

S Corporation ESOPs and Retirement Security

By Nancy Wiefek, Ph.D.
and Nathan Nicholson
DECEMBER 2018



Made possible with funding from:



Download this report at:
<https://www.nceo.org/r/s-corps-retirement>

Executive Summary

American workers at nearly every level of the income spectrum fail to save properly to be secure in retirement. Addressing this challenge will require a comprehensive policy discussion by both federal and state policymakers. Employee stock ownership plans (ESOPs) are the primary form of employee ownership, and for reasons explored in this report, companies organized as S corporations are especially likely to be fully ESOP-owned. This report finds that employee ownership in these companies, called “S ESOPs,” plays a vital role in boosting Americans' retirement security, while also increasing workplace productivity and pride of ownership among employee-owners.

The findings described in this report are derived from a survey of privately-held S corporation ESOPs conducted by the National Center for Employee Ownership, a private, nonprofit research, information, and membership organization. The report compares these findings to nationally representative survey data.

The online survey, conducted between January and March 2018, received responses from 39 companies that supplied the median and average account balances of a total of **61,020** plan participants. It breaks new ground by presenting retirement account balances by wage and age categories (e.g., 20,000 lower-wage workers and 8,000 employees nearing retirement).

CONTENTS:

- 3 Executive Summary
- 5 Introduction
- 6 Uses for ESOPs
- 7 Methodology
- 8 Background on the ESOP
- 9 Other Retirement Benefits
- 10 Account Balances
- 12 Benefits Beyond the ESOP
- 13 Turnover
- 13 Demographics of the Respondent Companies

The research reported here would not be possible without the gracious participation of the survey respondents.

IN SUMMARY:

- ESOP participants represented in this survey have more than twice the average total retirement balance of Americans nationally: \$170,326 versus \$80,339.¹
- This is not just a function of higher wage ESOP employees driving the average up. ESOP employees making less than \$25,000 a year also have on average more than double the retirement savings (\$55,526) compared to similar workers nationally (\$22,447).
- Nearly all of the respondent companies (97 percent) offer at least one other retirement plan in addition to the ESOP. By contrast, 32 percent of all workers in the U.S. workforce as a whole *do not* have access to any retirement benefits at work, and 49 percent of all workers are *not participating* in the plan that is available to them.²
- Additionally, these S corporation ESOP companies provide an array of benefits at levels solidly higher than firms overall where comparison data exist. Certainly, these benefits make their own contribution to retirement security because workers are less likely to have to dip into savings for critical investments or expenses, such as tuition, to advance their career or unexpected medical expenses.
- Among the surveyed S ESOPs, workers nearing retirement have on average a median account balance of \$147,522 in their ESOP plus \$98,974 in a non-ESOP plan(s). By contrast, more than one-third (35 percent) of all workers nearing retirement have neither retirement savings nor a defined benefit pension.³ This percentage rises to 50 percent among low-income workers in this age bracket.⁴
- As such, national data place the median account balance of all U.S. workers 55-64 years old at zero. Even among workers who have retirement accounts, the median balance nationally is \$100,000.

- A typical millennial worker (25-34 years old) at a surveyed S ESOP company has a median ESOP account balance of \$22,588 and a median balance of \$11,239 in a non-ESOP account. In contrast, the median savings of U.S. millennials is zero.
- Among the surveyed S ESOPs, lower-wage employees (\$10.00 to \$12.85 per hour) typically have median account balances in their ESOP of \$4,381 and in a non-ESOP plan of \$2,149.⁵ In contrast, nationally, 56 percent of workers in this category do not have access to any retirement benefits at work.⁶ This translates into a median savings for this group of zero.
- Finally, ESOPs are clearly associated with reduced turnover. Respondent companies report quit and separation rates that are more than two times lower than national rates.

Most of the respondent companies are large (more than 1,000 employees) and 100 percent-owned by their ESOPs. It is important to keep in mind that respondents self-selected to take part in the survey and cannot be considered a representative sample of all S corporation ESOPs. Still, the demographics of the respondents are not limited to just one industry, size, location, or performance category. More importantly, the strength of the findings reported here, even if on the highest end of the continuum, are more than enough evidence to point to the power of S ESOPs for all workers, not just the highest earners.

