

## business & labor

### MANAGEMENT

#### Through Ownership, More Employees Are Pumping Up The Company (8/18/2003 Issue)

Workers at all levels buy into their firms' futures—and their own

By Debra K. Rubin and Mary B. Powers

**M**ike Wilson, a manufacturing supervisor at Dallas-based specialty contractor TD Industries Inc., doesn't hesitate to chide a fellow employee who might be doing something that's wasting company money. To Wilson, it's personal. "That's my profit sharing you're getting into," says the 16-year veteran who started as a tradesman helper and is now among 85% of TDI's 1,300 "partners" who have invested their own money in the company's future.



At TDI, employee ownership is nothing new. The uniquely managed company, which has been in the Top 10 of Fortune magazine's 100 best companies to work for since the list debuted in 1998, has allowed employees to own a "piece of the rock" since 1952.

"My dad thought it was fair," says TDI Chairman Jack Lowe Jr., whose father, Jack Lowe Sr., founded the firm six years earlier. "The people doing the work should get their share of the gain." The employee ownership has helped protect the firm from management fads such as specialty contractor rollups.



**HEART OF THE COMPANY** At Dallas contractor TDI, 85% of the employees are owners despite recent stock drop.  
(Photo courtesy of TD Industries)

As generational changes and gyrating economic forces push engineering and construction companies to re-evaluate their financial and management structure, employee ownership is also undergoing change.

The vagaries of the public stock market have heightened interest in employee ownership. While many firms flocked to public ownership 20 years ago to raise capital, their stocks have been largely roasted or ignored in more recent years. Megafirms such as Jacobs Engineering Group Inc. and EMCOR Group Inc. remain committed to the public market, but many smaller design firms and contractors have bailed out in favor of alternative methods of financing, including employee ownership.

While Employee Stock Ownership Plans (ESOPs) have allowed staffers to build up retirement nest eggs and offered distinct tax advantages for the last two decades, companies are looking to further broaden employee ownership opportunities—to give better incentives to key producers and allow aging stockholders to "cash out" and to raise needed capital for future corporate growth and survival.

"Every 25 years, private firms go through a complete turnover of management, and replace the equity base," says Hugh L. Rice, managing director of management consultant FMI in Denver. "You either sell out and change the culture or sell to employees. It appeals to the 'piece of the rock' mentality that this industry has."

In a survey conducted last spring of nearly 400 contractors with revenue of at least \$15 million, FMI was surprised at the level of interest in wider firm ownership. "The third of respondents who felt that no one individual should necessarily have control was unexpected," says FMI Director Landon R. Funsten, the survey's author.

Employee ownership is more prevalent in design firms, which historically are more "relationship driven," says Michael Lucki, Americas director of construction services for Ernst & Young in Irvine, Calif. ESOP use among design firms tracked by EFCG Inc., a New York City financial management firm, doubled between 1997 and 2002 (see chart, p. 26). "ESOPs have allowed firms to tap into retirement funds that are now well funded," says President Paul J. Zofnass. "It's easy access to a new source of capital not otherwise available."

**The firm's ESOP can be a bidding disadvantage but "it's been very good for our firm."**

— JIM McNULTY,

CHAIRMAN, PARSONS



Parsons Corp., Pasadena, Calif., used its ESOP to buy up public stock in the mid-1980s and avoid a hostile takeover that could have dismantled the firm, says Chairman James F. McNulty. The ESOP allocates tax-free stock annually to members based on salary and operates as a single shareholder on their behalf. He says the stock valuation, based on the firm's earnings, market conditions and the share price of publicly traded competitors, "has been very good for our firm." McNulty says that while the cost of an ESOP can be a competitive disadvantage against non-ESOP

firms, the approach has boosted retirees' financial package and has been a "positive" recruiting tool.

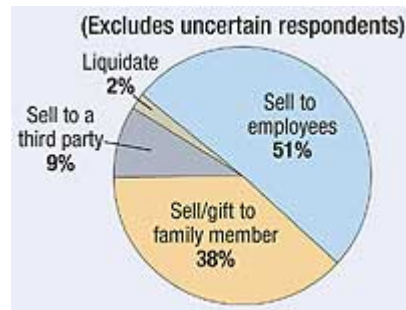
In some cases, however, firms are beginning to rethink the ESOP model as the sole or even largest shareholder, the so-called "creeping ESOP," says Zofnass. He points to complications of administration and compliance for smaller firms and to limitations as a productivity carrot. "It's not an incentivization tool for the real producers," Zofnass contends. As such, a number of firms are exploring ways to offer "equity shares" more broadly to their employees, and to improve the link between personal and corporate performance.

