Retirement Security and Wealth Accumulation in S ESOP Companies

NCEO
The National Center for Employee Ownership

Corey Rosen
The National Center for Employee Ownership
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By Corey Rosen
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Executive Summary

In the summer of 2005, the National Center for Employee Ownership - a private, nonprofit research, information and membership organization - surveyed members of the Employee-Owned S Corporations of America, "ESCA," to assess how well these companies provide financial security to their employees through their S corporation employee stock ownership plans (ESOPs). The survey was made possible through funding from LaSalle Bank and the law firm of McDermott, Will & Emery.

S corporations have been allowed to sponsor ESOPs since 1998, and, effective January 1, 1998, Congress created tax provisions to further enable and encourage the creation of S ESOPs. Since then, the number of S corporation ESOPs has grown significantly. In most cases, the S corporation is 100 percent owned by the ESOP.

This survey was intended to assess what benefits, if any, have been generated for employee-owners as a result of Congress' actions. To make this determination, we asked ESOP companies to compute average ESOP account balances, then asked employees to tell us their individual balances. From these, we were able to compute mean, median, and percentile ownership amounts. The data was then broken down by participant age.

The results - which reflect voluntary responses from 1,863 employees in 16 S ESOP companies spanning many industries across the nation - are impressive. Witness:

- The median account balances for S ESOP participants are *three to five times the comparable averages for 401(k) plans.* Median employee account balances in this survey range from of $75,000 to $100,000, while median account balances for employees in 401(k) and other defined contribution plans range from $20,000 to $22,000.
- S ESOP employees nearing retirement (ages 54-64) have median account balances that are about *six to seven times the median account balances* for employees nationwide in 401(k) and other defined contribution plans.
- S ESOP participants largely believe that their wages are as good as or better than employees doing similar work in non-ESOP companies, and that their retirement benefits are much better than their counterparts'.
- Turnover rates at S ESOP companies are considerably lower than the national average. Voluntary turnover is roughly half the national average, while involuntary turnover is less than one-third the national rate.
- S ESOP companies' stock prices vastly outperformed the stock market over the past five years. While the S&P 500 average annual gains was 2.3 percent over this period, more than two-thirds of responding S ESOP companies reported annual gains *four to nine times higher than the average.* Only one responding company in the sample group reported a five-year loss.
- S ESOP companies provide diversification in retirement savings beyond what is mandated by law. Ninety-four percent of company respondents say that in

addition to the ESOP they provide at least one other qualified plan to their employees.

The sample for the survey represents, of course, a group of companies committed to the ESOP concept. Nonetheless, an analysis of other studies looking at entire populations of ESOP companies suggests that - even with conservative adjustments for sample bias - ESOP participants are far ahead of their counterparts. The data also show that S ESOP participants do not, as often believed, give up wages or other benefits to be in the ESOP. Instead, the ESOP largely is "gravy" on top of other benefits and compensation.

Retirement Security and Wealth Accumulation in S ESOP Companies

In 1997, the law was changed, effective January 1, 1998, to allow S corporations to have employee stock ownership plans (ESOPs) as shareholders. Before the effective date, Congress refined the new law, exempting the ESOP trust from the unrelated business income tax (UBIT) on any earnings attributable to its share of ownership. This change meant that if an ESOP owned 50% of an S corporation, 50% of its profits would not subject to tax at the federal level. If it owned 100%, it would not have any current federal tax obligation (state laws vary with respect to the taxability of these profits). The tax in such instances is imposed when the employee-owner liquidates his or her ESOP account (i.e., at retirement) – at that time, the S ESOP participant pays ordinary income taxes on these earnings. The policy basis for this approach rests on the notion that allowing employee ownership in an S corporation fosters a broader distribution of wealth among employees who, as owners, will help their companies perform better, while also accumulating significant retirement savings.

Existing research supports the notion that ESOPs in general accomplish these purposes. In the largest and most comprehensive study to date, researchers in Washington State found that employees in ESOP companies received about 5% to 12% higher wages than comparable employees in comparable non-ESOP companies, while their retirement benefits (their ESOP account balances plus any additional retirement plans) were about three times as great. In fact, the diversified portion of their account balances was about the same as the total account balances of comparable non-ESOP employees.[a] In a 2005 study of Ohio companies, the median ESOP account balance was just over $30,000, while a study that same year in Massachusetts found that the median account balances were over $50,000.[b] As we shall see, both numbers are significantly higher than median 401(k) balances for employees nationwide.

