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Compassionate Capitalism: Understanding the Juxtaposition of Personal Gain and Concern for Others

Kelly O. Finnell and Molly E. Coyne, Executive Financial Services, Inc

Abstract

This article explores the concept of Compassionate Capitalism, which involves creating sustainable business models benefiting society and employees. Through Compassionate Capitalism, business owners can build trust with their customers and stakeholders, and in turn, enhance their long-term profitability through the Employee Stock Ownership Plan (ESOP) structure. The article also discusses the historical perspectives on Capitalism and articulates how Capitalism can coexist with compassion. It highlights the ESOP as a present-day example of Compassionate Capitalism, where employees are given a financial stake in the company for which they are employed. ESOPs redistribute ownership to the workforce and create a unique form of Capitalism that continues a successful company's tradition. The ESOP benefits the younger members of a company, enhances retirement security, and creates a sense of ownership among employees. The article explains how employee ownership can align the interests of workers with those of management, creating a more collaborative, equitable workplace, contributing to greater overall economic growth. This article includes a case study examining a defense contractor's decision to become an employee-owned company through an ESOP transaction in 2010. The ESOP consulting firm, Executive Financial Services (EFS), provided a feasibility analysis and implementation for the transaction. Over the next decade, the company grew rapidly and eventually sold for $1.6 billion in 2020, creating hundreds of millionaires among the ESOP participants. This decision exemplifies the Compassionate Capitalism model, where the owners chose to honor and support the employees who helped build the company, creating generational wealth opportunities for myriad families. The decision to become an employee-owned company through an ESOP transaction shows that Capitalism and compassion can be compatible.

Keywords

employee Stock Ownership Plan, employee stock ownership plan, compassionate capitalism, historical perspectives on capitalism, employee retention, employee-owned, leadership, exit planning, employee stock ownership plan consulting, generational wealth

When business owners consider selling their company, there are two disparate types of owners.

One type of business owner desires two things: Maximizing the sales price and receiving as much cash at close as possible. The

Corresponding Author:
Molly E. Coyne, Executive Financial Services, Inc, 3350 Players Club Parkway, Suite 330, Memphis, TN 38125, USA.
Email: mcoyne@execfin.com

second type of business owner wants something more expansive. In addition to desiring the best-selling price, this business owner wants a transaction that will protect and reward their employees and preserve the company culture.

This second type of business owner can best be described as a Compassionate Capitalist.

The degree to which Capitalism and greed are synonymous has been a recurring debate since the concept of Capitalism emerged. Philosophers, historical figures, and everyday people have all weighed in on the juxtaposition of Capitalism and greed. Some believe Capitalism inherently relies on greed to work successfully, others argue that Capitalism can still exist without rapaciousness.

Capitalism and compassion can work together by recognizing that businesses have a responsibility not only to generate profits but also to contribute to society by way of their employees. Compassionate Capitalism involves integrating considerations beyond just the bottom line into a business owner's decision-making. By creating sustainable business models that benefit society and his or her employees, business owners build trust with their customers and stakeholders, and in turn, enhance their long-term profitability. This approach also acknowledges that a healthy society is essential for businesses to thrive. By aligning profit-seeking with the greater good, Compassionate Capitalism can create a more equitable and sustainable economic system benefitting more people than simply the business owner.

Historical Perspectives on Capitalism

Karl Marx was a 19th century German philosopher and economist who is often known for his critique of Capitalism. Marx believed that Capitalism was inherently exploitative, and that it created deep social and economic inequalities that were unjust and unsustainable. He argued that Capitalists (i.e., owners of capital, such as factories and land) profited from the labor of workers, who were paid less than the value of the goods they produced. According to Marx, this exploitation led to a concentration of wealth and power in the hands of a few Capitalists, while many workers remained poor and powerless.

