Before Transitioning to Employee Owned, Financial Health is Key: Considerations for Employee Ownership

Transitioning any company into an employee owned organization can be a risky process. Often, the company will have to spend assets or borrow money to pay off the original owner. Therefore, the financial health of the company is a major factor in readiness for transition to employee ownership. If a company is not financially prepared, the company may not survive the transition, benefiting neither the employees nor other stakeholders. In fact, if a company can't survive the transition or faces an unprecedented struggle during the transition, attempting a transition could be worse for the stakeholders than doing nothing at all. Before the company approaches third parties, like banks or other potential financiers, and begins racking up expenses, they should first investigate whether the transition is worth the attempt. A combination of internal and external financial feasibility assessments can help answer questions about whether an ownership transition is a viable option.

Before using company resources or letting external firms examine the books, owners and internal staff with familiarity on financial issues should reflect on the company to develop an honest and realistic internal assessment. This helps create a preliminary picture of their financial situation and rule out dealbreaking factors that suggest the time isn't right for transitioning. This will have saved important resources and time. During this time, the management team can also answer questions such as who will be selling shares, how the transition will be financed, what are the rules and technical aspects the team needs to be aware of, etc. There are many online resources available to help guide a team through this assessment with free tools like financial health analysis (FHA) templates and guides. Some of the first steps of an internal assessment include conducting a preliminary valuation. Preliminary valuations, which are conducted by professionals like the company's CVA or CPA, usually consist of a range of relevant financial values as of a specific date but there are many different methods for doing an informal valuation, so choose the best for your situation by determining the financial values most important to you with a financial professional and ensuring they are included in your valuation.

There have been many successful transitions to employee owned, whether it be to an ESOP, EOT, or cooperative. Comparing your company to benchmark criteria of successfully transitioned businesses would be a good indicator of your chances of success. Examples of benchmark criteria include having more than 25 employees, making at least $1 million in revenue, and, the most crucial, having an owner or owners who are interested in selling the company to employees. These basic benchmarks can point owners and financial consultants toward their decision. The market is often unpredictable and this sometimes means that even financially healthy companies do not survive tumultuous periods so using these benchmarks may help ease some concerns.

Once an internal assessment has been conducted, the next step is getting an objective view of the company's financial situation using outside sources. This can be achieved through a third party assessment. Third party assessments are performed by professionals, usually accounting firms or auditors. External assessments are crucial in ensuring that owners get a guaranteed price that doesn't rely on the whims of the market. Settling on a fair price is crucial for all of the company's stakeholders, because owners want to be fairly compensated and it's important for the company to be able to pay off the debt. The sooner the financials are in good order, the sooner the new employee owners will begin to benefit from their ownership. Of course, procuring an external assessment can be costly and require the use of company resources, but this is why external assessments should follow internal assessments.

While not every owner is involved in the financial aspects of their company, it is important to know what to expect from a transition before it's too late to alter course. Doing a preliminary internal assessment and then an external assessment will save your company time and money, and will aid in preserving the longevity of your business. Regardless of whether a company is considering utilizing an ESOP, EOT, or cooperative structure, testing for financial feasibility is a constructive decision for anyone considering an ownership transition.

Source:
C. Ryan Stewart. "The ESOP Feasibility Study."