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Why ESOPs Can be a Good Fit for Agribusiness

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Agribusiness is a robust and diverse industry that is at the core of American success and food security. Over time, the agriculture industry has evolved from crop tillage to precision ag, and numerous types of companies—including implements and parts manufacturers, food processors and distributors and green and renewable energy firms, among others—have contributed to this evolution.

Currently, the U.S. is home to approximately 42,000 agribusinesses that employ over 10 employees, 5,800 of which employ more than 100 workers, according to Dun & Bradstreet. Many of these companies are facing the question of succession planning, and business owners are wondering what to do with their businesses when they retire. Project Equity, a nonprofit group dedicated to the movement to harness employee ownership, states that an estimated 60.0% of U.S. business owners are planning to sell their businesses within the next 10 years. Thoughtful succession planning is needed regardless of the type or size of one's business; however, the more employees involved, the more is at stake.

Traditionally, companies in the agriculture industry often looked to family succession and friendly neighbors when hoping to transition their business. For many, though, that opportunity may not exist because the younger generation is no longer interested in carrying on the legacy of the family business.

So, what alternatives are there? Selling to a third party, or someone who is outside of the business, may be an option. However, when considering this alternative, the seller should weigh the pros and cons of such a transfer. For example, investment firms, including private equity firms and foreign investors, have shown a high level of interest in agriculture assets over the past decade. On the other hand, the rural location of most agribusinesses can limit the pool of potential third-party buyers.

Additionally, business owners need to consider not only price and timing but also what impact the sale to a third party may have on the community, especially if the business is a sizeable employer. When selling to a third party, there is no way of knowing what will happen to the company once the sale is complete. If an agribusiness sells to a third party, the new owners may choose to move the company to another location; this loss of jobs would negatively affect not only the company's employees but also the community at large.

At the same time, the continuation of the company's culture and legacy could be at stake. Often, owners hope to preserve their legacy in the community and industry, even long after they retire. However, a third-party buyer may introduce a culture that is not compatible with the values of the community.

Consider an ESOP

This is where an employee stock ownership plan ("ESOP") can come into play. An ESOP is an employee benefit plan that governs a trust, which is established to own some or all of the stock of a corporation for the benefit of the sponsor company's employees. In order to qualify to participate in a company's ESOP, workers must meet eligibility requirements, such as being over 18 years old and working over 1,000 hours per year. ESOP participants receive an allocation of stock—at no cost to them—and these shares accumulate in their accounts over time. Wealth creation is achieved through the growth of the company's stock value and additional stock allocations over time. ESOP participants' vested account value is paid to them upon retirement or departure from the company. For more information on ESOPs, watch Prairie's video "What Is an ESOP?" here.

According to the most recent information from the National Center for Employee Ownership ("NCEO"), a nonprofit organization that supports the employee ownership community, there are about 6,500 ESOPs in the U.S. with nearly 14.0 million participants and total plan assets of over $1.6 trillion. The NCEO also reports that an average of 250 new ESOPs are created each year. Moreover, according to statistics provided by Certified EO, an organization that is building a network to bring national recognition to employee ownership through the use of a marketing and certification program for employee-owned companies, 104 companies in the agribusiness market have ESOPs. Notably, 58 of these companies are machinery, equipment and supplies wholesalers.

ESOPs and Agribusiness

Agribusiness owners should consider ESOPs as part of their ownership transition plan for a number of reasons. First, ESOPs are a way to enable the continuation of a company's culture as well as the owner's legacy. If businesses are sold to a third party, the likelihood of preserving both culture and legacy fades. However, putting an ESOP in place means that the company will remain in the hands of the workers that helped to build it. Therefore, the culture of the company will likely remain consistent, and the values of the original owner or owners will be carried out over the long term. The company will also remain independent and retain the brand appeal that the original owner worked so hard to build. As a result, the positive impact that the agribusiness has had in their community will continue.

In addition, ESOPs are a meaningful benefit that can attract and retain employees. Companies throughout the U.S. have struggled to recruit and retain employees, especially since the onset of the COVID-19 pandemic. While some companies are able to offer a work-from-home option to their employees, companies in the agribusiness industry most likely do not have that option since their staff is needed on-site. An ESOP is one benefit that could incentivize workers to join the company or remain over the long term. Indeed, the NCEO reports that workers at a company with an ESOP have a median job tenure of 5.1 years, which is 46.0% higher than the median job tenure for workers at companies without an ESOP. This is due to the fact that ESOPs have been found to increase an employee's commitment to the company and foster an ownership culture more broadly throughout the firm.

Oftentimes, employees at companies with an ESOP also see their wealth grow over the time they remain with the company. Wealth creation is especially important in the current environment when wealth gaps are prevalent. For instance, according to a 2022 survey published by financial services company LendingClub and financial news site PYMNTS.com, more than 50.0% of U.S. consumers are living paycheck to paycheck. In addition, PwC reports that approximately 25.0% of adults in the U.S. have no retirement savings. Comparatively, according to the employee ownership advocacy group Employee-Owned S Corporations of America, the average ESOP participant in employee-owned S Corporations has more than double the amount in his or her retirement account than the average American employee. Notably, 57.0% of ESOP companies offer an ESOP in addition to a pension or defined contribution plan, thus enabling their employees to help build savings.

There are also a number of financial benefits when a company sells to an ESOP. If a loan is used to finance an ESOP transaction, the contributions that are used to repay the loan are tax-deductible, so the company can repay the loan with pre-tax dollars. Additionally, for S corporations, the ESOP's share of recognized earnings is not subject to income tax at the federal level and, oftentimes, the state level. At the same time, owners of C corporations who sell their stock to an ESOP can defer capital gains on the sale under IRC §1042. Employees also receive a tax benefit in light of the fact that an ESOP retirement account is non-contributory and tax deferred.

Moreover, an ESOP can be structured to meet a variety of liquidity events. Depending on the owner's goals and timeline, it may not be practical or desirable to sell 100.0% of the company's stock to an ESOP. Regardless, an ESOP can be structured to provide partial liquidity to one or more shareholders. In fact, an ESOP is an excellent solution for a situation with multiple shareholders where one may be seeking liquidity and others wish to retain control. Notably, an ESOP can be structured to give the plan a minority share in the business at first, providing some liquidity. Thereafter, the remainder of the company's stock can be sold to the ESOP or a strategic buyer at a later date. In general, an ESOP provides agribusiness owners with a variety of options for transitioning their shares.

Overall, selling an agribusiness—or part of an agribusiness—to an ESOP can be extremely beneficial for not only the owner who wishes to sell but also the company's employees and the local community at large. When an agribusiness remains healthy and in its community, it is doing its part to keep the local economy vibrant.

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