RESEARCH BRIEF

Institute for the Study of
Employee Ownership and Profit Sharing

Why Few ESOPs? A Preliminary Exploration:

Barriers to Adoption Among Sellers Who Considered ESOP

Questions: Why are so few Employee Stock Ownership Plans (ESOPs) created? Why do business owners who proactively explore an ESOP sale but decide not to proceed make that choice? What do such sellers see as the key barriers? What information informs their decision? What are their primary transaction objectives? What alternatives do they opt to pursue instead of an ESOP?

Summary: This brief reports on in-depth interviews with eight sellers who considered an ESOP but chose not to proceed. The brief describes their transaction objectives, the key barriers they identify, their information sources, and the alternatives they pursue instead.

Among the barriers named, the desire for more cash up front, cost, complexity, and the absence of internal succession leadership were common. Smaller companies were more likely to express concerns about regulatory compliance.

These interviews generated preliminary exploratory answers to inform future research.

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We know from decades of research that ESOPs deliver benefits to companies, selling owners, and workers. Indeed, few other business-level tools share wealth with working people as effectively as ESOPs in successful companies can.

Yet the number of ESOPs remains small in proportion to the overall number of businesses in the economy. Only about 245 new ESOPs are created on average each year. With ESOPs disappearing at roughly the same rate as they are created—many being bought by external buyers—the number of ESOPs has plateaued, staying at about 6,500 for the past decade (Rosen 2023, Mygind 2023).

Indeed, the much-anticipated "silver tsunami" of exits by baby boomer-generation business owners has yet to produce any discernable surge in ESOP formations. Of the approximately 20,000 M&A transactions in 2022, fewer than 1.5% likely resulted in an ESOP.[1] Increasing broad-based employee ownership in the United States will require greatly increasing the ESOP conversion rate among M&A transactions and other sales.

Why are so few ESOPs created, even among well-suited companies? The data required to answer this question well is lacking.

This research brief takes an initial step, using an intensive interview approach. It reports on in-depth interviews with eight sellers who proactively considered ESOP but then chose not to proceed. By focusing on sellers who already knew about and seriously considered an ESOP, this research narrows the lens to the experiences of a small sample of companies whose leadership had an active interest in the model. These interviews, in other words, are with sellers who are among the most likely sort of candidates for an ESOP conversion today; indeed, these are individuals who walked several paces "down the path" toward establishing an ESOP before pausing or aborting the process.

Among the questions these interviews explored are: Why do business owners who consider ESOPs but opt not to sell to ESOPs make that choice? What do they report are the key barriers? At what point in the process do they opt against? What information, and from whom, informs their decision? What are their primary transaction objectives? What alternatives do they opt to pursue instead? How do their considerations vary by business size and sector? The interview protocol is at the end of this research brief.

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[1] Solid data do not yet exist on the number of companies that are truly "ESOP-able." The Rutgers Institute for Employee Ownership and Profit Sharing estimates that if we assume half of all small business owners are over 55 years of age and consider only those with more than 20 employees, while assuming that 10% of those businesses will be transferred to relatives, there could be as many as 305,000 companies currently in operation for whom an ESOP could potentially be relevant (Blasi, Kruse and Scharf 2024). If we assume further that a truly ESOP-able company must meet other criteria in addition, for example, being financially stable and profitable, with a reliable expected cash flow, substantial budget, and a leadership succession plan, and if we estimate conservatively that even 10% may meet the additional criteria, those 30,500 companies, if they adopted ESOPs, would extend ownership to millions of employees.

This research is preliminary and exploratory and is intended to inform additional research.

What We Know: Two Recent Surveys

Two recent surveys of company leaders' views on ESOPs inform the project, providing an empirical starting point and some context on which to build. Jared Bernstein (2020) conducted a nationwide online survey of 250 companies focused on perceived barriers to setting up an ESOP. He found that 67% of business respondents overall and 84% of respondents in companies with 50 or more employees were somewhat or very familiar with ESOPs. While Bernstein emphasizes that a "substantial minority" of business managers lack familiarity with the model, his data also show that the overwhelming majority do have some degree of familiarity with ESOPs. This contradicts the common "no one's ever heard of an ESOP" explanation for the low ESOP creation rate. Indeed, the conjecture that by and large, company leaders completely lack of awareness about the ESOP appears especially untrue among business managers and owners in companies with payrolls of 50 or more; only 14% of those respondents were somewhat or very unfamiliar with ESOPs in Bernstein's survey.

