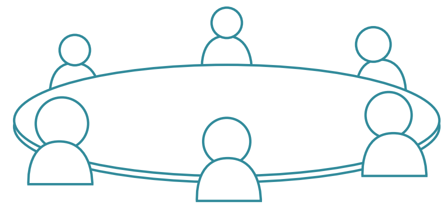
BUILDING *the* INCLUSIVE ECONOMY



# FINANCING ESOPS

## Strategies for Financing the Inclusive Economy:

**Financing employee stock ownership plans as a tool to create jobs and build community wealth**


Marjorie Kelly, Violeta Duncan, and Steve Dubb *for The Democracy Collaborative*
With contributions by Oscar Perry Abello and Corey Rosen


This paper is an adapted excerpt from *Strategies for Financing the Inclusive Economy,* the third report in Citi Community Development's Building the Inclusive Economy series.

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**Building the Inclusive Economy series:** Through three groundbreaking reports funded by Citi Community Development, the *Building the Inclusive Economy* series sets out effective, cutting-edge economic development models for city leaders and community development practitioners interested in embedding equity, community wealth, and sustainability into their local economic growth plan. This series, authored by The Democracy Collaborative, the Democracy at Work Institute, and Project Equity, lays out key tools and building blocks for equitable local economic growth through which all residents are able to maximize opportunities, thereby expanding urban economies where all can meaningfully participate and benefit.

**The Democracy Collaborative:** This nonprofit, founded in 2000, is a leader in equitable, inclusive, and sustainable development. Its work in community wealth building encompasses a range of advisory, research, policy development, and field-building activities aimed at enhancing the economic prospects of low- and moderate-income individuals. Its mission is to help shift the prevailing paradigm of economic development—and of the economy as a whole—toward a new system that is place-based, inclusive, collaborative, and ecologically sustainable.


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Broad-based ownership models bring substantial benefits to communities and workers, particularly those of low and moderate income.

# INTRODUCTION

And in an economy where wages have been stagnant for decades—and a disturbing 40 percent of jobs are now part-time, temporary, or contingent—broad-based ownership models offer a promising alternative.[1]

Given their impact, worker-owned companies, employee stock ownership plan (ESOP) companies, social enterprises, municipal enterprise, and new hybrid models with broad-based ownership are increasingly viewed as highly valuable tools for stemming and reversing rising economic inequality. But how to hasten their growth and build an inclusive economy, in which quality jobs are bountiful and ownership opportunities are widespread? How to increase understanding and comfort levels in these businesses' financing— *financing* being a key contributor to enterprise growth?

This paper—adapted from the *Building the Inclusive Economy* series' third report, *Strategies for Financing the Inclusive Economy*—begins to answer this question. It focuses specifically on how financial service providers, impact investors, foundations, local government, community development leaders, and others can finance cooperatives to build community wealth. As cooperative models spread, the role of lenders and investors will grow in coming years. That makes it critical to increase the field's understanding of the role of finance in supporting these models, how that role differs from traditional finance, and how that role is evolving.

ESOPs generally employ traditional financing, typically bank debt. Yet because ESOPs are structured differently than conventional businesses, the ESOP industry has developed its own ecosystem of support to handle the complexities of finance and culture-building. Among the characteristics of financing ESOP models that build community wealth for low- and moderate-income residents are:

- **Philanthropic and government funding are important.**
- **Non-traditional, specialized, and innovative forms of finance are often involved.**
- **Ecosystems of support reduce risk and increase likelihood of success.**
- **Knowledgeable lenders are needed to transition entrepreneur- and family-owned firms to worker ownership.**

In the sections that follow, this report offers innovative financing strategies, case studies of ESOP financing, and additional resources to help scale ESOPs as a tool for creating jobs and building community wealth.

