Case Study: Central States Manufacturing, Inc.

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October 11, 2021

The final version of this case study is published in the Journal of Participation and Employee Ownership, Emerald Publishing (DOI 10.1108/JPEO-09-2021-0012)

Abstract: This case study examines employee share ownership at Central States Manufacturing, where the employee stock ownership plan (ESOP) shares stunning sums of wealth with employees. Central States designs its ESOP to allow participants to access a portion of their ownership wealth while they are still employed at the company, through hardship and in-service withdrawals. This may make the "wealth benefit" of employee ownership more meaningful to lower wage workers navigating economic challenges. The case study adds to the discussion about how employee ownership can benefit low and moderate wage workers and close the wealth gap.

Data were collected via: (a) published accounts (b) structured qualitative interview with CFO (c) follow up emails and phone communication with company contact (d) review of plan document language. This paper lifts up an innovative company whose success and ESOP plan design benefit frontline workers.

A remarkably large segment of the working population of the United States endures poor job quality and financial insecurity. Fully 44% of employed Americans earn low wages.[i] Forty percent of surveyed workers say they usually or always live paycheck to paycheck.[ii] Nearly half of U.S. families have no retirement account savings at all and the median household has just $21,000 in savings as it approaches retirement.[iii]

A growing body of research demonstrates that employee ownership is an effective tool for delivering retirement assets to low and moderate wage workers. This brief case study examines one successful company whose employee stock ownership plan (ESOP) shares significant wealth with employees. At the same time, the company designs its ESOP in ways that may make the "wealth benefit" of employee ownership more accessible and more meaningful to lower wage workers navigating urgent economic challenges.

Employee-owned Central States Manufacturing, Inc., headquartered in Lowell, Arkansas, manufactures metal building components and building packages. It first established an ESOP in 1991 when founder Carl Carpenter sold a portion of company shares to the plan in order to give employees a stake in the company's future as he began to cash out himself. The company was structured as a C-Corporation at that time.

It became a 100% S Corporation ESOP in 2012 and has more than doubled in size in the years since. As of August 2021, Central States employed 1,037 people nationally across 10 sites with plans to add their 11th site in September 2021.

About half of the company's employees work in production, operating machines. Another 130 employees are over-the-road drivers. The remaining employees are office personnel, some hourly and some salary. Starting wages for the company's lowest-wage employees range from approximately $16 to $18 depending on the site.

Central States is unusual even among ESOP companies. It was once featured in *Forbes* in an article entitled "The Millionaire Truck Driver and Other ESOP Miracles," and indeed, millionaire truck drivers are not uncommon there. Workers who stay at the company for a period of years—including truck drivers and production workers—build stunning sums of wealth.

The average ESOP account balance for an individual employed for five years is over $75,000. For employees who work for over 10 years the average balance is just shy of $500,000. For an individual employed for over 15 years, the average ESOP account balance is over $1,000,000, according to Chief Financial Officer Chad Ware. "One employee owner with the company just retired with over $5 million in their ESOP account. The individual started in production and worked various other roles before retiring with over 25 years with the company," says Ware.

What explains the enormity of these account balances? The company has seen remarkable growth and a dramatic rise in share price—and thanks to the ESOP, employee-owners share directly in that success. Under current CEO Jim Sliker, Central States is eating up market share, expanding into more markets within the metal building component space by adding new sites. Meanwhile the company outpaces its competitors with operational excellence and superior digital tools for customers. "We are in a growing industry within the building material space and through a high level of operational execution have been able to outpace the industry growth over the last several years," says Ware. Internally there is a strong commitment to continuous improvement, accuracy, information-sharing, and open book management. The culture is very much "if you see a problem you go fix it; you're an owner," Ware explains. As a 100% S-Corporation ESOP, the company does not pay federal income taxes. This is a factor in the company's, and the ESOP's, success, insofar as it frees up cash for expansion and for distributions.

In addition to their base wage and ESOP contribution, employees receive a profit-sharing bonus based on volume and profitability growth targets. For the company these bonuses range from 5% to 10% of total compensation paid annually. The company also provides employees who choose to participate in the 401(k) with a match of up to 4% of pay.