1 Author's calculations using the Survey of Consumer Finances (2016). SCF is a triennial interview survey sponsored by the Federal Reserve Board of Governors in collaboration with the U.S. Department of the Treasury. Figures are based on individuals and exclude respondents with traditional/defined benefit pension plans.

2 Bureau of Labor Statistics, Employee Benefits Survey, <https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table02a.htm>

3 Ghilarducci, T., Papadopoulos, M., and Webb, A. (2017) "Inadequate Retirement Savings for Workers Nearing Retirement" Schwartz Center for Economic Policy Analysis and Department of Economics, The New School for Social Research, Policy Note Series

4 Defined as below the median income of \$40,000 as per analysis of Ghilarducci et al. (2017).

5 This group has median tenure of a little more than 1 year.

6 Bureau of Labor Statistics, Employee Benefits Survey, <https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table02a.htm>

Introduction

According to the most recent published data, there are 6,669 employee stock ownership plans (ESOPs) in the United States with 14.4 million participants and \$1.3 trillion in assets. Among them, 3,192 are at S corporations, which collectively have about 850,000 participants and just over \$80 billion in assets.⁷

An ESOP is a type of employee benefit plan that is similar in some ways to a profit-sharing plan. 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. Alternatively, the ESOP may 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.

Until 1998, only companies organized as C corporations were permitted to establish ESOPs. Federal legislation made it possible for ESOPs to own shares in S corporations⁸ and provided tax incentives that had the effect of encouraging S ESOPs to own all the shares of the sponsor company.

Shares in the trust are allocated to individual employee accounts. Although there are some exceptions, generally all full-time employees over 21 participate in the plan. Allocations are made either on the basis of relative pay, or some more equal formula. As employees gain seniority at the company, they acquire an increasing right to the shares in their account, a process known as vesting. Employees must be 100 percent vested within three to six years, depending on whether vesting is all at once (cliff vesting) or gradual.

When employees leave the company, they receive the value of the stock in their accounts, which the company must fund valuing the stock at its fair market value. Private companies must have at least an annual outside valuation to determine the price of their shares.

7 NCEO's analysis of the Private Pension Plan (PPP) Research File for filing year 2015 made available by the Department of Labor from data reported on the Form 5500. <https://www.nceo.org/r/esopnumbers>

8 C corporations are the original corporate form in the United States and allow for companies to have multiple classes of stock and to be traded on public markets. S corporations are privately held, can only have a single class of stock, and must have no more than 100 shareholders.

Uses for S ESOPs

1. To create an additional employee benefit.

A company can simply issue new or treasury shares to an ESOP, deducting their value (for up to 25 percent of covered pay) from taxable income, or it can contribute cash, buying shares from existing public or private owners. In either case, that stock creates a benefit for employees to use in their retirement.

2. To buy the shares of a departing owner.

Owners of privately held companies can use an ESOP to create a ready market for their shares. Under this approach, the company can make tax-deductible cash contributions to the ESOP to buy out an owner's shares, or it can have the ESOP borrow money to buy the shares.

When ESOPs are compared to other kinds of defined contribution plans, it is important to note that the most common defined contribution plan, the 401(k) plan, relies primarily on employee deferrals, which amount to about two-thirds of the total in these plans. Employer matches, frequently at about 50 percent up to the first six percent to eight percent of pay, are based almost always on what the employees defer.

This means that higher paid people with more risk tolerance and less current need for income will not only defer more, but get more from the employer, and some lower paid employees will defer (and get) nothing at all. By contrast, ESOPs must allocate contributions based on relative pay or a more level formula and are not triggered by what employees put in.

Methodology

In early 2018, the National Center for Employee Ownership, a private, nonprofit research, information, and membership organization, surveyed members of the Employee-Owned S Corporations of America (ESCA).

The survey was designed to collect data on the role played by S corporation ESOPs in the wider economy. There is relatively little systematic data available to demonstrate the impact of ESOPs on individual workers, particularly lower-wage workers.

To this end, the survey asked about median and average retirement account balances by wage and age categories. It also asked about other benefits offered in addition to the ESOP. This survey design allows for comparing the retirement balances and benefits among employees at surveyed S ESOPs to similar employees in the wider economy.