But ESOPs are rarely stand-alone retirement plans. These studies show that all but a small number of these plans have additional (and diversified) retirement plans. A 2002 assessment of ESOP plans nationwide by Douglas Kruse of Rutgers found that ESOP companies were much more likely to have other retirement plans than comparable companies were to have any kind of retirement plan at all. Moreover, extensive research shows that ESOP companies grow about 2.5% per year faster in sales, employment, and productivity than comparable non-ESOP companies.[c]

In this study, we look specifically at how S ESOP companies perform in terms of the first major policy question, namely how well they provide for the retirement security and wealth-building of their employees. The data were gathered from 16 S ESOP corporations ranging from under 100 employees to 10,000 employees. Most of the plans have been in existence for at least 10 years (meaning they were C corporation ESOPs before the 1998 change in the law). The study included analyses of data provided by the companies and retirement security surveys filled out voluntarily by 1,863 employees at

the participating companies, all of whom are members of the Employee-Owned S Corporations of America ("ESCA").

Because of the relative self-selection among survey respondents, our survey findings can be meaningful only if they demonstrate that respondents do not merely do *somewhat better* on measures of retirement security and wealth accumulation, but that they do *substantially better*. **That, in fact, is just what we found**.

The median account balances for participants in the S ESOP was in the range of $75,000 to $100,000, a number that is four to five times the median account balance for employees who have company-sponsored 401(k) plans. For employees nearing retirement age (those ages 55-64), the median account balances are even more impressive: At six of the companies, employees in this age range had balances of more than $300,000, and the median was between $150,000 and $200,000. All but one of the 16 S corporations provided at least one other retirement plan in addition to the ESOP (generally a 401(k) plan); of these corporations, two had a defined benefit plan and four had profit sharing retirement plans. Employer contributions to these plans are similar to typical employer contributions to retirement plans, even in the absence of an ESOP. In other words, the ESOP is, to a large extent, "gravy."

The impressive numbers are the result of two factors: first, these companies tend to make large annual contributions to the ESOP, with 9 of the 16 contributing 10% of pay or more. Second, their stock has done well. Over the last five years, two-thirds of the companies report stock gains averaging 10% a year or more, with four of these reporting gains of 20% a year or more. Only one company's stock had fallen. These numbers well outpace the stock market's performance.

Finally, the survey results illustrate that these significant benefits to S ESOP participants in wealth-creation and retirement savings - and the corollary benefits to their companies - would not exist but for the current tax rules which facilitate and enable S corporation ESOPs. Among companies participating in the survey, 43% of respondents said they would reduce the size of their ESOP and 29% said they would have no ESOP at all in the absence of current supportive federal tax rules.

Background

Employee ownership can be accomplished several ways. Employees can buy stock directly, be given it as a bonus, can receive stock options, or can obtain stock through a profit sharing plan. Some employees become owners through worker cooperatives where everyone has an equal vote. But by far the most common form of employee ownership in the U.S. is the ESOP. Almost unknown until 1974, about 11,000 companies now have these plans, covering about 10 million employees.

S Corporation ESOPs

An ESOP is a kind of employee benefit plan. In an ESOP, a company sets up a trust fund, the shares of which are allocated to individual employee accounts, generally all full-time employees over age 21. These employee accounts receive allocations over time either on the basis of pay or some more equal formula. As employees accumulate seniority, they acquire an increasing right to the shares in their account. When employees leave the company, they receive their stock, which - in the case of an S corporation - the company must buy back from them (or "repurchase") at fair market value.

Most S ESOPs are used to provide a market for the shares of departing owners of successful closely held companies, and to motivate and reward employees. In almost every case, ESOPs of S corporations are funded by the company; employees rarely actually purchase the shares.

