Insight

Jobs, Pay, Retirement, and Employee Ownership: The Case of S ESOPs

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Americans are becoming increasingly frustrated with the anemic recovery following the worst recession since the Great Depression. Despite relatively robust job growth in 2014, wages have remained stagnant and lower- and middle-income families have yet to see improvements in their standard of living. As policymakers search for ways to assist lower and middle class families and increase mobility, one promising sign is a bipartisan effort to expand employee ownership. Conceptually, employee ownership occurs when a company is owned in part by the workers that it employs. The recently introduced Promotion and Expansion of Private Employee Ownership Act aims to expand one of the most common employee ownership models, the employee stock ownership plan sponsored by S corporations (or S ESOPs for short). These companies proved resilient throughout the recession as they added jobs and paid high salaries, all while providing their workers with retirement security.

An ESOP is a tax-exempt defined contribution retirement plan, similar to a 401(k). However, unlike a 401(k), an ESOP is comprised of shares of a company's stock held for the company's workers. In other terms, an ESOP allows employees to own and profit from the company for which they work. Since 1998, lawmakers have allowed ESOPs to be sponsored by S corporations, which are not publically traded and are usually owned by employees to a much greater degree. In fact, many S ESOP companies are 100 percent owned by employees.[1] The Promotion and Expansion of Private Employee Ownership Act would foster the development of more S ESOPs by encouraging S corporation owners to sell their stock to an ESOP, expanding financing prospects for S ESOPs, providing technical assistance to companies interested in becoming S ESOPs, and allowing small businesses that become ESOPs to retain their Small Business Administration certification.

So, what does the impact of employee ownership mean for the company and the economy? Evidence consistently shows that by setting up workers to directly benefit from their companies' success, S ESOPs increase employee commitment, job satisfaction, motivation, and, as a result, productivity. In addition, S ESOPs reduce company expenses by lowering worker turnover. The higher worker productivity and lower operations costs tend to increase the firms profitability, which allows it to grow faster, hire more workers, and pay better salaries.[2]

The result? S ESOPs were among the most resilient companies throughout the Great Recession. According to American Enterprise Institute's Alex Brill, between 2001 and 2011 S ESOP employment increased 60 percent. The evidence suggests that this is due both to more companies transitioning into S ESOPs and to S ESOPs expanding employment within their own firms. For instance, Brill notes that between 2002 and 2009, employment within a fixed sample of S ESOP companies grew 20 percent.[3] That's a significant increase in jobs considering that according to Bureau of Labor Statistics (BLS) data, employment fell 0.4 percent in the entire private sector during the same time period.[4]

Moreover, the job growth within S ESOPs occurred in industries that particularly struggled during the recession. In 2010 roughly 52 percent of all S ESOP employees worked in manufacturing, retail trade, construction, and wholesale trade.[5] While employment in S ESOPs grew 20 percent from 2002 to 2009, jobs in manufacturing, retail trade, construction, and wholesale trade *decreased* 22.3 percent, 3.4 percent, 10.4 percent, and 1.2 percent respectively.[6] The ability of S ESOPs to add jobs in industries where everyone else struggled indicates that employee ownership could be an effective way to promote growth and job creation.

Employment Trends in S ESOP Industries (2002-2009)	
Industry	**Employment Change**
All Private Industries	-0.4%
Manufacturing	-22.3%
Retail Trade	-3.4%
Construction	-10.4%
Wholesale Trade	-1.2%

Not only do S ESOPs increase their workforce faster than the rest of the private sector, but they also pay their workers higher wages and salaries. In 2010, the average annual wage of an S ESOP employee was $58,876, while the entire private sector averaged $48,196. This means that an S ESOP employee's pay was on average 22.2 percent higher than the average pay in all private businesses. In addition, the pay advantage is significant in four of the major S ESOP industries. Comparing the average pay of an S ESOP worker to the average pay for all workers in each industry, an S ESOP worker earned 26.3 percent more in manufacturing, 8.3 percent more in retail trade, 1.0 percent more in construction, and 20.7 percent more in wholesale trade.[7]

Average Pay in S ESOP Industries (2010)			
Industry	**Industry Average ($)**	**S ESOP Average ($)**	**Difference**
All Private Industries	48,196	58,876	22.2%
Manufacturing	58,468	73,839	26.3%
Retail Trade	27,646	29,931	8.3%

Average Pay in S ESOP Industries (2010)			
Construction	51,842	52,381	1.0%
Wholesale Trade	65,100	78,586	20.7%

In addition to creating jobs and increasing pay, S ESOPs also result in a more secure retirement for workers. Intuitively, as workers become more productive and the company becomes more profitable, the value of the company increases. As a result, this increases the value of worker retirement plans. These trends are confirmed in the data. According to a recent report from Ernst and Young's Quantitative Economics and Statistics (QUEST), from 2002 to 2012 the average total return per participating worker in S ESOPs was $99,000, suggesting a compound annual growth rate of 11.5 percent. That is over 60 percent larger than the S&P 500 Total Returns index, which grew at 7.1 percent compound annual rate during the same time period. In addition, S ESOP per participant distributions are greater than 401(k) plan distributions. From 2002 to 2012, 401(k) plans distributed an annual average of $3,200 and S ESOPs distributed $5,000, 56 percent greater. Moreover, S ESOPs are likely to provide workers with more than one retirement plan. While only 45 percent of all businesses offer any retirement plan, 65 percent of S ESOP companies provide at least one retirement plan in addition to the S ESOP.[8]

Bipartisan efforts like the Promotion and Expansion of Private Employee Ownership Act are effective ways to spur growth and empower workers. By enabling workers to directly benefit from business profits, employee ownership models incentivize workers to increase commitment and productivity, which in turn grow the company. As demonstrated by S ESOPs, employee ownership results is greater job creation, higher pay in lower and middle income industries, and enhanced retirement security.

[1] Brill, Alex, "An Analysis of the Benefits S ESOPs Provide the U.S. Economy and Workforce," Matrix Global Advisors, July 2012, p. 1, http://community-wealth.org/sites/clone.community-wealth.org/files/downloads/paper-brill.pdf