These data were collected through an online survey conducted between January and March 2018. All respondents are S corporation ESOP companies and members of ESCA. The report below includes data for 61,020 plan participants and was provided by 39 S corporation ESOP companies representing a broad base of geographic, industrial and company size perspectives.

The number of plan participants covered in the survey are summarized in Tables 1 and 2.

TABLE 1. Number of employees by wage categories

EMPLOYEE HOURLY WAGE	NUMBER OF EMPLOYEES	TOTAL COMPANIES WITH ANY EMPLOYEES IN WAGE CATEGORY
\$10.00 to \$12.85	21,367	15
\$12.86 to \$19.22	11,202	27
\$19.23 to \$30.94	9,612	27
\$30.95 to \$47.01	6,239	27
More than \$47.01	7,813	26

TABLE 2. Number of employees by age categories

EMPLOYEE AGE	NUMBER OF EMPLOYEES	TOTAL COMPANIES WITH ANY EMPLOYEES IN AGE CATEGORY
Under 25	13,748	31
25-34	16,736	30
35-44	11,532	31
45-54	11,174	31
55-64	8,027	31
65 or older	1,543	30

Collapsing data reported into averages and medians limits our ability to analyze the data. It was necessary to lessen the time burden and ensure privacy for individual workers. Regardless, this survey presents some of the first fine-tuned data that provides a deeper look into the impact ESOPs have on employees.

The averages presented in this report for both median and average account balances are weighted. That means they are derived from multiplying the value by the number of employees in that category and then deriving an average. The survey prompted respondents to enter average and median account balance data for groups of employees across wage categories and age categories. Respondents were instructed to exclude retired or separated employees.

Background on the ESOP

Among respondent companies, the average number of ESOP participants is 1,565 and the median is 600. Most of the companies in the survey (82 percent) are 100 percent owned by their employees through an ESOP. Among the company respondents, the median value of the assets in the ESOP is \$132 million and the mean value is \$302 million.

Many ESOPs are financed with debt. Shares are held in suspense and gradually allocated to participant accounts as the loan is paid off. There was a mix on the percentage of ESOP shares allocated: 26 percent of companies with 100 percent allocated, 26 percent with less than 50 percent allocated, and the rest somewhere in between.

Among the 35 companies that responded with an amount, the median and mean assets held by the ESOP are presented in Table 3.

TABLE 3. Dollar value of assets held by the ESOP in...

	ALLOCATED SHARES	UNALLOCATED SHARES	ASSETS OTHER THAN COMPANY SHARES	TOTAL ASSETS
Median	\$68,537,624	\$12,774,986	\$322,609	\$132,823,170
Mean	\$206,761,520	\$54,006,511	\$41,554,172	\$302,322,204

TABLE 4. Annual contribution to the ESOP as a percentage of eligible payroll

	ALL RESPONDENT COMPANIES	LESS THAN \$200 MILLION IN REVENUE	\$200 MILLION OR MORE IN REVENUE
Median	11.8%	10%	12%
Mean	13.6%	14%	14%

Other Retirement Benefits

Nearly all of the respondent companies offer at least one other retirement plan in addition to the ESOP, with all but one of the 39 companies offering a 401(k) plan. Notably, 77 percent of respondents offer company contributions to a 401(k) as a benefit (see Table 12 on page 11). Respondents reported a median annual company contribution to these non-ESOP plan(s) of 4 percent with an average of 8 percent.

One of the only sources of comparison data at the level of businesses, the Annual Survey of Entrepreneurs, reports that 23 percent of all firms with paid employees make company contributions to 401(k) plans.⁹ While this is likely a low estimate since this statistic includes firms of all sizes, it remains a telling indicator.

Table 5. Non-ESOP retirement plans

ARE ESOP PARTICIPANTS ELIGIBLE FOR ANY OF THE FOLLOWING OTHER COMPANY-SPONSORED PLANS?	% OF RESPONDENT COMPANIES
401(k) plan	97%
Profit-sharing plan	23%
Defined benefit plan	0%
Money purchase plan	0%
Other retirement plan	13%

Respondents could select multiple options; percentages add to more than 100 percent.