An S corporation is a form of business ownership in which the shareholders, not the corporation, pay taxes on the entity's earnings (at applicable individual tax rates). S corporations often make a distribution to these owners equal to the amount of tax they owe. When owners of an S corporation sell their stock ownership interest, they pay capital gains taxes on the gain, but the amount taxed is decreased by any allocations of earnings on which they paid taxes. S corporations allow owners to avoid the double taxation on corporate earnings that applies to C corporations (the company pays taxes on profits; the owners pay taxes when the profits are distributed). Top C corporation tax rates are marginally lower than top individual rates, however, and 2%-or-more owners in an S corporation must include fringe benefits as taxable income. S corporations can only have one class of stock and no more than 100 shareholders.

Before January 1, 1998, S corporations could not have ESOPs or other non-taxable entities as owners. In 1996 (effective for 1998), Congress allowed S corporations to have certain non-taxable entities as owners, including ESOPs. In 1997 (effective 1998), Congress amended this to provide that the ESOP owner of an S corporation would not be subject to current federal taxes (in this case, unrelated business income tax). That is because when employees receive a distribution of their account balances from the ESOP, they must pay tax on them immediately or roll them into an IRA or other retirement plan, deferring tax until they take money out of that plan. Either way, the profits that are not currently taxed effectively add to stock value and are taxed later on. To tax profits at both the ESOP level and the employee level would be a double taxation, contrary to the concept of the S corporation.

Design of the Survey

At ESCA's request, this survey was conducted in the summer of 2005 by the National Center for Employee Ownership (NCEO), a private, non-profit research, information and membership organization located in Oakland, CA. The author of this report, NCEO's executive director, Corey Rosen, led the survey. Mr. Rosen has a Ph.D. in political science and is the author or coauthor of several books on the subject including, most recently, *Equity: Why Employee Ownership is Good for Business* (Harvard Business School Press, 2005). The NCEO's mission statement is to provide "the most objective, reliable information possible about broad-based employee ownership plans." That is a mission the organization takes very seriously, and it has not hesitated in the past to publish negative results about one aspect of employee ownership or another. NCEO is committed is to publish what it finds, not to shape what it finds into a politically useful product.

Companies who participated in this survey provided basic data about their plans and operations. They then offered employees the opportunity to fill out an on-line, privacy-protected survey set up by the NCEO. Survey responses were anonymous and contained no information that could identify individual employees. Companies either asked their entire workforce to participate or, for very large companies, opened the survey to a large, random sample. The distribution of responses by age, plan tenure, and other characteristics is very dispersed and does not immediately suggest any sample response bias. We asked both companies and employees about account balances, to see if the numbers from the two samples were internally consistent. For instance, the median account balances of respondents were substantially lower (in every case but one) than average account balances reported by the companies, which is the expected statistical pattern. The average mean account balance for all 16 companies was about 60% greater than the average median account balances reported by participants, a number that would be consistent with typical ESOP patterns (ESOPs tend to have a flatter distribution of account balances than other compensation plans because of limitations on the amount that can go to top earners, resulting in less skewing between means and medians).

Sample Characteristics

The 16 companies represented a diverse sampling of S corporation companies. Table 1 describes their primary characteristics.

Table 1: Sample Characteristics

% ESOP Owned		Age of the Plan		Industry		Employees	
100%	81%	1-5 yrs	12.5%	Manufacturing	37.5%	50-100	18.75%
50-99%	19%	6-10 yrs	31.25%	Wholesale	12.5.%	101-250	18.75%
		11-15 yrs	12.5%	Construction	12.5%	251-500	31.25%
		16+ yrs	43.75%	Banking/Insurance	12.5%%	500-1000	6.25%
				Other services	25.0%	>1000	25%

N=16

Almost all of these companies have at least one additional retirement plan, and some have two, as detailed below.

Contributions to the ESOP consist of two elements: first, the percentage of pay directly contributed to the plan each year by the company; and second, any additional distributions on earnings allocated to the plan (these are similar to dividends in a C corporation). Contribution rates by participating companies are as follows:

Annual percentage of eligible pay contributed to the ESOP by the company*

25%	1
20% to 24%	1
15% to 19%	3
10% to 14%	4
5% to 9%	4
<5%	3

*Eligible pay is the pay legally allowed to be covered by the plan.

These percentages are considerably higher than typical U.S. company contributions to defined contribution plans, which fall in the range of 2% to 3% of eligible pay, as described further below.

