about turnover. So if you look depending on the year, they'd done it a whole bunch of years. Now, the employee turnover in ESOP companies is between one sixth and one fourth, as much as for non-employee owners. So I don't mean a reduction of one sixth. I mean, it's literally one sixth, as many people who are employee owners experienced turnover compared to people who are not employee owners.

Tim Garbinsky, NCEO:

That's pretty drastic. What, what specifically occurs at ESOPs that sort of has that impact? Like what, what can a company do to reduce their turnover?

Loren Rodgers, NCEO:

You know, an ESOP CEO one time said to me that, you know, I, when I'm, when I'm looking at the workforce, trying to figure out how we invest, what kinds of things we do, he was thinking specifically about a wellness program in this case, but he said, you know, those are my shareholders. So I think whether it's companies that are, that begin companies and leaders that start with a different conception of how, what the responsibility of companies is to their workforce, or whether the ESOP changes their perception of, of the role and the importance of employees in the company, either way, ESOP companies tend to weigh employee interest, benefit, and the reduction of turnover specifically more highly than people in other companies.

Tim Garbinsky, NCEO:

Gotcha. Gotcha. We had a question in the chat that was specifically from a company that has high turnover, they were wondering what they can do. So what, what sort of things are they able to do with regards to investing or things in that, in that sort of realm?

Loren Rodgers, NCEO:

Sure. Yeah. Vesting is a great example. You've got flexibility about how investing works. So a number of companies choose to have a vesting schedule. That means people who leave get either less orwell forfeit some of their ESOP accounts. So they need to stay for three years or six years, depending on the vesting schedule to get all of the the value in their ESOP account. The other.. So vesting is one thing. The longer people stay in an ESOP, the more allocations they get into their, into their ESOP accounts, they'll get an allocation every year that they remain an employee. So the longer they stay, the more they benefit and those are dollars and cents things. Some things that companies do is they do a very focused job of education trying to explain to people, you know, they, they might be business literacy or financial planning education, and then that helps people understand how the ESOP fits into their own personal financial planning, you know, their own retirement planning.

Loren Rodgers, NCEO:

For example, another thing companies do is, is really focused on the culture. You know, you've probably heard that saying that people don't quit a company, they quit a boss. So a lot of the ownership culture comes from building a company where people the whole organizational structure is more aligned around making work, fulfilling, giving people good reasons to stay. That's sort of the real soft-touch side of, of making a company, a good place to work. And we've both seen this in all the companies that do really creative things and business literacy and involvement, programs, and celebrations, and all sorts of things to really build a sense of a family.

Tim Garbinsky, NCEO:

Yeah, that's, that's true. We see that all the time that they go above and beyond the cultural aspect. And I think you're right, that it's sort of combining that intangible, perhaps cultural aspect with the very tangible, you know, realizing the value of your ESOP account over time and knowing that it's going to grow over time with all that you put in then effort wise, that is to say really does have that tangible turnover benefit for ESOPs. Speaking a little bit about, you know, realizing the value in, you know, growing or expanding companies you would imagine that the valuation is going to increase year to year. So how does the change in value of the business impact the ESOP specifically?

Loren Rodgers, NCEO:

Sure. So the most obvious way is that when the value of a share of stock increases the value of well, every share of stock increases. So that means every employee that has an ESOP account has the value of that account go up. Great thing. Everybody's happy about that. It makes it makes for easier conversations around the dinner table, as they say. The other thing it does is it increases how much the company is going to need to pay, to buy back those shares when employees leave the company when they retire. So that is something it's called the repurchase obligation. And it's something that ESOP companies spend a fair amount of time planning around. They they spend time making projections of their repurchase obligation, figuring out how to make sure they're ready to cover the repurchase obligation. There are lots of ways to do it.

