



# **S ESOPs, Middle Class Jobs, And Retirement Savings**

**Fall 2015**

# Executive Summary

The following presentation outlines the benefits of S corporation employee stock ownership plans (S ESOPs) to employee-owners, businesses, and the economy. With former Secretary of State Hillary Clinton proposing profit sharing plans in her presidential campaign and other candidates talking about middle-class jobs and financial security, S ESOPs are an important profit sharing tool to keep in mind. The following presentation outlines the benefits of S ESOPs and a summary is below.

- **Americans report being worried about their finances and retirements.** Slow wage growth, lack of retirement savings, and rising income inequality have become important economic and political issues.
- **Labor's share of income has dropped significantly since the mid-2000's.** Workers' share of corporate profits was 72 percent in 2001, but now sits at 63 percent.
- **Turning workers into owners through S ESOPs has the potential to alleviate these issues.** S ESOPs are qualified defined retirement plans that give employees ownership stakes in their companies.
- **As a retirement plan, S ESOPs outperform the S&P 500 and earn more annually on average than 401(k)s.** S ESOPs go a long way in providing retirement security to employees.
- **S ESOPs also pay better wages on average.** The added retirement savings do not come at the expense of wages. On average, S ESOPs pay 22 percent more than other comparable companies.
- **S ESOPs are more productive and stable, because they align the goals of management and labor.** This enables S ESOPs to plan long-term and pay higher wages.
- **S ESOPs have strong bipartisan support in Congress.** A bill to promote the ESOP model has 61 co-sponsors from both sides of the aisle.

