

# **RESILIENCE AND RETIREMENT SECURITY: Performance of S-ESOP Firms in the Recession**

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## Executive Summary

A study of a cross-section of Subchapter S firms with an Employee Stock Ownership Plan shows that S-ESOP companies performed better in 2008 compared to non-S-ESOP firms along a number of dimensions, including job creation, revenue growth, and providing for workers' retirement security. The S-ESOPs paid their workers higher wages on average than other firms in the same industries, contributed more to their workers' retirement security, and—crucially in a year of recession—hired workers when the overall U.S. economy was pitched downward and non-S-ESOP employers were cutting jobs.

S-ESOPs help prepare ESOP participants – the workers – for a more economically secure retirement. Employee-owners accumulate shares of company stock as part of their compensation in addition to their wages and other benefits such as health insurance. This is a meaningful contrast between S-ESOPs and other firms: nearly 60 percent of working Americans do not have any assets in a work-related retirement plan and half of American workers do not even have access to an employer-sponsored retirement savings plan. S-ESOP firms play an important role in contributing to their employee-owners' retirement security—an ownership stake in their employer is a form of diversification compared to workers who otherwise rely on government retirement plans such as Social Security. Further diversification is achieved for workers as they near retirement, as ESOP retirement plans are mandated to provide asset diversification for workers aged 55 and older. In addition, previous studies have found that 80 percent of S-ESOP firms offer workers retirement savings plans in addition to the ESOP—and many of these firms make employer contributions to workers' retirement savings in these plans.

These findings are derived by comparing data from a survey of S-ESOP companies that are members of the Employee-Owned S Corporations of America (ESCA) with data on both national averages and data specific to the same industries as the surveyed S-ESOP firms.

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## I. Introduction

Firms organized as S-ESOP's – Subchapter S firms with an Employee Stock Ownership Plan – performed better in 2008, the first year of the recent recession, than non-ESOPs in terms of retaining jobs and increasing wages and revenues. S-ESOP firms maintained, and in some industries expanded, their workforce even when the overall U.S. economy was pitched downward and non-S-ESOP employers were cutting jobs. S-ESOP firms displayed this superior performance along a number of dimensions, including revenue growth, retirement security, and job creation.

The S-ESOP organizational form offers a potential explanation for the relative resilience of these firms in the recession. S-ESOPs provide employees with a direct ownership stake, so that employee-owned firms align worker and employer interests. Economic research has found that the introduction of an ESOP is associated with productivity improvements as well as increased commitment and motivation.<sup>1</sup> The employee-owners of S-ESOPs accumulate shares of stock in the firm as part of their compensation—participants in a firm's ESOP become owners in addition to their wages and other benefits such as health insurance. All firms were affected by the recession that began in the United States in December 2007, but S-ESOPs on average continued to hire when other firms laid off workers; S-ESOPs invested in their businesses when other firms were in retreat; and S-ESOPs expanded their contributions to employee retirement plans when other firms were doing the opposite.

These findings are derived from a survey of S-ESOP companies that are members of the Employee-Owned S Corporations of America (ESCA). Data on jobs, wages, retirement contributions, and other facets of firm performance obtained through this survey are compared to both national averages and to data specific to the same industries as the surveyed firms. The survey includes 49 S-ESOP firms with total revenues of over \$18 billion and more than 87,000 U.S. employees at the end of 2008.

Firms organized as S-ESOPs enhance the retirement security of their workers, as contributions by their employer together with growth in the value of the stock over time boosts employees' retirement savings. Taxes on the appreciated value of the stock in the retirement plan are deferred until the employee eventually sells his or her shares while in retirement. This tax treatment is similar to that of traditional defined benefit retirement plans and defined contribution retirement plans.

