ESOP CASE STUDY

S&C Electric Company

Based in Chicago, S&C Electric Company is an employee-owned, global provider of equipment and services for the electric power industry. S&C was founded in 1911 by Nicholas Conrad, who coinvented the first high-voltage power fuse. The company now has annual sales over $500 million, operates in six countries, and has 2,500 employees worldwide. The ESOP currently owns 75% of the company.

Private ownership has been a cornerstone of S&C throughout the company's 100-year history. Prior to his death, founder Nicholas Conrad put his stock into a generation-skipping, tax-skipping trust. His son, John Conrad, took over the business shortly after World War II ended. Under the aforementioned trust, John Conrad was able to vote the shares and retain dividend income, but he could not transfer the shares. He anticipated that his daughters, who would eventually own the shares following his death, would not be interested in running the business. Hoping to keep the company private, he began to plan an ownership transition, preferably one that involved employee ownership.

In 1989 the company decided to create a 401(k) plan. The plan used cash contributions from the company to purchase stock from the trust, providing the Conrad daughters with liquidity. The plan ended up owning 17% of S&C. The company hoped to continue this arrangement after John Conrad's death.

However, upon inheriting the additional shares, all daughters sought to sell the shares immediately. One daughter shared her father's vision for maintaining private ownership and chose to sell her shares to the company for the most recent valuation price. The other daughters held out for a control price (even though they did not have control) and threatened to bring in an unwanted buyer. The company's future was at a crossroads.

The solution was an ESOP. The company offered to establish an ESOP that would allow the remaining daughters to use §1042 to avoid seller taxes. The potential savings bridged the valuation gap between the sellers and the company. Thus, the company began its leveraged ESOP in 2007.

Designing the KSOP

When the ESOP was formed, S&C already had a generous retirement package including a defined benefit pension plan and a defined contribution 401(k) plan. A third retirement fund was not an option. The company put together a task force to design the new retirement plan. The task force, with help from consultants and lawyers, decided to merge the leveraged ESOP into the existing 401(k) plan, forming a KSOP and simultaneously freezing the pension plan. The goal of the new plan was to maintain similar retirement benefits for long-service employees and still be attractive to younger and future employees, all at an affordable cost.

To accomplish these goals, the company developed a contribution plan including transition contributions, core contributions, matching contributions, and discretionary contributions. The transition contributions varied based on age and length of service and provided continuity for older employees with substantial service. The core contributions are 3% of annual pay across the board. The matching contribution remained the same as the 401(k) plan, at 50% of an employee's contribution up to 6%. The provision for discretionary contributions also carried over from the previous plan and such contributions are made at the board's discretion, based on company profitability.

In order to inform employees about the new plan, S&C developed a multifaceted communication strategy, which included:

- A KSOP plan highlights brochure.
- Monthly KSOP newsletters, each with an in-depth discussion of a key aspect of the KSOP.
- Over 70 employee meetings facilitated by the director of financial services and director of employee benefits, each lasting 1.5 hours with approximately 25 employees of similar age and tenure.

When the KSOP was finally announced, the employees were familiar with the plan, understood why the company froze the pensions, and recognized it was part of a larger transition strategy to preserve jobs and pensions.

Getting the Most Out of the KSOP

The company now works to get the most out of its ESOP by treating its employees like owners. Its technique is simple: "communication, communication, communication." S&C communicates with its employee-owners through various means on a variety of business topics. Communication is embedded in the company culture with events such as:

- Annual updates from the CEO (in person or via video conference) to discuss company results, future plans, and strategic objectives.
- "Town hall meetings" with the CEO and other key leaders, where employee-owners can ask questions about the company, industry developments, employee ownership, or other topics.
- "KSOP days" to educate employees and encourage participation in the 401(k) part of the plan.

In 2009, the company initiated a formal, continuous improvement process called the S&C Lean Performance System. The process requires universal commitment and participation by employees to learn and implement lean manufacturing techniques. The stock price has more than doubled since the ESOP purchase transaction in 2007.