Lower-wage workers at ESOP companies are automatically enrolled in the ESOP¹⁰, which is funded by the employer only, often getting access to a 401(k) in addition. Data from the National Compensation Survey of all workers in the U.S. offer a striking contrast: among all workers in the U.S. making around \$12.00 an hour, 42 percent have access to any plan and just 21 percent are participating (i.e., actually making contributions).

TABLE 6. Access to retirement benefits¹¹, private industry workers by wage¹²

	AVERAGE HOURLY EARNINGS WITHIN THIS CATEGORY ¹³	% WITH ACCESS	% PARTICIPATING
All workers		68%	51%
Lowest 25%	\$12.25	44%	22%
Second 25%	\$18.78	67%	49%
Third 25%	\$30.08	79%	65%
Highest 25%	n/a	87%	77%
Highest 10%	\$46.73	88%	80%

⁹ <https://www.census.gov/programs-surveys/ase/data.html>

¹⁰ Once they have worked for 1,000 hours (in some plans fewer) and are over age 21 generally all employees become participants in the plan.

¹¹ Includes defined benefit pension plans and defined contribution retirement plans. Workers are considered as having access or as participating if they have access to or are participating in at least one of these plan types.

¹² Bureau of Labor Statistics, Employee Benefits Survey, <https://www.bls.gov/ncs/ebs/benefits/2018/ownership/private/table02a.htm>

¹³ As per the BLS, surveyed occupations are classified into wage categories based on the average wage for the occupation, which may include workers with earnings both above and below the threshold. The categories were formed using percentile estimates generated using wage data for March 2018.

Account Balances

Company respondents reported the median account balance among their employees in each of the wage categories in Table 7. We computed averages for each of the wage categories. Separately, we computed averages across the reported median non-ESOP retirement balances.

For companies with more than one additional retirement plan beyond the ESOP, respondents were directed to report the sum of balances across those plans.

For comparison, Table 7 includes a column of national data from the latest Survey of Consumer Finances. Across the board, particularly for lower-wage workers, ESOP participants have substantially more in retirement savings compared to workers in those same wage categories nationally.

Table 8 shows that the group of workers headed toward retirement have an average median account balance

of \$147,522 just in their ESOP with a sizable additional balance in a non-ESOP account. For comparison, national data from the Survey of Consumer Finances shows the median retirement savings of workers nearing retirement is **zero**.

The stark findings shown in Table 8 reflect the fact that large groups of workers nationally do not have access to any work-based retirement account, let alone an ESOP plus a 401(k).

Each company also reported the average account balance among their employees by wage categories. Note that for average amounts we are able to calculate an average **total** retirement balance. We did not do this calculation for the median balance tables because a company's median employee in terms of their ESOP account balance may not be the same as the median employee for their non-ESOP account balance.

TABLE 7. Weighted average of median account balances by wage

EMPLOYEE HOURLY WAGE	SURVEYED S CORPS ESOP PARTICIPANTS					NATIONAL DATA ¹⁴
	NUMBER OF EMPLOYEES	AVERAGE MEDIAN AGE	AVERAGE MEDIAN TENURE (IN YEARS)	AVERAGE MEDIAN ESOP ACCOUNT BALANCE	AVERAGE MEDIAN NON-ESOP RETIREMENT BALANCE	MEDIAN RETIREMENT SAVINGS
\$10.00 to \$12.85	21,367	24	1.2	\$4,381	\$2,149	\$0
\$12.86 to \$19.22	11,202	35	4.2	\$27,138	\$7,300	\$0
\$19.23 to \$30.94	9,612	39	5.8	\$42,736	\$17,728	\$5,900
\$30.95 to \$47.01	6,239	38	12.1	\$74,043	\$36,848	\$36,000
More than \$47.01	7,813	46	8.8	\$209,982	\$109,443	\$251,000

