

ESOP Administration Insights

THE ESOP MOVEMENT—PERSPECTIVES FROM THE ESOP ASSOCIATION LEADERSHIP

Malcolm R. Hartman

The ESOP community is a dynamic environment. The convergence of the various financial, business, legal, and political issues adds to the challenge to the individuals and institutions involved with ESOPs. Yet, it appears that the future is bright for ESOPs. And, many observers believe that the ESOP employee ownership movement is the wave of the future of American businesses. As a member of The ESOP Association Board of Directors, Mike Hartman solicited the insights and perspectives from other members of the Board. Hartman asked Steven Voigt, CEO of The King Arthur Flour Company, Inc., and chair of the ESOP Board of Directors about the future and the challenges facing ESOPs. Voigt graciously responded on behalf of The ESOP Association Board of Directors.

Insights: What do you see as the future for ESOPs and for the employee ownership movement?

Voigt: I envision a 21st century where the majority of American employees own stock in the companies where they work.

Just as we have seen the growth of all-natural and organic products in our nation's supermarkets, I believe we will see the development and use of more sustainable governance solutions in American corporations. Expanded employee ownership—through ESOPs—will play a major role in this development.

To again compare developments in the world that King Arthur Flour operates in, we see Americans selecting healthier foods. This trend is not because our government, or because large corporations, led the way. Rather this trend is due to values-driven, mid-sized companies in the food industry that laid out the information about food choices. And, consumers made their choices with this information in mind.

I expect a similar scenario in the world of employee ownership. This scenario is not just in the future, but it is developing right now. I see a scenario of values-driven, mid-sized companies, which are the core of the ESOP corporate community, leading the way with effective models of board governance, increased employee participation, and more equitable wealth creation.

Insights: In your opinion, what are the primary issues facing the ESOP community today?

Voigt: The ESOP Association and its board recognize that there are threats to the growth of, and even to the very existence of, ESOPs. These threats come from some quarters of government, academia, and media. However, we believe that these threats will be overcome, just as the ESOP community overcame similar threats in the 1970s, the 1980s, and the 1990s.

I compare this situation to the success of the small organic producers. Against their formidable competitors, these producers are winning space on the shelves of the major supermarkets. By winning that space, not only did the small producers win, but so did the grocers and the public.

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To cite one threat, The ESOP Association's board is very aware, and disappointed, that the current Administration (while professing a policy to promote an ownership society for America), has not been more responsive to the employee ownership movement. The current Administration has not, in any manner, made employee ownership in any form—and not just in the ESOP form—a part of that vision of an ownership society.

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It is my belief that employee ownership is as powerful in building a fair and just society as home ownership or mutual fund ownership. This belief is shared not only by the board of The ESOP Association but by anyone who has ever worked for, or with, ESOP-owned companies.

Also, the Presidential Panel on Federal Tax Reform seems to have left no room for ESOPs in the tax structure it has recommended to the Administration. The Panel's recommendations are now being reviewed by Congress in hearings and by the Treasury Department.

Insights: What are some of the challenges currently facing ESOP trustees (either internal or independent/institutional trustees)?

Voigt: The question arises: How does the current environment affect the trustees of ESOPs? With the well publicized scandals in the past eight or so years, the scrutiny of the duties and responsibilities of ESOP trustees and fiduciaries has intensified. And so the focus of ESOP trustees and fiduciaries on their responsibilities also has intensified.

And, I have observed that as the ESOP model becomes older, and is used more, coupled with developments with non-ESOP models of governance, then quite naturally the level of scrutiny of ESOP trustees and fiduciaries has increased. And it will continue to increase.

The response to this higher level of scrutiny of trustee and fiduciary decisions impacting ESOPs should be education, discussion, debate, and cooperation that explore policies, mechanisms, legalities, and best practices. In this way, the ESOP trustee is learning not just to meet basic legal requirements. The ESOP trustee is also learning to master the opportunities to maximize the role of ESOP-owned companies as models for American businesses.

I am pleased that The ESOP Association, in cooperation with its New England Chapter leadership, is in 2007 sponsoring a program for members of the board of directors of ESOP companies and trustees. The New England Chapter will be marketing this program nationally.

This program, pioneered by the New England Chapter, is an example of the type of education, discussion, debate, and cooperation noted above. And, it will bring together the top leaders of ESOP companies in an open and candid review of the crucial role that directors and trustees in an ESOP company must play in developing high performance companies.

Insights: In your experience, do you find that ESOP employer stock valuations are generally accurate? Are improvements needed in this area?

Voigt: There is a question whether the valuation of privately held ESOP company stock can be improved, and if so, how? I believe that the discounted cash flow analysis, commonly used in the ESOP stock valuation process, should incorporate the sponsor company repurchase obligation as projected. In comparison to ten years ago, I am pleased to see that more and more employer stock valuations incorporate the sponsor company repurchase obligation as projected.

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As a continuation of the emphasis on education of internal trustees and fiduciaries noted above, internal trustees are having greater appreciation as to who is legally charged with setting the value of ESOP sponsor company stock. As a result, internal trustees will be more involved with valuation issues. And, valuation professionals will have to accept this higher level of trustee involvement.

In conjunction with the trend that internal trustees will be more involved with valuation issues, I am extremely pleased that The ESOP Association's board has recently created an Interdisciplinary Advisory Committee on Fiduciary Issues. This committee complements and builds on the resources currently available to educate ESOP trustees and fiduciaries.

The new national meeting, the new advisory committee, and the growing awareness of ESOP company trustee and fiduciary issues will all help raise the bar as to what are the best practices in our ESOP community. And, these best practices will relate to governance, management, and day to day practices.

In looking over recent developments, and in thinking of the future, I am optimistic that ESOPs have a great future in our nation. This is because of the commitment, passion, and just plain horsepower of the people in the ESOP community.

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Insights: Steve, thank you for your time—and for your thoughtful observations.

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