

The Value of ESOPs in Engineering Firms

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While all kinds of businesses become employee stock ownership plan (ESOP) companies, there is a large percentage of engineering firms that have chosen the ESOP structure. Why so?

Why ESOPs fit so well in engineering firms

Like many privately held companies, engineering firms struggle with an optimal long-term succession plan. The founders of most engineering firms worked hard and took risks early on to build their successful businesses. Many owners also appreciate the hard work that their employees have contributed over the years. While many owners would like to sell the business to their employees, most employees do not have the wealth built up to buy the business directly. Implementing an ESOP offers indirect employee ownership while allowing the founders a flexible mechanism to ease out of the business over time.

Think about the typical engineer - hard working, Type A, smart, ethical, loyal, and they like to build things. Founders of engineering firms like their work so much that they have a hard time retiring cold turkey, which is what they typically have to do if they sell the firm to a competitor. With an ESOP, owners can arrange a staged exit on their own timetable. Engineers are also exact and often find the design and set-up of an ESOP intriguing – the plan design, valuation analysis, administration, and repurchase obligation planning. Many owners are loyal to their employees who helped them grow the business into a successful organization. Engineering firms are used to designing and building things, so "building" an ESOP is just another project they are not afraid to tackle.

Engineering firms are unique in that their most valuable resource is their employees. If firms don't keep their employees motivated with competitive benefits, employees leave. An ESOP can be a valuable long-time benefit to employees keeping them at the firm. ESOPs can also work well in engineering firms without significant hard assets. However, banks usually demand collateral for an ESOP acquisition loan. To avoid this complication, selling owners can provide a personal guarantee to the bank consisting solely of a pledge of their qualified replacement

property. This pledge is usually a necessary evil, but most owners don't want to totally disappear overnight. Plus most ESOP companies are strong with healthy cash flow and can take on leveraged responsibilities easily.

Case studies

KCI Technologies is a 100-percent employee-owned engineering, consulting and construction firm headquartered in Baltimore, Md. KCI serves clients nationwide with multi-disciplined service offerings for federal, state and local government agencies, as well as institutional and private-sector clients. KCI's revenue increase of more than 150 percent since 1994 is a tribute to the hard work and technical expertise of more than 900 dedicated employee owners.

KCI is ranked in the 2009 National Center for Employee Ownership's Top 100: America's Largest Majority Employee-Owned Companies. Fifteen percent of the companies in this group are engineering firms. KCI also is ranked among the top 100 hottest firms in the nation based on revenue growth by ZweigWhite, a national management advisor for engineering, architectural and environmental consulting firms.

According to KCI Chief Financial Officer Don McConnell, "The value of KCI has grown ten-fold since 1997. While KCI's reputation has always been good, it is even better today and a lot of our success is attributable to our ESOP. KCI had done well in an ESOP environment – we work better together, very open book, we hold town meetings every month and our collaborative spirit has helped us grow." McConnell went on to say that the leadership of their CEO, Terry Neimeyer, also has been a key to KCI's growth. Leaders cannot change the world by themselves but at KCI each employee is moved to work hard and is proud of their contributions.

Another successful engineering firm just up I-95 in Philadelphia has been an ESOP since 2001. Urban Engineers, Inc. provides planning, design and construction management services for highways, transit, bridges and airports. Urban Engineers is regularly selected as one of the 100 best places to work in Pennsylvania and their culture and customer commitment is admirable. The firm was founded in 1960 and enhanced by a new generation of ownership that has enabled the firm to grow and exceed client expectations.

Ron Swerdon, vice president of Finance has overseen the impact of the Urban Engineers ESOP first hand. "A lot of engineering firms have traditional ownership structures early on, but an ESOP is the best option for them," said Swerdon. "Engineers are very deliberate and scientific. They like process and tend to want to make things right. The ESOP is usually a legitimate, long-term succession planning solution. The engineering world is a close group and engineers are accustomed to collaborating with each other. Engineers are used to working in teams where everyone is working for the same goal. This team mentality fits nicely with the ESOP structure where committees are formed and working hard for the success of the firm is rewarded financially. Recently, our ESOP Committee held an offsite retreat and used Beyster Institute case studies to frame their discussion. These case studies really helped us and gave us great ideas and lessons to make us a better employee-owned firm."

Another ESOP company formed in 2008 is The Lane Group, Inc. of Big Stone Gap, Va. The

Lane Group is a small business providing engineering, architecture, environmental, and consulting services to clients in the Mid-Atlantic and Southeast U.S. Established in 1996, the firm supports municipal governments, state agencies, and private sector clients providing planning, design, resident project representation, and construction administration for diverse community-based projects. President, CEO, and founder Bobby Lane has already seen increased motivation since the ESOP implementation. "At the beginning there was a little bit of employee skepticism, but now employees see the ESOP is a good deal for them and they seem more motivated to grow the business." In fact, Lane said, "a few employees have made a point to stop by his office and say thanks for adding the ESOP. The ESOP was an opportunity for me to get some value out of the business while remaining in control over who will ultimately own the company." Lane has a great deal of respect for his employees and understands that like any engineering firm, the talented employees are their most valuable asset. The ESOP helps keep them at the firm and reward them long-term. Lane also remarked that, "when you get to retirement age, succession planning alternatives are limited, so letting your trusted employees take indirect ownership of the firm is great."

Final thoughts

Like any business, engineering firms face problems in putting together a good organizational structure. Bureaucracy, morale problems, political in-fighting, lack of customer focus, weak strategy, and slow innovation can and do exist in many professional service firms. Generally, if too much management time is spent resolving internal problems, the firm has structural issues. An ESOP won't cure these ills overnight, but the healthy corporate culture and teamwork apparent in most ESOP companies is not a coincidence. Engineers appreciate process and clear accountabilities. An ESOP helps empower employees to become more entrepreneurial in their day-to-day work, more creative in satisfying customer needs efficiently and encourages winning results.

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