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<sup>1</sup> Among many other studies, see Douglas Kruse, Richard Freeman, and Joseph Blasi, "Do Workers Gain by Sharing? Employee Outcomes under Employee Ownership, Profit Sharing, and Broad-Based Stock Options," National Bureau of Economic Research working paper 14233, August 2008; Joseph Blasi, Richard Freeman, Chris Mackin, and Douglas Kruse, "Creating a Bigger Pie? The Effects of Employee Ownership, Profit Sharing, and Stock Options on Workplace Performance," National Bureau of Economic Research working paper 14230, August 2008; and Steven F. Freeman, "Effects of ESOP Adoption and Employee Ownership: Thirty Years of Research and Experience," University of Pennsylvania Organizational Dynamics Working Paper 07-01, 2007.

S-ESOPs involve the important contribution to workers' retirement security of having a meaningful part of compensation set aside for employee-owners' retirement. This contrasts with the fact that, according to the Employee Benefit Research Institute, only half of Americans in 2008 worked for an employer that provided employees with a retirement savings plan, and that not much more than 40 percent of American workers participate in such plans. When nearly 60 percent of working Americans have no work-related retirement plan, S-ESOP firms play an important role in contributing to their employee-owners' retirement security—an ownership stake in their employer is a form of diversification compared to workers who otherwise rely on government retirement plans such as Social Security. Further diversification is achieved for workers as they near retirement, as ESOP retirement plans are mandated to provide asset diversification for workers aged 55 and older. In addition, previous studies have found that 80 percent of S-ESOP firms offer workers retirement savings plans in addition to the ESOP—and many of these firms make employer contributions to workers' retirement savings in these plans.

The results of this study show that S-ESOP firms contributed to stabilizing the economy and enhancing rather than cutting jobs in 2008. S-ESOPs paid their workers higher wages on average than other firms in the same industries, contributed more to their workers' retirement security, and hired workers when other firms were laying them off.

## II. Methodology

This study uses data from a survey of 49 S-ESOP companies to make comparisons between the performance of S-ESOPs and other firms as represented by national economic statistics. The comparisons are made for all firms and for firms grouped into several industries. The focus of this report is on performance in 2008, which corresponds to a full year of recession in the U.S. economy. Superior economic performance by S-ESOP firms is particularly valuable in this year, when the overall economic environment was negative.

Data were collected directly from S-ESOP companies belonging to ESCA. Of the 49 firms, 12 have a main line of business in construction, 13 are manufacturing firms, and the remaining 24 firms are in a mix of service industries including wholesale and retail trade, health care and social assistance, and financial or professional services. The data for each firm include employment, wages, non-wage compensation such as health benefits and retirement contributions, assets, revenues, net income, capital expenditures, and stock valuations. Information was collected as well on each firm's ESOP, including the number of participants in the employee-ownership plan and the value of the assets in each plan. These data are then compared to corresponding figures for the national economy and for firms within each industry.

Summary statistics for the 49 companies responding to the survey are provided in Table 1. In 2008, the respondents, on average, had assets of \$221.1 million and gross receipts of \$376.0 million. Respondents in the construction industry, on average, were somewhat smaller when measured by assets, but larger when measured by gross receipts. Firms in the manufacturing industry exhibited the greatest profitability, as measured by net income. The labor market characteristics indicate that the firms had, on average, over 1,300 U.S. employees. Respondents in the construction industry, on average, had 1,900 employees, more than twice the employment level for respondents in the manufacturing industry. Retirement assets for active ESOP participants, on average, totaled nearly \$100 million. ESOP assets totaled \$86.9 million for the construction industry, but \$237.3 million for respondents in the manufacturing industry. On average, respondents had 809 active ESOP participants representing about 60 percent of U.S. employment.

### III. Findings

The benefits of the S-ESOP organizational form include more resilience in creating and keeping jobs; better performance in paying higher wages and higher overall compensation; providing wage growth for workers; and making higher contributions to workers' retirement plans. S-ESOP firms on average have better performance than non-S-ESOPs in terms of revenue growth, which is a key measure of firm vitality. Taken together, these results suggest that the S-ESOP organizational form is associated with job creation and growth even in 2008 when the U.S. economy had entered recession. Table 2 provides results for the surveyed S-ESOP firms and for comparable national average data.

