New York State Comptroller
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Employee Ownership of Businesses in New York State

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Message from the Comptroller

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Federal, state and local policymakers have advanced many programs to bolster support for workers to increase their earnings or accumulate sufficient assets to retire with dignity. Research has shown that employee ownership can positively impact employee compensation and retirement assets making it an effective tool to create lasting wealth and improving employee satisfaction. Facilitating expansion of employee ownership models in which workers have an ownership stake in the companies they work for is one way to help achieve this goal. In addition to the benefits afforded to employees, employers are provided a pathway to convert or sell their business to those employees and managers who helped build the company, providing opportunities for workers and the community.

The most common forms of employee ownership differ in the ways they impact the individual worker, but overall they accomplish similar goals. One of the most popular forms of employee ownership is Employee Stock Ownership Plans (ESOPs) which combine employee ownership with a qualified retirement plan. Worker Cooperatives take a different approach, placing more emphasis on the goal of empowering employees through collective decision making and democratizing operational decisions. And yet another model, Employee Ownership Trusts, increases employee compensation by distributing company profits directly to employees every year.

New York ranks fourth nationally in the number of ESOPs, and these plans hold more assets than those in any other state. State policymakers could consider additional opportunities to educate businesses, workers and labor organizations on the advantages and risks associated with different forms of employee ownership and, if appropriate, leverage resources to assist New York companies pursuing these business models.

Thomas P. DiNapoli
State Comptroller

Introduction

Employee ownership (EO) is a broad concept describing arrangements in which employees own a defined element of the company they work for and does not necessarily mean that employees exercise control over the company's operations. Few workers benefit from having an ownership stake in the companies with which they are employed. Currently, only one in 10 Americans hold equity shares in the companies they work for, and 12 percent of the U.S. workforce is employed in companies that are employee owned.[1] Depending on the EO model used, ownership can be direct or indirect and may not be available to every employee. Many factors can determine which EO path is best, but ultimately the decision comes down to the goals that the business owners and employees are seeking to accomplish.

Common goals include:

- **Owner Succession Planning:** Business owners interested in retiring or stepping back from leadership can transfer ownership to their employees and managers. Depending on the model used, owners can sell their stake in the company or adjust their company's by-laws to transfer some level of ownership or operational control to their employees in a manner that maximizes their tax benefits and ensures the future success of the company.
- **Employee Job Satisfaction:** EO has been shown to align the interests of employees and firm performance more closely which can lead to increased job satisfaction and performance.[2] For example, executives at majority employee-owned firms surveyed in 2020 were more likely to preserve jobs, wages and hours compared to other firms, likely because these executives assigned higher value to preserving a culture of teamwork and retaining valuable employee skills.[3]
- **Employee Wealth & Retirement Security:** Studies have linked higher and more equitable compensation levels to employee-owned companies.[4]
- **Tax Benefits:** For some individuals and business entities, EO's have tax advantages that vary depending on the type of business and model used.

This report focuses on three prominent EO models in the United States: Employee Stock Ownership Plans, Worker Cooperatives, and Employee Ownership Trusts.

Employee Ownership Models

Employee Stock Ownership Plans

The most popular EO model in the U.S. is the Employee Stock Ownership Plan (ESOP), which transfers some percentage of ownership from corporate shareholders to workers through a qualified retirement plan. ESOPs accumulate shares of stock and cash from the company which are held in trust for its employee-owners and distributed when the employee leaves or retires from the company; in that way, they function and are regulated like other qualified defined contribution or benefit retirement plans.[5]

C Corporation vs. S Corporations

A **C Corporation (C-corp)** is a legal classification for a business entity whose owners or shareholders are taxed separately from the entity itself, which is usually subject to corporate income taxes. Many large firms that issue stock on the New York Stock Exchange and the NASDAQ are C-corps, but privately held small businesses can also have this designation. In 2020, C-corps made up 26 percent of firms and 53 percent of payroll, and employed 43 percent of all employees nationally.