In Bernstein's survey, the modal explanation given by business managers for why ESOPs are "a good vehicle" for a "company's succession/ transition of ownership" was that "ESOPs provide companies with tax savings, which help the company grow." Explaining why ESOPs might not be a good succession vehicle, 36% believed the "costs of an ESOP transition probably outweigh its benefits." In open responses to the question "Why not an ESOP?" the most common clusters of responses expressed concerns about cost and the size of their business.

In another recent survey, the ESOP advisory and financing firm Verit Advisors (2023) commissioned an independent research firm to survey leaders of 200 companies from three groups: 90 surveyed companies that had formed an ESOP, 80 who were considering an ESOP, and 30 surveyed companies who were not considering ESOP. It found that a common challenge associated with the ESOP structure involves the perceived complexities of ESOP regulatory reporting and the time involved in establishing an ESOP. These issues posed challenges across all groups. As was reported: "[O]ther initial concerns, such as company capitalization, the cost of repurchasing shares, and employees' grasp of the ESOP structure, proved less troublesome than anticipated."

Verit Advisors also reported: "Company founders tend to prioritize personal tax benefits when considering an ESOP, while non-founder ESOP leaders find corporate tax benefits more motivating. But if taxes are the sole priority without evaluating its workplace culture and employee benefits, leaders considering an ESOP are less likely to actually complete the plan."

In-Depth Interviews

Building on these two recent surveys, whose findings underscore the relevance of ESOPs as a succession vehicle, the importance of tax savings to decision-makers, and concerns about cost, the interviews summarized below plumb the perceptions of selling owners and their experiences exploring an ESOP at greater depth. This method helps identify the range of issues for a more systematic study.

As mentioned, the eight interviewees are all current or former business owners and leaders who considered a full or partial sale to an ESOP but chose not to complete the transaction. They were identified through referrals from five different transaction professionals. (2) The identities of all interviewees and their companies and the source of the referrals remain anonymous here to enable candor.

Here is how this research brief is organized. First, I provide a table summarizing the responses of interviewed sellers at a high level and discuss the different themes among their perspectives. Second I make recommendations for future research.

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[2] Referrals came from James Steiker, Menke and Associates, the University of Michigan's Economic Growth Institute, the Beyster Institute, and the National Center for Employee Ownership.

Summary of Interviews with Sellers

	Size	Problem ESOP Solves	Goals	Source of Information	Barriers	What Point in Process?	Alternative
1	350 employees ~$25m revenue	Transition out 10 shareholders with different retirement timelines	Fair return for shareholders. Continuation of company	Two ESOP Advisors ESOP Conference Trustees Other ESOP Companies Attorneys, Accountants	Trouble with ESOP advisor (delays, due diligence) Having to jump through "all the hoops" of ESOP process	Toward end of process, after about two years of due diligence. "We were close to moving forward."	Converted to equal ownership model with 26 partners Partnership limited to professional staff, which was just 8% of the current 500 employees
2	150 employees ~$6m revenue	Exit strategy for owners	Improve recruitment and retention	ChatGPT ESOP Advisor A CEO who sold to an ESOP in another industry	He has difficulty persuading partners who think he is trying to cash out. Difficulty convincing other stakeholders of the vision and plan	The process continues	Has not proceeded Has not definitely rejected ESOP The owner who favors ESOP is still trying to convince a co-owner.
3	50 employees ~$2.8m revenue	Owner's desire to sell	Create a buyer because external buyers were "few and far between."	Contracted with M&A firm for prospectus and market research ESOP Advisor	IRS/ERISA compliance Cost to comply Opaque ESOP process Complexity makes ESOP out of reach Needs healthier margins	After M&A firm prospectus After the owner's own research Pre-analysis by ESOP Advisor recommended $5m in gross revenue to consider ESOP.	Taking steps to purchase property for hard assets to improve company's position for eventual sale Still interested in an ESOP "but it's hard."
4	13 workers ~$2m revenue	Succession plan, owner liquidity	Take care of people who worked hard and helped to grow the company	ESOP Advisor	Small size	After speaking with M&A advisors and an ESOP Advisor who said ESOP in this case requires 15-20 employees	Seeking alternative EO model appropriate for smaller company. Researched Teamshares.
5	27 employees ~$14.5m revenue	Owners to sell a portion of equity as step toward future 100% sale. An older owner wants to "take some chips off table" soon.	Leave the business intact for the next generation of managing directors	ESOP Advisor Bank Internal network	Reluctance to bring on debt Long time to cash out Cannot preferentially give ownership / incentivize people Mistrust ESOP advisors Complexity. One owner opposed ESOP from the start, is unconvinced	After initial analysis with an ESOP Advisor	Talking to outside investors, looking at potential PE firm to take minority control