TABLE 8. Weighted average of median account balances by age

EMPLOYEE AGE	SURVEYED S CORPS ESOP PARTICIPANTS					NATIONAL DATA ¹⁵
	NUMBER OF EMPLOYEES	AVERAGE MEDIAN HOURLY WAGE	AVERAGE MEDIAN TENURE (IN YEARS)	AVERAGE MEDIAN ESOP ACCOUNT BALANCE	AVERAGE MEDIAN NON-ESOP RETIREMENT BALANCE	MEDIAN RETIREMENT SAVINGS
Under 25	13,748	\$11.73	1.0	\$2,498	\$1,671	\$0
25-34	16,736	\$19.30	2.8	\$22,588	\$11,239	\$0
35-44	11,532	\$27.26	4.8	\$58,473	\$30,911	\$0
45-54	11,174	\$28.46	7.1	\$92,575	\$61,740	\$0
55-64	8,027	\$28.42	9.8	\$147,522	\$98,974	\$0
65 or older	1,543	\$23.24	10.3	\$116,526	\$103,684	\$0

14 Author's calculation of SCF data. Respondents with a defined benefit pension plan are excluded. Figures include reported savings in an IRA or in a defined benefit account such as a 401(k), thrift, or profit sharing. Note it can't be determined if the survey responses include any savings in an IRA, so the differences may be even larger.

15 Ibid.

Table 9 demonstrates substantial differences across wage categories. ESOP employees making less than \$26,000 a year have on average nearly double the retirement savings (\$16,670) compared to similar workers nationally (\$8,827).

Table 11 adds a column showing the median retirement savings just among those who have a retirement account, that is, the figures exclude the individuals who report zero in savings. This shows that for most of the age categories, the ESOP participants and Americans have similar levels of savings in a retirement account such as a 401(k). **The key distinction is the sizable employer-funded ESOP account balances.**

TABLE 9. Weighted average of average account balances by wage

EMPLOYEE HOURLY WAGE	SURVEYED S CORPS ESOP PARTICIPANTS				NATIONAL DATA
	NUMBER OF EMPLOYEES	AVERAGE ESOP ACCOUNT BALANCE	AVERAGE NON-ESOP RETIREMENT BALANCE	AVERAGE TOTAL RETIREMENT BALANCE	AVERAGE RETIREMENT SAVINGS
\$10 to \$12.85	21,367	\$12,447	\$4,224	\$16,670	\$8,827
\$12.86 to \$19.22	11,202	\$43,381	\$12,145	\$55,526	\$22,447
\$19.23 to \$30.94	9,612	\$134,929	\$27,992	\$162,921	\$61,346
\$30.95 to \$47.01	6,239	\$182,985	\$59,214	\$242,199	\$117,042
More than \$47.01	7,813	\$525,678	\$184,816	\$710,494	\$723,720

TABLE 10. Weighted average of average account balances by age

EMPLOYEE AGE	SURVEYED S CORPS ESOP PARTICIPANTS				NATIONAL DATA
	NUMBER OF EMPLOYEES	AVERAGE ESOP ACCOUNT BALANCE	AVERAGE NON-ESOP RETIREMENT BALANCE	AVERAGE TOTAL RETIREMENT BALANCE	NATIONAL DATA AVERAGE RETIREMENT SAVINGS
Under 25	13,748	\$3,424	\$2,213	\$5,637	\$2,740
25-34	16,736	\$33,612	\$17,109	\$50,722	\$12,405
35-44	11,532	\$132,726	\$46,990	\$179,716	\$37,039
45-54	11,174	\$294,605	\$79,335	\$373,940	\$91,054
55-64	8,027	\$323,823	\$102,276	\$426,098	\$142,124
65 or older	1,543	\$233,602	\$92,039	\$325,641	\$108,363

TABLE 11. Compared to retirement savings nationally by age

EMPLOYEE AGE	SURVEYED S CORPS ESOP PARTICIPANTS		NATIONAL DATA ¹⁶	
	AVERAGE MEDIAN ESOP ACCOUNT BALANCE	AVERAGE MEDIAN NON-ESOP RETIREMENT BALANCE	MEDIAN RETIREMENT SAVINGS	MEDIAN RETIREMENT SAVINGS AMONG THOSE WITH AN ACCOUNT
Under 25	\$2,498	\$1,671	\$0	\$3,000
25-34	\$22,588	\$11,239	\$0	\$11,000
35-44	\$58,473	\$30,911	\$0	\$32,000
45-54	\$92,575	\$61,740	\$0	\$65,000
55-64	\$147,522	\$98,974	\$0	\$100,000
65 or older	\$116,526	\$103,684	\$0	\$102,000

16 Author's calculation of SCF data. Respondents with a defined benefit pension plan are excluded. Figures include reported savings in an IRA or in a defined benefit account such as a 401(k), thrift, or profit sharing. Note it can't be determined if the survey responses include any savings in an IRA, so the differences may be even larger.

