OWNERSHIP **TRANSITIONS**

Selling to an ESOP Versus a Sale to Another Company

The table below compares what issues come up in the sale of a company to an ESOP compared to a sale to a third party. It was prepared with the advice of professionals who have done both kinds of transactions. The table indicates that the overall level of complexity is similar, but ESOPs are much less risky in terms of the likelihood of finding a buyer. They are also considerably less costly, mostly because in the case of a sale to a third party, in addition to substantial legal, accounting, and sometimes other fees, the price paid to the seller is usually reduced by brokerage commissions paid by the buyer.

	ESOP	Sale to Another Company
Key legal documents	• ESOP plan document • Trust agreement • Lender agreements • Corporate resolutions • Stock purchase agreements • Corporate governance agreements • Employee contracts/management incentives	• Detailed selling memorandum • Sale agreement (similar to stock purchase) • Non-compete agreements (often) • Liens, escrow, security agreement, and personal guarantees • Corporate resolutions • Employee contracts/management incentives
Feasibility studies and preparation	Feasibility studies assess whether the company has sufficient payroll and cash flow to buy the desired amount of stock. Can be performed internally or with expert advice. Forensic due diligence rarely needed.	Companies must prepare a detailed and accurate description of the firm and its finances, prospects, and risks. Buyers will want to do a forensic due diligence investigation, and sellers should do the same to assess the financial soundness of the buyer and the terms of the offer.
Valuation	Outside appraisal required; valuation based on fair market value.	In smaller deals, outside appraisal not required but recommended; in larger deals price usually set by controlled auction.
Terms and risks	Plans can be structured in a variety of ways: • Flexibility in financing. • Rules for operating the plan must comply with ERISA, but there is lots of flexibility in design. • Escrow may be, but usually is not, required.	Buyers will typically have multiple contingencies: • Earn-outs often required, often in the 10% to 20% range. • Escrow held back. • Purchase price adjustments in companies that underperform post-transaction may be required, based on working capital or earnings requirements. • Buyers prefer to purchase assets, with potential tax and liability implications for sellers. • Financing may fall through.
Time to sell	Once the seller has decided on doing an ESOP and its basic structure, four to six months.	Median formal offer to sale time is 10 months for companies in the small to mid-market range.
Role of seller post-transaction	Flexible, depending on seller interests.	Buyer will usually determine role in smaller deals; in large deals, role is usually negotiable.
Sale of minority interest	ESOPs can buy any percentage of stock from any number of sellers.	Buyers almost invariably want to buy the entire company.
Success rates	If an ESOP is determined to be feasible, only rarely do transactions fall through once a decision to proceed has been made.	Overall, only about 25% of privately held businesses put up for sale are sold, and only about 50% of businesses with 100 or more employees are sold.
Transaction costs	• For most closely held companies, between $60,000 and $100,000, with a minority in the $100,000 to $200,000 range. • A small number of ESOPs will require investment banking assistance to raise financing, adding to costs. • No broker fees should ever be paid in an ESOP. • The ESOP pays the diligence, financing, and legal fees.	• Legal costs may be somewhat lower. • Feasibility and due diligence comparable to or higher than ESOPs, and considerably higher in larger deals. • Legal costs are similar for smaller sales and much higher for large sales. Appraisal costs, if needed, would be similar. • The buyer usually pays the diligence, financing, and legal fees. Broker success fees are generally between 5% and 12% of the sale price in sale prices under $5 million and drop as low as 1%–3% in larger transactions.

NCEO The National Center for Employee Ownership

The National Center for Employee Ownership (NCEO) is a nonprofit membership and information organization. Visit **www.nceo.org** for details on the NCEO and its resources, including publications like *Selling Your Business to an ESOP*.