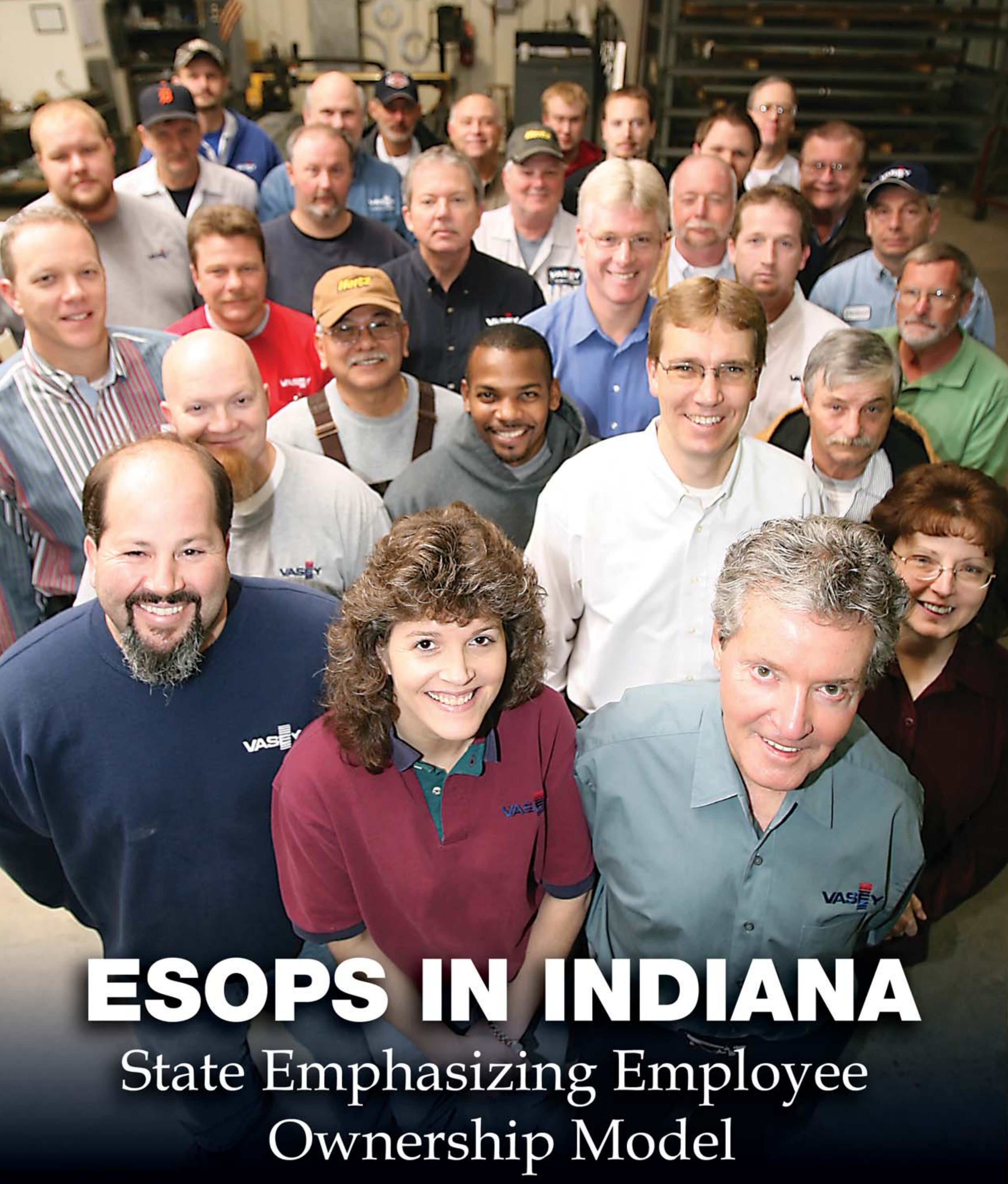


ESOPS IN INDIANA

State Emphasizing Employee Ownership Model

Staff members at Vasey Commercial Heating & Air Conditioning in Zionsville are company owners as part of an employee stock ownership plan.

By Matt L. Ottinger

As Indiana economic development leaders continue the focus on keeping businesses in-state, some are pointing to employee ownership as a means to help facilitate this objective. Consequently, employee stock ownership plans (ESOPs) are now being regarded as not just a method to motivate employees, but also a way to prevent businesses from transferring ownership outside of Indiana.

An ESOP is an employee benefit plan that turns employees into stock owners of their company. In an ESOP, a company sets up a trust fund into which it contributes new shares of its own stock or cash to buy existing shares. According to the National Center for Employee Ownership's web site, "the ESOP can also borrow money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan. Regardless of how the plan acquires stock, company contributions to the trust are tax-deductible, within certain limits."