Moreover, seven of the respondent companies add to their contributions by making annual distributions. Two companies contribute 25% or more of eligible pay; two contribute 20% to 24%; three contribute 15% to 19%; two contribute 10% to 14%, and one contributes under 5%. In all but one case, these contributions are the equivalent of 10% or more of employee pay. Factoring in the distribution thus means employees of these companies are seeing annual additions to their ESOP accounts in the range of 20% to

55% in these companies, contribution levels that would easily place these companies in the top 1% of all U.S. employers for employer generosity. [d]

Account Balances

From the taxpayer's standpoint, the real test of the value of the S ESOP structure is whether it does what it is intended to do—spread more wealth to more people. To address this question, we asked companies to report average account balances for plan participants. We also asked employees to tell us, within a range, what their account balances are. In the tables that follow, we break down these data in a variety of ways, including the mean account balances for all companies, the median for company account balances, median account balances per employee (weighted by individual respondent or counting each company's employee responses equally), and account balances for the 25% and 75% percentiles, as well as for account balances over $400,000 and under $10,000. We also break out the data by age. Where possible, we compare these data to national-level data. We focus primarily at medians, as these are a much better measure of how the typical employee fares (after all, Bill Gates and one million poor people have a mean net worth that makes them look comfortable).

In company weighting, we take the median for each company, array them in order, and take the median of that group. In employee weighting, we simply count each employee's response equally, without adjusting for company size, and compute the median. That means that employees from larger companies have more weight in the results.

The simplest way to look at account balances, however, is to take the average of balances in each company (weighting each equally). In this survey, that number is $151,848, compared to the national average 401(k) account balance in 2002 of $33,647[e] or roughly $55,000 in 2003.[f]

Because we used broad categories for account balance responses, there was little difference between the medians for the two ways of looking at the sample. The difference with the national 401(k) samples, though, is striking, with ESOP balances three or more times as great. That finding is even larger than the Washington State ESOP study, which found retirement accounts for ESOP participants were three times those of comparable employees in comparable non-ESOP companies. The participants in these plans, of course, also generally have diversified retirement assets, whereas the 401(k) plan is the only retirement plan for most non-ESOP participants. In short, the ESOP participants are doing vastly better in terms of retirement security.

Table 2 looks at the account balances as reported by employees, compared to national data.

Table 2:
Account Balances in S ESOPs and in U.S. 401(k) Plans
(median of medians)*

	S ESOP Corporations, Company Weighted	S ESOP Corporations, Employee Weighted	Fidelity National Sample**	Vanguard Center Study***
Median	$75,000 to $100,000	$75,000 to $100,000	$21,000	$21,182
75% percentile	$150,000 to $199,000	$150,000 to $199,000	n.a.	
25% percentile	$20,000 to $29,000	$20,000 to $29,000	n.a.	
>$400,000	7%	18.5%	n.a.	
<$10,000	14%	12.4%	n.a.	

*In this table, we report the median of the various account balances for the 16 companies (e.g., where half the sample comes out above and half below) in the first column and the medians for all respondents in the second category.
**Data come from *Building Futures*, Volume 5, which reports on data from 10,136 plans with 8.2 million participants administered by Fidelity Investments for 2003. There are a variety of other surveys, but this one appears the most recent and largest that calculates medians (most only calculate means).
***Data from *Vanguard Defined Contribution Plans—Current Practice*, Vanguard Center for Retirement Research, 2004.

Table 3:
Account Balances in S ESOPs and in U.S. 401(k) Plans, By Age Group
(median of medians)*

	S ESOP Corporations Company Weighted	S ESOP Corporations, Employee Weighted	Federal Reserve Study*	Vanguard Center Study
Age:				
25-34	$20,000 to $29,000	$20,000 to $29,000	n.a.	$8,076
35-44	$75,000 to $100,000	$75,000 to $100,000	$24,000	$20,051
45-54	$100,000 to $150,000	$100,000 to $150,000	$37,000	$33,630
55-64	$300,000 to $400,000	$200,000 to $300,000	$42,000	$45,803

*Data from Alice Munnell and Annika Sunden, "Coming Up Short: The Challenge of 401(k) Plans," a 2002 study from the Federal Reserve. The Fidelity study also broke out medians by age, but in different categories. The median for 60-64 was $41,000, for 50-59 $37,000, for 40-49 $27,000, for 30-39 $15,000, and for 20-29 $4,000.