An **S Corporation (S-corp)** is a business entity that does not pay federal income tax; rather, its profits pass through to the business owners, who report them on their personal income tax returns. A business with S-corp status avoids double taxation but is also limited to 100 shareholders and one class of stock. In 2020, S-corps made up 44 percent of all firms and 21 percent of payroll, and employed 27 percent of employees.

To convert to an ESOP, the corporation buys a percentage of currently issued shares of stock (or all of the shares when converting to a fully employee-owned company) from existing shareholders and contributes the shares to the ESOP.[6] The ESOP is only permitted to hold stock from the company sponsoring the plan. This transaction effectively transfers the shareholder's ownership stake in the company to the ESOP whose beneficiaries are the employees in the company. Each employee has a separate stock account that is transferred to the employee when they retire or separate from the company. Employees do not contribute to these accounts in the same way they do with other retirement options, like a 401(k).

ESOPs provide many benefits to employees and employers, but as federally regulated retirement plans they are also largely considered one of the most complex and expensive EO models for a corporation to form or convert to. Tax benefits for owners and workers are dependent on the business's corporate structure and the proportion of total stock contributed to the ESOP. For example, when a C corporation ESOP is created with a contribution of at least 30 percent of the company’s stock, the selling shareholders have the ability to defer their gains if they are reinvested within one year into a qualified replacement property.[7] Also, if an S corporation ESOP owns 100 percent of the company’s stock, the company’s profits are effectively exempt from federal taxes because S corporations are only taxed at the shareholder level, and the sole shareholder is a tax deferred retirement plan. The taxes will eventually be paid by the ESOP participants when they retire or leave the company and are distributed their shares of stock.

As a shareholder, an ESOP is afforded the same rights as any other shareholder in a conventional C or S corporation. The percentage of the company’s stock determines whether the employee-owners in the ESOP are able to influence operational, financial or leadership decisions within the company. The trustee of an ESOP that owns a majority of its company’s stock has significant influence over the election of the company’s board of directors and this influence is often passed through to the participating employees of the company. ESOPs that have less than a majority stake in the company, particularly those sponsored by larger C corporations, are limited in their ability to influence corporate decisions and instead largely function as a retirement benefit for employees.

Impact on Employee Financial and Retirement Security

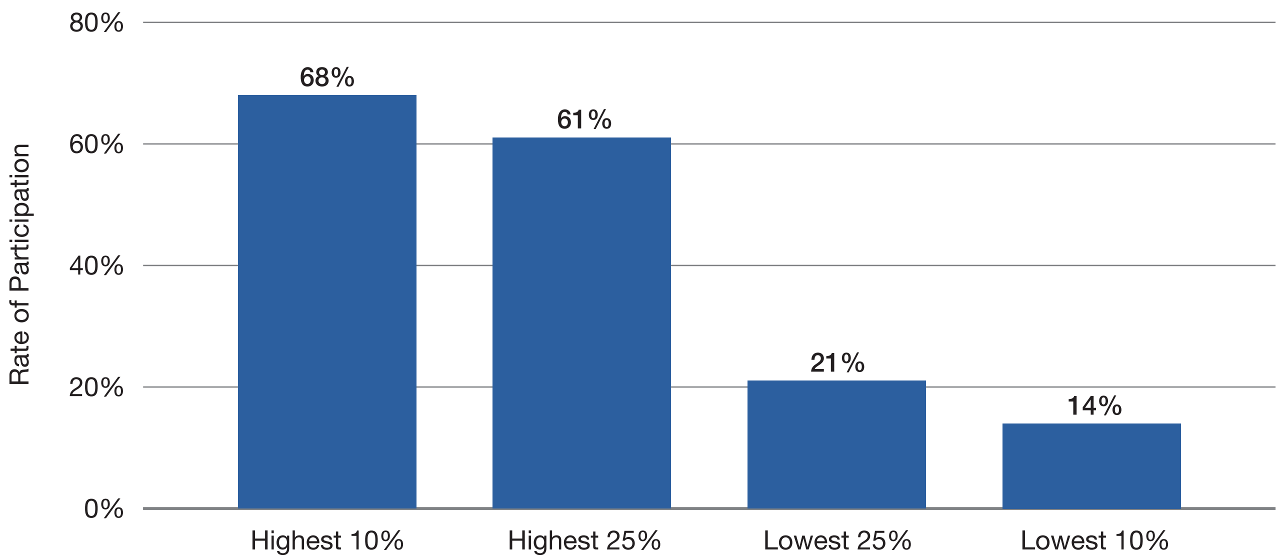
Studies have identified positive linkages between companies with ESOPs and the average overall compensation of the employees that work there. One study found that wages alone were 8 percent higher among C corporations’ ESOPs that held as little as 5 percent of the company’s stock compared to other public companies with less or no level of ESOP ownership.[8]