Loren Rodgers, NCEO:

And we have sessions at every conference. We often have webinars specifically about the repurchase obligation and what steps companies have available to them to to make sure it all works well. One other thought on that you know, one of the premises of the question is that the stock is going to increase from year to year. And hopefully that's true. A lot of our member companies didn't have that experience this year. They've seen their values decrease, and it it's a good exercise for companies to get ahead of that and make sure that people understand that stock goes up on average more than any other type of asset, partly because it is risky. And it can go down too. It's good for companies to be upfront about that so that employees understand and are caught off guard if there is a year where the stock price goes down.

Tim Garbinsky, NCEO:

Yeah. I think that's something a lot of companies are giving a lot of thought to now and have been recent years even before this downturn, thankfully, but just exactly how you communicate the implications of one's ownership in the ESOPand what it means to see a dip or what it means to see it rise. I think setting those expectations, being clear and making sure you're communicating about those things goes a really long way as we've seen with a lot of the companies we work with. Our next question, switches gears a little bit. And it's about it's a little bit about the flexibility of who's in the ESOP. So does the ESOP have to include part-time employees for example, or even freelance workers or who aside from full-time workers is involved in an ESOP or how is it determined who is actually in the ESOP?

Loren Rodgers, NCEO:

Yeah, good question. So contractors are not in the ESOP in terms of part-time the law that governs ESOP says that everybody who works a thousand hours during a plan year and meets other eligibility requirements needs to be a participant in the ESOP. Those other eligibility requirements are having been employed a full calendar year and being age 21 or higher. A thousand hours is just shy of half-time. So anybody who works half-time or more in a calendar year needs to be an ESOP participant. They need to be in the plan. They have people also need to meet that thousand hour requirement every year in the future in order to get an allocation of shares into their account for that year. So now that thousand hours is the highest threshold that companies can have and many of our member companies have lowered that threshold.

Loren Rodgers, NCEO:

They've said anybody who works 800 hours or 600 hours is going to be a participant in our ESOP. That's the opposite of the direction the person who asked the question wants to go, but we've had a number of companies that have people like McKay Nurseries as people come by every season to work in the tree nurseries. And they don't get to a thousand hours because they're only there for part of the year, but they do come back year after year after year and McKay wants those people in their ESOP. So they lowered the thousand hours to get more people involved.

Tim Garbinsky, NCEO:

Interesting, interesting. So hopefully that clears that up for anyone with the questions around eligibility, between part-time and full-time there are few more questions we're going to tackle here in no particular ranking or priority or order. So forgive the, the occasionally slapdash nature of some of these questions. This next one is just a little bit about the different types of employee ownership. So there was a question, a little bit about, you know, worker cooperatives and what they are compared to an ESOP. How are they structurally different from an ESOP?

Loren Rodgers, NCEO:

Sure.

Loren Rodgers, NCEO:

So they are different in, on several different dimensions, a worker cooperative is defined by each state. So every state has its own legal definition of what constitutes a worker co-op. Some states don't have a definition, so they, people can call themselves a worker co-op even if they don't meet any particular objective definition. But there, there is a federal definition that applies for a few tax reasons, but basically worker cooperatives are defined by each state. An ESOP is purely a federal creation. So it's clearly in solely designed by, by federal retirement law, the employee retirement income security act an ESOP itself. Is a retirement plan, whereas a worker co-op is a form of organizational structure. So that's, that's one difference. There are the kind of different types of things that you can be an ESOP-owned company, or you can be a worker cooperative.

Loren Rodgers, NCEO:

Another difference is that a worker cooperative is by definition and every place that exists, it is a democratically run organization. So everybody who's a member of a worker cooperative has a one person, one vote influence on the direction of that worker cooperative. An ESOP is indirect ownership. The trust owns shares and the participants in the trust can vote those shares. So if I have half as many shares as, as you do, then I get half as many votes on any voting issues as, as, as you would. So that's one big difference. That's the second big difference. A worker cooperative needs to have needs to be non-discriminatory in who becomes a member of the worker cooperative. And that's actually a similarity an ESOP can't have any form of of discrimination either, just the same way that no company in the United States can have any discriminatory hiring policies.