# Agenda

## **Americans' Financial Security**

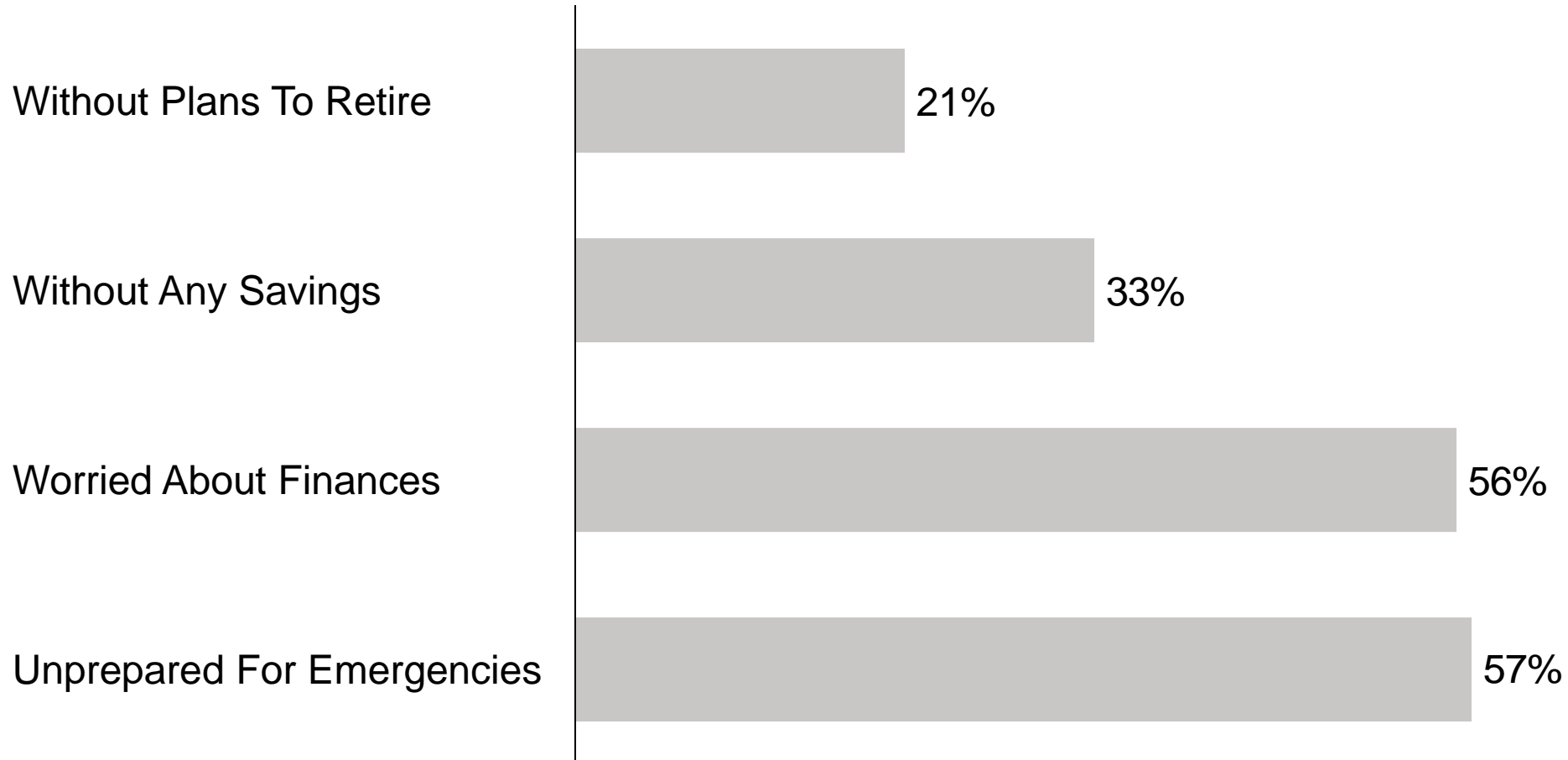
**Employee Stock Ownership**

**Benefits Of S ESOPs**

**Misperceptions And Opportunities**

# Americans Are Worried About Their Financial Security, Both In The Short And Long-Term

In Q4 2014, Americans Reported They Were ...

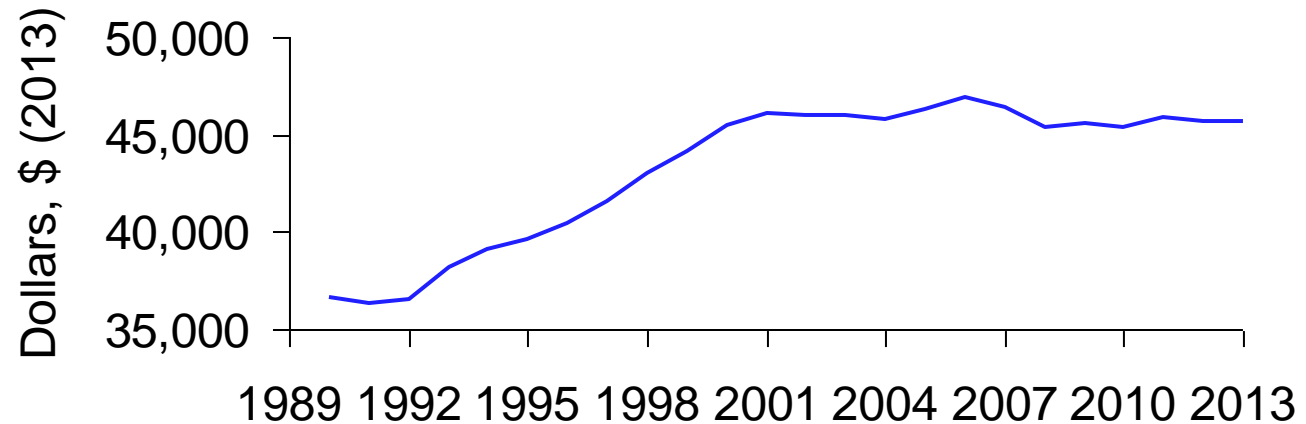


# Gaps In Retirement Savings And Income Have Created Uncertainty For The Middle Class

## Stagnant Wages:

- After a period of growth in wages during the 1990's, wage growth leveled off in the 2000's.

