Comparing Employee Ownership to other exit strategies

Introduction

For business owners, deciding on how to leave their company can be a daunting task. After all, owners work hard to grow their firms, cultivate a strong work environment, and build lasting relationships with customers and their communities. For owners who have poured time, energy, and money into their company, making sure the company they built thrives after they retire is a task of the utmost importance. However, one option offers distinct benefits as compared to other exit strategies: employee ownership. Employee ownership offers a simple, straightforward, and financially rewarding way for owners to exit their firm while preserving its company culture, maintaining a strong legacy within the business, and ensuring the company is passed along to people they know and trust.

Breaking down possible exit strategies

In order to contextualize the benefits of employee ownership, it is important to understand how it stacks up against other exit strategies available to business owners. The four main types of exit strategies are trade sale, equity investment, management buy out, and employee ownership.[1] The first available option, trade sale, is the simplest to understand: it simply involves selling the company to an outside buyer, usually another company. Although this is the safest option from a purely financial perspective (since the owner can negotiate the price), it has a number of notable downsides. First, unlike with other options, owners have no control over the timing of the sale, since it is entirely reliant on an interested buyer appearing. Additionally, owners cannot realistically expect to maintain any further involvement in the company post-sale, have no way to preserve their legacy at the company (50% of mergers fail on culture clash)[2], and might be subjected to drawn-out negotiations.

The next option, equity buyout, is when an outside investor makes a large investment into the company. This is often risky and time consuming, as good investors can be hard to find. Outside investors also often have priorities which conflict with those of the owner, leading them to focus heavily on purely financial expansion at the expense of company culture or concern for employees' wellbeing. Selling to outside investors can also be financially risky, as many investors value assets based on projected future growth. The third option is a management buyout, which, as the name suggests, involves selling the business into the hands of the management team. Although this option is generally good, it can pose major financial risks for the owner, as management might be hesitant to put too much of their own money at stake for the company.[3]

Why employee ownership

While other exit strategies have a variety of pros and cons, employee ownership has a host of benefits which make it the safest and most reliable exit strategy for owners. First, one of the most universally-appealing aspects of employee ownership is its solid financial outcomes for owners. Although trade sale

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[1] Boardroom Advisors, 2020. "A Complete Guide to Employee Ownership."
[2] 2008. "M&A Beyond Borders: Opportunities and Risks." Marsh, Mercer, & Kroll and The Economist.
[3] Boardroom Advisors, 2020. "A Complete Guide to Employee Ownership."

exits may allow an owner the highest raw return, these sales often include high transaction costs which can eat into the owner's profits. In some EO models, employee ownership ensures that selling owners still receive market value for their company while taking advantage of capital gains tax benefits associated with exiting the company in this way. Read more about different models of employee ownership in related articles about employee stock ownership plans (ESOPs), employee ownership trusts (EOTs), and worker-owned cooperatives. Equity investment and management buyout both have financial complexities which limit the value an owner is likely to receive as well, demonstrating the relative advantages of employee ownership.

Maintaining company culture and owner involvement

Employee ownership also provides the best options for retaining company culture, something which can be essential for many owners. Since the company culture is already ingrained in the employees, an owner can pass the company via employee ownership on with complete confidence that the company will maintain the culture and environment they have built up. Additionally, the owner can choose how involved to be during and after the ownership transition, meaning they can stay around to work with the company on preserving the work environment. Crucially, only employee ownership can provide such strong assurances about company culture: in both trade sales and management buyouts the old owner's influence in the company is either eliminated or dramatically reduced, and the decisions about company culture fall into the hands of the new owners. Similarly, some companies have particular social missions they aim to accomplish beyond simply making profits, and employee ownership is usually the best (or only) way of maintaining these missions going forward. Management buyouts are a solid alternative, but they cannot provide the same level of involvement.

In tandem with that, employee ownership also offers appealing options for owners who might want to stay involved in the company after exiting, a unique benefit. Depending on the exit agreement they arrange with the employees, retired owners can retain shares in the company and/or continue working with the company in some capacity after they have stepped down from their leadership position. While management buyouts offer similar options, this is a level of control which owners are unable to maintain through either trade sales or equity investments: both place the company in the hands of new owners, who will likely want to implement their own visions for companies.

Additionally, employee ownership is one of the easiest and most cost-effective exit strategies available. Since the owner already knows everybody involved in the transaction, there is no need to vet the potential new buyer, and both parties can negotiate in good faith. Meanwhile, trade sales and management buyouts both often include price chipping — the act of lowering the offer at the last minute — which can both draw out the negotiating process and put a meaningful dent into the final amount that the owner walks away with. Equity investments are typically even worse in this regard, as investment advisors often charge steep commissions which are handed down to sellers.

Lastly, by exiting via employee ownership, owners can choose precisely when they want to pass along their company, and can coordinate with employees to make sure the transition works for everybody involved. In the employee ownership exit, there are no outside buyers or investors who are involved in the process, meaning the owner has complete control over how and when to initiate the process. Because of this, the owner can wait until they feel the time is right to exit the company, and don't have to worry about feeling rushed or pressured by outside financers — on the flip, owners can also utilize this if they happen to need immediate liquidity. This can also allow the owner to ensure everything happens on a well-structured timetable, which smooths over the transition process.

Conclusion and possible considerations

While employee ownership and management buyouts provide many benefits to retiring owners looking to exit their companies, it should be noted that employee ownership typically requires a certain culture to work. As such, owners should keep in mind that employee ownership is a particularly great option if they want to preserve a legacy and they already have some paritory management or profit sharing culture in place. However, these benefits are maximized when owners have laid the necessary groundwork which allows these employee ownership systems to thrive. If owners are less concerned about these things and simply want to move on, this reshapes the calculus of the situation — although employee ownership still has some benefits in this instance, they are less meaningful and pronounced. Similarly, employee ownership is also only viable when companies are profitable — otherwise, employees would obviously be uninterested in purchasing the company. Ultimately however, employee ownership still provides a great exit for owners of profitable companies concerned with a variety of factors, including maximizing their returns and maintaining a company culture.