Tim Garbinsky, NCEO:

Gotcha. You mentioned a little bit you mentioned briefly the sort of direction of the company voting shares and what have you and that in a worker cooperative it's one share one vote. So it's the answer in that respect, it's a simpler structure. And there was some confusion And this is a common misconception about how then is the board formed? How is, how, how is the governance then? How does that take place in an ESOP? So for example many companies, when they sell to an ESOP, the selling-owner still sits on the board. So even if you sell a hundred percent of your shares, it's possible for the former owner to be on the board, but is that a requirement? How does that, how does that typically play out? How does that work?

Loren Rodgers, NCEO:

Yeah, yeah. Good question. And it is it is a complicated answer. So this we'll talk about it briefly here, but this is something that people may want to dig into a little bit more for their own, their own situations. But the short version is that a sale is a sale. If Bob owns a business, Bob sells to an ESOP, the ESOP is now the owner and Bob no longer is. And the ESOP, as the shareholder, is the ultimate controller of the business. The ESOP as that shareholder is legally bound by, by federal law, to operate in the interest of plan participants. Now that means in their interest as plan participants, it doesn't mean that it needs to think about their good as, as an employee or a person. It needs to think about their good as someone who holds an account, a retirement account in the company.

Loren Rodgers, NCEO:

So the ESOP can't take any other interest into account, but the ESOP does aim to be, to not to second guess the company ESOP trustees do their best, not to intervene and a company needs to behave fairly egregiously before the ESOP has an obligation to step in. If the CEO of the company is pulling out all of the company's profit as a bonus, that's egregious, the trustee has an obligation to step in. One thing that many trustees do is they insist that when the ESOP is put in place, the company bring on outside directors, non-employee directors onto the board, and those directors like all directors, when they're wearing their board of directors, have a, their, legal obligation is to the shareholders in this case to the ESOP. So the directors the standard of their performance is acting in the interest of the shareholder of the ESOP. Now that said, the directors are protected by the business judgment rule, which means that the shareholders, the courts give a lot of deference to the best judgment of the of the directors. And they rarely intervene in how the company works.

Tim Garbinsky, NCEO:

Understood. Understood. So, yeah, like Loen just said, though, that's a very big topic that's worth diving into if you're considering a new ESOP. We're of course, happy to answer questions and have more conversations about that one as we are about all these other topics, for what it's worth, but definitely definitely worth doing your due diligence on all of these things. So we've talked about a lot of different topics here a wide variety of sort of implications of what it means to be an e-stop or how to become an ESOP or what to expect when you're in ESOP. So how could somebody who wants to encourage somebody to be an ESOP, say a business coach or an exit planner or whatever, how can they best present the ESOP idea to their clients and then also best match their clients with the right ESOP advisors?

Loren Rodgers, NCEO:

Hmm, good. You know, Tim, I think I expect, you've seen the same thing I have, which is that a lot of people who know ESOP who like to encourage companies to do ESOPs, they love what they do. And they often lead with kind of the technical details and the tax implications and the different structures that are possible. And I don't think that's the right way to approach somebody who's considering an ESOP. I think what we've seen be a lot more effective is to start with motivation, help people understand if an ESOP is something they want, if they want their company to be employee owned, if they want their employees to own their business after they do. And the best way to do that isstories. And the best person to tell this story is not an advisor or a business coach.

Loren Rodgers, NCEO:

It's a peer it's somebody else who owned a business and made a decision about how they were going to exit that business. It would be somebody like Ashleigh Walters. And I think if we start there and all the other stuff falls into place, if somebody is not motivated and they shouldn't pursue all the other stuff, if they are motivated, they'll figure everything else. The other question that that person asked is how do you connect the people with talented business advisers? And we at the NCEO have a service provider directory, which is a great way to get connected with service providers. These are people who invest in the field and are really engaged in making sure they know their stuff. Another good approach is to come to a conference, or speak to webinar presenters or come to the Fall Forum. And then you can talk to people and have a conversation to decide who feels like a good fit as a possible advisor.