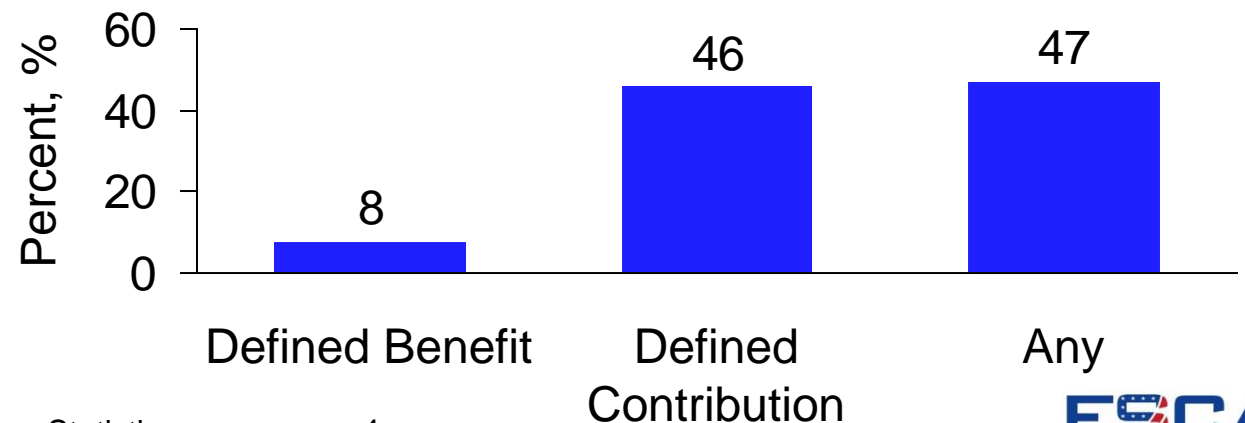
## Average Wages Over Time



## Retirement Gap:

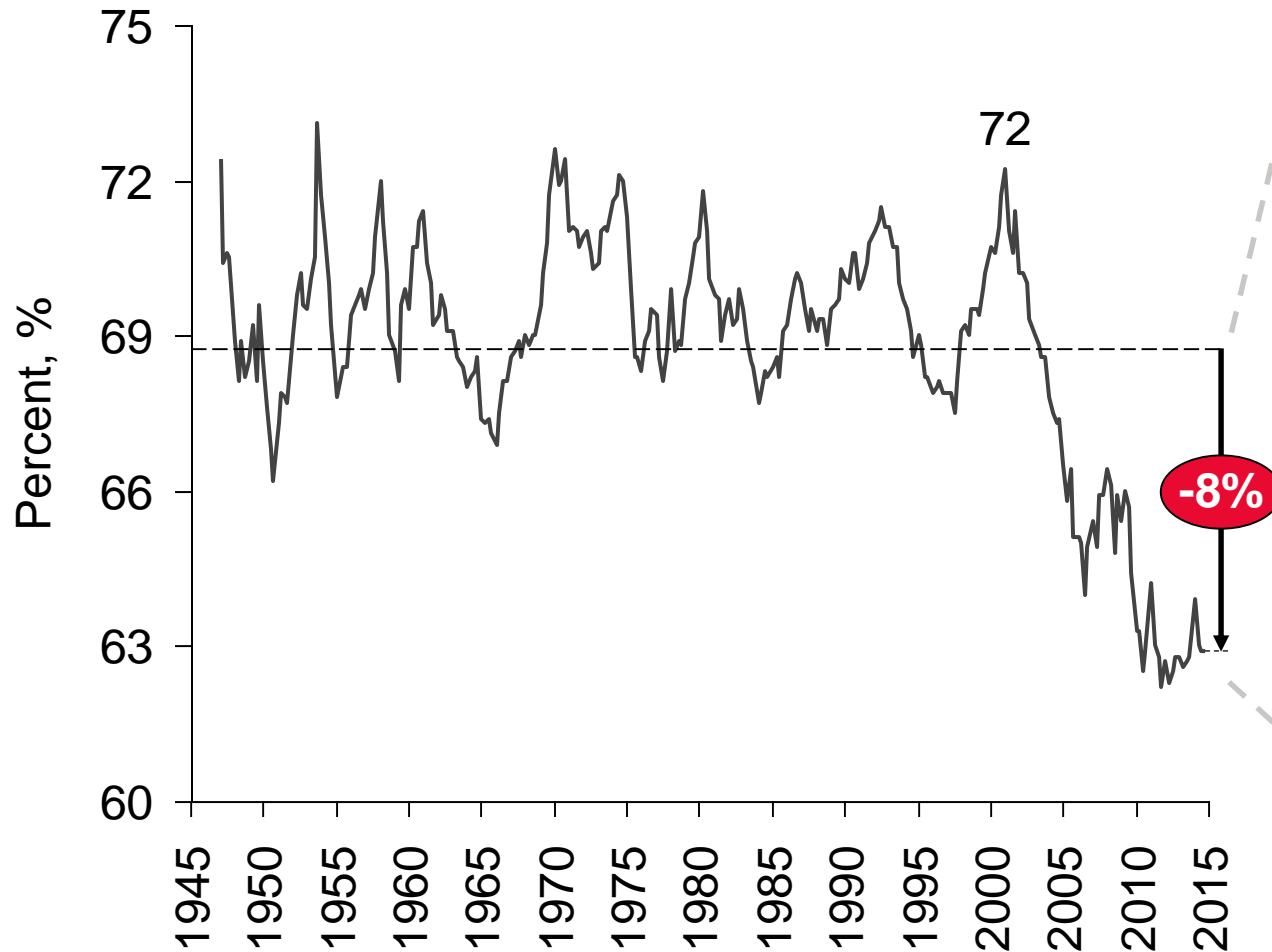
- Fewer than 50 percent of employers offer retirement benefits of any kind.

## Establishments Offering Retirement Benefits



# Relative To Ownership, American Workers Are Sharing Significantly Less In Their Companies' Successes

## Labor Share Of Income (Nonfinancial Corporate Sector)



### Workers' Share:

- Since it peaked in the early 2000's, labor's share of national income has dropped to new lows.
- This means that more of the value produced by U.S. businesses is going to the owners of those businesses than before.