The overall wealth of an employee-owner participating in an ESOP has a relationship to the amount of equity the employee receives and accumulates during their tenure with the company. A 2021 study published in the Harvard Business Review investigated how an increase in the number of U.S. companies sponsoring ESOPs can impact the overall wealth of employee-owners. The study estimated that if 30 percent of all U.S. businesses sponsored an ESOP with at least 10 percent of the company’s stock, the share of all wealth held by the bottom 50 percent of American wage earners would more than quadruple from 1.4 percent of total net worth to 6.4 percent. Moreover, median wealth among Black households would grow from $24,000 to $106,000.[9]

A survey of business executives in 2018 found that ESOP employee-owners had an average retirement balance of $170,326 compared to $80,339 for employees working for non-ESOP sponsored companies.[10] The savings were particularly significant for low-to-moderate income workers who were close to retirement. Employees surveyed between 60 to 64 years of age who participated in an ESOP plan had 10 times the savings of all other employees in that age group nationally.[11]

Improved retirement savings is an important benefit. In 2021, only one in five U.S. workers participated in a defined benefit plan that provides a guaranteed payout in retirement and approximately 43 percent participated in a defined contribution plan.[12] However, as shown in Figure 1, participation rates are significantly lower for employees earning the lowest 10 and 25 percent of wages.

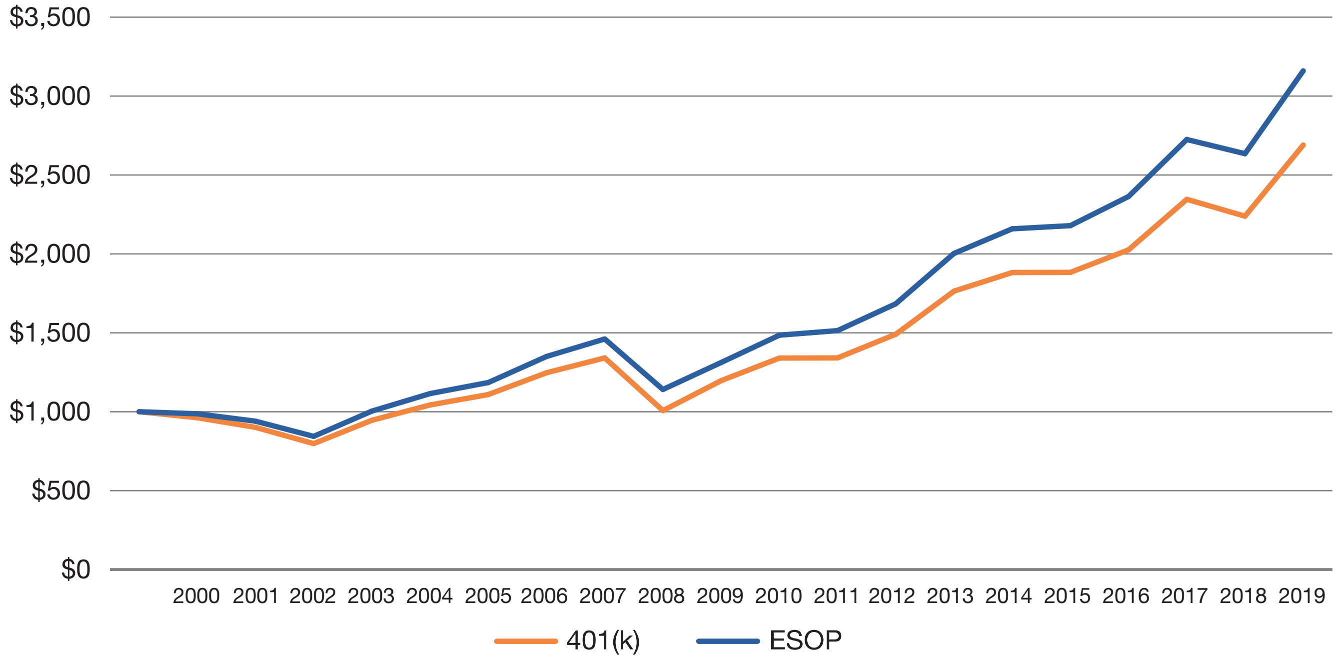
FIGURE 1
Defined Contribution Plans, Participation Rate by Employee Wages, 2021