Resilient job creation. S-ESOP firms were resilient employers in 2008, with employment growing by 1.9 percent among surveyed S-ESOP firms even as it fell by nearly 3 percent in the overall U.S. private sector. Employment was flat at S-ESOP manufacturing firms, but even this compares favorably to non-S-ESOP manufacturers, where the number of employees fell by more than 6 percent. Overall, S-ESOP firms adjusted their workforce by less than other similar firms. Key findings on job growth include that:

- Employment in S-ESOP firms rose in 2008 by 1.9 percent, while overall U.S. private employment fell by 2.8 percent.
- These trends hold up across industries, including construction, manufacturing and services:
  - Construction employment was up by 3.0 percent for S-ESOP firms in 2008, even while overall construction employment in that year fell by 9.1 percent.
  - Manufacturing employment was flat for S-ESOP firms in 2008, compared to a 6.4 percent job loss for all private manufacturing firms.
  - Services employment was up by 1.9 percent for S-ESOP firms in 2008, and down by 1.3 percent for overall services firms.

Faster wage growth per worker. Employees at S-ESOP firms experienced faster growth in wages per worker in 2008 compared to other firms. Wages are cash wages calculated using data on earnings from W-2. Key findings on wage growth include that:

- Wages per worker in S-ESOP firms rose in 2008 by 5.9 percent, while overall U.S. earnings per worker grew by only 3.2 percent.
- This result holds for construction, manufacturing and services:
  - Construction wages per worker increased by 7.1 percent for S-ESOP firms in 2008, compared to an increase of only 3.3 percent overall.
  - Manufacturing wages per worker were up by 1.9 percent for S-ESOP firms in 2008, and up by 1.8 percent overall.
  - Services wages per worker was up by 7.1 percent for S-ESOP firms in 2008, and up by 3.6 percent overall.

Higher average wages. Employees at S-ESOPs have higher average wages than workers on average in the private sector.

- The average wage per worker in S-ESOP firms was \$50,225 in 2008, compared to \$31,600 for workers in the overall private sector.
- S-ESOP wages are higher for manufacturing and services firms, with wages in construction firms essentially the same between S-ESOP and other firms:
  - For manufacturing, the average wage for S-ESOPs was \$55,600, as compared to \$37,600 overall for private sector firms.
  - For services firms, the average wage for S-ESOPs was \$53,200, compared to \$29,900 overall for private sector services firms.
  - For the construction industry, the average S-ESOP wage of \$43,500 was nearly the same as the average wage of \$43,800 in private sector construction firms.

Benefits growth. Workers in S-ESOP firms enjoy stronger growth of health benefits and retirement contributions than workers in other firms, in addition to higher wages.

- The growth of benefits for S-ESOP firms was 11.0 percent in 2008, but only 1.9 percent for the overall economy.
  - These trends hold up for all industries with the growth of benefits in 2008 in the construction at 9.9 percent, in manufacturing at 12.5 percent and other S-ESOP firms at 11.0 percent. The growth of benefits for comparable industries in the overall economy was about 1 to 2 percent (national average data are not available for benefits growth in construction firms).

Retirement security. Employees of S-ESOP firms have employer-provided retirement contributions that are superior to those received by employees of firms in the overall economy. This is particularly the case for ESOP participants, demonstrating and reflecting the benefits of ownership. Moreover, S-ESOP employee-owners have substantially more resources accumulated for their retirement than typical workers at other firms.

- Employer contributions to retirement benefits rose by 18.6 percent for all employees in the S-ESOP firms surveyed. This compares to 2.8 percent growth of contributions by all employers to employee retirement plans.