	Size	Problem to Solve with ESOP	Goals	Source of Information	Barriers	What Point in Process?	Alternative
6	30 employees ~$11m revenue	Owners exit	The brand to live on The company to thrive Reward team for contributions Avoid people having to leave their jobs Cash in on company's value. "I need to make that liquid."	ESOP Consultant M&A Attorney Their Regular Financial Advisor at a major firm	Recognized an ESOP is like "giving myself a loan." There would be a lack of leadership if current owner sold and left Risk: "if business fails without you, you don't get paid."	After communicating with a major national ESOP consulting firm Written materials from the firm led them to conclude an ESOP "is taking out a giant loan and paying it back to yourself over time." Then their regular financial advisor suggested other paths in order to exit, e.g., private equity, strategic buyers	Now seeking a strategic buyer whose leadership values align with theirs with the energy to grow the company further – but not Private Equity
7	First time (early 2000s): 110 employees $10m Second time (~2020): 155 employees ~$18m revenue	Considered ESOP twice First: exit strategy for founder Second, future growth & succession plan	Succession plan, future growth while getting money out up front	ESOP Advisor	Same reasons both times: "We couldn't get enough money out up front." "The ongoing annual costs were very high."	Both times: After contracting with ESOP Advisor to do a complete analysis of the business	Probably traditional Private Equity
8	230 employees ~$199m overall volume of sales	Succession plan	The owner should not be the only person able to retire successfully: "I don't believe you're successful if your employees can't retire successfully."	A well-known high profile ESOP company Referred to ESOP consultant they worked with	Their industry has unique features. Their manufacturer and the new owner must approve the transaction. Require you own 51%.	After discussing the sale to ESOP with the manufacturer Had explored ESOP seriously for several months but did not do a feasibility study.	Sold to an ESOP Holding Company

The Goals of the Company Business Owners

Overwhelmingly, the sellers sought out and explored the ESOP in order to solve challenges related to exit strategy, succession planning, and liquidity. While for most interviewees, these needs were primary, other desired ends balanced them. More than half of the interviewees stated that they wanted their business to continue after the sale, remain intact, or continue to thrive. Several interviewees also articulated, each in different words, their desire to reward or take care of employees who had contributed to and helped to grow the company. In sum, sellers were seeking ways to access liquidity for owners and to exit—while simultaneously seeking other desired ends.

The ESOP Idea's Appeal as They Saw It

When asked what initially seemed most appealing about the idea of an ESOP and what made it worth exploring, the responses varied. One interviewee associated ESOPs with success. Another interviewee said they saw the ESOP as an "exit strategy with fair ROI for shareholders." Others liked the idea that "all employees have a stake" or that they would " pass it on to the people who built it with me."

Key Points in the Process Experienced by the Companies

The interviewees pursued ESOPs for various lengths of time, deciding not to sell to the ESOP at different specific points in the process.

One interviewee's company had contracted with a respected ESOP advisor twice in the early 2000s and more recently. Both times, after a complete and detailed analysis of the business, with the advisor providing a recommendation and a plan, they decided to not pursue the ESOP. In both cases, "we couldn't get enough money out up front, and the ongoing annual costs were very high," they said.

In another case, a company had worked with an advisor for two years but then experienced delays and had concerns about the quality of the advisor's due diligence.

Other companies hit speedbumps earlier in the process, after an informal assessment by an ESOP Advisor or consulting with other non-ESOP M&A or financial advisors, but before contracting with an ESOP Advisor for a complete analysis.