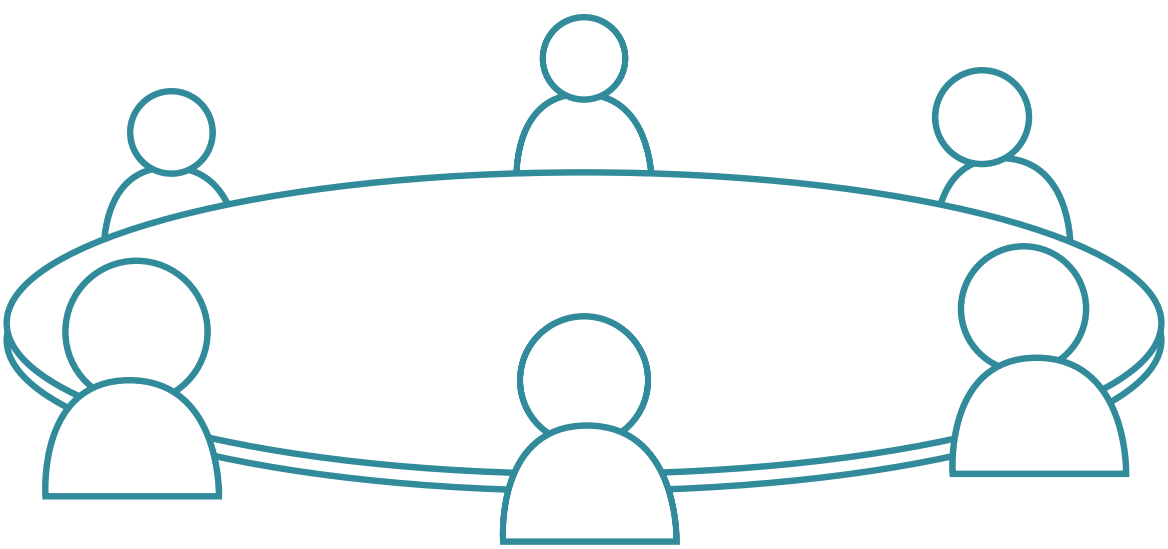
Every day, millions of customers pour into Publix Super Markets and Wawa Gas & Convenience Stores, two of the most successful companies in their industries.

Both are known for having nearly cult-like brand loyalty due to the superior service of their highly engaged employees.[2] There's something else these chain-retailers have in common: both are owned wholly or in part by their employees through the structure of an employee stock ownership plan (ESOP).

# Financing Employee Stock Ownership Plans

While the worker cooperative form works for both startups and conversions to employee ownership, the ESOP model is primarily used in conversions of existing companies (and also as an employee incentive program). The ESOP form is appropriate for larger companies, generally 20 employees or more. Indeed, ESOP companies can be extremely large. Publix, which is approximately 85 percent worker-owned, has 179,000 employees and in 2015 had revenues of $32 billion—placing it at 101 on the Fortune 500 list of largest companies.[3]

There are at least 6,795 ESOPs in the United States, compared with only 350 worker cooperatives.[4] About 4,000 of the ESOPs already are or are on a path to becoming majority employee-owned.[5] The economic impact of ESOPs is significant: These companies employ over 10.5 million workers, and ESOPs control assets of $1.23 trillion.[6]



The coming wave of retirement among baby boomer enterprise owners offers an enormous opportunity to leverage the ESOP structure for the benefit of workers and communities. David Freedman of The McLean Group estimates that more than 671,000 middle market businesses worth some $2.5 trillion will have to be sold, closed, or otherwise disposed of between 2011 and 2029 by baby boomers alone. That's about 35,000 middle market businesses per year.[7] If even one fifth of these businesses were to convert to employee ownership, that would double the number of employee-owned businesses in a single year. (Middle market firms have between roughly $10 million and $1 billion in revenue.)

How this sea change affects communities depends on who buys these businesses. Indeed, who buys the businesses will help determine who benefits from what is poised to be the largest generational transfer of wealth in U.S. history.[8] Employee ownership could ride this wave to become a major force for preserving jobs, enhancing employee wealth, reducing inequality, and creating a broader and more racially diverse class of business owners.

Employee ownership has begun to appear more prominently on the national policy agenda. For example, the Center for American Progress, a major progressive think tank, has released a series of reports on employee ownership, including one in July 2015 entitled *Capitalism for Everyone*, which explores federal policies to promote broad-based worker ownership and profit sharing.[9] Jared Bernstein, former chief economic advisor to Vice President Joe Biden, released a report in January 2016 entitled *Employee Ownership, ESOPs, Wealth, And Wages*, in which he concluded that if ESOPs were to proliferate, "their impact on inequality reduction could well be significant."[10]

Interest in employee ownership among philanthropic leaders is also rising. For example, Phillip Henderson, president of Surdna Foundation, published an op-ed in the *Chronicle of Philanthropy* in spring 2016 in which he said, "Philanthropy should embrace the largely untapped potential of worker ownership" as a solution to inequality, and he called for a new alliance of foundations to collectively take on this challenge.[11]

## Understanding ESOPs

Unlike a worker co-op—where one share is held directly by each employee-owner—in an ESOP shares are held in trust, and the number of shares can vary among employees. ESOPs are a form of retirement plan. Employees cash out upon retirement or when they leave the firm. Companies can be wholly or partially owned by employees through the ESOP trust, which is managed by a trustee.