Tim Garbinsky, NCEO:

Yeah. 100% agree with you, especially on that first point. You're absolutely right. That leading with what your expertise might be depends on what your expertise is. Right. So if you're very good at the valuation stuff, it's important to know, but it's not necessarily the strongest selling point. And I'd say, I don't want to say a hundred percent because I don't want to be an absolutist, but almost everybody who sells to an

ESOP, the common denominator is that they, they want their employees to own their business. They see a sort of larger narrative to it, and they want to do something beyond themselves, whether it's for their legacy, whether it's for their workforce, whatever it might be.

Loren Rodgers, NCEO:

Yeah. And you have a lot of those conversations, Tim. I mean, I think that it's been great to see you gather all these first-person narratives and the videos you're working on. I think that's a great way to make sure that people can, can see a real peer of theirs when they're thinking about an ESOP.

Tim Garbinsky, NCEO:

Exactly. It's really, you know, you got to learn from the mouth of somebody who's done it. That first-person experience really, you know, goes very far in trying to communicate what we want these business owners to understand which has the implications for their real life. You know, we don't live that real life. We help them to do it. But we know the business owners who haven't done it and we're happy to put people in contact as well. So yeah, thank you. Thank you for providing that, that extra info there, especially about the service provider directory as well. So once you get to stage of trying to link people up, we of course have that resource, but you know, just integrating yourself into the community and sort of getting a feel for who's out there, what they specialize in, what they're, you know, what sort of companies they work with, all of that comes with just, you know, becoming familiar with the employee ownership community. So I think those are both, you know, spot on pieces of advice. Another somewhat non-sequitur questionabout just setting up an ESOP which is how, how long does it take to set one up? Like what's the average duration you would say to set up an ESOP?

Loren Rodgers, NCEO:

Well, we have we have data, the transaction survey that we talked about before, it says that the average time to set up an ESOP from the decision to do it. And when somebody does a feasibility study until the time all the paperwork is signed is on average six months. If you look at the 25th percentile to the 75th percentile, then the range is four to nine months. We've seen companies take a year and we often see companies take a really broad amount of time between when they first start thinking about an ESOP until they actually do. I know we had a company call the other day that said, I heard one of you speak 10 years ago, and now we're ready to start thinking about it.

Tim Garbinsky, NCEO:

Yeah. Well, just like we said before, with the cost it's, there's no one size fits all and that holds true here as well. So again, as always, your mileage may vary, but there's flexibility in there of course is what that also means. Speaking of flexibility what is, I don't know if we, we have to touch on this, but what is the minimum percentage of share required to be sold to the ESOP? How much, how much to sell to an ESOP before you're actually considered an ESOP? Like, what does that look like?

Loren Rodgers, NCEO:

It's 0% actually. As odd as that may sound? Companies can put just cash into the ESOP and have that cash sit in the ESOP for sometime, some years. Generally up to five years is okay. So once the, once the ESOP once it has cash, it needs to eventually buy shares. But we do have a fair number of member companies that have 0% of their shares in their ESOP. I guess the, the more real answer is that a lot of companies have very small percentages in their ESOPs. You mentioned Cape air earlier, Tim, and they've got a business model where they maintain a minority of shares inside the ESOP. Although it goes up or down publicly traded companies could have half a percent of their shares in their ESOPand just maintain that minimal level for years and years and years. And then the most common percentage of shares owned by an ESOP trust is a hundred percent and it has been ever since that S-corporation ESOP law was passed.

Tim Garbinsky, NCEO:

Gotcha. And then I believe if I'm not mistaken for the C-corporation benefits to be realized you have to sell a specific amount as well to the ESOP, is that right?

