



The ESOP Playbook:

HOW TO STRUCTURE A SUCCESSFUL OWNERSHIP TRANSITION





As business owners consider the best exit strategy for their companies, they're increasingly turning to employee stock ownership plans (ESOPs). In fact, there are currently more than 6,600 ESOPs in the U.S., holding more than \$2 trillion worth of assets for 15 million participants. The plans are gaining popularity for good reason.

Jason Muhme, Northwest Bank Head of ESOP Finance, says that many business owners have realized that neither a family successor nor a sale to a third party is a realistic outcome. Family members may not be interested in owning the business, and strategic buyers or private equity firms often introduce uncertainty around employee retention, culture and the organization's long-term independence.

“What makes ESOPs particularly relevant in today's environment is that they solve multiple challenges simultaneously. They create liquidity for shareholders, provide a succession plan, reward employees, preserve legacy and often offer compelling tax advantages.”

Jason Muhme
Northwest Bank Head of ESOP Finance



Very few ownership transition strategies can accomplish all of those objectives at once.

Dive into this playbook to learn more about:

- The tax advantages of ESOPs for business owners
- Practices that can help position your ESOP for long-term success
- What to look for in an experienced ESOP banking partner

ESOPs are on the rise:

6,609
ESOPs IN THE U.S.

309 new plans in one year

15.1 MILLION
PARTICIPANTS

56,663 new active participants in one year

Source: NCEO



WHY ESOPS WORK

For Muhme, ESOPs provide his clients with an exit strategy that checks several items off their wish list. “ESOPs are attractive because they deliver multiple benefits through a single transaction,” he says. “Very few exit strategies can accomplish so many objectives at once.”

The plans offer business owners the following benefits*:

1 Liquidity for shareholders

An ESOP provides business owners with a path to liquidity while creating an ownership benefit for employees. Through an ESOP trust, the plan acquires shares from selling shareholders, which are generally allocated over time to eligible employees’ ESOP accounts.

Employees can benefit from the company’s future value creation, and as they retire or leave the organization, their vested ESOP benefits are ultimately converted to cash. This creates a future repurchase obligation that ESOP companies need to incorporate into their long-term financial planning.



2 Potential tax advantages

In addition to liquidity for owners and ownership for employees, ESOPs offer a range of tax benefits, including:

- **Federal income tax exemption.** Companies that are 100% ESOP-owned S corporations are not required to pay federal income tax.
- **Tax-advantaged leveraged buyout.** Corporations can also receive tax deductions for contributions used to repay the principal on an ESOP loan used to purchase company stock, subject to applicable limitations.
- **Allowance of tax deferral.** Under certain circumstances, eligible shareholders of a C corporation may defer capital gains taxes on the sale of stock to an ESOP by reinvesting the proceeds in qualified replacement property, subject to applicable requirements.

3 Maintaining company culture and independence

Business owners, especially those of family-owned companies, are often concerned with sustaining the company culture they've worked so hard to build. With an ESOP, that culture and independence remain a company strength and are often enhanced by the opportunity for employees to participate even more.

4 Management continuity

Unlike selling to a third party, the ownership and leadership transition with an ESOP is often more gradual. Owners and executives typically stay in their roles post-sale and often take time to cultivate the next generation of leadership.

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“Unlike a sale to a strategic buyer or private equity firm, an ESOP is designed around continuity. Owners can monetize the value they’ve built while maintaining greater control over the transition process and preserving the legacy of the business for employees, customers and the communities they serve.”

Jason Muhme
Northwest Bank Head of ESOP Finance

ESOPs at work

\$114 BILLION

in ESOP contributions in 2023

\$166 BILLION

in ESOP distributions in 2023

Source: NCEO

HOW TO MAKE YOUR ESOP SUCCESSFUL

While each ESOP is as unique as the company itself, the most successful employee-owned companies have several things in common. “They view the ESOP as more than an exit strategy or succession plan,” Muhme says. “They embrace it as a long-term business strategy.”

To put your ESOP on a path to success, consider the following.





1 Combining employee ownership with strong leadership

Muhme says that companies that report strong outcomes focus on maintaining strong leadership through the ESOP and post-sale. These organizations prioritize strong financial performance and sustain cultures that are transparent and accountable.

