

Financial Participation for a New Social Europe

**Focus: Business Succession in SMEs
Developing a European ESOP Model**

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EU-15: „Mature market economies“ have massive Succession Problem due to aging of population

- **Commission Communication 2006**

aging of Europe's population

30% of entrepreneurs will withdraw within next 10 years

mainly those running family enterprises

This affects affect up to 690,000 SMEs and 2.8 million jobs across EU *every year*

Primily mature market economies: 610.000 in EU-15

- **Study Deutsche Bank Research May 2007**

less than 50% of Firms will find a successor in the family

10% plan EBO

21% look at sale to outsiders

Growing interest of international investors in German SMEs

process threatens successful regional structure of European (family-owned) businesses

EU prepares for massive transformation of ownership of SMEs

EU prepares for massive transformation of ownership SME

- Entrance of int. investors into what used to be primarily domestic markets
- Growing # of Private Equity firms targeting Europe's SMEs

Comparison of an alternate leveraged buy-out tool

- the Employee Stock Ownership Plan (ESOP)
- ESOP and PE fund have same roots

The two markedly differ in one crucial respect

- Private Equity buy-out concentrates ownership of firms & of their income
- ESOP broadens economy's ownership base and distribution of income
- Benefit different constituencies and have different economic/social effects

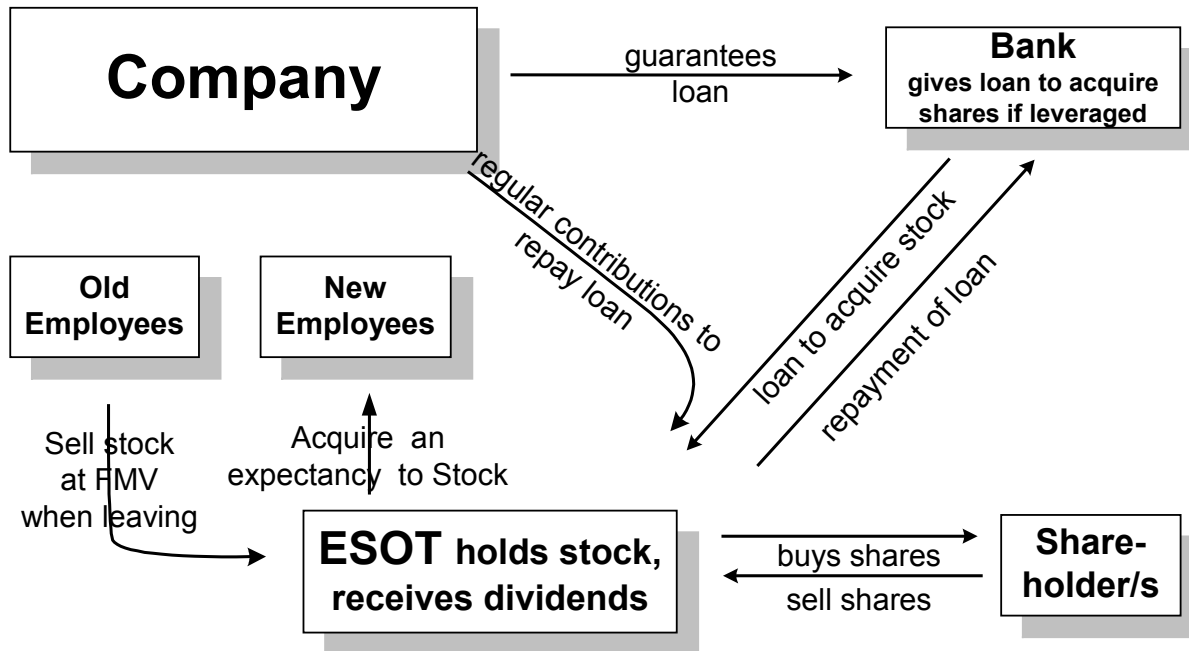
The choice is

- Quick profits for a few, who are already well-capitalized
- incomes rising over time for employees motivated by ESOP to make their enterprises more profitable and competitive

Employee Stock Ownership Plan (ESOP)

- **Company establishes Employee Share Ownership Fund**
 - Continental Europe: Corporation/Foundation/Association
 - Anglo-american law: as a rule a Trust
- **Usually financed by a Combination of**
 - Company Contributions and Borrowings
 - Credit directly from Bank or from Company, which in turn takes Loan from a Bank or other Lender
- **Loan may be repaid by**
 - direct cash contributions from the company to the trust ESOP,
 - monies from sale of shares to the share-based profit-sharing scheme
 - dividends on the shares held by ESOP
- **ESOP-Fonds holds Shares in Trust for Employees**
 - Shares allocated to individual accounts/distributed after holding period
 - Period determined by Trustee, driven by the need to repay borrowings