# Turning Workers Into Owners Has The Potential To Alleviate This Issue

## Changing Dynamics:

- ESOPs represent an opportunity to change the economic dynamics for American workers.
- As a form of profit sharing, ESOPs give workers the opportunity to share in the success of their companies.
- But, more importantly, ESOPs turn workers into owners, aligning the goals of the company, its management, and its employees.

## ESOPs Help Workers And Firms

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- 1 Employee-owners have more retirement savings.** S ESOPs create retirement funds that grow faster than the S&P 500, and are more likely to offer a second retirement plan, like a 401(k), than other companies are to offer even one work-based savings plan.
- 2 S ESOPs pay higher wages.** In nearly every major sector, S ESOPs pay more than other firms. On average, they paid 22 percent more than others in 2010.
- 3 Employee-owned firms are more productive and stable.** Aligning the goals of the employees and the company helps boost performance – there is a 4 percent gain in productivity associated with switching to an ESOP.

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# There Are Almost 3000 S ESOPs In The U.S., Accounting For \$92 Billion In Direct Economic Output

## Employee Ownership:

- An ESOP converts workers into firm shareholders via a qualified defined contribution plan.
- In an ESOP, a company sets up a trust fund into which it contributes new shares of its own stock or cash to buy existing shares.
- When organized as S corporations, which have flow through tax treatment for owners, ESOPs are more effective.

## Key Numbers:

**470,000**

Number of people directly employed by S ESOPs.

**40-45 Percent**

Percentage of ESOPs that are S corporations

**60 Percent**

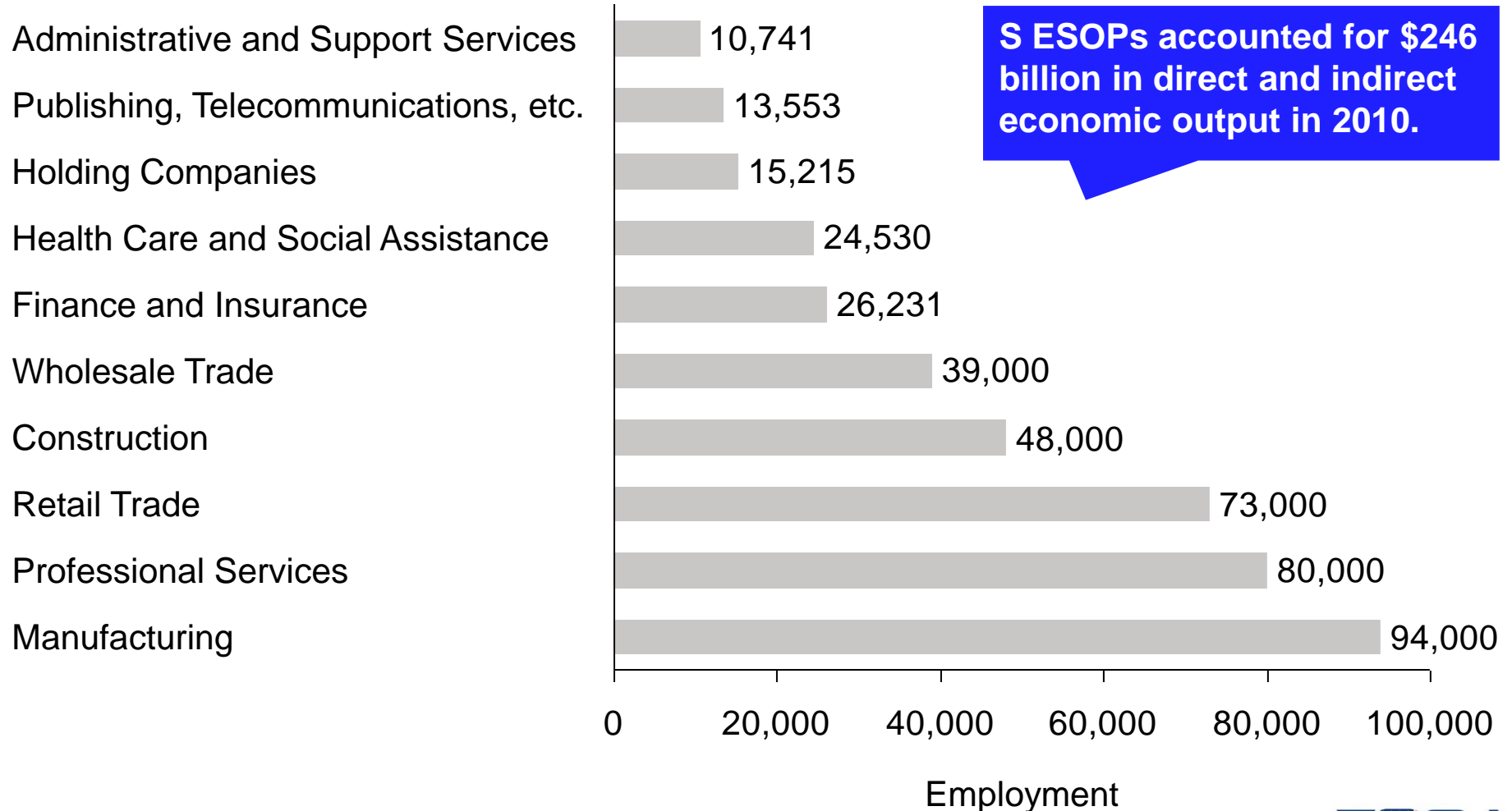
Employment growth at S ESOPs between 2001 and 2011 (compared to flat growth in the overall economy).

