Business Wealth Solutions℠

INSIGHT

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TIPS AND RESOURCES TO HELP YOU GET MORE OUT OF YOUR BUSINESS.

Our mission is to shepherd as many business owners as possible to fulfillment of their goals and their ideal lifestyle.

Keys to a Successful ESOP

By

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Business owners are often intrigued by the idea of establishing an ESOP (Employee Stock Ownership Plan). There is no shortage of salespeople and professional advisors offering to help you set one up. But before you do, check out the following. These tips can help to insure that your ESOP fulfills your requirements, is viable long after you establish it, and, that you are not setting yourself up for a law suit(s).

- **Meet with at least two or three highly qualified, experienced ESOP advisors.** Chose one who has designed and installed numerous ESOPs that are still in existence many years later. You would be wise to avoid anyone who says he ***can* do** an ESOP in favor of one who has **actually *done*** numerous ESOPs over a long period of time. Ask your prospective ESOP advisors:
  - How many ESOPs they have actually designed and installed
  - What is their current status – have there been any problems
  - What was their role

- **Retain a qualified advisor to prepare a detailed feasibility study that addresses all aspects including:**
  - A complete analysis of the up-front and annual cash outlay
  - A long term cash flow projection that includes **all** expenses and an analysis of tax savings related to the ESOP
  - A detailed analysis comparing an ESOP to a third party sale to a financial buyer, including taxes and fees for each type of transaction
  - An extensive preliminary "business valuation" prepared by an appropriately credentialed valuation expert. (A full blown fair market value valuation will need to be prepared when the ESOP is established and annually thereafter)

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- The fee for this in-depth study can be in the neighborhood of $20,000. It can be less, especially if the advisor will receive additional compensation from another source

- **Ask the ESOP expert advisor for the names of other professional advisors and entities he/she has worked with when establishing an ESOP (CPAs, attorneys, trustees, banks, and insurance companies' specialists, etc.) and then speak with them to discover:**
  - The roles they played
  - How many ESOPs they have advised on that have actually been installed
  - Their opinion about the appropriateness of an ESOP for you and your company

- **Speak with shareholder(s) of a company in your space who sold their shares to an ESOP and solicit their view of the transaction. Ask:**
  - How long ago did they set up the ESOP
  - What was their level of satisfaction or dissatisfaction with the ESOP advisor(s)
  - Were there any surprises
  - What did they learn during and after the transfer of shares
  - What were the up-front fees
  - What are the annual maintenance expenses
  - Were they fully aware of the repurchase requirements and expenses at the outset
  - Would they do it again

- **Be clear about which advisor(s) will receive any portion of the fees/commissions from product sales related to the ESOP, such as life insurance.**

- **Select a third party administrator that has significant experience in administering ESOPs.**

- **Select experienced, members for your Board of Directors who are educated about ESOPS.** They should have ***no*** conflicts of interest and be independent of business operations. That rules out your friends, your professional advisors, your relatives, and anyone who lacks the courage to think independently and who could not say "no".

- **Be clear about the role of the ESOP trustees and chose them wisely**.

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- **Be sure you are comfortable with the requirement that the company must be run so that it remains healthy and viable long into the future. This might result in more modest salaries, perks, and distributions for ownership and managers.**

- **Be clear about how having shares owned by an ESOP would affect the eventual sale of the company to a third party, and, how mergers and acquisitions advisors could view ESOPS when attempting to sell the company.**

- **When setting up financing, be certain that the loan is titled correctly and that the bank-to-company loan and bank-to ESOP loans do not have the same terms.**

- **Make certain the repurchase obligation is set up properly, is funded properly, is in compliance with current rules, is properly communicated to employees, and that distributions are not too liberal.**

- **Make certain that there are no conflicts between other qualified and non-qualified plans, especially stock options, and the ESOP.**

- **Be aware of issues involving S Corporation requirements and make certain your plan is not in violation.**

- **Educate your employees about the ESOP. Determine in advance how to communicate with, and deal with, employee and management issues.**

An ESOP can be an excellent growth and exit strategy when: the owner is well-informed, and selects the most qualified advisors, Board of Directors, and trustees; the business is well-positioned and is in a qualified industry; and if the ESOP is established for the right reasons. But, if these and other guidelines are not followed, an ESOP can lead to law suites, fines, unexpected expenses to correct errors, and unhappy employees and business owner(s).

Joan M. Ridley is president of Business Wealth Solutions, a Dallas-based advisory firm that consults with business owners about how to successfully grow and leave their business. Visit our website at www.businesswealthsolutions.net. **Call us today at 214.692.9192 for** a complimentary meeting to learn how we can help you get where you want to go. Ask for our complimentary brochure.