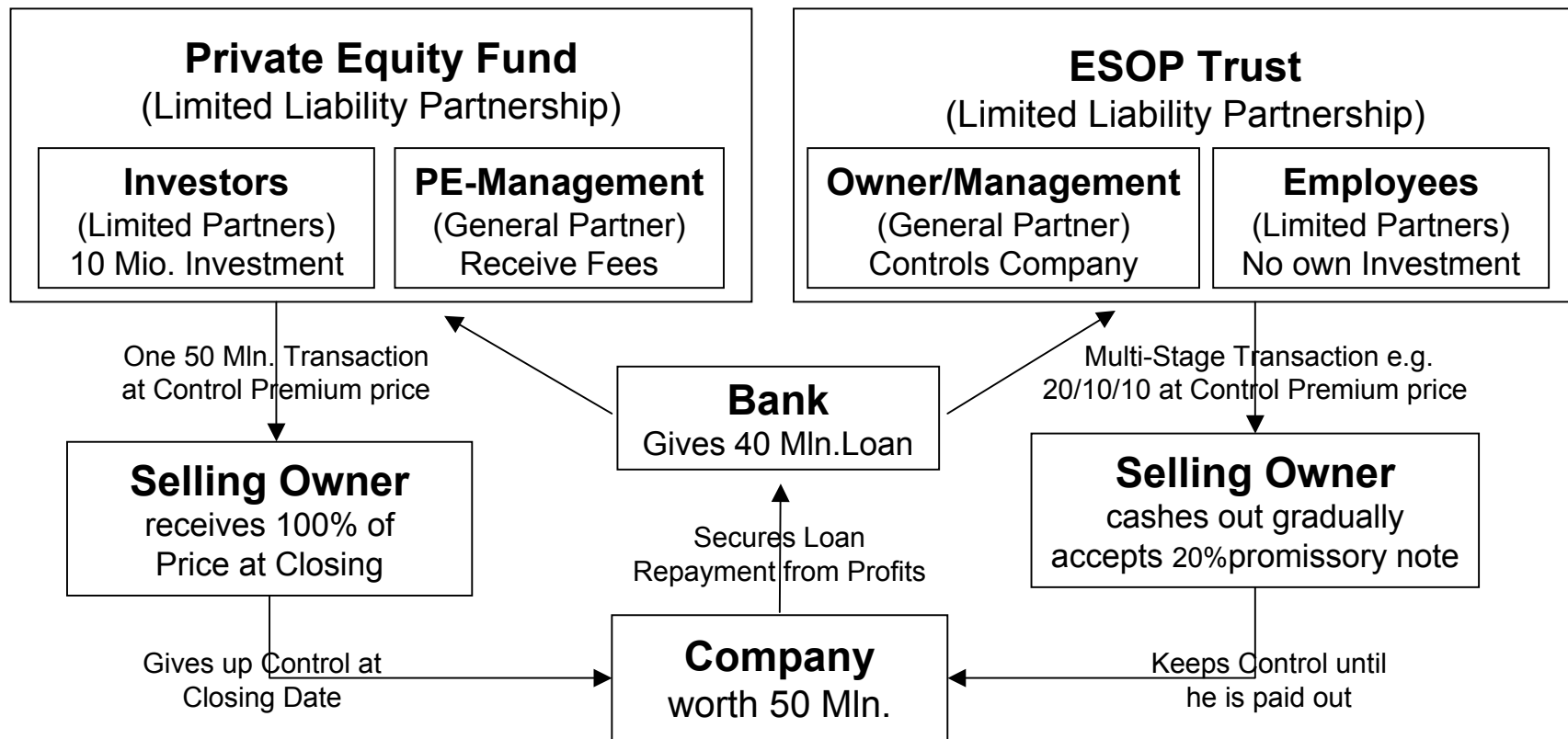
ESOP as a Vehicle for Business Succession in SMEs



ESOP as a Vehicle for Business Succession in SMEs

- **Internal Market in unlisted SMEs without source of Liquidity**
 - All shares are bought at Fair Market Value
 - Owners may diversify Investment Portfolios without going public
- **No Dilution in Equity per Share of current Stockholders**
 - No new Shares are issued
 - Buy-out Shareholder, permitting others to retain their Equity Position
- **Attractive Alternative to selling the Business to Outsiders**
 - Keeping Control of Business within a Family or a Key-Employee Group
 - Opportunity of gradually cashing out without giving up immediate Control
- **Creates Market for retiring Shareholders at acceptable Price**
 - Ownership is transferred gradually to motivated Employees
 - Who have a vital Interest in the Company's long-term Success
 - The Company remains local

PE vs. ESOP: Structure of a 50 Mln. Buy-Out



Aim for PE Fund:

- Restructures & sells Company
- MBO / IPO
 - Trade Sale / Secondary Sale
 - Buy Back / Write-off

Aim for ESOP Trust:

- Ensures Continuity of the Company
- Holds shares for employees
 - Buys shares from retiring employees
 - Warehouses shares for new employees

PE vs. ESOP: Similarities, Differences, Benefits

Private Equity

- Seller loses control at closing date
- Sale at FMV with Control Premium
- 80% Loan + 20% Investment
- One 100% Transaction
- Sale (MBO, IPO, Secondary Sale, Buy Backs Trade Sale, Write-off)
- PE-Fund, Investors and Bank
- Company secures Loan
- Restructuring
- Increase of Company Value
- High Return on Investment
- Corporate Financing for SMEs
- Liquidity at Capital Markets

ESOP

1. Control

- Seller is gradually cashing out
- He keeps control until he is paid out
- FMV+Control Premium but loss of interest

2. Financing

- 80% Loan + 20% Promissary Note
- Multi-Stage Transaction 5-7 years

3. Exit Strategy

- Trust “warehouses” shares and creates a market in non listed companies

4. Risk

- Selling Owner and Bank
- Company secures Loan
- No additional risk for employees

5. Main Benefits

- Continuity of the Company
- Company remains local
- Employees become Owners
- Raise in Motivation and Loyalty,
- Raise in Productivity and Profitability

The US Experience in Numbers

- ESOP part of social/economic fabric of corporate America
- Over 50% of *Fortune* 500 companies sponsor ESOPs
- Over 40% of *Inc.* magazine's 100 fastest growing private companies sponsor ESOPs
- As of 2007 there were approximately 11,000 ESOPs in the U.S., covering approximately 10 million employees
- Vast majority sponsored by privately-held firms, of which about 3,500 majority and 2,000 100% owned by ESOP
- 2004 survey: out of 108 million people in the private sector, 21% of employees own company stock,
- The median value of the employees' company stock ownership is over one-fifth of their annual pay