Case Study 6.3

Allied Plywood

Allied Plywood is a wholesaler and manufacturer of plywood and related building materials. Established in 1951 by Ed and Phyllis Sanders, the company is now headquartered in Virginia and operates across multiple states in the south eastern states of America. It was one of the first companies to establish an ESOP and has managed to combine one hundred per cent employee ownership with a unique financial and governance participation structure.

ESOP

The first ESOP was established in 1977 as a means for the owners to retire from the business. Acknowledging that the employees had played a significant role in the development of the business, the owners felt strongly that the employees should be given the option to purchase the company. By 1981, the ESOP held almost fifty per cent of the company's shares. This process did not involve the employees providing any of the funding needing to purchase the shares; a portion of the company's pre-tax profits was placed in the ESOP annually and used to purchase the shares from the original owners (known as an unleveraged ESOP). In 1982, the ESOP trustees took out a bank loan and purchased the remaining shares from the owners, meaning Allied Plywood had now become one hundred per cent employee-owned.

From 1981 onwards, the company's performance improved dramatically. Sales increased ten times while the number of employees increased seven fold. Even in 1990, a year of severe recession in the housing industry, productivity was over seventeen per cent higher than before the ESOP. Once the company repaid the loan it took out to enable the ESOP to purchase the shares in 1985, it issued new shares to the ESOP to enable current and future employees to participate in the employee ownership of the company. The net value of the equity in the company increased from $1.3m in 1981 to $7.4m in 1995 and the benefits to employees are substantial; all employees who have been on the Allied payroll since the ESOP was installed have accumulated accounts close to or exceeding $100,000.

A note on vesting

Employees become eligible for shares in the ESOP from the day they are hired. Most ESOP companies have a probationary period of one year before employees are allowed participate in the scheme. Employees are not entitled to the full value of their shares immediately, however; the process of vesting occurs over a number of years.

ESOP accounts of those who quit or are fired before three years of service are zero per cent vested, meaning that when they leave, they forfeit all their accumulated ESOP benefits. Upon three years of service, vesting begins at twenty per cent, with twenty per cent added each following year. In year seven, an employee's account becomes one hundred per cent vested and is no longer subject to any forfeiture. Those who reach retirement age, become disabled, or die become one hundred per cent vested automatically.

Combining financial reward with participation in governance

Since the 1960s, the company operates a profit related pay system whereby employees are paid less than the market rate (around twenty per cent) but are entitled to an equal share of thirty per cent of operating profit, paid monthly in arrears. This significant financial participation was coupled with a practice of sharing company performance information. There is also an annual cash profit distribution based on a weighted formula based on the individual performance of the employee (for example, number of days worked, peer review, and importance of the job).

There is something reminiscent of a worker co-operative about Allied Plywood's profit-related pay system. The employees are motivated by individual interests (annual bonus based on performance) as well as a mutual interest in ensuring the company is profitable long-term (boosting their ESOP accounts and the ability of future employees to participate in the ESOP).

The company has five board members who govern the business and also act as the trustees of the ESOP. Two of the members are elected (on a one share/one vote system) by management representatives and two from worker representatives. The fifth member is an independent candidate chosen by both groups. The ESOP facilitates the sharing of risk and reward amongst the employees of the company, creating an ownership structure that allows employees to share in the rights and responsibilities of ownership.

Source: R. Oakeshott, *Jobs & Fairness: The Logic and Experience of Employee Ownership* (Norwich: Michael Russell Ltd, 2000), pp 536-52.