

Largest Study Yet Shows ESOPs Improve Performance and Employee Benefits

In the largest and most significant study to date of the performance of employee stock ownership plans (ESOPs) in closely held companies, Douglas Kruse and Joseph Blasi of Rutgers have found that ESOPs appear to increase sales, employment, and sales per employee by about 2.3% to 2.4% per year over what would have been expected absent an ESOP. ESOP companies are also somewhat more likely to still be in business several years later. Moreover, ESOP companies are substantially more likely to have other retirement-oriented benefit plans than comparable non-ESOP companies. While the results are in line with previous studies, no study of closely held companies yet has matched the scope of this one.

Methodology

Kruse and Blasi are the preeminent researchers in the employee ownership field, and have previously worked with the NCEO on studies on ESOPs and stock options. In this study, they obtained files from Dun and Bradstreet on ESOP companies that had adopted plans between 1988 and 1994. They then matched these companies to non-ESOP companies that were comparable in size, industry, and region. They then looked for which of these companies had sales and employment data available for a period three years before the plan's start and three years after. The sales and employment growth data were then compared for each year for each paired company. They also checked the companies' filings with the Department of Labor to determine which of the companies had other retirement-oriented benefit plans. Finally, they looked to see what percentage of the companies remained in business in the 1995 through 1997 period.

The process yielded 343 ESOP companies and 343 pairs for the overall sample. However, missing data meant that employment data were available only for 254 ESOP companies and 234 pairs, 138 ESOP companies and 77 pairs for sales, and 115 ESOP companies and 65 pairs for sales per employee (some pair companies could be used for more than one ESOP company).

To illustrate the methodology, assume Bill's Hardware set up an ESOP in 1990. Bill's sales and employment data for 1987, 1988, and 1989 would be compared to Joe's Hardware for the those years, as well as for the three-year period after 1990. Bill's sales grew at 3% per year in the pre-ESOP period, while Joe's only grew at 2%. In the post-ESOP period, however, Bill's grew at 4% per year, while Joe's stayed at 2% per year. The conclusion would be that, relative to Joe's Hardware, Bill's grew 1% per year faster in the post-ESOP period than before. In other words, the ESOP at least appears to be associated with a one percent increase in sales over what would have been expected.

Results

The results showed that ESOP companies perform better in the post-ESOP period than their pre-ESOP performance would have predicted. The table below shows the difference in the pre-ESOP to post-ESOP period for ESOP companies on sales growth, employment growth, and growth in sales per employee:

Difference in Post-ESOP to Pre-ESOP Performance	
Annual sales growth	+2.4%
Annual employment growth	+2.3%
Annual growth in sales per employee	+2.3%

It might be assumed that sales per employee would not go up by 2.3% per year since sales and employment growth differences were about the same, but, the researchers explain, the differing compositions of the samples for the measures makes such a simple comparison misleading. The relative growth numbers might seem small at first glance, but projected out over 10 years, an ESOP company with these differentials would be a third larger than its paired non-ESOP match.

Blasi and Kruse also looked at whether the ESOP companies stayed in business longer than the paired comparisons. Looking at 343 companies and their matches, they found that 77.9% of the companies survived through 1996, compared to 62.3% of the non-ESOP companies, while 69.6% survived through 1999, compared to 54.8% of the non-ESOP matches. "Survival" here means continued to do business as the same entity. Closing, sale, or merger would constitute non-survival.

The final point of comparison was whether the companies had other kinds of benefit plans. The table below shows striking differences:

Percentage of Companies Having Other Retirement Plans		
	ESOP	Non-ESOP
Defined benefit	20.1%	4.9%
401(k)	33.3%	6.2%
Non-401(k) profit sharing	35.7%	8.0%
Other defined contribution	14.7%	2.3%

What the Results Mean

The results show that sales, employment, and productivity all grow faster in companies after they set up their ESOPs than would have been expected based on their performance relative to comparable companies prior to setting up their plans. They are also more likely to survive as independent companies, despite the fact that some ESOP companies feel compelled to sell in order to handle their repurchase obligation. That may reflect the fact that many ESOPs are set up specifically to help closely-held companies retain their independence. Finally, and perhaps most strikingly, ESOP companies are considerably more likely to offer other kinds of retirement plans. The general assumption by economists and many observers about ESOPs is that they must be a tradeoff for other wages or benefits. While this may be true in some ESOP companies, this study shows that in the benefits area, they are an overall net addition, not a substitution, to retirement plans.

These results are strikingly consistent with previous research by the NCEO in 1987 and by Gorm Winther in studies of companies in New York and Washington. Using the same pre- and post-ESOP methodology, but smaller samples, the NCEO study found post-ESOP sales were 4% per year higher, while employment growth was 3% per year higher. Winther, using a smaller sample still, found that employment growth was 3.3% per year greater, but sales growth was .7% slower. Studies of public company ESOPs have focused primarily on return on asset measures, coming to somewhat mixed results, although the largest of these studies, by Hamid Mehran at Northwestern, found that public ESOP companies had an increase in this measure 2.7% per year better than what would have been expected based on pre-ESOP experience. The results also are consistent with a study of ESOPs in Washington state by Peter Kardas, Adria Scharf, and Jim Keogh that showed that ESOPs pay employees more than comparable non-ESOP companies.