In two cases, the companies were told that they needed to be bigger or needed a stronger financial profile to proceed with a feasibility study.

In one case, the company's sector had an industry-specific barrier, namely, the national body representing a manufacturer had authority over ownership transitions and rejected their proposed sale to an ESOP. In that case, the interviewee had "explored (an) ESOP seriously for several months but did not do a feasibility study."

Some interviewed have delayed the decision but have yet to rule out an ESOP.

Reservations and Barriers That Impacted the Decision-making By the Companies

The desire for more cash up front was named as a barrier in more than half of the interviews. As interested as we were in exploring an ESOP, one individual said, "our personal goal is getting money up front." They plan to look at "more traditional private equity" instead, they said. The founder of a smaller company who is weighing an ESOP sale against the idea of selling to an outside buyer expressed concern that with an ESOP loan, if the business failed after they exited, they might not be paid. They want "a guaranteed check" that they could "walk away with."

Cost—a reluctance to bring on debt in the context of rising interest rates, the cost to establish an ESOP, and most importantly the ongoing annual costs to administer a plan—represented another consistent barrier articulated in companies of all sizes.

Complexity and compliance were commonly named as primary barriers. "We had to change to a C Corp to get the true tax benefits and they were limited on the investment options to defer tax benefits until step up… it just seemed too complicated," said one individual who is now "looking at a potential private equity firm to take minority control" instead. Smaller companies were more likely to name IRS/ERISA compliance rules as major barriers that put ESOP out of reach.

When asked what other concerns, reservations, or uncertainties related to the ESOP interviewees had had, a few highlighted concerns about their bench of internal leadership and lack of a strong succession team ready to step in. "The team is great executing my vision. I am not confident that without me it would continue to thrive," said one individual. Our team is "Competent but could not take on my and my partner's role" in addition to their own. Replacement leadership will be required, said another interviewee considering a sale to private equity instead of to an ESOP.

Some responses indicated uncertainty about how to articulate the vision and build support from other stakeholders along with building the internal consensus needed for an ESOP sale. Two respondents expressed distrust or disappointment in their ESOP Advisors.

The interviewees had unsolicited suggestions for how ESOPs could be made more accessible.

For example, the owner of a smaller company concerned with IRS compliance said: "The SBA should have an ERISA compliance office or program with resources specifically for ERISA compliance; like how you can get help as a business owner for filing taxes." Another smaller company urged the ESOP community to make the ESOP process more clear and less opaque. There are "a lot of decision points," they mentioned, "Owners want to know from point A to Z how their ownership will transition, exactly." A related suggestion was to make available an easy-to-use, clear website to walk a selling owner considering an ESOP through the process or a basic version of the process, much more simply and straightforwardly.

Concerningly, multiple interviewees suggested that their M&A advisor or regular financial advisor had actively steered them away from ESOP or indicated that these (non-ESOP) advisors were unresourceful on the ESOP question. One observed that there exists a stark divide among professionals in their network. People are very much "either in the ESOP camp or not."

Alternatives Being Pursued

For those who considered but opted not to sell to an ESOP, what alternatives are they pursuing? One was outside buyers. Many are seeking strategic buyers with the goal of continuing the company. They are finding it challenging, however, to identify an outside strategic buyer whose leadership values align with theirs and who will continue to build the firm. Others are seeking outside investors or traditional private equity to take minority or full control.

Other conversions were being examined. Three pursued new, non-ESOP, ownership models.

One did so with an "equal ownership model" that included 26 partners but that was unlike an ESOP. In this case, ownership is limited to professional staff who constituted just 8% of their 500 employees.

Another sold to a holding company that itself has an ESOP. Another small company, too small for an ESOP, is proactively seeking an alternative employee ownership model more appropriate for a company of its size.

Other sellers have hit barriers or failed to build a consensus among existing owners, but while they so far have not completed a sale, they also have not definitely rejected the ESOP. In one case, the owner who favors ESOP is still trying to convince a co-owner. In another case, the owner is taking steps to improve the company's position for an eventual sale. They say they remain "intrigued by ESOP—I want to do it, but it's hard."

Observations and Analysis

Here are several working conclusions.