Source: U.S. Bureau of Labor Statistics, National Compensation Survey, Employee Benefits in the United States, September 23, 2021

Moreover, ESOP investment returns outperform 401(k) plans, the most common defined contribution plan.[13] Between 2000 and 2019, among retirement plans with more than 100 participants, the average annual rate of return for defined contribution plans was 5.2 percent; ESOP plans performed better at 5.9 percent.[14] The differences in rates of return may seem small, but they compound over time. As Figure 2 illustrates, $1,000 invested in 2000 would have yielded a return of $2,690 in an average 401(k) account but would have been worth $3,160 in an average ESOP account—a difference of 17 percent.[15]

FIGURE 2
20-Year Growth of a $1,000 Investment, 2000-2019



Source: U.S. Department of Labor, Private Pension Plan Bulletin Historical Tables & Graphs 1975-2019, Table E20, September 2021

ESOPs in New York State

According to annual filings with the U.S. Department of Labor, in 2020 there were 6,434 ESOP plans nationwide, sponsored by 6,284 companies with over $1.8 trillion in assets held in trust for nearly 14 million participating employee-owners.[16]

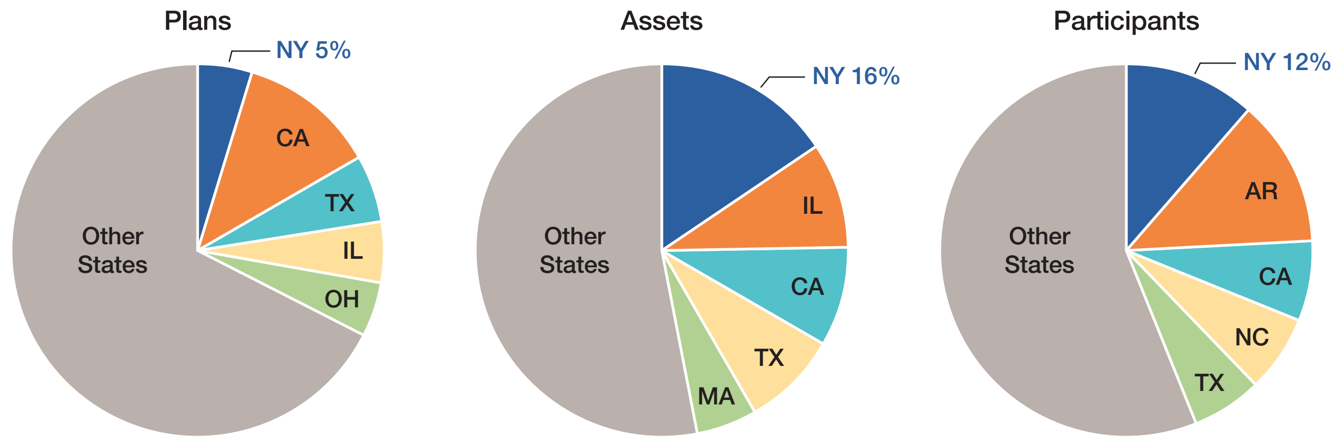
Companies headquartered in New York sponsored 313 of these ESOPs with over 1.6 million participants and $287 billion in assets, representing 4.9 percent, 11.6 percent and 15.7 percent of all ESOPs in the U.S., respectively.[17] The average account balance in 2020 across all industries was $176,000 in New York State, compared to $131,000 nationally.

