OWNING Engagement

MARY JOSEPHS, Founder and CEO of Verit Advisors, says the power of employee-owned companies can serve investors of all stripes

If you've ever been in a Publix Super Markets store and wondered why the service is fantastic, it's because most of the nearly 200,000 employees are owners. Curious about how W.L. Gore grew into a global manufacturer? Or how Parsons, through the economy's ups and downs, retains top engineering talent to oversee clients' multi-year mega-projects? Employee ownership.

Two separate and sweeping surveys of research in recent years have found employee-owned companies more profitable than like-situated competitors – more resilient in downturns and more successful in growing. Yet despite such evidence, the popular view of employee ownership in the investor community is largely negative.

Let's understand how we got here: beginning in the 1980s, companies sought to align management with shareholders by granting meaningful ownership to executives. Mostly this worked. In the language of the moment, executives became "engaged."

From the 1990s, companies aggressively eliminated lower-and-middle management positions to increase efficiency. But as costs fell and work sped up, it also became more standardized and less interesting. Workers felt isolated. Manager-worker contact was reduced. Employees today are far less supervised. Sure, as a top executive you may see performance data on your workers, but your managers and workers probably aren't talking to each other.

Since the 2009 financial crisis, virtually every CEO and business owner I visit complains about the difficulty attracting and keeping skilled workers – from truck drivers to senior management.

What's missing is that sense of ownership that aligned executives with shareholders. Imagine workers self-policing to reduce waste and eliminate poor work habits; becoming ardently customer-focused – not to meet a sales quota but because that's what is good for the business.

The US has 7,000 Employee Stock Ownership Plan businesses, or ESOPs. They have collectively shown that employee ownership makes companies stronger. Investors think they know about ESOPs, but much of what they take for granted is wrong.

MARY JOSEPHS

The Founder and CEO of Chicago-based Verit Advisors, Mary Josephs previously led the ESOP Solutions Group for Bank of America-Merrill Lynch. She founded and built the ESOP group at Chicago's LaSalle National Bank into the US's leading middle-market ESOP advisory team and co-founded a leading ESOP Advisory practice for ABN AMRO LaSalle Corporate Finance.

FOUR big myths abound.

1 The inmates run the asylum ESOPs operate under traditional governance structures, with a board often made up of independent directors, and executives who hold decision-making authority.

2 ESOPs can't make acquisitions Many buy other businesses and many are sold. The structure is flexible. Tax advantages provide superior earnings retention to help finance deals and grow value.

3 Investors have no role ESOPs are compatible with various co-ownership structures. Some private equity firms successfully invest as partners with ESOPs. Many founder-owners sell stakes to an ESOP while staying on to run the company.

4 ESOPs can't attract the most talented executives Synthetic equity – a stake in the company's future without an upfront cost – can be added to the compensation package to allow mature employee-owned companies to compete for talent.

When it comes to taxes, ESOPs offer a clear opportunity. When a C-Corporation, which is taxed separately from its owners, sells stock to an ESOP, the seller can defer federal capital gains taxes on the sale, potentially forever – that's $200 million on a $1 billion sale.

An S-Corporation, where owners are taxed, can be structured as an ESOP and pay no federal income taxes until the employee owners cash in their stock. Such a company might otherwise have a 35 percent tax rate.

I've spent 30 years helping companies convert to employee ownership. The tax provisions enable the transactions. But turning employees into owners is what makes the companies successful.

Central States Manufacturing in Lowell, Arkansas, bends metal to make low-rise commercial buildings. Because its employee-owners are compulsive about quality and service, that dreary-sounding model became a higher-margin company with loyal customers. Along the way, some ground-level workers have become millionaires. WinCo Foods in Boise, Idaho, enjoys stronger worker continuity than other discount grocers thanks to three decades of employee ownership. In return, employees have a path to retirement rarely seen at their income levels.

You want engaged workers? Make them your partners. Then go prosper together. That's simple capitalism – played as a team sport.