EMPLOYEE STOCK OWNERSHIP PLANS: AN EFFECTIVE RECRUITING AND RETENTION STRATEGY

By Nathan Perkins and Leila Bidad

Forty-seven million people left their jobs in 2021, a workforce rupture referred to as the Great Resignation.

Once you even out the below-average quit rate in 2020 and higher-than-average exodus in 2021, though, we see a trend that predates the pandemic, and it's one that is well known to engineering and construction (E&C) firms – the systemic shortage of labor.

Each year from 2009 to 2019, the average quit rate increased about 0.1 percentage points across the economy, and we are now back in line with that rate, according to an analysis by Harvard Business Review. The labor market was already tight for construction. In April 2022, the number of unemployed construction workers hit a 22-year low, per the Associated General Contractors of America.

Attracting and retaining labor has long been identified as one of the top challenges facing E&C firms, exacerbated by aging leadership and a hollowing out of the talent pipeline. One third of construction workers who lost jobs after the 2008 financial crisis went to other industries, and firms also failed to hire enough young workers during this time the Wall Street Journal found.

If you want to bid on a job, you need to know you can staff it, and that assumption has gotten tricky in an era where most workers have the option to go elsewhere.

What Makes Top Talent Stay

Firms risk their best performers being poached by other companies or lured into other industries. Construction doesn't lend itself to remote work as easily as other industries and can't always compete with tech salaries, for example. So how can E&C firms prevent further loss of talent?

Compensation is one tool. Pay rates have been rising from the long-term benchmark of 3% to 3.5% that FMI has tracked for the past 20 years. Industry pay rose 4% in 2021 and is expected to increase 4.7% in 2022, according to FMI's 2022 Pay Practices Survey. Compensation perks are clearly an important piece of the talent retention strategy, but they won't work in a vacuum. Compensation should be tied to a sense of investment by employees.

As Benjamin Granger, an executive at Qualitrix, told Bloomberg, "People are looking at work through a very different lens. The lens is things like, 'I am not working for a paycheck. That's not what this is about. I need to be fulfilled.'"

A survey of 52,000 workers by PwC found that while 71% of respondents would change jobs for a pay increase, almost as many—69%—would change employers for better job fulfillment. Decades of research by FMI has shown that employees stay when they feel a company is invested in their future.

There is a tool that's gaining in popularity to attract and retain workers. Employee stock ownership plans, or ESOPs, allow employees to earn shares in the company as a part of their retirement plans. In an ESOP, shareholders work to create value for the firm, knowing they will directly see the results of their labor.

The Benefits of ESOPs

ESOP models are particularly well suited to E&C firms, which are often closely held companies facing succession planning challenges.

Many construction firms are not suitable for third-party sale FMI estimated since they are often family-owned and -run and the company's value contingent on a successful transfer of ownership. ESOPs create liquidity, allow owners to sell their shares at a fair market rate through a leveraged buyout, and come with significant tax advantages for the company.

They are equally attractive for employees, who are motivated by a rewards-based compensation package that helps them plan for retirement. As evidence of their popularity, job search engines like Indeed.com and SimplyHired.com now allow users to filter jobs for ESOP-run companies.

The monetary value of joining an ESOP is only part of the story, however.

How ESOPs Inspire Employees

For jobseekers, an employee-owned and -run company might have an edge over one that offers them no share of ownership; but this difference will play out many times over through retention.

ESOPs reduce turnover, increase productivity by 52% and improve engagement for employees, according to research by the National Center for Employee Ownership (NCEO). But why, exactly?

In a classic research paper on self-determination, the psychologists Edward Deci and Richard Ryan found that motivation boils down to three ingredients: competence, autonomy and relatedness. By design, ESOPs allow employees to realize a sense of competence, watching and participating in the progress of the company. They can view financial and management-related information and see the contribution they make to the bottom line through reaching their own strategic goals.

ESOPs also allow employees to recognize their need for autonomy through the decisions they make about their futures within the firm. They may sell their shares and leave the company or stay and help build its legacy, while engaging in mentoring and sharing of ideas to grow the company. The interdependence that runs through these decisions provides a sense of relatedness. In its structure, an ESOP makes all owners a part of the whole.

Through helping grow a company, employees create a deep sense of meaning around their work and career. In other words, they are more fulfilled.

