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# EMPLOYEE STOCK OWNERSHIP: GAINING A Foothold WORLDWIDE

By Frank A. Amato, Arizona ESOP Group

Employees have become major players in capital ownership worldwide through employee stock ownership plans (ESOPs), according to a new analysis. Touted as the "the ultimate instrument of corporate finance," a well-designed ESOP successfully accomplishes major corporate goals to provide owners with a superb return on capital investment, unequalled tax advantages and rewards long term loyal employees far better than the common retirement plans, such as 401(k) and profit sharing plans. Rewards, such as stock appreciation, are quantifiable, but there also is what can be called the "adventure reward."

According to the Arizona ESOP Group, employees who share in equity appreciation begin to think and act like owners, and owners always work harder than employees do. To illustrate, Home Depot's stock ownership program created more than 1,000 millionaires in 1998, according to Bernard Marcus, cofounder of Home Depot. Statistics reveal that 17 to 18 million U.S. employees now own from \$650 million to \$1 trillion in stock through employee stock ownership plans, 401(k) plans and broad-based stock options, and the appreciation potential is dramatic.

## Global Growth

The worldwide business community is recognizing the beauty of sharing equity with employees. As impressive as the growth of employee ownership in the United States has been, there have been even more striking developments abroad. The most important are:

### Russia

Most large enterprises in Russia have been sold to their work forces, while thousands of other businesses have become employee owned in other formerly socialist countries. Enterprises with more than 200 employees have been sold primarily to their work forces. The average ownership by nonmanagement employees is about 55 to 65 percent. Employees hold their stock as individuals and, so far, relatively few have decided to sell. In the future, many of these enterprises are likely to be sold in whole or in part to investors or other companies unless legal changes are made.

### China

Millions of employees are becoming owners in their companies, and both the central and local governments are seriously exploring the idea of large scale enterprise reform through employee ownership. Several local governments have sold off most of their enterprises to employees, and the central government now is seriously investigating implementing employee ownership on a wide scale.

### Eastern Europe and Former Soviet Republics

Most of these countries have provisions to encourage at least minority employee ownership in privatized enterprises. In some countries, particularly Slovenia, Hungary and Poland, hundreds of enterprises have become majority employee owned.

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## England

Legislation similar to U.S. ESOP law has been in place since the late 1980s. Recent changes have made it more attractive and several hundred companies now have broad ownership. A few dozen large companies now are majority employee owned.

## Canada

Most Canadian provinces have legislation providing substantial tax credits (up to 40 percent) for investment in employer stock. Several hundred companies have taken advantage of this process.

## Jamaica

A 1994 law in Jamaica provides strong incentives for companies to share ownership with employees.

## Japan

Ninety percent of Japan's publicly traded firms provide mechanisms for employees to buy company stock. Participation in these plans extends to most employees, and the average per-employee holding is about \$16,000. However, these plans generally result in employees owning only about two to three percent of their firms.

The trend toward employee ownership started in the United States in the 1970s, when ESOPs were given specific tax benefits and regulatory guidelines. Today, more than 11,000 of these and similar plans cover almost 9 million employees who own about \$213 billion in assets. ESOPs can be found in major firms like United Airlines and Home Depot. Thousands of smaller, closely held companies also sponsor ESOPs. Employees can own anywhere from a few percent to 100 percent of the company.

In recent years, there has been an explosive parallel growth in employee ownership through 401(k) plans. The major factor in this growth has been an increasing tendency for companies to match employee contributions to the plans with company stock. Employees also are putting more of their own investments in company stock. Recent estimates indicate more than half of all 401(k) matches are made in company stock. It is estimated that there are at least 2 million participants in these plans, about 2,000 of which have a majority of their assets in company stock. Employees own about \$250 billion in company stock through 401(k) plans.

## Employees Prefer Stock

People want stock as pay. More than 16 million employees now get stock as part of their pay. Why does this number continue to increase? There are numerous reasons.

Three of the more salient are:

- Tax incentives for owners and their companies are unequalled by any other financial strategy.

- There is a growing corporate desire to create an "ownership culture" - owners always work harder than employees.

- Employees are asking for it.

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In the past 25 years, the stock market is up more than 11 times, while the real median wage is up a few percentage points. Business owners and HR professionals should take note: Employee equity participation will be a major theme in the 21st century. The federal government recognizes this and encourages businesses to become ESOP sponsors by creating working capital by enjoying tax deductions for contributions of stock to their ESOP. Using an ESOP to borrow affords the unique advantage of tax deducting principal payments as well as interest.

Finally, there has been rapid growth in companies making stock options available to most or all employees. Most technology companies that use stock options now make them available to most or all employees, according to recent surveys from Share Data, a stock options plan administration firm. This is another method of building employees into equity participation, but without the same preferential tax benefits enjoyed by both ESOP sponsors and employee participants.

At the same time, more and more major companies, such as Pepsico, Starbucks and Whirlpool, are giving options to most of their employees. While firm estimates are not possible, it appears that at least 5 million employees participate in these plans. This is a potential value in the hundreds of billions of dollars.

The trend toward employee ownership is being fueled by three factors. First, where employee ownership has been around long enough to study, especially in the United States, data clearly and continually shows a strong positive relationship with corporate performance when these plans are tied to a participative management philosophy. More and more companies are concluding that sharing ownership and encouraging employee input makes good economic "dollars and sense." Second, the privatization of state owned enterprises is more politically palatable if employees are included as owners. Finally, to encourage businesses to sponsor an ESOP, the federal government offers tax savings and cash advantages too rich to overlook.

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7911 Herschel Ave. Suite 402, La Jolla , CA 92037  
Fed@fed.org  
[Http://www.fed.org](http://www.fed.org)

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