## Household Names:



# S ESOPs Employ Americans Across A Variety Of Industries

## S ESOP Jobs By Industry



# Employee-Ownership Makes Firms More Productive, Which Leads To Better Results, Pay, And Retirements

1

## Long-Term Perspective

### Better Productivity And Sales

- Employee-owners are focused on retirement, so the company is able to plan long-term.
- Employee ownership corresponds to a 4 percent increase in productivity on average.
- ESOPs have also been found to average 2.5 percent higher annual sales compared to non-ESOP firms of similar makeup.
- ESOPs are less likely to default than other comparable firms, meaning they are more stable.

2

## Goals Shared By Workers And Firm

3

## Participation & Transparency

### Better Pay And Retirement

- Productivity and sales gains flow directly to the employee-owners of the company.
- This results in better pay and higher retirement fund contributions.
- Over time, the enhanced performance of the company leads to the enhanced performance of its shares, which is why S ESOPs outperform the S&P 500.

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**Americans' Financial Security**

**Employee Stock Ownership**

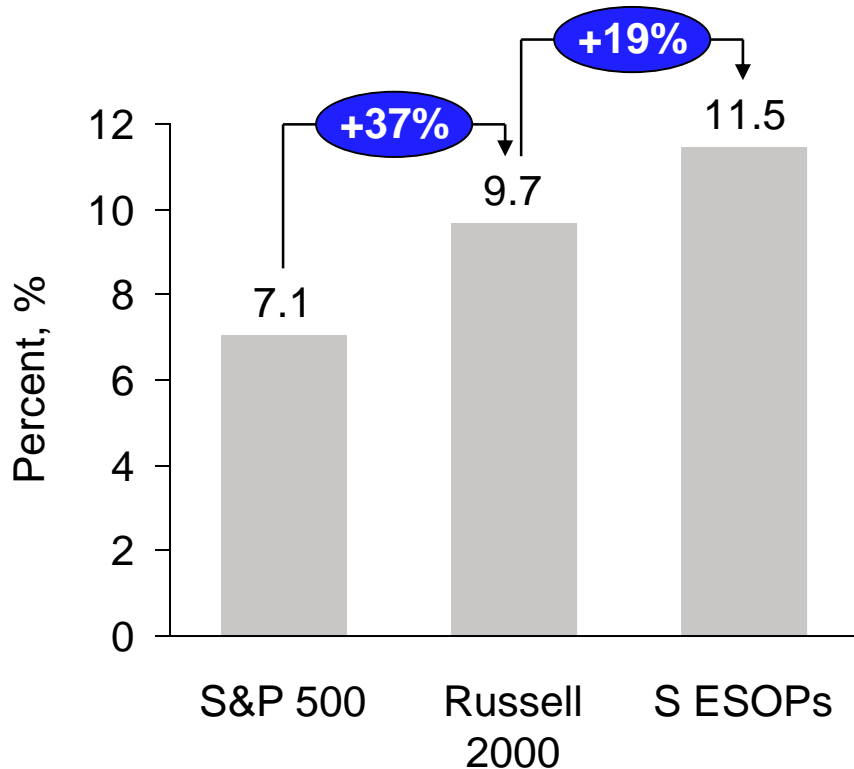
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# S ESOPs Outperform The S&P 500 And Prepare Workers For Retirement Better Than 401(k)s

