Speaker Remarks
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EMPLOYEE OWNERSHIP
MOTIVATING AND DEVELOPING EMPLOYEE OWNERS

"To get the full value of joy, you must have people to divide it with"
--Mark Twain

As some of you may know, I'm a great believer in employee ownership. It was a dream of mine for many years. About 5 years ago, we had the opportunity to buy our company from Thermo Electron, our parent company for 13 years, and make it employee owned. We did just that. [Please note that these remarks are longer than those for the presentation].

Why Am I Such a Believer in Employee Ownership?

We live in a rapidly changing world. This change began after WWII and has been picking up pace ever since. To be competitive and be one of the very best companies, you need creativity, adaptability, flexibility, innovative ideas and highly motivated employees. The best way to do this is to truly engage your employees in the business by giving them a stake in what they've helped to build.

Employee ownership empowers people and engages them in major decisions affecting the company, their lives and livelihood. Employees are more motivated to gain a better understanding of their company. There can be an improved attitude toward work and the company, that translates into improved company performance. [There is research to support this]. Overall, they have a great opportunity to make a difference—to overall company success and to their own success and well being.

Success can mean many things to an employee. It can include meeting such basic needs as safety and security. It can mean an interesting, challenging and professionally fulfilling job; recognition; a fair wage and good benefits. Some of this certainly can be achieved without ownership. BUT…for employee owners, success also includes; more access to company financial information, input into major decisions affecting the company; more influence over management decisions; truly being part of a team of owners; and a chance to help their company be more successful. Success also means creating long term value for the employee owners through growth, profitability, interesting, challenging and rewarding work; and a long term return on investment. Employees get a piece of the action and a piece of the success.

How Did I Get Here—So Committed To Employee Ownership?

Before I go further, I'll talk briefly about my professional journey and about the company history because both greatly influenced my belief in employee ownership.

In terms of the company, Normandeau Associates was founded in 1970, a pioneer in the new industry of environmental consulting. The company has a lot of very dedicated, professionally excellent, long term employees who essentially built the company and its reputation. I was one of those early employees.

For many years in the 70's, the company was privately owned by its founder, Don Normandeau. It was a booming business with little regional competition. In the early '80's, business became much more competitive, and the company was sold to a group which built financial institutions that was looking to diversify. That didn't work out, so in 1984 Don Normandeau bought us back. However, he put us up for sale in 1985. And in 1987, we were sold to Thermo Electron Corporation, a large public company, based in Waltham, MA. They owned us for 13 years.

In all of the above transactions (except when we were sold by Thermo), we, the employees did not have any say in these major (buy/sell) decisions, or in most cases, even knowledge of what was happening except through the rumor mill. Yet our dedication and "sweat" had built the company. It was also very distracting and de-motivating, even for highly motivated employees. In addition, we didn't directly share in the financial success of the company since we were not owners (we also did not have the risk of ownership).

Most of you are in this business and you know what I'm talking about. This industry has been characterized by restructuring, mergers, bankruptcies and consolidations for years. It affects not only the people but the long term success of many companies.

In terms of myself, I started with the company in 1971, taking a temporary leave from a PhD program in Zoology. The leave became "permanent" as I really enjoyed this business and "applied" science. I spent the first 10 years or so as a marine scientist, project manager, and department manager. But early on, in the '70's, I recognized the dire need for some good managers in this new and exciting industry. So I pursued a business degree (part time over 5 years). During that period I became a true believer in "participative management"—engaging employees at many levels in organization in goal setting, decision-making and then delegating the needed authority and responsibility. I was also always very interested in motivational theory.

As a result of company history, my personal and professional journey, and a gut feeling, I came to believe that the most successful companies over the long term would be those that engaged and empowered employees. The best way to do this is through employee ownership, not the “feel good” employee participation in business activities, but ownership that empowers, motivates, inspires and rewards.

Where There’s Opportunity, There’s Risk

In late 1999, an opportunity came along when our parent company, Thermo Electron, who had owned us for 13 years and treated us well, decided to return to its core business and divest of many companies, including us.

I met with the President of our Thermo subsidiary. He told me what was planned and asked me what I wanted to do. I indicated that before we were put up for sale on the street, “I wanted the opportunity to try to buy the company and make it employee-owned” (not just management owned).

Although the recommendation to buy the company and make it employee owned was mine, I strongly felt we needed “buy in for the buy out” from the senior and mid level company managers. I met with the 20+ company managers, told them what was happening, and recommended we buy the company, assuming we could buy it at a fair price and find a way to finance the buy-out. However, if the managers did not want to buy it, then we would not do it. After much discussion, just about all of the company management supported a buy out.

Of course, with opportunity came considerable risk. How could a group of rather conservative scientists buy the company, have all employees be owners, and minimize the risk? It wasn’t a small company. Sales were in the $13-14M range. We had some money for a down payment (from 20+ managers) but we needed to borrow a considerable amount to buy it. And I was 55 years old (young); some people retire by then or are thinking about it.

But were the other options for our company--acquisition by one of the mega firms or a buy out by some venture capitalists—less risky? Many of us didn’t think so.

The Buy Out

This is a long story but I’ll keep it very short. I talked with many people outside of the company including Thermo Electron, investment bankers, and a company called ICA. Thermo was very helpful in providing guidance. The investment bankers were totally opposed to my employee ownership idea—considered it a “can of worms”. ICA, a consulting company we ultimately hired to help us do the deal, thought we had a great idea. ICA lined us up with a team to make it happen—a bank for financing, a very knowledgeable law firm and a company valuation consultant.

