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Inside Eileen Fisher's Employee Stock Plan

By Theo Francis

Eileen Fisher, the New York clothing designer, faced a dilemma common to a growing number of baby-boomer entrepreneurs pondering the future of companies they built from scratch: how to cash out some of her closely held company and diversify her holdings.

Last fall she found a solution. She set up an employee stock- ownership plan, or ESOP, for her 624 employees, transferring nearly a third of the shares of the company into it.

The move let Ms. Fisher, 56, take out about $30 million of the value of the company in cash without incurring a big tax bill, thanks to federal tax incentives designed to encourage employee ownership. And it let her keep control of her company, **Eileen Fisher** Inc.

For employees, ESOPs are a kind of retirement plan, invested almost exclusively in the shares of the sponsoring employer. The shares are gradually deposited into employee accounts over time; when employees leave the company or retire, they sell their shares back to the plan for cash. Eileen Fisher expects its annual contributions to the plan to be the equivalent of 14% of employees' compensation.

"The combination of both selling and giving the piece of the business to the employees felt right," Ms. Fisher said. Plus, she said, "It allows me to get some money out." Ms. Fisher has a 17-year- old son and 13-year-old daughter, and she sees diversifying her holdings as a way to protect their future inheritance.

Decades older than the 401(k) plan, ESOPs date back to the 1950s, and gained tax breaks on the theory that employee-shareholders bolster capitalism and make companies more efficient, and because, in the best case, they can help workers accumulate retirement savings.

The programs have been controversial because of scattered abuses in which owners have used ESOPs to dump illiquid shares, getting cash themselves and leaving employees with worthless stock. And as retirement plans, they leave much to be desired, because employees are locked into a single stock. Thanks in part to ESOPs, high-profile corporate failures at **Enron** Corp. and other companies decimated employees' retirement accounts that were stuffed with company stock. Closely held firms sometimes fail when markets change and they can't keep up.

But in some circumstances, ESOPs can benefit both company owners and employees.

Ms. Fisher, an unconventional boss who offers employees yoga classes at corporate headquarters, had long wanted to give workers a stake in the firm she founded in 1984, known for its stylish, flowing women's clothes. Last year, the company, which has 37 stores in the U.S. and also sells clothes through other retailers in the U.S. and Canada, rang up sales of $225 million.

Ms. Fisher rejected the idea of taking the company public, because she feels public companies can be too focused on shareholder returns. She also decided against selling a piece of the company to private investors. "I don't want to have to bring in outsiders," Ms. Fisher said. "I want to keep the company intact with the people who've grown it."

Meanwhile, employees told her they wanted a retirement program to supplement the rudimentary 401(k) the company offered in addition to annual cash profit-sharing payments.

So Ms. Fisher decided to set up an ESOP. The firm borrowed about $30 million from a consortium led by Bank Leumi USA and then lent it to the ESOP. The ESOP in turn used the cash to buy a portion of Ms. Fisher's shares.

That left the ESOP with about 31% of the firm's shares and a $30- million debt to the company; the company owed $30 million to the banks; and Ms. Fisher had $30 million cash but only a 69% stake in the company.

Over the next eight years, the company will contribute cash from its revenues to the ESOP, paying off the loan in the process. But tax breaks make the loan repayments less painful: the company can deduct not only the interest on the loan, but the principal as well, as contri-

Eileen Fisher

Delores McDonald, an Eileen Fisher employee who takes part in the company's ESOP, corrects a pattern for the designer.

Stock Exchange

Employee stock-ownership plans, or ESOPs, offer advantages—and some drawbacks—for the company, owner and employees.

Owner

- Can diversify assets but retain control of the firm
- Proceeds aren't taxed if reinvested in U.S. securities

Company

- Can borrow to fund transaction
- Principal and interest are tax-deductible
- Dividends paid to ESOP are also tax-deductible

Employees

- Get a stake in the company
- Can exchange shares for cash at retirement
- Retirement savings are at risk if the company fares poorly