Richard Mourdock, Indiana state treasurer, says ESOPs are structured so the entire staff of a company benefits.

"Each year when a company is profitable, the board of directors or ESOP trustees determine how much of the profit is used to pay off ESOP debt and how much is used to buy employee stock," he reports. "It's based on a percentage of payroll per person, so there's a formula in place so it's not just the top employers who get all the stock."

A state treasure?

ESOPs have become such a priority in Indiana that Mourdock is leading an initiative to plant the employee ownership seed throughout the Hoosier state.

"I've been referred to as the ESOP evangelist," he quips.

Mourdock reports his sermon began shortly after being elected to the post in 2006.

"I sat down with the governor and told him I wanted Indiana to be the leading state on ESOPs in the country," he says. "They give higher returns on investment and equity than other plans. Then I told him there has never been an ESOP company move to Mexico or China. That's when he said, 'Oh, now I get it.' "

Mourdock adds that the overall goal is to prevent the drain of assets out of the state, and that an ESOP served as a personal blessing to him. He was an employee and president at Koester Mining, Inc. in Evansville.

"When I left Koester in 2000 (after having an ESOP since 1984), I didn't have to worry about retirement savings for a couple years," he notes. "In fact, at age 50, I was able to write in my day planner: 'Today I begin the second half of my working life.' There's not a lot of people who are given that kind of freedom at age 50, and I have an ESOP to thank for that."

Treasurer of State Richard Mourdock (right) discusses ESOPs with his communications director, Chris Conner. Mourdock is leading an initiative to make ESOPs more popular in Indiana.

A geologist by training, Mourdock now negotiates the rugged terrain of retirement savings in Indiana in an effort to help Hoosiers take ownership in local companies in more ways than one. He also hopes to find ways to motivate banks to fund ESOPs more readily.

"ESOPs give employees a sense of long-term commitment in their jobs and what their company does," he explains. "It's also great to see people who otherwise would never invest build impressive portfolios."

He adds that through his experiences in traveling to ESOP companies, Mourdock has heard workers debate the most minute details while moving materials in an effort to protect the company's bottom line as well as their own savings.

In order to educate companies about employee ownership, Mourdock has formed three ESOP committees – finance, legislative and education/outreach – comprised of business leaders in the state. He explains that nothing definite has been planned in terms of specific action at the state level.

"A lot of that is still being decided," he says. "There are some things I can do without the Legislature and the governor, but there are some things I might want to run by the Legislature in order to give our actions more credence."

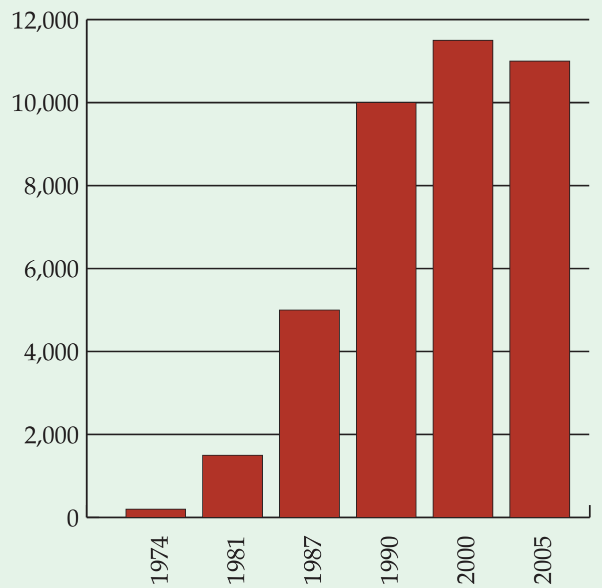
Mourdock adds that if addressed by the Legislature, ESOPs could truly be a bipartisan effort.

"I think Democrats would support this because it really helps the working man, and Republicans would support it because it's all about creating wealth," he states.

When asked if he anticipates public funds being allocated toward ESOPs, Mourdock explains that also has yet to be decided.

"It would be great if all I had to do was use the pulpit (as treasurer) to start making companies aware of ESOPs and then start implementing them, and then all the state would incur was nothing more than my traveling expenses," he notes.

Approximate Number of Operating ESOPs in the United States



Source: The ESOP Association

In Indiana

Indiana is one of 18 states involved with the national ESOP Association.

"Our main objective is to be an educational resource for Indiana companies who either have ESOPs or are in the exploratory phase," offers Indiana ESOP Association chapter president Andy Manchir.

Each year, the association hosts an educational event called "ESOP Round Tables and Round Ball" at Conseco Fieldhouse (to be held on February 1, 2008) that coincides with an Indiana Pacers game. The event is open to existing ESOP companies and employees, as well as those interested in learning about ESOPs, according to Manchir.