Impact on Turnover

As a result of the retirement savings and wealth accumulation benefits in S ESOP companies, and the investment of these employee-owners in their companies, S ESOPs surveyed have very low turnover rates. We asked for the voluntary quit rate and the involuntary quit rate. Table 4 compares the ESOP companies to national data for 2001-2004 developed by the U.S. Bureau of Labor Statistics.

Table 4:
Turnover Rates in S ESOP and U.S. Companies

	S ESOP Companies	U.S. Companies
Voluntary turnover	8.1%	15.0%
Involuntary turnover	6.1%	21.1%

Almost all the companies surveyed have at least one additional retirement plan, and some have two. Fifteen of the sixteen companies reported that they offer 401(k) plans, four offer profit sharing plans, and two offer defined benefit plans. Of the sixteen companies, then, 15 have at least one plan, and six have two plans in addition to the ESOP. For companies with 401(k) plans, 11 of 15 provide an employer match of some kind.

Looked at another way, we asked the companies to indicate the annual percentage of compensation the company contributes to its retirement plans outside of the ESOP. The distribution is described below:

Percentage of Compensation Contributed Annually to Retirement Plans Other than the ESOP

Percentage	# of company responses
0%:*	4
.5% - 1.5%:	4
1.6% - 3.0%:	4
3.1% - 5.0%	2
10%	1
19%	1

*Plan funded entirely by employee deferrals (for companies which offer a qualified plan in addition to the ESOP)

The data here looks at the percentage of pay contributed as a percentage of eligible pay (that is the pay of people in the plan eligible for contributions). There are no directly comparable data on how much employers who have retirement plans contribute to their plans. According to a variety of sources, the most typical matching formula for a 401(k) plan is 50% of deferrals, up to 6% of pay.[8] But many employees make no deferrals or they defer considerably less than 6%, meaning employer costs are lower than 3% of pay. Data from the Employee Benefit Research Institute finds that the typical employer contribution to defined contribution plans accounts for about 1.8% of total compensation costs, though they do not translate this into the average employee match. It seems reasonable from these data, however, to conclude that average contributions among U.S. plans to defined contribution plans are in the 2% to 3% of eligible pay range for companies that offer such plans. Even so, it is important to remember that many companies, especially smaller ones, offer no retirement plans of any kind. Just one-third of employers with fewer than 100 employees have any kind of plan, while 62% of those with more than 100 employers do. Yet in our sample of 16 companies, 94% offer at least one retirement plan in addition to their ESOP and, the data suggest, fund these plans at levels that are roughly comparable to other employers' total contributions to all retirement plans.

A common – and yet inaccurate – criticism is that S ESOPs *de facto* cause employees to rely excessively on company stock for their retirement. The findings here amplify that this simply is not true. First, ESOPs by law and practice become partially diversified as they mature. Under ERISA, S corporation ESOPs must allow employees to diversify up to 25% of their investment out of the company's ESOP once they hit age 55, if they have at least 10 years of service to the company. If an employee elects to diversify 25% of his account, the amount diversified equals or exceeds the median in 401 (k) plans for similar aged employees. On top of this automatic diversification, as we find here, most S ESOP companies are already providing their employee-owners with qualified retirement plans above and beyond the ESOP.

Stock Performance

The companies in the sample have had strong stock performance over the last five years, as indicated below. We asked companies only to report a range, not a specific number, to make it easier for them to compile the data.

During that same time, the S&P 500 had an average annual gain of only 2.3%, and the NASDAQ declined overall. Thus almost all participating S ESOP companies outperformed both those indexes. Had employees been investing their ESOP balances in the stock market over this period, their retirement savings would have fared substantially worse.

Change in Stock Prices Over Prior Five Years

Percentage	# of company responses
20% per year or more:	4
10% to 19% per year:	7
0% to 9% per year:	4
<0% per year:	1

Retirement Confidence and Planning

The central findings of this project focus on how S corporation ESOPs contribute to the retirement security of participants. We looked at five issues to address this directly: how confident people are in the retirement security; the percentage of total retirement assets the participants expect the ESOP to comprise; how ESOP participants think their wages and benefits compare to comparable employees; how they think their retirement benefits compare, and the size of participant account balances.

