

Saving Jobs

How and Why U.S. Helped 500 Workers Take Over a Machine-Tool Manufacturer

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SOUTH BEND, Ind. —The workers take over a factory, and the government backs them to the hilt. Moscow, 1917? No, South Bend, 1975, but don't worry. The revolution hasn't come.

What has come is federal assistance for employes who want to buy up the stock of troubled companies in areas that can't afford to lose industry. The objective: to keep the companies from going out of business and adding to the economic woes of their communities. The tactic has saved a machine-tool maker here—South Bend Lathe Inc.—and is spreading to bigger concerns elsewhere.

These rescue operations are being conducted by the Economic Development Administration (EDA) of the Department of Commerce, using an increasingly popular 20-year-old vehicle, the Employee Stock Ownership Plan, or ESOP.

Your average ESOP isn't a rescue operation. Rather, it is a handy way for management to raise funds while the employes reap a benefit: a stake in the business. Workers buy company stock through a trust that borrows the purchase money from conventional lenders and uses the shares as collateral. The company contributes to the trust. In recent years, Congress has enacted a number of tax breaks to encourage the use of ESOPs. Beyond that, the government has had nothing to do with them.

The kind of ESOP that has come to South Bend Lathe is different in two basic ways:

First, the government has quite a lot to do with it. The EDA grants funds to a state or community, which then lends the funds, at low interest, to the trust, supplementing what the workers can borrow from conventional lenders.

Second, although the purpose isn't to finance worker take-overs, that is the effect. The workers wouldn't need federal help if they were simply buying a small stake in the company rather than buying the whole kit and caboodle.

Role of 1965 Act

It was the Public Works and Economic Development Act of 1965 that paved the way for this use of ESOPs. Title 9 of the act says funds can be granted to states or local communities for "any reasonable means" of effecting economic adjustment in areas threatened by high unemployment. The law makes no mention of ESOPs but instructs regional EDA administrators to give priority to innovative projects. In late 1974, somebody at the agency decided that ESOPs would be an innovative and reasonable means.

The idea was first tested at South Bend Lathe (SBL), a 70-year-old concern that early last year was facing extinction after a string of unprofitable years as a division of Amsted Industries Inc., a Chicago-based conglomerate. Today it is a thriving independent enterprise. Its orders and shipments are outpacing those of the machine-tool industry as a whole. The productivity of its 500 workers is up 25%. Pretax profit is running at 9% of sales, as against losses a year ago. The company estimates that sales will total \$18 million to \$20 million in the fiscal year that began last July 1. (Previous years' sales by SBL weren't broken out by Amsted.)

Since South Bend Lathe built its better ESOP, the world has been beating a path to South Bend. "I had a Fortune 500 conglomerate in here last week, and another is due next Tuesday," says Dick Boullis, who was SBL's president under Amsted and, like some other management people, has remained in his post since independence. Mr. Boullis estimates that he has had inquiries from a couple of hundred companies.

The first concern to set out on the specific trail blazed by South Bend Lathe is Okonite Co. of Ramsey, N.J., a producer of wire and cable. Okonite was slated to be sold by Omega Alpha Inc. to Italian interests when a \$13 million EDA grant to the state of New Jersey produced an ESOP instead. Also

preparing to follow the same path is W. R. Grace & Co.'s Seapak frozen-seafood division at Brunswick, Ga., where a threatened closing imperils over a thousand jobs.

It Started With an Article

Events leading to South Bend Lathe's pioneering role in federally funded ESOPs began in January 1975 when a trade journal carried the news that Amsted was considering liquidating the division. Mr. Boullis, who had been president of the division since 1969, broached the idea of employe ownership to Robert F. McGinty, director of area development for three South Bend banks. Mr. McGinty was aware of the possibility of EDA funding, and the two men approached the agency.

The EDA had already decided to run a test of the ESOP approach, and the agency says South Bend Lathe emerged as the best candidate because of "the character of the company itself—its background and management." A \$5 million grant was approved.

The city of South Bend was the actual applicant for the grant, and lent the money to the ESOP at 3% interest. Repayments to the city will go into a revolving fund for economic-development loans to other area companies, also at 3% interest. Thus, according to an EDA official, "the initial government outlay will become a self-perpetuating wellspring of counterinflationary economic development."