Born a generation after Marx, Andrew Carnegie, was a Scottish-American industrialist and philanthropist, who believed that Capitalism could be a force for good. Carnegie argued that the accumulation of wealth was a natural and necessary part of the economic system, but that wealthy individuals had a moral obligation to use their wealth to benefit society. He believed "the man who dies thus rich dies disgraced," (Carnegie Corporation of New York, 2017, p. 15) and throughout his life, he donated millions of dollars to support causes such as education, the arts, and public libraries.

While Marx and Carnegie both had strong opinions about Capitalism, they differed in their fundamental views of the economic system. Marx saw Capitalism as inherently unjust and exploitative, while Carnegie felt it helped create wealth and opportunity, and Carnegie believed Capitalism was good if the wealthy used their resources to benefit society. Marx believed that workers should own the means of production (i.e., factories and land) and that wealth should be distributed more equally, while Carnegie believed that philanthropy was a way to address the problems of inequality and poverty within the existing economic system. In short, Marx saw Capitalism as a problem to be overcome, while Carnegie saw it as a tool to be used for the greater good.

Capitalism and Compassion in Present Day Society Through ESOPs

Determining whether Capitalism and compassion can co-exist plays a unique role in understanding the function of wealth, government, and personal gain. Some argue that true Capitalism requires self-interest and minimal government regulation, while compassion requires putting aside self-interest for the greater good of others. Carnegie posed in his essay *The Gospel of Wealth*: "The question then arises—and, if the foregoing be correct, it is the only question with which we have to deal—What is the proper mode of administering wealth after the laws upon which civilization is founded have thrown it into the hands of the few?" (Carnegie Corporation of New York, 2017, p. 6).

This argument has led to opposing philosophical theories about these two contrasting driving forces—Capitalism and compassion—and the degree to which they coexist. Ultimately, both require a certain degree of mutual respect and understanding. For Capitalism to survive, altruism and kindness must be visible; similarly, feelings of generosity need to be tempered by prudence and responsibility so positive outcomes may be produced in the long run.

While understanding Compassionate Capitalism may pose difficult challenges and raise complex questions, examples throughout history suggest that Capitalist economies do have the ability to exist with compassion at their core. The perfect present-day example of the symbiotic relationship is an Employee Stock Ownership Plan (ESOP).

ESOPs have become a popular strategy for Capitalists, yet at their core, they are centered in compassion for others. By giving employees a financial stake in their company, ESOPs essentially redistribute ownership to the workforce and create a unique form of Capitalism that utilizes aspects of Socialism. Currently, in the United States, there are 6,500 ESOP-organized companies employing 10.5 million workers; these companies grow at a higher rate and offer great job stability for the employees than similar non-ESOP companies (National, 2017, p. 3). While ESOPs, at first glance, may appear to be solely succession plans for a company owner, they are also generational wealth opportunities for a company's entire employee base.

While a Compassionate Capitalist business owner prioritizes his or her company culture and the employees' future, they may also be concerned about the purchase price offered for their life's work. An ESOP fits the Compassionate Capitalist model best because the owner can receive an excellent purchase price while still protecting their employees, the company culture, and the future of their organization. An ESOP provides a ready market for the sale of the company's shares and the ESOP can be structured to provide tax benefits for the company and the owner, helping to maximize the purchase price. This is because ESOPs can be structured in a way that allows the company to borrow money to buy back shares from the owner. The company then makes tax-deductible contributions to the ESOP to repay the loan and, in certain structures, allows the company to operate tax-free. This structure can help business owners get a fair price for their company while also providing employees with an ownership stake in the business.

Further, a company's shift toward becoming an employee-owned business demonstrates how ESOPs provide more benefits to workers than traditional Capitalist models, as employees benefit from corporate profits and job stability. In this way ESOPS are an innovative approach to creating an alternative model among Capitalist organizations that incorporate elements of Socialism and empowers those who do the actual labor. As Carnegie wrote, "Our duty is with what is practicable now; with the next step possible in our day and generation" (Carnegie Corporation of New York, 2017, p. 5).