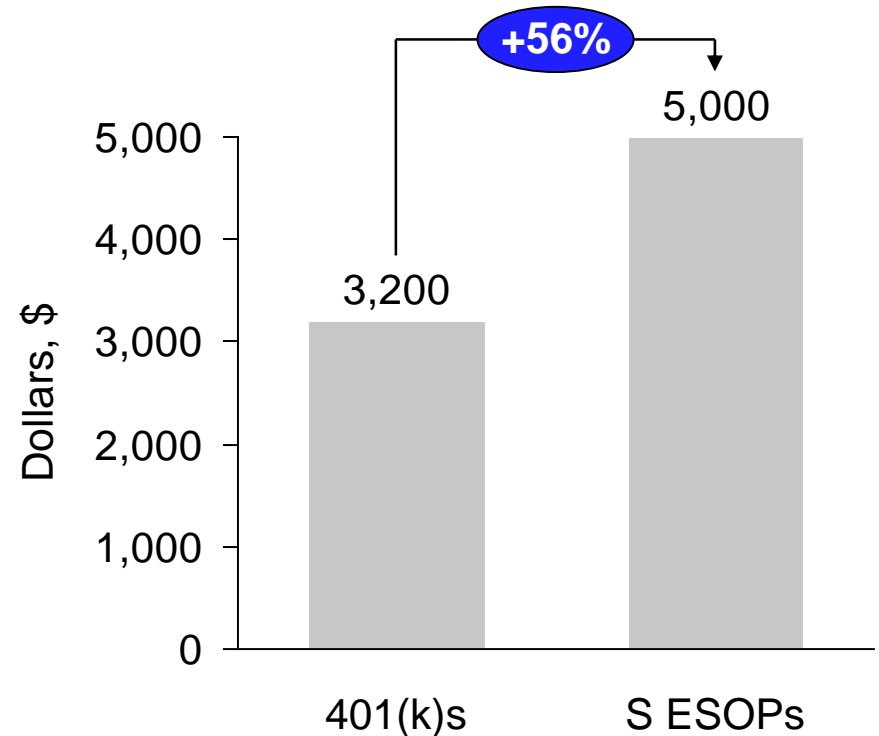
S ESOPs outperformed the stock market between 2002 and 2012. Employees were better off in an ESOP than the market ...

Average Annual Growth In Returns, 2002-2012



... S ESOPs also distributed more annually than 401(k)s, meaning ESOPs better prepared participants for retirement.

Average Annual Distribution By Plan Type



# S ESOPs Are More Stable Than Other Firms, Allowing Employees' Retirement Funds To Grow Over Time

Some critics claim that S ESOPs encourage savers to put "all their eggs in one basket."  
This is not a concern, because ...

## S ESOPs Encourage Diversification In Retirement Investments.

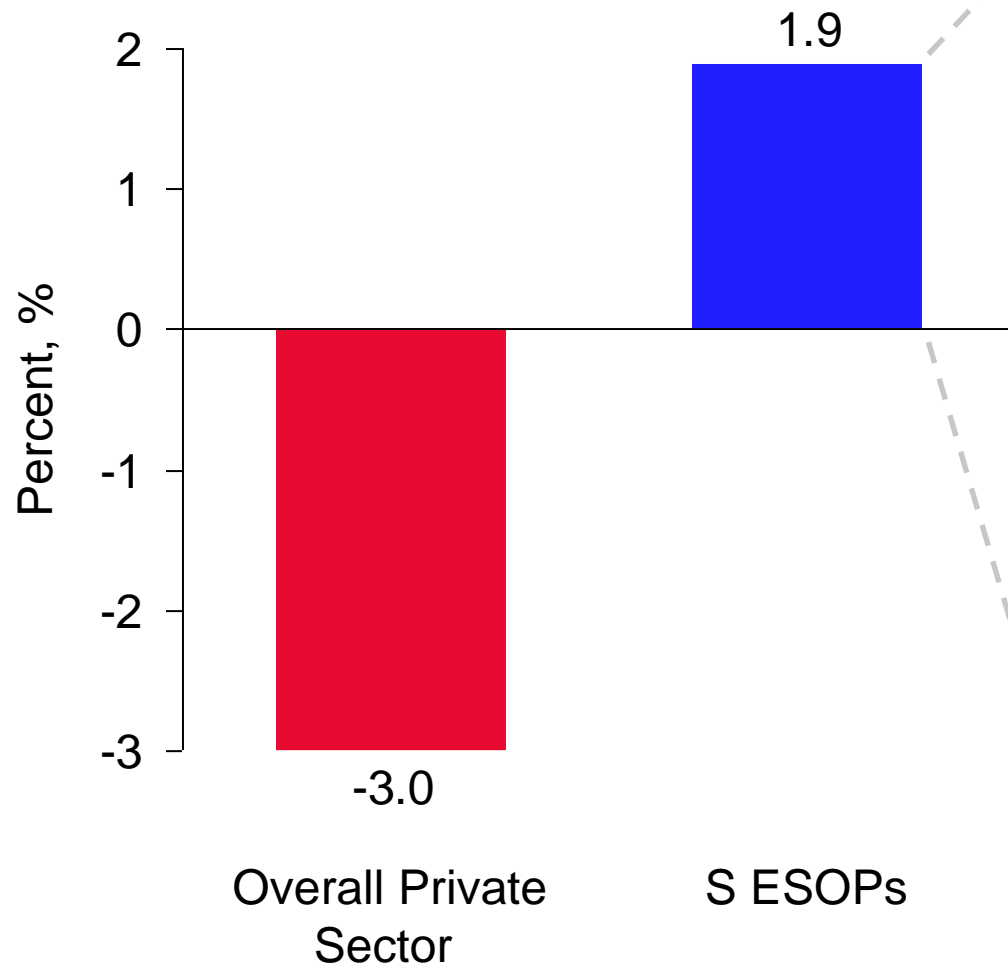
- Sixty-five percent of S ESOPs also offer a second retirement plan, like a 401(k), whereas only 45 percent of American businesses offer any retirement plan at all.
- Law requires S ESOPs to provide participants an opportunity to diversify as they get closer to retirement and as they stay in the plan.