- These trends hold up for all industries with the growth in retirement benefits in 2008 in the construction industry at 17.4 percent, in manufacturing at 20.4 percent and the growth for other S-ESOP firms at 18.9 percent.
- The employee-owners of S-ESOP firms accumulate substantial amounts for retirement. The value of S-ESOP assets per active participant was \$100,000 in 2008, compared to only \$45,500 for the average 401(k) account for the overall economy.
- Moreover, the ESOP assets withstood the downturn in the equity markets to a much greater extent than 401(k) assets. S-ESOP plan assets fell by 3.8 percent in 2008, compared to a decline of 23 percent for defined contribution plan or 401(k) plan assets.
  - S-ESOP plan assets per active participant fell by 6.2 percent in 2008, while average 401(k) balances fell by over 30 percent.

Firm growth. The S-ESOP organizational form is conducive to strong performance, not least because it provides clear incentives for employees, who are the owners of the firm. Revenues for all S-ESOP members in the survey grew by 15.1 percent in 2008, compared to a decline of 3.4 percent for all private industry revenues.

- Sales rose by 3.5 percent for S-ESOP members in manufacturing, compared to a 9.8 percent decline in sales by overall manufacturing firms.

#### IV. Conclusion

With all tax structures facing close scrutiny in a tight federal budget situation, these findings suggest the value of the S-ESOP form in terms of employment resiliency, the contribution of employers to workers' retirement security, and firm and wage growth. In 2008, S-ESOP firms performed better than other firms along these important dimensions, highlighting the contribution of the S-ESOP organizational form to the U.S. economy.

Even looking beyond the recession, employee-owners at S-ESOP firms are much better prepared for retirement than workers at other types of firms, with substantially higher account balances on average in their S-ESOP plans. The contrast is especially stark when comparing with the 60 percent of workers who have no assets in an employer-sponsored retirement plan, either because they choose not to participate or because such a plan is not offered by their employer in the first place. For employee-owners at S-ESOP firms, the employee stock ownership plan represents a vital part of their retirement security—and illustrates that providing the opportunity for workers to accumulate these retirement assets is a key advantage of the organizational form.

**Table 1: Data Summary for S-ESOP Firms, 2008**  
(Average figures per firm responding to the survey)

	All Companies	Construction	Manufacturing	Other
<b>Company Characteristics</b>				
Assets, \$mn	221.1	186.0	232.7	232.3
Gross Receipts, \$mn	376.0	488.6	326.4	346.5
Net Income, \$mn	22.2	24.4	38.0	12.6
<b>Labor Market Characteristics</b>				
U.S. Employment	1,329	1,900	893	1,279
Wages, \$mn	68.4	83.9	50.1	70.6
Health Benefits, \$mn	5.5	4.5	4.6	6.5
Other Benefits, \$mn	1.7	1.4	0.9	2.2
<b>ESOP Retirement Characteristics</b>				
ESOP Assets, \$mn	98.9	86.9	237.3	131.4
Contributions & dividends, \$mn	7.4	9.5	5.0	9.3
ESOP Participants	809	613	590	1,025
Respondents	49	12	13	24



**Table 2: Performance for S-ESOP Firms vs. Overall Economy, 2008**

	<b>S-ESOP</b>	<b>Overall Economy</b>
<b>Job Growth, %</b>		
Total	1.9	-2.8
Construction	3.0	-9.1
Manufacturing	0.0	-6.4
Services	1.9	-1.3
<b>Wage Growth, %</b>		
Total	5.9	3.2
Construction	7.1	3.3
Manufacturing	1.9	1.8
Services	7.1	3.6
<b>Benefit growth, %</b>		
Total	11.0	1.9
Construction	9.9	...
Manufacturing	12.5	0.9
Services	11.0	2.1
<b>Retirement contribution growth, %</b>		
Total	18.6	2.8
Construction	17.4	...
Manufacturing	20.4	...
Services	18.9	...
<b>Revenue growth, %</b>		
Total	15.1	-3.4
Construction	35.1	-10.0
Manufacturing	3.5	-9.8
Services	9.9	...
<b>Avg wage, \$</b>		
	<b>S-ESOP</b>	<b>Total</b>
Total	50,225	31,616
Construction	43,457	43,791
Manufacturing	55,585	37,615
Services	53,223	29,881

#### About the authors:

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