With co-ops, employees make a modest payment for their membership share, sometimes out of a payroll deduction. In ESOPs, by contrast, employees become owners without paying a cent. How is that possible? Instead of employees purchasing shares in the company, the company funds contributions to the trust, and employees receive those shares as a benefit.

Because both models enable business ownership to be shared among a broad base of employees, both ESOPs and worker cooperatives are valuable in promoting inclusion. The National Center for Employee Ownership finds that employees at ESOP firms on average enjoy 5 to 12 percent more in wages than workers in comparable non-ESOP firms, and have more than double the retirement savings. ESOP companies also have 2.5 percent per year greater growth in employment, sales and productivity than would have been expected absent an ESOP.[12] In 2014, when close to 10 percent of employees without stock ownership reported being laid off, a layoff was reported by just 1.3 percent of employees at firms with employee ownership.[13] Employee-owned companies are, in addition, disproportionately represented among *Fortune*'s 100 Best Companies to Work For. Of the 100 companies for 2015, 37 had some kind of broad-based ownership plan.[14]

Employee ownership benefits communities as well, since it keeps companies rooted locally over the long term; employee-owned companies are typically locally owned and thus less likely to relocate. A large number of studies have shown that about three times more revenue recirculates in a community when spent at a business that is locally owned than with national chains.[15] Due to these and other social benefits, Congress has provided tax advantages to incentivize the creation of more ESOPs and employee-owned firms.[16]

## Tax Benefits for ESOPs

There are three forms of tax advantages for ESOPs and for owners who sell to them:

- **Company contributions to an ESOP are tax deductible.** This means both principal and interest on a sale to an ESOP are deductible; in a non-ESOP transaction, only interest is deductible.
- **An owner selling at least 30 percent to an ESOP can defer capital gains taxes,** by investing the proceeds in another U.S. company. Capital gains from the sale are not taxed until that newly purchased stock is sold.
- **S corporation ESOPs pay lower or no taxes on company income.** S corporations pass gains and losses through to shareholders. When an ESOP trust is a shareholder in an S corporation, income to the trust is not taxed until employee-owners cash in their shares upon leaving the company. If an S corporation is 100 percent owned by an ESOP trust, it pays no corporate income tax. (This is a key reason S corporation ESOPs are today a fast-growing category of ESOPs.)[17]

## Traditional Financing for ESOPs

Companies generally transition ownership into an ESOP using debt of various kinds. ESOP trusts enjoy a special privilege as the only benefits plan that can legally borrow money.

**Leveraged ESOP:** A large majority of conversions to employee ownership are accomplished through a leveraged ESOP, in which an ESOP borrows money and buys the owner's stock, repaying the loan over time out of cash flow. According to a 2015 survey by the National Center for Employee Ownership, 72 percent of ESOP transactions are leveraged. Because lenders generally prefer to loan directly to the company (since its assets can better secure the loan), the transaction is often accomplished by the company borrowing money and then relending it to the ESOP plan.[18]

**Non-leveraged ESOP:** In this method, the ESOP uses company contributions to purchase stock each year, rather than to repay a loan. Employee ownership is created by simply contributing stock directly to the ESOP plan (a transaction that is tax deductible). Or companies can make pre-tax contributions of cash to the plan, which the ESOP plan then uses to buy stock from the company (either common or preferred).