TDI's broad plan is set up so no one at the firm, including top execs, owns more than 2 to 3%, says Lowe. Employees can join the stock program quarterly and invest up to 10% of gross pay. "To participate, you have to put up your own money," he says. "With an ESOP, employees don't do that." The company then matches it. "We put 15% of profits into the plan," Lowe says. "Some years, it's a lot of money, and some, it's not."

Jeff Riddle, a seven-year TDI veteran and construction vice president, says ownership was appealing "for obvious reasons, and ones not so obvious." The stock enjoyed double-digit increases in six of the last 10 years. The softer economy drove the stock down 5% in 2003, but he says ownership has other benefits. "Over time, you find yourself passionate about what goes on here," says Riddle.

CH2M Hill Cos., Denver, implemented a broad internal ownership program in 2000 that would bolster its industry leadership position and "align employees' work product and financial reward," says Michael D. Kennedy, president of its transportation business group and chairman of its ownership and incentive compensation committee. "We are very pleased with the results. We are seeing changes in behavior." Two-thirds of CH2M Hill's eligible employees now own equity shares and are voting shareholders, but the firm hawks the program with an array of slick materials, including its 17-page "owners' manual."

**CONTRACTOR OWNERSHIP TRANSFER PLANS\***



\* Among 393 respondents to spring 2003 survey. Source: Falls Management Institute

Because CH2M Hill's stock ownership program includes more than 500 employees, the firm must register with the federal Securities and Exchange Commission. This has triggered much of the same scrutiny that public firms face, including financial reporting requirements and compliance with new Sarbanes-Oxley governance rules (ENR 7/21 p. 24). "We have to go through the quarterly dance," says Kennedy.



**"Stock ownership fits in with [our] culture and allows the firm to perpetuate itself."**

— JIM GILLETTE,  
CEO, SWINERTON

Mindful of that 500-person threshold, San Francisco building contractor Swinerton Inc. is still broadening ownership away from an ESOP that was set up in 1985 with a 31% stake in the firm, says CEO James R. Gillette. That share has since been "whittled down" to 20% and has stayed "frozen," he says. Some 292 individuals now own the remaining 80%, but no one person owns more than 20%, Gillette notes.

Swinerton uses company stock as part of its total compensation program, offering certain eligible employees as much as 60% of a bonus in stock. While the arrangement excludes some lower-paid and newly hired staff, "we have a lot of estimators, accountants and marketing people who are eligible," says Gillette. "It fits in with the company culture, and our company can perpetuate itself."

HDR Inc., Kansas City, also is looking ahead in its financial future. The design firm expects to pay off in 2005 the loan used by its ESOP to buy itself back from French contractor Bouygues in 1996, says HDR Chairman Richard R. Bell. "We will then have more money for investment or to sell more stock," he says.

As have other private firms, HDR has overhauled its governance to increase employee confidence that the firm is a good investment for their 401(k) funds. "In 1977, I thought it was my obligation to buy stock," says Bell. "But that is no longer the case. We want employees to make the choice."

For Vivian Pappel, HDR's national water marketing coordinator, "the decision to purchase was a pretty easy one," she says, following investment guru Warren Buffet's advice to invest in firms "you're comfortable with." Pappel says that the administrative burden of ownership means it's for the long haul. "I would not invest if I was only planning to be here a few weeks," she says.

Increasingly, however, more potential employee owners are concerned about how easily or quickly they can get at their investments. Post-Enron skepticism is a formidable barrier, experts say. "There's an increasing demand by employees to have liquidity in the stock," says Zofnass. "Firms are trying to figure out new liquidity processes."