The ESOP Association estimates that Indiana had 226 ESOPs in place in 2004, although the totals can be difficult to quantify.

"(Estimating the number of ESOPs in the state) can be hard to measure because closely held companies don't have the same reporting standards as other companies," Manchir qualifies.

Steve Smith, a partner at Krieg Devault LLP in Indianapolis, is an ESOP proponent and labels his firm as "the largest ESOP practice in the state" since it has four staffers dedicated to the subject. He ranks Indiana's ESOP status as "fair" when compared to other parts of the country.

Mourdock agrees, contending that states bordering Indiana are further along in ESOP adoption.

"Illinois, Wisconsin, Michigan, Ohio, Kentucky – they all have more ESOPs than we do," he says. "They're really popular on the West Coast in California, Oregon and Washington as well."

Ohio specifically utilizes financial resources available to help companies become employee-owned. Steve Clem, senior program coordinator for the Ohio Employee Ownership Center (OEOC) at Kent State University, explains a grant is available through the Ohio Department of Job and Family Services that aids in prefeasibility studies for employees and companies that want to explore employee ownership.

"The studies are conducted to see if employee ownership is a viable alternative to job loss in a particular situation," Clem notes.

He adds that there is $150,000 available each year, and that each study typically costs $10,000 to $20,000, depending on the company.

Ohio also enacted the Employee Ownership Assistance Act in the late 1980s, which recently had its sunset clause repealed so it's now a permanent part of Ohio's code. The act requires the Ohio Department of Development (ODOD) to promote and assist employee ownership in Ohio. The ODOD contracts with the OEOC to deliver those services.

"We then provide education and preliminary technical assistance to groups pursuing employee ownership," Clem explains. "We can save them a lot of money because our service is free. So when they need to speak with professional service providers, they will go in with a lot more knowledge than they would have otherwise."

Could ESOPs flop?

ESOPs have existed in Indiana since the 1970s and have not been without critics. Even advocates of the programs concede there can be logistical problems when not approached appropriately.

"These are complex and highly regulated because of the tax benefits involved," Smith says. "They require professional service providers like lawyers, firms and trustees. If mistakes are made in the implementation, fixing the mistake can be very expensive because of the penalties. The key is to get the right advisors.

"In the early days, some were put in and not structured properly and a few were done negligibly," Smith adds. "They either took on too much debt or failed to plan for repurchase liability."

Bill Waltz, Indiana Chamber director of tax and fiscal policy, is a member of the state's ESOP Legislative Review Committee. He believes the complexity may be a hindrance for some businesses.

"ESOPs are a great option, but they're complicated and expensive, so the tool isn't being utilized as often as it could

ESOP Facts

- The ESOP Association represents over 1,400 ESOP companies. Total membership is over 2,500.
- Approximately 99% of ESOP Association members are private, closely-held companies.
- ESOPs exist in large and small companies – 71% of Association members have less than 250 employees.
- While ESOPs are prevalent in a broad range of industries, approximately 28% of Association members are in manufacturing, followed closely by construction and distribution at 13%.
- 87% of Association members offer a supplemental benefit plan in addition to the ESOP, including 401(k) plans, pension plans and profit sharing plans.
- 82% of ESOP Association members report that motivation and productivity increased as a result of the ESOP.
- ESOP Association members report the average contribution the company makes to the ESOP each year, as a percentage of covered compensation, is 13%.

This information was obtained from the "2005 Company Survey," conducted among ESOP Association members and listed on the association's web site.

and probably should be," he states. "The initiative (by the treasurer) is to help companies through both the complications and expense issues."

Mourdock explains that with consulting involved, a company could incur costs of $30,000 to $80,000 during the consideration process alone.

Additionally, Smith contends that some companies might benefit from avoiding ESOPs all together if their earnings lack stability.

"ESOPs are definitely not for every company," he says. "Let's say you're a small manufacturing company with volatile earnings; you're probably not a good candidate because you need stable revenue to pay the debts involved with ESOPs."

Manchir states smaller companies could have a more difficult time wading through the technical aspects of ESOP implementation.

"It's very complex," he says. "Larger companies are used to that complexity, but it can be jarring for smaller companies; you have to understand the technical terms, valuation and other legal matters."

Manchir adds that a company must be of sufficient size to adopt an ESOP, stating an organization with $1 million in sales would probably be undersized, and a company gaining $3 million to $5 million in sales would be a candidate for an ESOP, albeit a small one.

Smith, though, sees the greatest condemnation of ESOPs as a problem of perception, not reality or inherent limitations.

