Three ESOP Myths, Debunked

By Camille Kerr

Myth #1: ESOPs are too risky for employees

One argument against employee stock ownership plans (ESOP) is that they invest primarily in a single asset, company stock, which puts too many eggs in one basket. That argument makes sense in theory, but in practice it does not apply to the vast majority of ESOPs for three reasons. First, ESOPs do not pose any financial risk to employees; in general, they are fully funded by the company. There is no employee contribution to lose, only a benefit to gain if the company does well. Second, employee-owned companies are more likely than traditional companies to have a 401(k) plan in addition to the ESOP. As a result, employees at ESOP companies have 2.5 times more in their retirement accounts on average than employees at non-ESOP companies. Lastly, while ESOPs are designed to invest primarily in employer stock, they provide for some diversification. Participants approaching retirement age (and meeting tenure requirements) must be given the option to diversify a percentage of stock held in their accounts, and ESOPs often have assets besides employer stock in the plan.

Myth #2: ESOPs are more likely to fail than traditional companies

There is a misconception that employee-owned companies have a higher failure rate than traditional companies. One reason that this myth exists is the handful of highly publicized examples where ESOP companies went bankrupt, such as the Tribune Company or United Airlines. We once heard an employee owner say, “ESOPs just have a harder time succeeding. Over 90 percent of them fail.” In fact, the opposite is true. ESOP companies almost never fail to repay the loan that most take out to become employee owned (under 0.5 percent in a study conducted by the National Center for Employee Ownership.) In contrast, similar purchases of companies by private equity firms fail at a rate that is 10 to 20 times as high. ESOPs also have 25 percent higher job growth over a 10-year period. In addition, employee owners were one-fourth as likely to be laid off during the recession as employees without an ownership stake in their

companies. However, ESOPs are not a silver bullet. Like any business, ESOP companies can suffer declining performance or even close their doors. In general, though, employee-owned companies are more durable and more likely to outperform the competition.

Myth #3: An ESOP is nothing more than a retirement benefit

While an ESOP is similar to a 401(k) plan in many ways, employee ownership has benefits beyond contributions to a retirement account. The fundamental difference is that ESOP participants have ownership stakes in their companies, which gives them the right to benefit financially from the success and growth that they help to build. At companies that foster an ownership culture, the benefits of employee ownership are even greater. Employee owners at these companies experience structured opportunities for participation and increased decision-making authority, a heightened sense of camaraderie and teamwork, and a fairer work environment. For example, here is one employee's response when asked what comes to mind first when you think about employee ownership: "How special it is to not only be part of a team but to know that everyone is empowered to make informed decisions and pull on all of our combined strengths and weaknesses. We truly are all in it together." This is not the unique perspective of one employee owner. In the NCEO's Ownership Culture Survey database of responses, which includes data from more than 15,000 respondents at more than 90 companies, employee owners rank "being treated fairly" and "a sense of community" as the two most important aspects of ownership, followed by "getting the maximum financial payoff."

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