A leveraged ESOP sounds simple enough, but the actual transaction is a bit more complex. The company must first set up the ESOP trust and then take out a commercial loan (this is called an outside loan) and/or, very commonly, the seller takes a note. Next the company re-lends the funds directly to the ESOP trust (an inside loan). The proceeds are then used by the ESOP to buy shares of stock in the company, which are placed into a "suspense account," to be released gradually as the inside loan is repaid. To enable the ESOP to repay its loan to the company, the firm makes cash contributions, which are tax-deductible, directly to the trust. Eventually, the loan is repaid, the shares are fully paid for, and the employees own the shares free and clear through the ESOP.[19]

### How a Leveraged ESOP Works:

**STEP 1**
Company ABC sets up an ESOP trust.

**STEP 2**
Company ABC borrows $ from a lender (called an outside loan) and/or the seller.

**STEP 3**
Company ABC re-loans $ to the ESOP, usually at a similar interest rate (an inside loan).

**STEP 4**
The ESOP then uses the proceeds from the loan to buy shares of the company. These could be existing shares or newly issued stock.

**STEP 5**
Stock purchased by the ESOP is held in a "suspense account," to be released to employee accounts over time, as the loan is repaid.

**STEP 6**
The company makes tax-deductible contributions to the ESOP so that it may repay the loan. It may also issue dividends (also tax deductible) on shares held by the ESOP.

**STEP 7**
The ESOP uses those contributions plus any dividends to repay the loan from Company ABC or the commercial lender.

Source: Scott S. Rodrick et. al, *Leveraged ESOPs and Employee Buyouts*, Oakland, CA: National Center for Employee Ownership (NCEO), 2000.

ESOP financing generally employs a combination of these forms:

- **Traditional commercial lenders:** ESOP transactions are often financed with senior debt. Either the ESOP trust *or* the sponsor company can seek a loan to fund the ESOP's acquisition of shares in the company. If the company takes the loan, it will usually re-loan those funds to the ESOP. There are a number of national and regional banks that have dedicated ESOP lending departments.[20]
- **Seller financing:** The current owners can lend money and take a note, instead of or in addition to a loan. Partial seller financing can help smooth the way for a loan, and it allows the seller to enjoy interest income as well as income from the sale itself.
- **Partnering with private ESOP development firms:** A large ESOP advising industry exists, including firms that have helped structure thousands of ESOP transactions.[21] The ESOP Association, the industry trade association, maintains a general directory of firms that work with ESOPs.[22]
- **Mezzanine financing:** This form of financing can supplement capital raised from traditional debt and the selling owners. *Mezzanine financing* refers to a layer of financing between senior debt (which takes priority in repayment) and owner equity. It may take the form of *debt* capital that gives the lender the option of converting to equity.
- **Bond market:** Though not a common practice, ESOPs can issue bonds to raise debt capital.

## Challenges, Solutions, Opportunities

- **ESOP companies can face challenges with fees or excessive debt.** One ESOP challenge is generating adequate cash to make regular contributions to the ESOP (if unleveraged) or payment on debt service (if leveraged). An additional challenge is that some companies can be too small to afford the fees and annual administration costs of setting up and managing an ESOP. Smaller companies may be better off seeking conversion to a worker cooperative.
- **Challenges to seller financing:** Forming an ESOP with seller financing generally requires strong motivation by the seller. There are challenges that could impact a seller's interest, including:

  **Price competition**—Legally, an ESOP can purchase shares of a company only at fair market value, as determined by an independent valuation, based on what a financial buyer would pay. Yet, in a fairly small minority of cases, strategic acquirers may be willing to pay a premium. This can create a competitive disadvantage for the ESOP model, if the owner prioritizes maximizing sale price.

  **Liquidity**—A seller who seeks to immediately and completely cash out of a business may find it difficult to obtain the necessary financing unless he or she is willing to take on a substantial seller note as part of the deal. If the owner is leaving, there also needs to be qualified successor management.
- **ESOPs may not mean employee ownership in perpetuity.** ESOPs are governed by the Employee Retirement Income Security Act (ERISA), which governs pensions and requires trustees to act in the best interests of beneficiaries, which is generally taken to mean selling the company to the highest bidder. In essence, if a trustee receives an offer to purchase the company—for example, from a private equity firm—he or she often feels obligated to sell. Employees themselves also may seek to sell the

company when their shares represent substantial wealth. One example is Full Sail Brewing, once a model ESOP company, until employees and founders voted nearly unanimously in 2015 to sell to a private equity firm. (It's worth noting that the two founders apparently initiated the sale, controlled more than 40 percent of the company, and served as the sole trustees of the ESOP.)[23] Another challenge is the need for the company to cash out employees when they retire; this is called the "repurchase obligation." In particular, when many employees retire at once (say, because of a demographic bulge in the workforce), this can create a cash crunch, which may lead the ESOP board to choose to sell shares to an outside buyer rather than be forced to deplete cash reserves.[24]

