

Texas ESOP Initiative

EEA Consulting Engineers President Michael Hart, P.E.

Testimony for Texas House Committee on Business and Industry

HB 4171 - Defining majority ESOPs as HUBS

I want to thank the Committee members for scheduling this public hearing. Texas is known around the country as having a business-friendly culture.

Employee Stock Ownership Plans (ESOPs) are qualified pension plans that are funded by the employer. Funds are put into a trust that buys and holds the company stock for the benefit of the employees. The company makes contributions to the plan, and the money or stock is allocated to the employees on a percentage of annual compensation. Median contributions are in the range of 10-12% of compensation. I am grateful to be a life-long Texan who learned valuable lessons as an independent newspaper carrier at age 12, and had the opportunity to work for a variety of businesses and government agencies during high school, college and graduate school.

I had the good fortune to start my engineering business shortly after leaving graduate school 40 years ago. My mission in starting my own business was to create value for my customers and employees as well as fulfill a vision to establish a great place to work. To me a great place to work was defined as building a company where everyone shared in the benefits that they helped create and enjoy the security of making a difference in the long-term health of the company.

I learned about new ESOP legislation during my time in graduate engineering school in 1974-75 from a friend doing graduate work in economics. The employee ownership concept was inspiring to me because I had seen how employees become discouraged and feel exploited in many organizations both large and small. It is clear that wealth is being concentrated in our country and honest, thoughtful people disagree on the best solutions for many public policies; however, there is almost universal agreement that employee ownership works to create wealth for employees while at the same time making their companies more efficient and productive.

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The current Historically Underutilized Business (HUB) legislation has been successful in creating financial opportunity for women and minority owners, but the benefits have been concentrated and it has also created obstacles to ownership transition. Many HUBs have a high concentration of business with State government, and sale of the business puts the HUB status in question and limits the value and flexibility for ownership transition. We will be submitting testimony regarding some specific cases.

The proposed HB 4171 offers existing HUB owners the option to exit their business by creating an ESOP and allowing their employees who helped build the business to become owners and continue their employment. ESOPs have been used for the last 40 years as ownership transition strategies and have been very successful.

Having majority ESOP companies qualify as HUBs allows all of the employees of these small businesses to prosper and benefit by providing services to State government. Why concentrate the benefit to only one or two owners?

In 2015 Texas had about 13,000 HUBs and 224 ESOP companies, or about 1.7%, in most survey data, and about 40% to 50% of the ESOP companies have less than 100 employees. Since HUBs have to qualify as Small Businesses under Federal SBA guidelines, I think it is fair to say a maximum of half of existing ESOPs will qualify as HUBs, and probably even fewer will have an interest because of their business focus. This proposed bill is likely to incentive the transformation of many new ESOPs, clearly some of them will be existing HUBs. I believe this legislation will at a minimum triple the number of ESOPs in Texas, creating maybe 500 new ESOPS averaging 60 employees and benefiting 30,000 hard-working Texans. Currently there are about 7,000 ESOPs in the United States, and if Texas had our proportionate share, we should have 600 or more. My hope and ambition is that Texas will have many more ESOPs and be the leader in paving the way for other states to follow in creating incentives for employee ownership that costs the taxpayers nothing. In fact, we believe that having a few more qualified HUB vendors will actually save the State money. Research that is about to be published by the National Center for Employee Ownership and funded by the Kellogg Foundation has data from more than 5,500 men and women proving that

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employee ownership and economic well-being are highly correlated for young workers aged 28-34 in the following:

1. Employee owners had 33% higher income than employees in peer companies
2. Net wealth for employee owners was 92% higher than employee in peer companies
3. Employee owners have much greater access to benefits at work eg. 23% of employee-owners had access to childcare benefits vs 5%
4. Employee owners had more job stability with 5.2 years of tenure vs 3.4 for peer companies employees
5. Employee owners had median household income of 378% of poverty line vs. 293% for peers
6. Employee owners of color had 30% higher income from wages and 79% greater net household wealth and 36% greater tenure in their jobs compared to peers company employees of color.

In summary, HB 4171 will do the following at no cost to the State:

1. Provide thoughtful value preservation for existing HUBs to exit their business by protecting their HUB status.
2. Incentive the creation of new ESOP companies and generate wealth for all employees of the company
3. Slightly increase the number of qualified HUBs to serve the needs of Texas State Government
4. Improve the quality of life for Texans employed by existing and future ESOP companies.