## S ESOPs Are Significantly Less Likely To Fail Than Other Firms.

- Numerous studies have found S ESOPs to be more stable than other firms, so the risk of loss is lower.
- An NCEO report found that ESOPs defaulted on bank loans at a 0.2 percent annual rate compared to a 3.75 percent annual rate for other firms.
- Other studies have found that ESOPs are less likely to go bankrupt and are 20 percent more likely to survive than other businesses.

# Employment Growth At S ESOPs Outpaced The Rest Of The Private Sector

Change In Employment In 2008 By Type



## More Patient Capital:

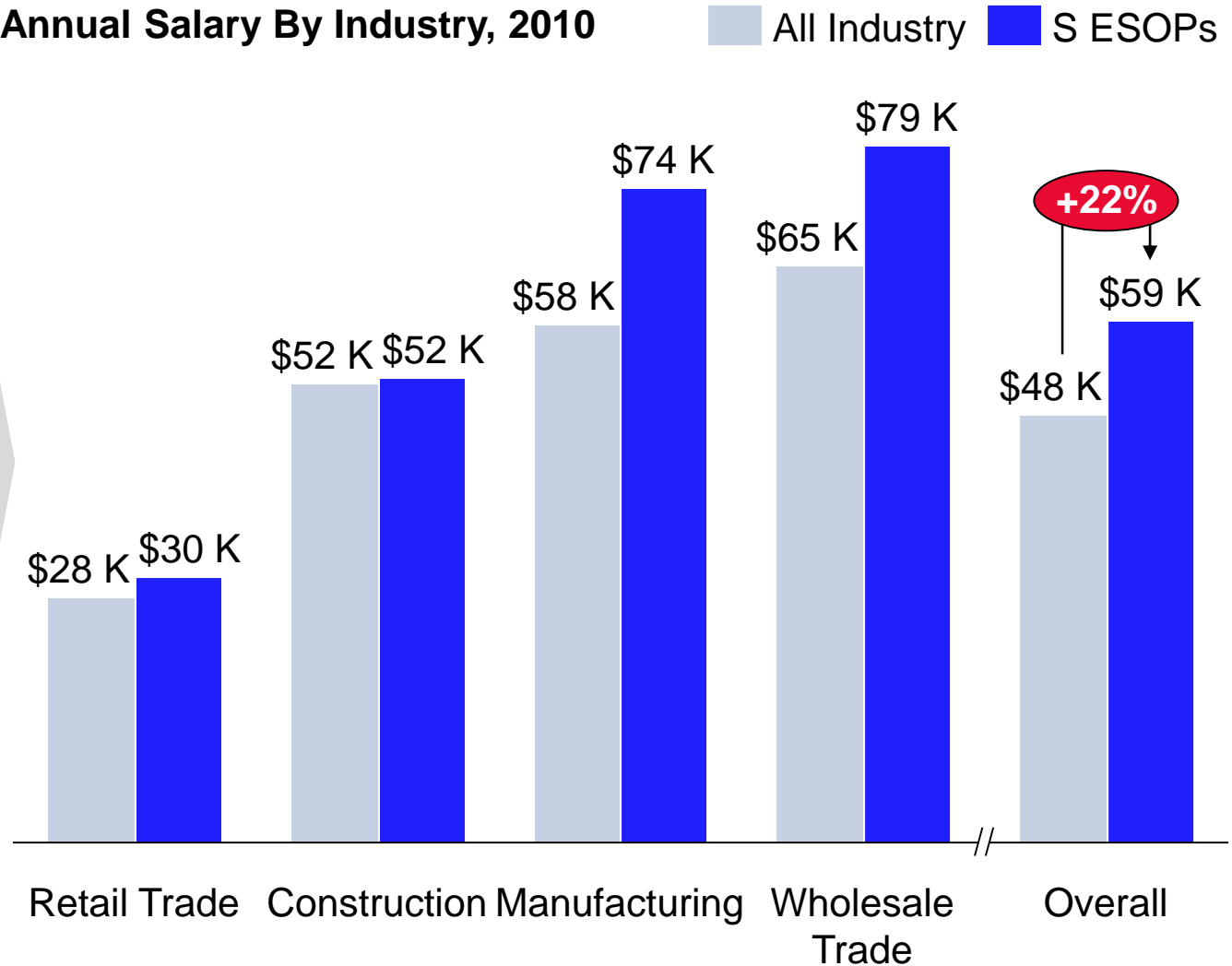
- Employee-owners are focused on retirement. So while public company shareholders are focused on instant results, S ESOPs are focused on long-term success.
- The ability to prioritize long-term success over quarterly numbers means S ESOPs are not reactionary, even in a recession.
- This is why S ESOPs added jobs during the last major recession when the rest of the economy shrank.