Loren Rodgers, NCEO:

That's right. For the C-corporation benefits, which is a deferral of capital gains tax, the ESOP has to own at least 30% of the shares after the transaction. So you could sell 25% of the shares and not get any deferral of capital gains. Then next, if you sell 5% or 6% of the shares, you would get the capital gains deferral on that because the ESOP would own 30% after your second transaction.

Tim Garbinsky, NCEO:

Gotcha. Yeah. I wanted to touch on that just because I very often, as I'm sort of looking in the news about new, ESOP's see that they've sold around 30% to start. And I think that plays a big factor there that sort of cap gains deferral. So one more question. It's a little bit of a specific one, but I think it's worth touching on here. This is of course from one of our attendees, New York state restricts professional companies, which is to say doctors or lawyers or veterinarians, et cetera. So it restricts professional companies ownership to the licensed professionals themselves. So only the doctors only the lawyers would have. How does that impact an ESOP in New York or other States with the same laws?

Loren Rodgers, NCEO:

Yeah, thanks. This was probably going to be the least satisfying answer of the of the, of our whole conversation here, Tim. Unfortunately it does vary from state to state and it varies from profession to profession. I can tell you, we have a lot of dental practices that have ESOPs. We've got CPA firms, which are often subject to the same requirements of professional company ownership and architects that do have ESOPs. I can tell you that there was a recent Connecticut law that passed just two years ago to allow architects and other firms that are subject to the professional licensing requirements to have an ESOPs. So unfortunately the answer to that is it's going to depend on your state and your profession. It is possible in many States for many professions, and it often involves setting up two separate companies. There may be one company that has the ESOP and then a second company where all the professionals are, are employed and then how you structure that you'll needa lawyer familiar with this to make that happen. Right.

Tim Garbinsky, NCEO:

Gotcha. And we had a question come in in the chat just now. So I'll go ahead and put that to you real quick, Loren, which is how long does it take when the paperwork starts? So once the paperwork starts rolling. So, you know, not somebody who's thought about it for 10 years and then calls us, but somebody who's like, all right, got my lawyer. I've got my team going. Here we go. How long does the process then take to get to an ESOP? And that of course, I know it's flexible, but just a little more color there.

Loren Rodgers, NCEO:

Yeah. Good. Thanks for asking that, Tim, that that actually is the six months, it does take a fair amount of time from hiring the first professional to having the paperwork signed. And that's partly because there are a bunch of steps in the process. Most companies need to have a pretty thorough review of their books. Maybe they've already had an audit and they don't need it, but they may need to have some review of their books. Then it'll take some time to get the valuation done after that. And when the valuation is done, there's still a bunch of work that needs to be done to figure out the terms of the deal and the structure of the deal. And then there's also all the work to set up all of the administration, how each employee will interact with the plan. So that six months is actually the time from when it starts until the deal is done.

Tim Garbinsky, NCEO:

Understood. All right. Well, thank you for providing that extra color there. That actually puts us right here at time. So I believe that will do it for us. Just want to thank you again, Loren, for your time today for providing your expertise on these answers. I know that, you know, again, with another hour, there's so many more questions and answers that we could've gone over, but I think this will have to do for now. To our attendees or anybody who ends up watching this later on down the line as always, we are very happy to have your questions come to us anyway. So if you have any questions, you can email us, we'll make sure you have our email addresses. You can always give us a call. We're happy to chat and help you sort of navigate any uncertainty or any other questions you might be dealing with.

Tim Garbinsky, NCEO:

And of course we have other resources on the website, I believe by now. Some of you watching this we'll have our ESOP essentials, so you will have quite a few things to read and watch on our website, quite a course there available to you. But, if that leaves you with more questions as it like we should, we're happy to help direct you there as well. So again, thank you so much for joining us today. We wish you much luck on your journey to employee ownership and hope we can be helpful as you move down that path. So thank you.

Loren Rodgers, NCEO:

Thank you.