Benefits Beyond the ESOP

Majorities of these S corporation ESOP companies offer other valuable benefits. Job training, for example, which is offered by 87 percent of respondents, is a benefit that has a positive impact for society, employers, and employees. There is little in the way of national comparison figures, but at the individual level, an estimated 40 percent of workers report receiving job training.¹⁷

Tuition reimbursement is another benefit that has far-reaching positive benefits for employees and the economy, as well as helping employees avoid using their savings to advance their careers. The Annual Survey of Entrepreneurs reports that 5.1 percent of all employer firms provide this benefit.¹⁸ Again this may be an underestimate since the ASE statistics include all firms. It remains a strong indicator and confirmation of ESOPs tendency to invest in the long term at relatively higher levels.

The findings in Table 12 comport with data at the individual worker level from the National Longitudinal Study (NLS). Research conducted by the NCEO found that employees with an ESOP at work are much more likely to have an array of benefits compared to similar employees who do not. The NLS is a nationally representative panel study following a group of workers over time. The data in Table 12 were collected when respondents were 28 to 34 years old.¹⁹

17 Lerman, Robert, I. 2015. "Are Employers Providing Enough Training? Theory, Evidence and Policy Implications." National Academy of Sciences.

18 2015 Annual Survey of Entrepreneurs. <https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk>

19 For more on this study visit <https://www.ownershipconomy.org/>

TABLE 12. Benefits offered

BENEFIT	% OF RESPONDENT COMPANIES
Medical insurance	100%
Dental benefits	97%
On the job training	87%
401(k) contributions/matching	77%
Tuition reimbursement for certain types of schooling	74%
Flexible work schedule	59%
Paid maternity or paternity leave	56%

TABLE 13. Benefits available to younger workers

BENEFIT	EMPLOYEE-OWNERS	NON-EMPLOYEE-OWNERS
Medical, surgical, or hospitalization insurance which covers injuries or major illnesses off the job	97%	67%
Dental benefits	94%	60%
Tuition reimbursement for certain types of schooling	62%	24%
A flexible work schedule	52%	34%
Paid maternity or paternity leave	65%	31%
A retirement plan other than Social Security	89%	53%
# of respondents	975	3,931

Turnover

Finally, we see evidence that all of this – providing relatively more retirement security, benefits, and investments in the long-term – translates into lower turnover.

TABLE 14. Average annual quit and separation rates

	RESPONDENT COMPANIES	NATIONALLY
Average annual voluntary quit rate over the last four years	10.75%	27.13%
Average annual involuntary separation rate over the last four years	6.74%	16.0%

Demographics of the Respondent Companies

The next several tables describe the characteristics of the respondent companies.

TABLE 15. Industry

Manufacturing	26%
Professional, scientific and technical services	18%
Construction	18%
Wholesale trade	18%
Retail trade	8%
Other	13%
# of respondents	39

TABLE 16. Revenue

\$50 million or less	13%
\$51 million to \$200 million	21%
\$201 million to \$500 million	33%
\$501 million or more	33%
# of respondents	39

TABLE 17. Age of ESOP

More than 20 years old	56%
In the last 20 years	44%

TABLE 18. Stock price and profits

	AVERAGE ANNUAL CHANGE IN STOCK PRICE OVER THE PAST FIVE YEARS	PRETAX PROFITS AS A PERCENT OF REVENUE IN THE MOST RECENTLY COMPLETED FISCAL YEAR
0-10 percent	23%	74%
11-20 percent	46%	18%
21 percent or higher	28%	3%
Negative (we had a decrease/loss)	3%	5%
# of respondents	39	39

National Center for Employee Ownership
1629 Telegraph Ave., Suite 200
Oakland, CA 94612
(510) 208-1300

NCEO



NATIONAL CENTER FOR
EMPLOYEE OWNERSHIP

www.nceo.org