We accomplished the buy out and made the company employee owned through a "Leveraged Employee Stock Ownership Plan (ESOP)". An ESOP is a type of employee benefit plan that makes employees owners through the distribution of company stock to employee accounts in an ESOP trust. ESOP's are one of the key ways used to make a company employee owned. Employees do not buy stock; it is given to them over time. An ESOP is also unique among qualified employee benefit plans in its ability to borrow money.

On June 30, 2000, we signed the agreements. Over 20 senior and mid level managers provided a "down payment", becoming "founding" shareholders. (Several others wanted to help with the down payment but we were advised by our lawyer not to do this due to SEC regulations). 63% of the purchase price, representing <u>majority</u> interest, was financed by a commercial bank loan through a "leveraged ESOP" with company assets as collateral.

What Did We Accomplish?

We accomplished several goals with the buy out: 1) wide spread employee ownership though the ESOP trust which gives employees rights and power regarding key company decisions; 2) improved employee motivation and participation; 3) a very good financing mechanism for the buyout; 4) reduced corporate taxes; 5) a second employee retirement plan where company stock is distributed to employee accounts at no cost to them; and 6) most importantly, a true linkage between employee efforts and company performance was established.

In addition, our ESOP is the market for the common shares initially purchased by management. These are not part of the ESOP, but, as managers retire or leave the company, shares will be bought by the company at a market value based on the annual company valuation. The plan is to sell these shares to the ESOP and distribute them to employee accounts. Thus at some point the company will be 100% employee owned.

In 2004, 137 employees had company common stock in their ESOP accounts, giving them certain rights in key company issues that directly affect their lives and well being. These issues include the closing or sale of the company, liquidation, capitalization, and other issues related to the basic structure of the company. Like other retirement plans, ESOP's have trustees who have fiduciary responsibilities for the trust and actually vote the common stock based on the vote of the ESOP employees. The ESOP also votes for the company Board of Directors. Key company financial information, including the annual business plan and monthly actual performance are also shared with employees. And there is an ongoing effort to engage more employees in the planning and training. There is a formal ESOP Advisory Committee consisting of non-management employees which functions in several capacities, most importantly communication—peer to peer and non-management to management. Non-management employees attend key ESOP association meetings. The ESOP Advisory Committee also participates in our Annual Meeting.

Meeting The Challenge

Managing an employee owned company is quite challenging. Challenges include employee training and understanding; employee trust; employee rights and responsibilities; understanding the legal and fiduciary requirements of the ESOP; managing risk, as owners; nurturing the ESOP Advisory Committee without interfering; and management training and succession planning--very critical since our long term intention is 100% employee ownership. We've made a lot of progress in all of the areas but there were certainly surprises along the way and all took more time than what was originally anticipated. It is also an ongoing process and will continue to be so.

Initially some employees thought employee ownership met they had a say in daily management decisions. More detailed financial training and understanding is still in its early stages. Most employees now understand that with certain rights, employees have responsibilities. Succession training and planning is ongoing.

We had been in business for 30 years- first as a close, privately held company, then as part of a public company, before we became employee owned. The change to an employee ownership culture is not an easy one, even for the senior management. Yet the change has been well worth it!

More about ESOP's (for the very interested)

An ESOP is a tax-qualified employee benefit plan that makes company employees owners of company stock. To accomplish this, an ESOP Trust is created by the company. The company makes annual contributions of stock to the trust. The stock must be the highest form of stock offered, usually common stock. An ESOP is also unique among qualified employee benefit plans in its ability to borrow money. This is termed a "leveraged ESOP". ESOP's are governed by ERISA (the Employee Retirement Income Security Act) and must comply with Section 401(a) of the Internal Revenue Code, which covers profit-sharing and pension plans.

Companies create ESOP's for a number of reasons including: 1) an employee retirement plan; 2) for the purposes of business financing; 3) to give employees a voice in key company decisions; 4) to motivate employees; and 5) to buy out existing owners/shareholders. ESOP's also have tax advantages, e.g., for a leveraged ESOP, both interest and principal are tax deductible.

With an ESOP, most employees are eligible (need to complete one year of service working at least 1000 hours) to receive stock, and thus become employee owners (with stock in the ESOP Trust). ESOP's can own a small interest in the company, majority interest, or 100%. Distribution of stock to employee accounts usually occurs over a period of years and can be based on different formulas with the most common being in proportion to compensation. Similar to 401(k) plans, there is a vesting schedule where employees become entitled to an increasing percentage of their accounts over time. 20% per year is the least liberal schedule allowed by law. Employees receive the vested portion of their accounts at termination, disability, death or retirement. And these distributions, particularly for termination and retirement, are made in installments over a period of years.

ESOP's have trustees who have fiduciary responsibility for the ESOP and actually vote the ESOP trust stock. The ESOP trust may have both allocated (to employee accounts) and unallocated (not yet allocated) shares. The trustees can vote the unallocated stock according to the employee vote (directed ESOP) or independently, depending on how the ESOP is set up. Thus in the early years of an ESOP, when the majority of shares are unallocated, if trustees vote independently, they can "over rule" the employee vote.

More on Normandeau Associates' ESOP

Normandeau Associates has a "directed ESOP", so with the ESOP owning 63% of the company's common stock, employees immediately had rights and power. We have a lot of long term employees and we highly value long term commitment by employees, so we elected to distribute shares to employee accounts based on compensation level (50%) and years of service (50%). This is quite unusual. Vesting is 20% per year; employees who had been with the company for 10 years at the time of the buy out were automatically vested an additional 20% in year 1, so many were fully vested in June 2004. At the end of June 2005, all eligible employees who were with the company at the time of the buy out will be fully vested. Approximately 5/7ths of the ESOP common stock will have been distributed to employee accounts by July 1, 2005. Share price has increased since the buy out.

References

The ESOP Reader. An Introduction to Employee Stock Option Plans. The National Center for Employee Ownership. Oakland, CA. 1998

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