

## Common misconceptions about ESOP Fiduciary responsibility.

Adapted from Owners At Work

One of the most misunderstood ESOP concepts is that of fiduciary responsibility. Fiduciaries - and all employee-owners and ESOP participants - should have no misconceptions about what it means to have fiduciary responsibility. They should have confidence that they are complying with the requirements accompanying their position.

**Misconception ... Management selects/hires the ESOP trustee.**

*Generally, no. Management may assist in the process - for example by soliciting and reviewing proposals and making recommendations to the Board. But the responsibility usually falls on the Board of Directors unless the plan document provides otherwise.*

**Misconception ... Management hires the ESOP stock appraiser.**

*No. The ESOP stock appraiser works for the ESOP and therefore should be hired by the ESOP trustee.*

**Misconception ... The appraiser sets the price for ESOP shares of company stock.**

*No. The appraiser's role is as a financial advisor. It is usually NOT a fiduciary role. The ESOP trustee has the responsibility to determine the price of shares of company stock. The valuation report is merely a recommendation. The Trustee can either accept or reject that value.*

**Misconception ... Only MBAs and/or CPAs are qualified to be trustees, and, certainly, non-management employees do not qualify to be ESOP trustees.**

*A committee of people can be the trustee. While someone on the trustee committee must be able to read and understand financial statements, there is no requirement that everyone serving as an ESOP trustee be financial experts. However, it is advantageous for anyone serving as a trustee to receive training on the responsibilities of being a trustee.*

## Majority-owned ESOPs more productive.

Adapted from The ESOP Association online.

A recent research study provides strong evidence that majority employee-owned businesses have a significant advantage over comparable traditionally-owned businesses in sales per employee. The average advantage, \$44,500, means that a typical 200 person ESOP firm could be expected to have an almost \$9 million annual sales advantage over its non-ESOP counterpart! *Sales per employee is the total of a company's sales divided by the number of employees, and is a commonly used measure of a company's productivity.*

“What is important about this study is that it substantiates what we have been saying about ESOP companies being more productive for the past 30 years. When matched along side non-ESOP firms, employee owned companies are more productive as defined by the traditional productivity measure of sales per employee,” said J. Michael Keeling, President of The ESOP Association.

A total of 328 ESOP firms and over 2,000 matching non-ESOP firms were included in the study. To read a summary of the research paper, go to:

[www.esopassociation.org/pdfs/Kramer\\_Summary.pdf](http://www.esopassociation.org/pdfs/Kramer_Summary.pdf)

**Highlights ...**

- Employee-owned firms that ask for non-management employee input into innovation in work processes have an advantage in sales per employee over non-ESOP companies.
- On average, the employee ownership effect weakens as firms grow larger. For each increase of 100 employees, the average sales per employee advantage over non-ESOP companies decreases by about \$2,250.

*Think of a challenge not as adversity, but as an opportunity to show what you are made of.*

## Keep your statements simple.

Adapted from ESOP Edge.

The most important communication from your ESOP is likely to be the participant account statement. Even though accuracy and timeliness remain primary objectives, providing participants with an understandable document is paramount. Simplifying your statement can help you more effectively communicate the benefits of your ESOP to plan participants.

**Too much detail.** Some companies include unnecessary detail on their participant statements. Breaking down the company contribution by source may be more information than your participants need. For the most part, participants are concerned with the total contribution made to the accounts.

**Items that don't apply yet.** If your company has a newly implemented ESOP, there are issues to consider when creating the first participant statement. For example, participants will be starting at zero, so there's little reason to show a beginning balance. It is also likely that distributions, forfeitures, and diversification will not impact the ESOP in the first few years. Remove these lines from the statement and add them in later years when they're relevant.

**Items no longer relevant.** Eliminate confusion by removing line items that no longer apply to your plan. Keeping such items on the statement may cause employees to think the accounts are missing something.

**Unidentified terms.** If your statement includes data defined as "adjustments" or "other," you might want to either redefine the terms or combine them with another appropriate line item to minimize confusion.

**Critical information.** Is the most important information clearly highlighted in your statement? You can do this by organizing it in one location, where plan participants can clearly see what they most want to know.

### WHAT DO PARTICIPANTS WANT TO SEE ON THEIR STATEMENTS?

- Total account value
- Contributions from the company for the year
- Current stock value
- Vested percentage and vested balance
- Overall growth in account value from the previous year

## Ways to educate for ESOP success.

Adapted from The ESOP Report

Quite often, ESOP success is hindered when people lack a basic understanding of their company's ESOP and feel they are unable to make a difference.



Below are several approaches which can be taken to educate employees and thus pave the way for a successful ESOP culture.

**1** Share financial information regularly, on a monthly and quarterly basis, utilizing visual aids. Be sure to hand out copies of the company's financial statements prepared in layman's terms.

**2** Organize frequent meetings and classes. Perhaps provide a social gathering with food such as a luncheon. Try playing games to break the ice. Plan to include families in as many events as possible. And be prepared to follow up employees' questions with answers.

**3** Publish a quarterly ESOP newsletter. Include an ESOP dictionary, pictures, fun facts, giveaway contests, and the names of employees who are newly eligible for and invested in the ESOP.

Educating employee owners about their ESOP helps foster communication and builds a true ESOP culture.

### ABOUT SANDRA PAAVOLA



Sandra M. Paavola, AVA is a Vice President and Principal at Enterprise Services, Inc., a firm that provides financial consulting services to business, specializing in business valuations and ESOPs. Ms. Paavola has extensive experience in the financial services industry spanning over 25 years in both public and private firms. As a senior officer in both domains, she gained superb insight into virtually all phases of financial administration, strategic planning, operations, and other aspects of management. Ms. Paavola holds a BA in Communications and Business Administration and is accredited in business valuations by NACVA (AVA designation).