# S ESOPs Pay Higher Than Average – Better Retirement Savings Does Not Replace Pay

## Better Pay:

- A common misperception of S ESOPs is that the benefits they give come in lieu of salary.
- S ESOPs actually pay more than other private sector companies on average and across industries.
- This is the result of better firm performance and productivity.

Annual Salary By Industry, 2010





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# Criticisms Of S ESOPs Miss The Mark – S ESOPs Provide A Solution To Several Economic Issues

## Myth

S ESOPs prevent employees from having a diversified portfolio.

## Fact

65 percent of S ESOPs offer a second retirement plan (only 45 percent of other firms offer any retirement plan) and law requires S ESOPs make other investment options available over time.

S ESOPs don't have to pay any taxes to the federal government on profits allocated to an ESOP's ownership of stock.

Profits are taxed as income when workers withdraw money from their ESOP upon retirement or when leaving an S ESOP firm.

Profit sharing plans are better than ESOPs, because they compensate workers up front on a yearly basis.

Employee ownership is a form of profit sharing that turns employees into owners, aligns the incentives of a company's management and workforce for the long-term, and leads to better pay

# S ESOPs Can Solve Economic Issues Without The Polarizing Politics Of Other Commonly Cited Solutions

## Many Proposed Solutions To Economic Issues Are Divisive Or Unfeasible.

- **Minimum Wage Increases**
  - Conservatives fear minimum wage hikes will reduce competitiveness and result in fewer jobs.
- **Tax Policy**
  - Debates over corporate rates, capital gains taxes, and a more progressive tax system divide Democrats and Republicans.
- **Capital-labor Relations**
  - Confrontation over changing union and management structures; emergence of right-to-work laws in previously unionized sectors do the same.

## S ESOPs Boost Wages And Growth While Enhancing Private Ownership.

- **Republican Support For S ESOPs**
  - Offer a free market solution to low worker compensation and slow wage growth.
  - Emphasize private ownership incentives that encourage greater productivity and better firm performance.
- **Democrat Support For S ESOPs**
  - Promote "inclusive capitalism" that aligns incentives between workers and management.
  - S ESOPs are a form of profit sharing that go further than just distributing money – they turn workers into owners.

# The Promotion And Expansion Of Private Employee Ownership Act Has Bi-Partisan Support In Congress

## Congressional Support:

- The legislation has been introduced to the 114<sup>th</sup> Congress in both the House of Representatives and Senate.
- The House bill was introduced by Dave Reichert (R-WA) and Ron Kind (D-WI) and has 36 co-sponsors.
- The Senate bill was introduced by Ben Cardin (D-MD) and Pat Roberts (R-KS) and has 25 co-sponsors.

## The Bill Aims To...

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- 1 Encourage owners of S corporations to transition their company to ESOP ownership.
- 2 Encourage banks to lend to ESOPs to enable employees to own more of the company (House bill only).
- 3 Provide technical assistance for smaller companies that may be interested in forming an ESOP.
- 4 Ensure small businesses that become ESOPs retain their SBA certification.
- 5 Affirm the importance of preserving the S ESOP structure in the Internal Revenue Code.

# Conclusion

**1 Employee-owners have better retirement savings.**

**2 S ESOPs pay higher wages.**

**3 Employee-owned firms are more productive and stable.**