“You want employees to understand how their day-to-day decisions impact the company’s financial performance, and ultimately the value being created for everyone involved.”

Jason Muhme
Northwest Bank Head of ESOP Finance

2 Prioritizing ESOP communication

The companies that realize the greatest benefits from employee ownership take the time to educate employees about what the ESOP means, how value is created and how individual contributions drive results.

“When employees start to think and act like owners, that often leads to stronger retention, higher engagement, improved productivity and better alignment across the organization,” Muhme says.

In fact, employee-owned companies often outperform peers when ownership is paired with active employee engagement and participative management practices. ESOP communication often begins shortly after the sale and continues as employees learn what ownership means in practice.





3 Taking a long-term approach

The most successful ESOPs are not defined by the immediate sale or transaction. Instead, their success comes from what happens after employees gain ownership. Companies that thrive use employee ownership as a foundation for long-term growth, leadership continuity and a shared commitment to the business.

“While valuation, financing and liquidity are important, owners also need to consider whether the company has the cash flow, leadership team and organizational structure necessary to thrive as an employee-owned business for years to come,” he says.

“Successful ESOPs require more than completing a deal. They require thoughtful planning around governance, leadership succession, future capital needs and employee engagement.”

Jason Muhme
Northwest Bank Head of ESOP Finance

4 Setting realistic expectations

While ESOPs can be exceptional succession planning tools, successful transactions also balance shareholder liquidity with the company's ability to invest in future growth and meet long-term obligations.

“If the main goal is how much cash can I get at closing, then you can put the company's ability to borrow in the future at risk. The decisions made at closing can impact the company's flexibility, growth opportunities and employee benefits for decades.”

Jason Muhme
Northwest Bank Head of ESOP Finance





WHY ESOP FINANCING EXPERIENCE MATTERS

ESOPs are highly specialized transactions that require knowledge of corporate finance, succession planning, company valuation, tax strategy and employee ownership and benefits.

Muhme says that while they share some aspects with traditional leveraged transactions, the long-term considerations are very different. “An ESOP finance structure must support the transaction at closing and the company’s ability to grow, invest and recruit talent, while also accounting for future obligations such as repurchase obligations, warrants, SARs and other transaction-related commitments,” he says.



This is why an experienced ESOP lender can make all the difference. An experienced ESOP lender can offer:

A deep understanding of ESOP impacts. They understand how transaction size, leverage levels, seller financing, future repurchase obligations and cash flow dynamics interact over the life of the ESOP.

In-depth knowledge of roles and participants. ESOP-experienced lenders also understand how to coordinate with trustees, valuation firms, attorneys and other advisors to help ensure the transaction is structured appropriately from the outset.

A long-term view. Business owners only get one chance to structure their ESOP, and a poorly structured transaction can leave your organization overleveraged, restrict future growth investments, create liquidity challenges and strain company cash flow. A properly structured ESOP can provide liquidity to shareholders while helping position the company for long-term success.

As you consider which financing partner makes sense for your ESOP, you want to compare more than interest rates or financing terms. Muhme says business owners should seek lenders that understand the complexities of employee ownership and have experience helping companies navigate the ESOP lifecycle.

Lastly, Muhme advises business owners to find a financing partner who takes the time to understand your goals. “Some owners prioritize maximizing liquidity, while others focus on retaining control, rewarding employees, preserving legacy or creating a succession plan for management,” Muhme says.

“An experienced ESOP lender can help tailor a capital structure that aligns with those objectives while positioning the company for future growth and financial flexibility.”

Jason Muhme
Northwest Bank Head of ESOP Finance



HOW NORTHWEST BANK SUPPORTS ESOP TRANSITIONS

Northwest Bank provides ESOP financing and guidance for business owners planning an ownership transition. We help owners and organizations structure transactions around shareholder goals while keeping the company's long-term needs in view.

Our ESOP financing capabilities include:

- Senior debt financing for new ESOP formations
- Working capital lines of credit to support access to capital after the transaction
- Coordination with your team of advisors throughout the transaction
- Guidance on future financing needs, such as acquisitions, real estate and equipment
- Options for refinancing the seller's note
- Wealth management guidance for selling owners



If you're considering an ESOP, connect with Northwest Bank to talk through your goals and financing options.



Northwest Bank

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