From the perspective of some lower-wage workers in the United States, a limitation of the ESOP model of employee ownership, in terms of its wealth-building utility, is its "deferred" nature. Because ESOPs are designed as retirement plans, employees accumulate shares in their accounts over time but cannot typically access that wealth until they retire or leave the company. On the one hand, this preserves ESOP balances as a source of retirement wealth and facilitates asset growth through compound interest. On the other hand, however, for low-wage workers navigating housing, school and medical costs, and emergencies, with limited disposable income, the ability to access liquidity is vitally important.

Central States innovates in its ESOP by permitting workers to access a portion of their ownership wealth while they are still working. That is, Central States ESOP participants have access to liquidity before they retire or separate from the firm.

Hardship withdrawals: The Central States ESOP plan document allows participants to receive hardship distributions. (Hardship distributions are permitted but not required by the IRS for "immediate and heavy financial need" including medical care expenses, the purchase of a principal residence, tuition and other educational expenses for post-secondary education, eviction prevention, and other safe harbor situations of financial hardship provided by IRS regulations or rulings.) Central States not only permits employees to access withdrawals for these purposes; it proactively educates employees about this opportunity. Last year the ESOP paid out about 26 hardship withdrawals totaling just under $2.5 million. The average amount employees withdrew from their accounts was $90,000. (Employees must pay an extra 10% tax penalty; the company instructs them about that.)

For example, a production worker took out around $100,000 when a close family member needed to go to a special hospital for care. A truck driver took out over $200,000 and paid for his home all at once. He had worked for the company for about 14 years. He and other employees who withdraw funds for this purpose often say, "Without the ESOP hardship withdrawal, I'd never have owned a home."

In-service withdrawals: Central States also gives workers access to in-service withdrawals. Currently an employee who has worked at Central States for six years may withdraw up to $5,000 each year from their ESOP account. Someone employed for at least 10 years is allowed up to $10,000. An employee of 15 years may withdraw up to $15,000. The in-service withdrawal is popular: Approximately 100 active employees people requested and received in-service withdrawals in 2019 and 2020. The company streamlines the process to reduce the administrative complexity: During a window of time each year in the fall, letters are mailed to people who are eligible. Employees fill out the form and the company remits the funds to them. "There's no stipulation, it's just 'do you want $5, 10k or $15k?'" says Ware. New changes approved this year will allow employees to take in-service withdrawals after just two years of service starting in 2022, and will increase the amount that employees can withdraw.

Some observers may argue that such withdrawal opportunities undercut the value of the ESOP as a deferred benefit. Clear communication is key at Central States. While on the one hand, the company informs employees of their right to access hardship and in-service withdrawals, on the other hand it also reminds employees that if they leave the shares in their ESOP accounts for 20 or more years without withdrawing any shares, their accounts will likely be worth exponentially more through the power of compounding. "You've just got to make sure you communicate and educate employee-owners on the pros and cons of taking early withdrawals from their retirement account," says Ware.

Celebrating early retirement: At Central States, ESOP wealth delivers a remarkable degree of financial freedom to employees who stay for a decade or more. As a result, people have the ability to retire young. Several employees in the past two years have retired, comfortably, in their early 50s. "People know if you've been here for 15 or 20 years you likely will have the financial freedom to be able to retire if you so choose. It's something to celebrate. When people do retire, we love to celebrate them and their accomplishments."

Central States is truly unusual. It is unusual first in its pace of growth and second in the enormous scale of wealth that longtime employees including production and trucking employees accumulate through the ESOP. It is unusual, third, in how its ESOP design allows workers to access a portion of their ownership wealth prior to retirement. That design choice makes particular sense for this company, given the sheer size of participants' ESOP account balances. Still, its choices are worth considering in light of the growing interest in employee stock ownership as a tool to benefit lower wage workers and address the wealth gap.

Perhaps the most critical takeaway from Central States' story, though, is this simple fact:

In a remarkably successful company, the proceeds of success are not funneled narrowly into the pockets of investors or a handful of outside shareholders. Instead, through the employee stock ownership plan, long-term employees from the top to the bottom of the company share richly in its success, accessing wealth and financial freedom to a degree that is rare for production and transportation workers in the U.S. economy.

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