New York companies ranked fourth nationally in the number of ESOP plans sponsored. California companies sponsored the most ESOP plans nationally—nearly 2.5 times more than New York, and more than Texas and Illinois (second and third highest) combined. Delaware had the fewest plans with eight.

New York sponsored ESOPs had more assets than any other state, largely because four of the nation's top 20 most highly-funded ESOP plans — International Business Machines Company (IBM), JP Morgan Chase Bank, Verizon and Pfizer — are New York companies. The ESOP with the most assets nationally is the Boeing Company in Illinois.

New York is second in the nation in plan participants after Arkansas, which is home to Walmart. Walmart's 1.7 million ESOP participants are more than any other company by a significant margin.

FIGURE 3
New York State Compared to Other Leading States, 2020



Source: U.S. Department of Labor, Form 5500 data analysis by the Office of the New York State Comptroller

In 2020, New York's Manufacturing firms sponsored the greatest number of ESOP plans. However, as Figure 4 illustrates, Finance and Insurance, and Professional, Scientific, and Technical sectors had the most assets. These three industries make up over half of all plans, 80 percent of all assets, and 73 percent of all participants in the State. Despite having only four ESOP plans statewide, the Real Estate, Rental, and Leasing industry had the largest average ESOP account balance per participant with $411,587.

FIGURE 4
New York State ESOPs by Industry, 2020

Industry	Plans	Assets (dollars in millions)	Participants	Assets per Participant
Finance and Insurance	59	$111,701	665,168	$167,929
Professional, Scientific & Technical	36	69,634	249,248	279,377
Manufacturing	72	46,672	275,372	169,486
Information	11	43,278	206,039	210,046
Mining & Utilities	5	5,696	23,516	242,204
Retail Trade	24	5,280	156,499	33,737
Management	6	2,477	19,911	124,426
Construction	33	550	3,410	161,405
Agriculture, Forestry, Fishing	1	322	4,858	66,283
Wholesale Trade	33	303	4,488	67,600
Real Estate Rental and Leasing	4	282	685	411,587
Health Care and Social Assistance	12	274	10,092	27,195
Transportation and Warehousing	8	147	2,736	53,856
Accommodation and Food Services	4	70	2,504	27,909
All Other Industries	5	12	2,750	4,275

Source: U.S. Department of Labor, Form 5500 data analysis by the Office of the New York State Comptroller

Worker Cooperatives

Worker Cooperatives (WC) are a type of business that is 100 percent owned and governed by its employees. Democratic member control and collective decision making are the hallmark principals of a WC. By being directly owned and democratically governed, WCs promote greater employee participation, equity and overall engagement in the success of the business. Unlike ESOPs, WCs can be adopted by any type of business, not just corporations.

The ownership and management structure of a WC is codified in the company's by-laws and other legal filings. If the WC is converted from a non-EO company, a valuation of the company is needed to determine a price for which the new employee-owners would purchase the company. The capital needed to purchase or launch the company is partially generated through a system where workers become owners in a cooperative by purchasing a membership share guaranteeing equal voting rights within the company. Based on a survey of 1,147 workers in 82 WCs in the U.S., the median cost for a share was $500 in 2016.[18]

These member shares generally only provide less than 10 percent of the capital needed to start the WC company, so owners often need other financing options. This can be a challenge because workers may have limited personal capital to invest beyond their membership share and conventional lenders are skeptical about financing a WC because of the pace of decision making by multiple owners and the lack of voting shares for non-members of the cooperative.[19]