There were about 1,850 individual responses to each question, with small variations in the number of responses per question. We present the responses in two formats. The first format takes the mean (average) or median numbers for each company, then takes the median of these scores. The benefit of this approach is that it equally weighs companies. Some companies had hundreds of respondents to the survey; some had fewer than 100. If the few very large companies have a much different pattern of responses than the smaller ones, than they would largely determine the outcomes.

Retirement Confidence

Table 5 provides results for the retirement confidence question. Respondents were asked "How confident are you that you will have enough money to retire comfortably?" This question is the same as that asked by the Employee Benefits Research Institute in their 2005 Retirement Confidence Survey, the leading national survey on this question.[h]

For these data, there is little difference based on how the results are weighted. Our question differed slightly in that it had a mid-point question. If we did not ask that, the two categories ("somewhat comfortable" and "not too comfortable") would have increased proportionately. The results do not show a marked difference between the national sample and the S ESOP sample, except for the very notable difference between the very small portion (less than 4%) of our sample who report they are "not at all comfortable" about their chances for a comfortable retirement, compared to 17% of respondents in the national sample.

Table 5:
How Confident Are You That You Can Retire Comfortably?

	S ESOP Corporations, Company Weighted	S ESOP Corporations, Employee Weighted	EBRI National Sample
Very comfortable	21.4%	20.7%	25%
Somewhat comfortable	45.4%	44.7%	40%
Neither comfortable nor uncomfortable	17.4%	19.1%	not asked
Not too comfortable	12.3%	11.4%	17%
Not at all comfortable	3.7%	3.8%	17%

Diversification

ESOP law provides that employees must be allowed to diversify 25% of the stock in their ESOP accounts once they have reached age 55 and have 10 years of service in the plan. We asked participants if they planned to do this when they had the opportunity.

Table 6
Employee Diversification Intentions

	Company Weighted Responses	Employee Weighted Responses
Leave it in company stock	32.3%	25.7%
Diversify out of some of the stock	41.5%	46.8%
Diversify out of most of the stock	9.3%	12.2%
Don't know	17.1%	15.3%

We checked to see if this correlated with recent stock performance, but there was little relationship. The results indicate that ESOP employees are comfortable with a significant amount of the stock they own in their company remaining undiversified. Forty percent of the respondents said they made or expected to make the choice they did because investment advisors told them diversification is a good strategy, while another 27% said they decided on their own on a more conservative approach. Among those keeping their accounts in company stock, 34% said they knew their company well and thought it was

a better choice than making a different investment, while just 3% said they kept their accounts in company stock because it was simpler to do so.

Perceptions About Wages and Benefits

Generally, participants believe that their companies provide better wages and benefits than other companies, as Tables 7 and 8 show.

Table 7
Perceptions of How Wages Compare to People Working in Similar Non-ESOP Companies

	Employee Weighted Responses
Much better	9.5%
Somewhat better	27.7%
About the same	42.8%
Somewhat worse	17.3%
Much worse	2.6%

Table 8
Perceptions of How Retirement Benefits Compare to People Working in Similar Non-ESOP Companies

	Employee Weighted Responses
Much better	36.5%
Somewhat better	31.2%
About the same	14.9%
Somewhat worse	6.3%
Much worse	1.6%
Don't know	8.7%

In analyzing the perception of retirement benefits, we looked at each employee as the unit of analysis, but the company responses were virtually identical. Overall, employees at S ESOP companies tend to feel they are paid as well or better than employees in comparable companies. The differences are even more striking, however, for retirement benefits, where 72.8% of respondents believe their benefits are somewhat better or much better, while only 5.4% believe they are somewhat worse or much worse.

One important implication of these findings is that they undermine the notion that ESOP companies pay for their plans through reductions in wages and/or other retirement benefits. We have already seen this is not true for other retirement benefits. Here we find, at least according to employees, wages do not seem to be sacrificed for the ESOP either, and are more likely to be higher.

It bears noting that, in the current domestic economy, consolidation is a frequent phenomenon, and one generally considered to be negative from the perspective of the acquired company and its employees. Acquisitions by S ESOP companies are, however, frequently a boon for the employees of the acquired company, who become - immediately or soon thereafter - eligible to participate in the S corporation's ESOP.

