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Employee Ownership and the (Rural) Problem of SMEs Ownership Succession

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The Ownership Succession Problem

What is succession in SME?

What is the ownership succession problem?

- SMEs (roughly 60% of all employment)
- Part of the demographic trend (ageing population)
- Recognized by different international institutions (WB, EC, etc.)
- In the rural Europe ageing population is combined with brain-drain – huge pressure on SMEs
- Loss of jobs, tax income, local social programs of these enterprises (sporting sponsorships, charity, etc.)

The following question arises: **Who is the primary stakeholder interested in the success of the company?**

ESOP: A Tool for Ownership Succession (1)

A time-tested EO model from the USA

- 7000 ESOP companies, covering 13 million USA workers (10% of the private workforce)
- Highly effective (above-average productivity, sales, survival rates, lower employee turnover etc.)
- Socially responsible (decreasing economic inequality, democratization, bringing ownership into the hands of the people with inherent interest in the survival and success of the company)
- In the literature, ESOPs are often described as ownership-succession tools

What is ESOP?

- A separate legal entity (a trust) to do a buy-out in the name of the employees
- Employees are members of the trust and indirect owners (rights and responsibilities of ownership)
- Buy-out financed through the retained earnings of the company

ESOP: A Tool for Ownership Succession (2)

What ESOP is not

- ESOP is **not** a stock option plan or a profit-sharing motivational scheme (on the contrary, ESOP establishes a sustainable and inclusive EO in a company)
- ESOP is **not** a return to the self-managed past (state socialisms), but a step into the post-capitalist future (a cooperative economy based on private-property and democratic self-determination)

Europe is missing an ESOP!

- No ESOP-like mechanism in Europe
- IED adapted the American ESOP for the Slovenian legislatory system
- A sister institute in Stockholm, Sweden (Center for Employee Ownership)
- Trying to set up sister institutes in the ex-Yugoslavian region

Setting up a Slovenian ESOP: A Hypothetical Example (1)

STEP 1

A contract is signed between the company and the EO trust (a cooperative with employees as members) about the general details of the buy-out arrangement, about the evaluation of the firm and about the monthly contributions for the purpose of the buy-out

STEP 2

Owner transfers the agreed % of the shares to the trust and in return receives a note receivable (he/she will be paid of in time), or directly receives the full value financed through the bank credit

Setting up a Slovenian ESOP: A Hypothetical Example (2)

STEP 3

Every year, the company contributes a certain percentage of its revenues to the coop-ESOP. The money is used to either:

(1) Pay out the owner, if the agreement is ''seller's credit'', or
(2) Pay out the principal and interest if the agreement is ''leveraged buy-out''

Every month, the value of the shares paid out, is being transferred from the suspense account to the individual accounts of employees

Setting up a Slovenian ESOP: A Hypothetical Example (3)

STEP 4
When all the debt (either to the owner or to the bank) is repaid, all the shares are distributed in the individual accounts.

However, the money flow does not stop. Now, in addition to shares, employees are getting cash on their individual accounts. This has two purposes:

1) It serves as a profit participation scheme, and
2) It establishes an internal market for ownership – when an employee leave the company, the money of other workers is used to buy them out. New workers are automatically included in the scheme, departing workers are automatically bought-off.