A recently released census of worker cooperatives by the U.S. Federation of Worker Cooperatives (USFWC) [20] indicated that in 2019, the ratio between the highest and lowest paid workers in a WC averaged 2:1 compared to 351:1 for all other U.S. companies.[21] When the data was analyzed further, the average hourly wage was between $2 (median) and $3.52 (mean) higher at a WC.[22] In addition to a more egalitarian pay structure, WCs often make distributions to employee-owners. The Federation also noted that in 2018, the average patronage distribution to each employee-owner was nearly $8,300.[23] In addition, approximately three-quarters of WC employee-owners surveyed had more job satisfaction than they had at their previous job.[24]

As qualified retirement plans, ESOPs are required to file annually with the U.S. Department of Labor; in contrast, fewer data exist on WCs. However, through its periodic census, the USFWC has identified 465 WCs in the U.S. generating over $550 million in annual revenues and employing 7,000 workers. These are generally smaller companies in service sectors with an average of six workers and $298,000 in annual revenues per company.[25]

In 2019, USFWC identified 60 cooperatives in New York State, with 80 percent located in New York City.[26] The City is also home to the two largest WCs in the country: the Drivers Cooperative and Cooperative Home Care Associates, with 2,500 and 2,000 workers respectively. In city fiscal year 2015, the City invested $1.2 million to launch the Worker Cooperative Business Development Initiative, a loan fund that works with partner organizations to support the development of WCs. Based on annual reporting from the City, between 2015 and 2020 the Initiative had formally launched 99 new WCs and was in the process of launching 117 others.[27] In their 2019 report, the City noted that of the 21 WCs that were launched in the program's first year, two-thirds were still operational, surpassing the average 5-year survival rate for small businesses at 50 percent.[28]

Employee Ownership Trusts

An Employee Ownership Trust (EOT) is a form of EO that provides current owners a way to sell their business to their employees without the expense and complexity of creating an ESOP. An EOT is a profit-sharing plan that allocates profits to the company's employees. Unlike ESOPs, EOTs do not offer the federal tax benefits for the shareholders, companies or employees-owners, but legislation in Maryland and Wisconsin has been advanced that would provide state capital gains tax exemptions on sales to EOTs as well as ESOPs.[29]

The owner converting to an EOT sells their interest in the company to a trust, making it the new owner of the company. Unlike an ESOP fiduciary that holds corporate stock in trust for each participating employee, EOT employees do not own stock in the company and instead receive a share of the company's annual profits. The stock remains in the trust in perpetuity until the company is sold or dissolves which is why this plan is also often referred to as a Perpetual Trust. Unlike WCs that are directly owned and democratically governed by all their employee-owners, an EOT company grants employees certain authority over the company's operations and leadership structure by amending the company's bylaws. In essence, the employees do not directly "own" the company. Instead, the trust is the direct owner, and the trustees operate it for the benefit of the employees who are trust beneficiaries.

EOTs are popular in Europe but are relatively new in this country with an estimated 13 U.S. firms having transitioned to this EO model.[30]

Conclusion and Recommendations

Research has shown that empowering workers through EO can improve job performance, reduce turnover, and provide stability for shareholders and workers. Federal policies have encouraged the expansion of EO, particularly for ESOPs, which may be a contributing factor to their popularity in this country. Legislation passed in the 1981 Economic Recovery Tax Act, the 1984 Deficit Reduction Act, and the 1986 Tax Reform Act provided deductions and tax benefits to corporations in order to incentivize the creation of new ESOPs.

