Trends in Employee Ownership: Important Demographic Developments

*As the baby boom approaches retirement, prospects for employee ownership are ramping up*

By Martin Staubus

Just a few decades ago, company-stock ownership plans were limited to only the most senior levels of corporate management. Today, thousands of American companies of all sizes have established stock-ownership programs that extend far more broadly, often reaching virtually every level of the workforce.

The types of programs through which these firms are making stock ownership available vary from company to company. Public companies make wide use of qualified employee-stock purchase plans, which give every employee the opportunity to purchase company stock through a payroll deduction system, typically at a discounted price. Small technology firms almost universally offer stock options or other equity compensation vehicles that give most of their employees a stake in the value of the business.

In terms of both numbers of participants and the dollar value of the ownership held by employees however, the most significant program of employee ownership is the Employee Stock Ownership Plan (ESOP). While it is difficult to get an exact count, the best estimates are that there are now more than 11,500 such programs involving nearly 14 million employees, who as a group hold almost $1 trillion in company stock. Prospects for the future of ESOPs then – especially their rate of new formation – will have much to say about the rate of growth that we can expect to see in employee ownership as a whole.

One last bit of background. ESOPs, it's clear, are different in a key way from other employee stock program vehicles. Yes, like all the other employee stock program vehicles, ESOPs deliver equity-ownership interests to the participating employees, creating an incentive for those participants to help their company prosper. But uniquely, ESOPs offer something more. Because of their ability to finance the purchase of company stock through commercial borrowing, combined with major tax subsidies that reduce the after-tax cost of such borrowing, ESOPs also offer an attractive source of liquidity to shareholders of privately held businesses. Indeed, it is this feature of ESOPs that experts agree accounts for the existence of the majority of today's ESOPs.

**The Baby Boom Retires**

That's why fundamental demographic trends are so significant. The best estimates are that there are 78 million baby boomers in the U.S. (people born between 1946 and 1964). The oldest of this demographic bulge are now in their 60s. About 8,000 Americans turn 60 each day, and that number is growing. In short, baby boomer retirement is rising.

These individuals, well along in life and career, have amassed over $13 trillion in assets – about 50 percent of the total held by all Americans. And a good portion of those assets takes the form of privately held businesses. According to the U.S. Census Bureau, there are approximately 6 million businesses with employees. More than half of these businesses are owned by boomers – who will want to unload those firms as they retire.

The Federal Reserve estimates that in 2008 – the first year that the oldest baby boomers officially hit 62 - nearly 500,000 of these businesses were put up for sale. In the next few years, predicts Kiplinger Business Resource Center, the annual rate of firms put on the market will rise to 750,000. Others estimate as many as half of privately held companies in the U.S. will change hands between 2011 and 2020.

In short, a staggering number of private-company owners will be looking for liquidity over the next 10 to 15 years. As a result, ESOPs will begin to show up on the radar screens of many of these owners and their professional advisers. Of course, for a variety of reasons, many of these firms will not be good candidates for an ESOP. They may simply be too small or the owner may play an essential, irreplaceable role in the business, leaving it non-viable once the owner has exited. Still experts estimate that in the next few years there will be 150,000 to 300,000 businesses that baby boom owners may want to liquidate and that are very well-suited for the ESOP-based exit strategy.

Of course, plenty of businesses that were excellent candidates for an ESOP have been liquidated in recent years by owners who chose other routes for their exits. Is there any reason to think that the ESOP exit strategy will gain new-found popularity? Analysts in the middle-market investment-banking field have been studying the prospects for retiring boomer business sales, offering predictions on what can be expected. They all seem to be raising the same alarm: if their projections for businesses coming on the market in the next several years prove true, this surge may cause the market to become glutted, with the supply of businesses being offered for sale far exceeding the appetite of conventional business buyers. Just as the maturation of the boomer generation will place unprecedented strain on areas like social security and health funding, so the boomer business transition bulge will seriously strain, and possibly overwhelm, the available supply of buyers.

For this reason and others, boomer business owners may see considerable advantage in the flexibility that ESOPs offer – especially the ability to sell just a portion of their ownership to the employees, holding on to the balance until they choose to initiate another sale. This feature will allow owners to diversify their wealth, as every financial adviser recommends, while retaining a stake in the firm that he can liquidate at a later time when conditions are favorable. Indeed, advisers are recommending that owners start the liquidation process sooner rather than later, taking some value off the table before the predicted glut truly hits the market.

In sum, the surge in boomer business owners hitting retirement is getting started even now. For these folks, an ESOP is likely to prove an attractive solution. As we say on the beaches of San Diego, “catch the wave!”

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