"I'm not sure why, but a lot of business owners think they'll lose control of the company (by adopting an ESOP)," he explains. "It's a trust; it relies on existing management. It doesn't want a seat on the board."

In practice

Rieth-Riley has called Goshen home since 1916. It now has several locations in the Midwest and boasts a workforce of around 1,800 (with roughly 400 invested in the ESOP). The contractor has built a healthy portion of Indiana's roads and highways and was actually awarded the Indiana Department of Transportation's first contract.

According to Brian Inniger, Rieth-Riley executive vice president of finance/administration, the ESOP was adopted in 1985 after weighing different options.

"The Rieth family was looking at succession options, and ESOPs had great tax benefits," he says. "The workforce was multigenerational; there were fathers and sons both working here so they wanted to do something for them."

Inniger notes the company became 50% invested in the ESOP in 1985, and then bought the other 50% in 1992 to become totally ESOP-owned. Now a point of pride with the company, the main page of its web site boasts, "We are a 100% employee-owned company. This results in ownership pride in our work." In fact, 75% of registered ESOP companies advertise the fact that they're employee-owned, according to the ESOP Association.

Not only is the ESOP mentality used to attract customers, but it's also a means to attract a talented workforce.

"It's a big recruiting and retention tool," Inniger confirms. "I think it's less of a factor when we hire younger workers, but it's a big factor with middle-aged workers, and we get a lot of experienced people wanting to work here because of the ESOP. It's also a key reason we have very low turnover."

Inniger believes that ESOPs can get an undeserved, negative reputation from the media and others.

"ESOPs seem to only make the news when it's negative, but there are so many variations that you can't lump them all into one," he says. "It's a shame some people abuse them, like Enron, but we're a good example of an ESOP done right. Some of the balances are in the six and seven figures for people who otherwise wouldn't have a lot in terms of savings."

Inniger also explains that Rieth-Riley's ESOP does not allow employees to purchase company stock.

Largest Corporate Members of ESOP Association

Company	Location	Number of Participants
Procter and Gamble Co.	Cincinnati, OH	40,000
The Sherwin-Williams Co.	Cleveland, OH	32,000
Anheuser-Busch Companies	St. Louis, MO	17,200
Amsted Industries	Chicago, IL	12,500
Parsons Corporation	Pasadena, CA	12,000
Lifetouch, Inc.	Eden Prairie, MN	11,500
Brookshire Brothers	Lufkin, TX	9,000
Ferrell Companies	Liberty, MO	7,400
W.L. Gore Associates	Newark, DE	7,000

Bill and Kathleen Oliver popped the proverbial cork in celebration of employee ownership in 2006, bringing an ESOP to Oliver Winery in Bloomington.

"Participants can't buy our stock; they work for us for a certain period of time and then we give it to them," he states. "It's the benefit of ownership without the risk of ownership. We still encourage them to diversify too."

New to the mix

Many Indiana University graduates are likely familiar with another ESOP company – Oliver Winery in Bloomington. Even though the company has been growing on the vine since 1972, Oliver Winery's ESOP was just adopted in 2006.

"The Olivers wanted a way to preserve the legacy and the culture of the business, and reward the employees who have made it so great," explains senior vice president Valerie Pena. "They had done some research and attended a conference on ESOPs and decided this was the best way."

The winery is now a fully owned ESOP company, with 35 of its 80 employees qualified to be in the plan. Pena notes that employees are eligible after 500 hours of service.

To educate staff, the winery distributed a brochure to its employees upon the adoption of the ESOP. Included in the literature was a letter from president Bill Oliver, as well as a FAQ sheet specific to the winery's plan explaining how long it would take staff members to become fully vested. It also explains that Monroe Bank is the ESOP trustee, indicating it's the trustee's job to "make decisions that protect the interest of the ESOP participants."

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ESOPs

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Additionally, Oliver Winery has created another education component by developing an ESOP Benefits Committee, made up of managers on staff who can teach workers about the plan and answer their questions.

Like many who invest in the ESOP, Pena touts its earning potential as a key attraction for talent.

"It's a great way to entice employees to come work for you; it's an extra perk you can offer," she says. "It's a big reason why I left the company I was with after 20 years to come here. This is a great company with a lot of growth still left, plus I know I'll benefit from my own hard work."

INFORMATION LINK

Resources: Richard Mourdock, Indiana State Treasurer, at www.in.gov/tos

Steve Smith, Krieg Devault LLP, at (317) 238-6218

Andy Manchir, Indiana ESOP Association, at (317) 428-1134 or www.esopassociation.org

Brian Inniger, Rieth-Riley, at (574) 875-5183

Valerie Pena, Oliver Winery, at (812) 876-5800

Steve Clem, Ohio Employee Ownership Center at Kent State University, at (330) 672-0335