Reynolds, Smith and Hills Inc., Jacksonville, Fla., is among them. With about 25% of the engineer's 500,000 shares owned by former employees, "we want to develop a model for some level of liquidity without breaking the bank or forcing the sale of the company," says Ken Jacobsen, general counsel and CFO. The share price has risen from \$5 to nearly \$20 since 1990, but the firm cannot buy back shares and younger employees with less loyalty and big mortgages remain a tough sell, he claims. The firm expects to unveil a stock transition plan next month, says Jacobson.

	By # of Firms				By Revenue (\$/bil.)			
	# of Firms		% of Total		Revenue		% of Total	
TYPE OF OWNERSHIP	2002	1997	2002	1997	2002	1997	2002	1997
Public	17	25	10	15	8.5	5.1	29	31
Subsidiary of Public	8	24	5	14	2.6	4	9	24
Sub-total public	25	49	15	29	11.1	9.1	38	54
Private C-Corp.	97	84	58	50	15.2	6	52	36
Private S-Corp.	41	33	25	20	2.6	0.7	9	4
Private partnerships/LLC	4	3	2	2	0.1	0.9	0	5
Sub-Total Private	142	120	85	71	17.9	7.6	62	46
Total Public & Private	167	169	100	100	29	16.7	100	100
ESOP	42	22	25	13	9.7	2.2	33	13

\*Among 167 firms surveyed in November 2002 and 169 in November 1997  
Source: EFCG Inc.

But there may be new wrinkles in the employee ownership horizon, in the form of new regulation that could up-end the delicate balance of firms and employees buying and selling stock.

This past May, the Financial Accounting Standards Board (FASB), a Norwalk, Conn., non-government body that polices financial accounting and reporting standards for both public and privately owned firms, issued a new edict that critics say will negatively affect how firms account for stock they buy back from employees and could complicate or even threaten a long-established covenant in many firms.

FASB's "Statement of Financial Accounting Standards No. 150" was rushed back onto the front-burner after the 2001 Enron scandals. The rule requires that companies that have employee stock buyback programs at specified times such as termination or death indicate such repurchases as debt on their balance sheets, rather than as equity. FASB contends that the change is critical to restore investor and public confidence in corporate reporting by showing information that is "unbiased, verifiable, and more representationally faithful."

The accounting rule is already in place for public firms and is set to take effect for private ones, as of the accounting year that ends in December. Financial executives say the rule could have dire consequences, particularly for privately held firms. "It will change the landscape for 80% of private firms," says Ernst & Young's Lucki.

FMI's Rice says showing stock purchasing as debt on the balance sheet could hurt a firm's standing with lenders, bonding companies—and potential clients. "If you're trying to get prequalified with a state DOT, they may take a look and see a lot of debt," he says.

Some industry groups, reportedly including the Associated General Contractors and Associated Builders and Contractors, are trying to lobby FASB to exempt private firms. And last month, the Financial Executives International organization, which represents 15,000 CFOs and other number-crunchers, sent a letter to FASB Chairman Robert H. Herz requesting the board to reconsider the 150 rule or delay its implementation by private firms.

The letter, sent by FEI's Committee on Private Companies, contends that forcing firms to take a loss on stock buybacks could undermine competitiveness between public and private firms. "What FASB did is stealth accounting," says Richard Schrader, CFO at Parsons Brinckerhoff. "They are going to make a lot of companies revisit shareholders' agreements."



**MARKETING** CH2M Hill attracts employees to buy company stock.

Lucki says that barring delays or changes, firms will likely have to accept the new rules and figure out how to maintain viable stock buyback plans and employee confidence in them. "You can rewrite agreements but it's a huge educational process," he says.

Others say firms can still follow the letter of the rule without compromising its spirit. "Instead of a firm mandatorily having to buy back stock, make it subject to approval by the board of directors," says EFCG's Zofnass. He adds that subordinating a firm's stock repurchase liability to bank debt could also mollify lenders.

But as TDI employee owners readily admit, ownership is as much about entrepreneurship and personal contribution as it is about financial reward. "People at TDI may not cash a check like the consolidators," says Lowe. "But the company that allows people to be great will outperform the others." And the zeal that TDI employee-owners seem to have for their favorite investment is palpable. Says Riddle: "We have plumbers who can dissect a balance sheet."

**FASB's new accounting rule "will change the landscape for 80% of private firms."**



— MICHAEL LUCKI  
ERNST & YOUNG