And as many Baby Boomers are retiring or near the end of their careers, it's helpful to analyze how an ESOP can benefit the younger members of a company. In a 2017 study focusing on Millennials (ages 28-34) in the workplace illustrated that the median household net wealth was 92% higher for employee-owners than for non-employee owners (National, 2017, p. 1). The difference remains consistent across most subcategories examined, such as unmarried females, caregivers of young kids, individuals without a college degree, and employees from ethnic minorities (National, 2017, p. 4).

Further, ESOPs provide a major financial benefit to the company's employees and have become an important tool for distributing wealth among employees and encouraging organizational stability and success. This distribution is just as Carnegie writes:

> We shall have an ideal state, in which the surplus wealth of the few will become, in the best sense, the property of the many, because administered for the common good, and this wealth, passing through the hands of the few, can be made a much more potent force. (Carnegie Corporation of New York, 2017, p. 9-10).

Likewise, with an ESOP, employees have their retirement savings invested in the company for which they work. A recent study from EY, presented that "the average return per [ESOP] participant in S corporation ESOPs from 2022 to 2019 was over $300,000 for a compound annual growth rate of 12.1%, which is approximately one-third higher than returns from the S&P 500 over this time period." (EY-ESCA-S-ESOP-Analysis-2022.04.2257.pdf, 2022, p. i).

These returns are impactful and, in fact, the Compassionate Capitalist ESOP model works for all age ranges of families. Employee-owners with young children, aged between 0 and 8 years, significantly benefit from employee-ownership as it results in a median household net worth that is almost twice the number of families without such ownership (National, 2017, p. 4). In addition, they also gain nearly an extra year of job security, and an additional $10,000 in annual salary (National, 2017, p. 4). Evidence suggests that the implementation of Compassionate Capitalism through employee-ownership can have a positive impact on both employees and their families, thus creating a more sustainable and equitable economy for all.

This sustainability occurs at all stages of a person's career because for ESOP employee participants, as the value of their company increases, their retirement savings increase, as well. A recent EY study examined how "distributions to [ESOP] participants totaled over $77 billion from 2022 through 2019, and annual distributions increased almost 13-fold during this period." (EY-ESCA-S-ESOP-Analysis-2022.04.2257.pdf, 2022, p. 9). These numbers emphasize the role ESOPS play in enhancing retirement security for participants, many of whom wouldn't have actualized this type of wealth from their 401K plan alone. For many workers, this can be extremely helpful in reaching their financial goals and saving for the future.

Besides providing a potential return on investments for employees, ESOPs motivate workers by giving them a real stake in the success of the company. An ESOP creates a sense of ownership among employees often leading to increased engagement, higher morale, and a larger sampling of benefits within the workplace. Employee-owners are significantly more likely to enjoy a variety of benefits such as adjustable work hours, pension offerings, maternal/paternal leave, and educational refund fees. To illustrate, about 23% of employee-owners are entitled to childcare benefits, which is a noticeably higher percentage compared to only 5% of non-employee-owners (National, 2017, p. 4).

NCEO's 2017 study also highlights that employee-ownership can lead to substantial benefits for individuals of color, including higher income, increased household wealth, and longer job tenure, compared to non-employee-owners (p. 5). Such outcomes not only promote a more compassionate form of Capitalism but also challenge the notion that Capitalism inevitably leads to economic inequality. By providing employees with a greater stake in the companies for which they work, employee ownership can align the interests of workers with those of management, creating a more collaborative, equitable workplace. ESOPs can also contribute to greater overall economic growth, as workers are more likely to invest in the long-term success of their company when they have a direct stake in its success.

As employees are given the opportunity to become part-owners of the business, they now share the profits and losses of the organization rather than just taking home a salary. This, in turn, puts workers in an active role in helping shape their own future as well as that of the company, incentivizing more strategic decision-making and providing these individuals with greater wealth potential. In fact, studies show teams with greater company ownership tend to outperform those without it.

A Case Study in Compassionate Capitalism

During the fall of 2010, a client of the ESOP consulting firm, Executive Financial Services (EFS) considered a transaction that would result in it becoming employee-owned. The company considering the ESOP was a defense contractor with 1200 employees, 200 of whom had a PhD in engineering or physics. At this time, the world was beginning to recover from the financial crisis stemming from the bankruptcy of Lehman Brothers in September 2008.