The South Bend area has been economically troubled off and on since Studebaker Corp., the auto maker, ended production in 1964. Earlier, in 1950, more than 60% of South Bend's labor force was engaged in manufacturing; the present estimate is only 25%, and South Bend would like to raise that to 35%. Unemployment in the area, about 7%, isn't horrendous, but EDA officials felt that the loss of 500 jobs would be a severe blow to the community.

Delivered by Pitcher

The \$5 million in EDA funds was delivered to the city on June 6, 1975, by Wilmer D. (Vinegar Bend) Mizell, the former major-league baseball pitcher then serving as assistant Secretary of Commerce for economic development. An additional \$2 million that SBL needed to buy out Amsted was supplied by banks. Within a month, SBL was an independent concern.

SBL has since renegotiated lower interest rates on the bank loans, in view of what the banks call the firm's excellent progress. The company is about seven months ahead on the bank payments; its first-year contribution to the ESOP, for payment to the city of South Bend, will be \$750,000, the maximum allowed for the tax breaks that ESOPs enjoy. (A major benefit is that ESOP loan payments, both interest and principal, are tax deductible.)

Besides paying off its loans, South Bend Lathe is giving each employe a vacation bonus of a week's extra pay at a total cost of about \$100,000. The workers also got a turkey at Thanksgiving, a \$50 Christmas bonus and a pay increase that wasn't due until next October, bringing average pay to nearly \$5.75 an hour.

SBL's prosperity reflects a wealth of changes instituted since independence, which appropriately was achieved over last year's Fourth of July weekend. Mr. Boullis and his management team have slapped tighter controls on inventories and expenses and have vigorously attacked a major problem: excess space.

The company's offices are in a big two-story structure that once housed Studebaker's engineering department, and its factory occupies the old Studebaker engine plant next door. Mr. Boullis has leased out the entire second floor of the office building for auto-parts storage at about \$40,000 a year. To fill part of the first floor, SBL acquired Dynablast Inc., a small local maker of machines for smoothing plastic parts. Still another area is rented to Mr. McGinty, the bank consultant, who has gone into business for himself as an ESOP designer and community developer. Ultimately, South Bend

Lathe may move its offices into the plant, making room by storing some materials outdoors.

Biggest Job in History

But more important than such ancillary income as rentals is SBL's performance in the marketplace. The current rate of incoming orders is 75% ahead of last year. The company just landed the biggest job in its 70-year history with a bid of \$1.5 million to supply 236 lathes to Tennessee schools for use in industrial-arts classes. (Government and school orders account for about 25% of SBL's business. There is a South Bend lathe aboard virtually every vessel in the Navy.)

Ray Manley, a drill foreman who has been with the company 25 years, senses "a great change in attitude." He says that previously "this was just another job, but now we all realize that broken tooling and excess scrap come out of our own pockets."

Another 25-year worker, Gordon Sears, says that better management-worker communication is the biggest change that ESOP has wrought. Bulletin boards keep workers abreast of the company's progress. Mr. Boullis holds meetings of his foremen every two weeks, and of the entire work force every month. "If there's anything we don't like," Mr. Sears says, "we scream and holler."

Right now, most of the hollering is about pensions. The sale to the employes terminated Amsted's retirement plan, on the theory that pensions were being replaced by stock ownership: At retirement, a worker can sell his shares back to the ESOP trust at a value set by an outside consultant. However, current older employes can't accumulate enough equity to match their lost Amsted rights.

10,000 Shares Issued

When South Bend Lathe was set up as an independent entity, it issued 10,000 shares of stock, all held for the workers in an employe stock ownership trust and put up as collateral for the loans to buy the company. A committee of five employes, including Mr. Boullis, decides how the trust will vote the shares. As the loans are paid off, stock becomes available for vesting to individual employes under a point system based on pay and length of service. For the average employe, that means about 2.3 shares the first year. Shares are worth just over \$1,000 each.

Gerald Vogel, one of two United Steelworkers local officials on the ESOP committee that decides how unallocated stock is voted, calls the retirement problem "a thorn in our side" and the only aspect of the change that workers are unhappy with. The union, which had a contract with Amsted and continues to represent the workers, has gone to court to force arbitration of the pension responsibilities of SBL and Amsted. Mr. Boullis says SBL is willing to do everything it can to "make whole" the retirement benefits of veteran employes.

Among most workers, the pension difficulty is overshadowed by the essential fact that they still have their jobs in a going concern whereas a year ago they thought they'd be on the streets by now.

Chalk up a save for Vinegar Bend Mizell.

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