Most recently in August 2018, the Main Street Employee Ownership Act, sponsored by Senator Kirsten Gillibrand and Representative Nydia Velazquez, was signed into law to improve access to capital for small businesses looking to transition to employee ownership by making the U.S. Small Business Administration’s 7(a) loans, the most common federal small business loans, available to employee-owned businesses.[31] This program provides up to $5 million in working capital to, among other things, establish a new business or to acquire, expand or convert an existing one. The Act also fast tracks loan dispersals to businesses converting to EO.[32]

At the State level, legislation was enacted in 2022 to provide for the expansion of the pool of employees permitted to participate in ESOPs sponsored by Design Professional Service Corporations.[33]

New York could encourage employee ownership more broadly by developing the following strategies:

- Expand networks and partnerships of business owners, employees, labor unions, and economic developers to provide technical assistance to and educate potential employee-owners on the benefits and drawbacks of EO;
- Be creative in leveraging resources or identifying new opportunities that can support EO as a way to create or retain jobs and strengthen communities; and
- Develop ways to educate the public on what EO is and which companies around the State and in their local communities are employee-owned.

Expand EO Networks and Partnerships

Understanding the complexities of converting to EO can be challenging. New York has a vast network of governmental and nonprofit resources that can help enhance the business community’s understanding of the benefits and drawbacks of each model.

In December 2020, New York City launched the Employee Ownership NYC Initiative (EONYC) to provide technical assistance and resources to business owners and to advise them about the benefits and complexities of employee ownership through a network of service providers. Over time, the network expanded by tripling the number of service providers with experience in EO. To date, hundreds of businesses have reached out to EONYC, 72 percent of which were previously unfamiliar with EO.[34]

The State could consider sponsoring a similar employee ownership “Center” within a State entity, university, or not-for-profit organization. In addition to providing technical assistance and mentorship, these centers could also provide general information to the public on the benefits of saving for retirement and creating wealth and financial stability. In 2020 there were at least 10 states with active, state-level centers that included California, Massachusetts, Vermont and Pennsylvania. The common thread through each of these centers are their missions to educate and provide technical assistance to businesses while cultivating relationships with economic development organizations and other employee-owned businesses.[35]

Leverage Resources to Support EO

The State should consider ensuring that any State or federal programs available to assist small businesses are inclusive of and marketed to companies that are employee-owned or are in the process of converting to EO.

One pilot program launched by New York City leveraged the federal Workforce Innovation and Opportunity Act’s (WIOA) Customized Training Grant program. This long-standing workforce training program encourages businesses to invest in enhancing the skills of incumbent workers in ways that meet their business needs. In 2021, three EO businesses were awarded a Customized Training Grant as a consortium to train new employee-owners on core business and finance skills.[36]

Educate the Public on Employee-Owned Companies

While the benefits of EO to the employees who participate in them may be clear, which companies are and are not majority employee-owned is not always apparent. Consumers should know which companies in their communities are owned by their workers so they can support these companies if they choose. Additionally, businesses that are majority employee-owned could more prominently advertise this on their website and company literature.

An example of efforts to promote this awareness is the Pennsylvania Center for Employee Ownership; a nonprofit organization that focuses on raising awareness and promoting all forms of EO. The Center has invested in radio, television and social media campaigns to direct people to their website which has detailed information and a five part course to educate businesses and communities about EO. The website also provides an interactive map to pinpoint the name and locations of business in the state that have adopted an ESOP business model.[37]

Endnotes

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6 ESOPs are permitted to borrow funds to purchase stock directly from shareholders. The loan is later paid back by the company.

7 As defined by Internal Revenue Code (IRC) section 1042, qualified replacement property includes the stock or bonds of an operating company incorporated in the U.S. provided 50 percent of the company’s assets are used in active conduct of a trade or business, and no more than 25 percent of the company’s gross receipts can come from passive sources.

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15 Ibid, with data analysis from the Office of the New York State Comptroller.

16 For the purposes of this report, OSC staff analyzed raw data over 10 consecutive years. In most cases, the state reported as the sponsoring company’s address was the company’s registered U.S. corporate headquarters. To ensure consistency and validity of the data, OSC staff verified information for all ESOP plans with more than $500,000 in total assets and attributed company sponsorship in a limited number of cases to the state in which the company was headquartered.

17 U.S. Department of Labor, Form 5500 data analysis by the Office of the New York State Comptroller.

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