EFS prepared a feasibility analysis for the transaction which included a lateral transfer feature allowing employees to elect to transfer a portion of their 401K account to the ESOP where it was used to purchase stock. The transaction was financed with debt, including bank debt and seller notes. Seller notes are promissory notes issued by the ESOP and assumed by the company. Since this debt is subordinated to the bank debt, it is entitled to a significantly higher rate of return than the bank debt.

The transaction closed June 30, 2011. Effective July 1, the first day of the company's fiscal year, the company made an election to be taxed as an S corporation, resulting in its income no longer being subject to income tax either at the corporate or shareholder level.

The company grew rapidly over the next decade, partially because of its tax-free status, and in February 2020, the company sold for $1.6 billion. At the time of the sale, the company had grown to 2200 employees who shared in the sales proceeds.

In September 2021, Kelly Finnell, founder and owner of EFS, had dinner with the company's former CEO. The two discussed the company's sale and how it benefited the employees and the local community. The sale had created hundreds of millionaires among the ESOP participants. One story from the company's CEO was particularly moving.

The former CEO said that a long-tenured employee, "Sam," entered his office after the acquisition was announced. This gentleman had been with the company for over 40 years and, during most of that time, had been in a lower-pay position in the company's mailroom. Sam asked the CEO what the sale would mean to him. The CEO got on his computer and told Sam that he would have over $4 million of cash distributed from his ESOP account. Sam was overjoyed. He told the CEO that he would use this money to establish a fund that would pay college tuition for his grandchildren and their children.

There are thousands of ESOP stories like Sam's. And companies like this defense contractor perfectly exemplify the Compassionate Capitalism model, when they became employee owned thus creating generational wealth for 2000+ employees and their families.

The owner chose not to sell his company to a larger company, nor to sell to a private equity; instead, the CEO honored what his employees had helped him build and followed his intuition to support a cause larger than himself: his community of employees. This is just as Carnegie notes:

> What commends itself most highly to the judgment of the administrator is the best use for him, for his heart should be in the work. It is as important in administering wealth as it is in any other branch of a man's work that he should be enthusiastically devoted to it and feel that in the field selected his work lies (Carnegie Corporation of New York, 2017, p. 35).

In an ESOP transaction, the owner does not have to accept a lower purchase price and he or she can still protect the business' employees. The business owner centers the employees, preserves company culture, and creates generational wealth opportunities for myriad families. The business owner, the Compassionate Capitalist, choosing an ESOP is thus "soothed and sustained by the still small voice within, which, whispering, tells him that, because he has lived, perhaps one small part of the great world has been bettered just a little" (Carnegie Corporation of New York, 2017, p. 37). As such, through this one legacy decision, it is realized that Capitalism and compassion are not necessarily juxtaposed; in fact, they can be compatible.

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ORCID iD

Molly E. Coyne https://orcid.org/0009-0004-9214-7225

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Author Biographies

Kelly O. Finnell, J.D., CLU, AIF® is one of the nation's premier ESOP consultants, having spent more than 40 years executing ESOPs. One of the most sought-after ESOP speakers, Finnell has presented at more than 300 conferences throughout the world. Finnell wrote the preeminent ESOP book, *The ESOP Coach: Using ESOPS in Ownership Succession Planning*, the most comprehensive guide to ESOPs today. Finnell has published dozens of articles on ESOPs in succession planning. An active member of several national ESOP organizations, Finnell is a consistent pillar of leadership in the ESOP community.

Molly Coyne is Vice President for Client Engagement at Executive Financial Services in Memphis, Tennessee where she manages all client relationships and marketing efforts, focusing on streamlining all client touchpoints at EFS. Before EFS, Coyne worked in corporate sponsorships and events for a company focused on studying the technology transformations of large, complex organizations. In addition, Coyne has extensive experience in college-preparatory education, academic publishing, and university development and advancement.