ESOPs by the Numbers

Construction represents the largest share of new ESOPs at 27% of all new plans tracked by the NCEO in 2019, the latest year with available data. Most of ESOPs formed that year were in privately held

companies, and the NCEO estimates that around 14 million employees participate in the more than 6,500 ESOPs in the U.S., including firms like Sundt, Parsons, Swinerton Builders, Cianbro and Hensel Phelps.

Consolidation has seen the number of plans decrease in the past 10 years although the number of participants is expanding. Those in majority-employee-owned firms control about 8% of corporate equity.

The payoffs are well documented. According to a 2017 analysis of Bureau of Labor Statistics data, employee owners aged 28 to 34 had 92% higher median household wealth, earned 33% higher wages and stayed at their jobs 53% longer than those who weren't owners. The transition to an ESOP model also boosts the rate of growth.

Owners can realize additional benefits, including the ability to sell their stakes without subjecting proceeds to capital gains taxes. The ESOP model also provides incentives via corporate tax deductions for contributions to an ESOP up to a threshold and, as discussed above, creates liquidity for closely held private companies needing to transition ownership.

Transitioning to an ESOP

For any number of E&C firms run by their founders, the leadership and ownership structure may be bound by someone planning to retire by 2030. This transition risks both putting a drain on available capital to transfer the ownership stake and the prospect that the pipeline of successors is spotty.

ESOPs can solve both these challenges, creating a board of directors to oversee the transition and strategic plan and an ESOP committee of stakeholders, including next-generation leaders and possible successors. It sets the stage for other talent development initiatives that formalize the leadership pipeline.

Opening ownership to the wider pool of stakeholders also helps companies improve the quality of diversity, equity and inclusion at work and to leverage multigenerational perspectives and subject expertise. This is a shift from founder-made and -led outfits that put an outsized burden on the head of the organizational pyramid.

What Makes for a Good ESOP?

Firms looking to execute an ownership transition, who have some form of succession plan in place, are good candidates for an ESOP.

During 2021, many firms were able to deleverage their balance sheets, leaving a more attractive prospect for an employee-owned share model—think companies with:

- Stable or growing earnings.
- A solid performance history.
- A low level of debt.
- High payrolls.

Listen to What Employees Are Telling You

"Work was crazy stressful, and I was far from my family," an employee told Bloomberg at the end of 2021. "And at a certain point, it was like, 'For what?'" From the pervasive sense of burnout across the economy to the scarcity of free agents in the E&C industry, employees are making clear not only their need to be compensated generously for the work they do, but also their desire to contribute to a fulfilling cause.

The built environment offers tangible payoffs for those who do the work: world-class projects and feats of engineering. Success within the space is tied to a sense of shared ownership with employees feeling they have buy-in and a say in the decision-making process.

ESOPs are a great means to an end, because there is a profound shared goal at work on both ends of the employer-employee equation: to create something larger than themselves.

Authors

Nathan Perkins is a managing director with FMI Capital Advisors. Nathan is an expert in employee stock ownership plans (ESOPs). He regularly speaks to industry groups about the value of these transactions for employees and as a liquidity strategy for business owners. He has advised on more than 300 ESOP M&A deals representing billions in value during his more than 20-year career.

Prior to joining FMI in 2022, Nathan was a managing director at CSG Partners where he focused on ESOP strategies for middle market companies. Nathan began his career as a financial advisor with Morgan Stanley in Washington, DC, and held a similar position at Bank of America Merrill Lynch.

Nathan can be reached at ***nathan.perkins@fmicorp.com.***

Leila Bidad is a consultant with FMI in the Denver office, Leila supports client engagements by creating assessment reports for succession planning and developing content for leadership development. Leila is passionate about utilizing her conflict prevention and resolution background to advance the thought leadership initiatives within the Leadership and Organizational Development practice. Leila aspires to dive deeper into facilitating, training and coaching the architecture, engineering and construction industry on managing dysfunction and building consensus to develop exceptional teams.

Prior to joining FMI, Leila worked as an independent contractor and certified mediator, serving a variety of industries in consumer and employee conflict management. Leila has managed two international dialogue facilitation programs and is fascinated by the role that culture, relationships and world view play in the success of organizations.

Leila can be reached at ***leila.bidad@fmicorp.com.***

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CONTACT US

RALEIGH HEADQUARTERS
223 S. West Street
Suite 1200
Raleigh, NC 27603

919.787.8400

fmicorp.com

OFFICES

Denver
44 Cook Street
Suite 900
Denver, CO 80206
303.377.4740

Houston
1301 McKinney Street
Suite 2000
Houston, TX 77010
713.936.5400