ESOP adoption can be a longterm process, with a single company considering ESOP more than once over its lifecycle, and with research followed by pauses and consensus building, then revisiting.

Costs are a big issue, namely, transition costs and ongoing annual costs of ESOP--were named as a deterrent by larger and smaller companies alike.

The fear of IRS and ERISA compliance was emphasized primarily by the smallest companies interviewed.

The ESOP model has a liquidity problem. We know that an ESOP transaction generates less cash at close compared to a taxable sale, and the time frame for repayment is generally longer.

Several sellers who were highly motivated to form an ESOP opted not to follow through because they required more cash at close than current models allowed. Future surveys may probe this more—what would sellers require up front? These interviews suggest that in order to increase ESOP conversions among interested sellers, and compete with private equity, better tools are needed to enable more sellers to access more cash at close in an ESOP deal.

Complexity is a major barrier particularly for smaller organizations. The responses suggest that if it is a goal to move more small companies to consider ESOP, making available a simpler off the shelf process for smaller companies is necessary. An easy to use website enabling navigation through the first steps of the process, with explanations, could be helpful.

Conclusion

Some barriers to ESOP adoption have been identified by other scholars and industry leaders (Bonham 2023; Josephs 2023, Blasi, Kruse and Scharf 2024), but they mainly have raised more questions than answers.

These interviews have generated some preliminary exploratory answers to inform future research.

Additional data compilation is urgently needed to enable systematic study in order to identify the most important barriers, and pathways, to increase ESOP formation.

Recommendations for Future Research

I recommend:

1. A partnership with a major national organization of ESOP advisors to build a larger representative sample of at least 50 selling business owners who considered but opted against ESOPs, in order to survey a larger representative sample of businesses interested in ESOPs about barriers to ESOP adoption. Such a survey would validate and expand on these interview findings, with a larger more representative sample of companies enabling more nuanced identification of patterns and correlates.
2. A survey of ESOP transaction professionals about their experiences and observations with transactions could also yield important complementary insights.
3. Because several interviews named mainstream M&A and financial advisory firms as entities "not in the ESOP camp," it could be fruitful to conduct interviews with non-ESOP advisors, who are key sources of information and guidance for many candidates for ESOP, and who, interviews suggest, may steer their clients away from the ESOP model. Such research would focus on professionals who are not ESOP specialists or members of ESOP networks to ascertain their perceptions of and beliefs about ESOPs in comparison to other exit alternatives. These interviews suggest that such advisors may be key to ESOP expansion.

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Rutgers School of Management and Labor Relations

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SEMI-STRUCTURED INTERVIEWS WITH

COMPANY LEADERS WHO CONSIDERED ESOPS

1. What is your title at your company, today?

2. Are you the original founder of the business?

3. Today how many co-owners are part of your business?

4. I understand that at some point, you sought information about or considered an ESOP.

Thinking back to that time...can you tell me:

-What was the problem that you needed the transaction (the equity sale, etc.) to resolve?

-What were your desired end results? (OK to list multiple desired ends, but please indicate which was/were your primary (top 1-2) goals). Note: Goals may be business or personal, etc.

5. What year approximately was this (in what year did you consider ESOP)?

6. When you first began considering an ESOP, what did you hope it could achieve? What seemed most appealing about ESOP initially; what made it worth exploring?

7. What staff, professionals, networks, or other sources of information did you consult internally or externally?

8. At what point in the process did you decide that ESOP was not a fit?

9. What were your top concerns, reservations, or uncertainties about the ESOP?

10. How did you come to learn about these potential challenges with ESOPs?

11. Who were some of the most important people advising you internally and externally, staff or professionals? Who (broadly speaking) informed you of these challenges or cautioned you?

12. What other offers or options did you consider? What offer/option/transaction did you decide to pursue in the end, instead of ESOP? What made it more attractive than ESOP?

13. Did your transaction require financing? If so, do you think that financing would have been as easily available had you gone the ESOP route?

14. At the time you were considering ESOP:

-About how many employees DID your business have?

-About what was the total gross revenue?

-What was the business structure (e.g., partnership, S Corp, LLC, etc.)

15. What year was company founded [if they have not already said]

16. Can we contact you in the future again if we have follow up questions.