

Owning It

TEXT BY ETHAN BUTTERFIELD

WEIGHING THE PROS AND CONS OF EMPLOYEE OWNERSHIP.

MOST DESIGN FIRMS in the United States—95 percent of them or more—are owned and controlled by an individual or a small number of them, says Hugh Hochberg of management consultancy The Coxe Group. What about the other 5 percent?

Some firms are owned by a large group of employees; others are owned by the entire staff in an employee stock ownership plan (ESOP). ESOPs, which were created by federal legislation in the 1970s, now number more than 11,000 in the United States. Here's how they work: A firm sets up a trust and makes contributions to it, and stock is allocated to individual employees based on tenure, pay, or some other criterion. The firm's contributions to the trust are tax-deductible, within certain limits; likewise, employees don't pay tax on allocations to their ESOP accounts until they receive distributions (usually but not always upon retirement), according to the nonprofit National Center for Employee Ownership.

Boston's Goody Clancy became an ESOP in the early 1990s as the original generation of owners moved out of the business. Now all 112 employees own the firm, which is governed by a board of seven principals who also control the most stock—though by law, no one can own more than 10 percent of the firm's shares. The board makes all company decisions together, says Geoffrey Wooding, a Goody Clancy principal. "We govern by consensus, kind of like running Switzerland," Wooding explains. "There is no titular head. We've done it this way for a number of years, and it works for us."

Another attraction of expanded ownership is that it may help firms keep experienced employees by tying their financial success to that of the company over the long term. CO Architects in Los Angeles, an 85-person firm that is owned by about 20 of its employees (and is therefore not an ESOP proper), has a stock ownership plan that offers major benefits to employees who stay with the firm and cash out at the age of 62.

CO's shareholders do not have to retire at age 62, but they do have to start selling their shares back to the company for book value. After four yearly sales have purged them of all their holdings, the now former shareholders are also paid four years' worth of goodwill payments based on how much the value of their stock increased during their tenure. If a shareholder leaves the company before age 62, the goodwill payments are reduced, explains managing principal Scott Kelsey.

For a company to become more broadly owned, there must be a plan in place years ahead of a transition, giving employees time to buy in and accumulate company stock. Often the switch is prompted by a leadership transition. As owners grow older and face retirement, they want to maximize their profit by selling back shares while also ensuring the firm's continuation.

The poor economy could see more firms exploring the ESOP option, especially if small groups of high-level employees can't raise the necessary cash for buyouts as senior owners retire. Although employee-owned companies are thought to have a performance edge, Hochberg cautions that pride in indirect ownership may not be equivalent to the pride of a direct owner, and that if firms expand ownership too far, nonleaders could wind up in leadership roles. Hochberg predicts, "The stronger, healthier firms out there are going to be pretty much the same—in terms of staff to owner ratio—coming out of this recession as they were going into it." □