After the Acquisition: Keys to Post-transition Success in Employee-Owned Companies

After committing to transitioning to an employee ownership model, there are many things which owners need to consider. Establishing a well-run employee-owned company requires continual support throughout the transition, and owners must keep a variety of issues in mind. Some of the most important things for owners to focus on in the long term of an employee ownership transition are employee education and culture building, leadership challenges, financial challenges to themselves as the owner, and, specifically in the case of ESOPs, legal requirements.

Education and Culture

First and foremost, owners must focus on educating their workforce of new worker-owners and continue working to maintain a strong company culture that aligns with the values of employee ownership (EO). EO structures are typically somewhat complex, so employees often struggle to understand their overall structure and identify their own personal roles within the setup.[1] This is the most important issue owners have to address, as employee ownership only functions when employees are cognizant of, and subsequently support, the ownership model. Without buy-in from workers, the company can grind to a halt and lose many of the advantages of employee ownership. In order to develop a strong culture around EO, owners must often allocate significant time and money to training and educating employees about its benefits and their role as owners. Employees must specifically be educated about the type of EO the firm uses and how it affects them; this training often must be ongoing. Depending on the specific model the company uses, its complexity (and therefore the amount employees have to understand and remember) varies greatly, which is an advantage of simpler and more intuitive styles. This can continue to be true for several years after the transition as new employees come on board.

Post-transition Leadership

After educating their employees, the next most important thing for owners to consider is their company's post-transition leadership. The next leaders will not only oversee the operations of the business, but will maintain –or change– the culture of the business for years to come.[2] It is important to note that this section may apply more directly to owners who are retiring and/or selling their companies rather than those who are staying on to manage the day-to-day operations. However, any owners who are stepping down must consider their succession strategy and think carefully about the leadership team that will lead the now employee-owned company after their retirement. Finding replacements for top executive positions such as CEO is often particularly difficult, especially since owners usually do not have somebody in mind when they begin the transition process. Additionally, depending on the type of employee ownership model the company is shifting to, other employees, such as the CFO, might have to step up and play larger roles in the firm's management.

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[1] January 2022. "Project Equity's Thrive Program." Project Equity.
[2] 2020. "6 Steps of Transitioning to ESOP Ownership." Fifth Third Bank.

This is something which owners must specifically stay on top of because, although selling the company to its employees is an excellent way for owners to retire, picking new leadership is an entirely different process yet must be conducted around the same time. Among companies which have transitioned to employee ownership when the previous owner retired, they spoke about the importance of creating a succession plan separate from the entire transition process, as a way of making sure the two were both done as thoroughly as possible. Generally, companies should fully tackle these leadership challenges before beginning the shift to employee ownership, since creating a thorough and useful succession plan can take many months.[3]

Structuring the Payout

Assuming the owner is using employee ownership as a way to sell their company and retire, they must consider how to best structure their exit to ensure they are fairly compensated but do not strain their ties with the company. Generally, a retiring owner who is converting their company to employee ownership can have their equity stake paid out in two ways: a full payout and a longer term payout.[4] To pay the equity stake, the company can either use revenue or debt, depending on what works better with their financial situation at the time. The value of these shares is typically determined via an external valuation; this process is absolutely essential, so it is sometimes recommended that owners or firms have the company re-valued if they are severely concerned with the initial estimate.

Each method an owner can receive their payout has pros and cons. A full payout gives the owner more money in the short term, which can be attractive if they are looking for a comfortable bump to start their retirement (they can then obviously reinvest this money in stocks or bonds later on). However, owners can also end up leaving money on the table if they opt for full payout: they may miss out on unrealized earnings if the company grows in the few years following their departure. Because of this, many owners opt for the longer term payout, which can be adjusted based on the (now employee-owned) firm's performance over time. This is an attractive option for owners who have left their company in a good position to continue growing and/or do not need an immediate payout. However, it is generally suggested that the adjusted payout not run too far into the future — this might upset employees, who feel the owner is continuing to take from the company's profits long after their actual influence over its performance has waned. Although this is a particularly pointed example, this last issue also serves as a good reminder that financial issues such as these can be touchy subjects, and both owners and firms should navigate them with maximal care. Because of its relevance to both the owner's financial well-being and relations between the exiting owner and the company going forward, this is something which should be considered thoroughly.

Legal Concerns

For certain types of employee ownership structures owners will have to spend a certain amount of time and money making sure they are aligned with the legal guidelines which regulate their structure. This is

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[3] Aaron Juckett, CPA, CPC, QPA, QKA. "How Long Does It Take to Complete All the Steps for an ESOP Setup?" ESOP Partners.

[4] Peter Newman. November 2021. "The What, Why, How, and When of ESOP Ownership." Peak Wealth.

most relevant for ESOPs, which are regulated by the Department of Labor and have to follow specific guidelines in various situations, such as when an employee leaves the company. However, legal alignment is a topic which owners should generally seek to stay on top of, regardless of the specifics of their firm.[5] One particular point which many firms making the transition have highlighted is that the process typically involves more outside consultants, bureaucracy, and paperwork than they had expected.

Conclusion

Ultimately, owners have a host of items to consider after deciding to convert their business to an employee ownership model. However, with strong preparation, each of these issues can be fully resolved, allowing the transition to occur as smoothly as possible. Additionally, if the situation requires it, owners can often rejoin the company after the transition to employee ownership in a more limited capacity, serving to oversee the company and help maintain stability in the short term. Although this is certainly not a sustainable strategy in the longer term (especially if the owner wants to retire) it can help ensure the company remains primed for success going forward.

[5] 2020. "6 Steps of Transitioning to ESOP Ownership." Fifth Third Bank.