



ANDREA L. JAKOB, PA

*Legal knowledge, human wisdom:
Helping you plan today, so you can
sleep better tonight.*

Employee-Based Succession Planning: MBOs and ESOPs Explained

A Simple Guide for Business Owners Thinking About Retirement

When you've spent years building a successful business, thinking about retirement can feel exciting—but also a bit overwhelming. One of the most important steps is deciding **who will take over** when you step back.

Many owners pass the business to family or sell to an outside buyer. But there's another meaningful option: **selling your business to the employees who helped you build it.**

Two common employee-based succession strategies are:

1. Management Buyout (MBO)
2. Employee Stock Ownership Plan (ESOP)

This handout explains both options in clear, simple terms so you can decide whether one might fit your goals.

I. Management Buyout (MBO)

An **MBO** happens when the company's existing managers—the people who already help run the day-to-day operations—join together to buy the business from you. This can happen all at once or gradually over time.

Why Owners Choose an MBO

- The transition stays *in-house* and is usually more private and efficient.
- You already know and trust the buyers.
- Managers understand your business, culture, and customers.
- You can leave slowly and stay involved as a consultant or adviser, if you choose.
- You keep the company's legacy in familiar, capable hands.

Key Questions to Consider

- Do you have a strong, committed management team?
- Are they interested in owning the business?
- How much money do you need for retirement?
- Are you comfortable selling at fair market value instead of the highest possible price?
- Will your managers need time or financing to complete the purchase?
- When would you like the transition of control to happen?

Potential Drawbacks

- You may receive less than you would from an outside buyer seeking strategic advantages.
- Your management team might not have immediate access to the full purchase funds.

Still, for many owners, an MBO offers a smooth path to retirement while rewarding loyal employees who have contributed to the company's success.

2. Employee Stock Ownership Plan (ESOP)

An **ESOP** is a special, government-regulated retirement plan that allows employees to become owners of the company through shares held in a trust.

You can sell some or all of your company stock to the ESOP. Employees do *not* buy shares themselves; instead, the trust allocates shares to them over time.

When employees retire or leave, the company buys back their shares at fair market value.

Why Owners Consider an ESOP

- Offers significant tax benefits for both the owner and the company.
- Allows for a gradual transition—you can sell over time.
- Keeps ownership within the company rather than with an outside buyer.
- Helps motivate and retain employees, who now have a direct stake in the company's success.

Important Things to Know

- **Cash Flow:** The company must have enough funds to buy your shares and later repurchase shares from departing employees.
- **Fair Allocation:** ESOP rules require shares to be distributed fairly based on employee compensation and service—not just to executives.
- **Ongoing Costs:** ESOPs require annual valuations, legal and administrative work, and compliance oversight.
- **Strong Leadership Needed:** Your management team must be prepared to continue running the business successfully.

Which Option Is Right for You?

Both MBOs and ESOPs allow you to:

- Keep your business in trusted hands
- Reward the team that helped you build the company
- Transition at a pace that works for you
- Preserve your company culture and legacy

However, each option has different financial, tax, and operational considerations. Choosing the right path depends on your goals, your team, and your timeline.

We're Here to Help

If you're thinking about transitioning your business to your employees, we would be happy to walk through your goals and help you determine the best strategy to protect:

- Your business
- Your retirement
- Your legacy
- Your valued employees