ESOP Contribution to Overall Retirement

Finally, we asked respondents what percentage of their eventual retirement assets they believed would come from the ESOP. Keep in mind that for most respondents, the ESOP component will be primarily, but not entirely, in company stock. Table 9 provides the results to this question

Table 9
Percentage of Retirement Assets Expected to Come from the ESOP

	Company Weighted Responses	Employee Weighted Responses
0% to 24%	31.7%	22.8%
25% to 49%	27.6%	29.6%
50% to 74%	26.8%	30.2%
75% to 100%	13.9%	14.9%

The results show that in either sample, somewhat fewer than half of the respondents say that they expect their ESOP account to provide 50% or more of their retirement assets. Given the very large account balances the data have shown for the S ESOP accounts, this suggests that employees either have already done a fairly good job of diversifying, believe they ultimately will diversify, or, perhaps in some cases, are very cautious about the certainty of company stock.

Conclusion

There is reason to believe that the employees taking part in the survey are representative of the S ESOP participants in these companies. As we indicated at the outset, the data here are in line with what would be expected based on other, broader studies of ESOP companies that have looked at a census of companies (the Ohio, Washington, and Massachusetts studies). While the numbers reported in those studies show account balances that are somewhat less than half of what is reported here, the companies in these studies included all kinds of ESOPs, not just S corporations. Because of tax differences, C ESOPs tend to own much less of the company's stock than S ESOPs do. Most majority, and virtually all 100%, ESOPs are now S corporations; few S corporation ESOPs own less than 50% of the stock. In order to get that much stock into the plan, companies need to make larger annual contributions. Therefore, other things being equal, S ESOPs should have larger account balances by a significant margin.

Nonetheless, it is probably appropriate to view the results conservatively. Even if these numbers were reduced by a third to reflect sample bias (which represents a reasonably conservative estimate), they would still be three or more times as large as the numbers for defined contribution plans in other companies. If we add back in the additional 401(k) and other retirement benefits the S ESOP companies offer, the difference would increase even further. The performance of the companies in this sample is also impressive, but, again, other studies of ESOPs indicate there is no reason to believe that a representative sample of other S ESOP companies would also not outperform peers.

The evidence thus seems persuasive that the change in tax laws to encourage ESOPs in S corporations has resulted in significant, and often dramatic, enhanced retirement benefits for ordinary employees. Few of the participants in these plans would have much chance of accumulating this kind of wealth and retirement security any other way.

Appendix

Data on Trustee and Auditor Practices

There are 16 companies in the sample. Data are reported by the number of companies, not the percentage.

Which best describes your ESOP trustee?

Inside trustee: 8
Outside Independent Trustee: 5
Directed Trustee: 3

Are your most recent company financial statements audited?

Yes: 15
No: 1

Is a plan audit required with your annual form 5500 filing?

Yes: 11
No: 5

If required, are plan audits and company audits provided by the same firm?

Yes: 7
No: 7

(this is an anomalous result—some companies who answered no to the prior question also answered this one)

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[a] Peter Kardas and Jim Keogh of the Washington Department of Community, Trade, and Economic Development, and Adria Scharf of the University of Washington, "Wealth and Income Consequences of Employee Ownership," (National Center for Employee Ownership, 1998).

[b] Data are from the 2005 Summer issue, *Owners at Work,* Ohio Employee Ownership Center, 2005.

[c] Douglas Kruse and Joseph Blasi, "Largest Study Yet Shows ESOPs Improve Performance and Employee Benefits," National Center for Employee Ownership web site (www.nceo.org). Study was completed in 2002 and is in submission for publication.

[d] Data based on submissions from approximately 750 small to medium-sized companies (a category that fits almost all respondents here for the annual Principal Financial "Best 10 Companies for Financial Security" awards, 2005. The author participated in the judging of this competition.

[e] The Employee Benefit Research Institute surveyed 401 (k) balances for more than 10 million participants between the ages of 21 and 64 (EBRI Notes, January 2005).

[f] In 2003, Fidelity Investments assessed the account balances of more than 8 million 401 (k) participants and found an average balance of $55,000.

[g] See, for instance, Profit Sharing/401(k) Council of America, 47th *Annual Survey of Profit Sharing and 401(k) Plans*, or Hewitt Associates, *2005 Trends and Experiences in 401(k) Plans.*

[h] Employee Benefits Research Institute, "2005 Retirement Confidence Survey," 2005.