- **One solution to the perpetuity problem is employee ownership through a perpetual trust**—similar to the trust that owns the John Lewis Partnership, a large department store and grocery store chain in the U.K. that is 100 percent owned by its employees**.** The first U.S. company to adopt this innovative model was WATG, an architecture and interior design firm with 365 employees, which created a perpetual trust for employee ownership in 2014. Previous company owners, who were senior company leaders, rejected a handsome buyer's offer, instead opting to create the trust. WATG took a bank loan and used it to make a gift to the trust, which allowed the trust to purchase 60 percent of shares; the ultimate goal is 100 percent ownership. The trust's founding document says its purpose is to hold shares of WATG "as a permanent part of ownership and governance." Employees benefit by receiving a share of annual profits, but do not actually own any shares or benefit from the growth in equity value.[25]
- **Significant tax advantages accrue to both sellers to ESOPs and to ESOP companies themselves.** If owners sell to an outside buyer, they will pay taxes on the net long-term capital gain. But if owners sell at least 30 percent to an ESOP, they can roll over the proceeds into U.S. stocks or bonds and avoid paying tax until that replacement investment is sold. In addition, when companies make contributions to an ESOP to buy a seller's stock, those contributions are fully deductible, which reduces company income taxes. If an ESOP company is an S corporation, it will pay no income taxes on retained earnings that accrue to the ESOP; employees will owe taxes on that income when they terminate their employment (at a time when their taxable income may be lower, due to retirement).[26]
- **Reduced turnover can be a major benefit of an ESOP.** For example, Carris Reels, which makes packaging for the wire and cable industry, is a company with $83 million in annual sales and 450 employees; it is now 100 percent ESOP-owned. CFO David Fitzgerald has said, "Before the ESOP, we had 100 [percent] employee turnover in our Michigan and North Carolina facilities. Now that the ESOP owns the company, turnover is 20 percent companywide."[27]

## Innovative Financing for ESOPs

Innovations are emerging in ESOP financing that may offer clues for how to increase the total number of ESOPs as a share of total U.S. businesses. Some examples include:

**Small Business Investment Companies**

The Small Business Investment Company (SBIC) program of the U.S. Small Business Administration (SBA) increases capital for small businesses by licensing private investment funds as SBICs; these funds then use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses.[28] A few private equity firms now use SBICs to finance leveraged ESOP transactions. In Charlotte, North Carolina, the private equity firm Mosaic Capital Partners raised a $165 million SBIC fund that provides $3 million to $15 million in mezzanine debt and equity to lower middle market companies to fund ESOP buyouts.[29] Working in collaboration with a private credit fund and a bank that provides senior debt, Mosaic Capital Partners has completed four transactions in one year alone, including the leveraged ESOP buyout of the previously family-owned, California-based Hollandia Produce, a leading greenhouse grower of hydroponic lettuce in the U.S.[30]

**State employee ownership centers**

Employee ownership centers include the Vermont Employee Ownership Center, the Ohio Employee Ownership Center, the Rocky Mountain Employee Ownership Center, the Pennsylvania Center for Employee Ownership (an affiliate of the National Center for Employee Ownership), and the California Center for Employee Ownership run by the Beyster Institute at the University of California, San Diego. They promote employee ownership through information, outreach, and preliminary technical assistance. Both the Vermont and Ohio centers also operate revolving loan funds.[31] Several other state centers are in development.[32]

**Public incentives to drive private investment**

Governments can offer direct investment for employee ownership, or use loan guarantees and other credit enhancements. One example is the Indiana ESOP Initiative (IEI), created by then-Treasurer Richard Mourdock in 2007. “No group of employee owners has ever, ever, ever, ever moved their company to Mexico or China!” Mourdock once exclaimed.[33] Having participated in an ESOP earlier in his career, Mourdock chose to encourage the creation of ESOPs through a $50 million linked deposit program.[34] The state treasurer purchased CDs at a slightly reduced rate of interest, which served as collateral, allowing reduced interest rates for companies.[35] In its first two years, IEI helped to create more than 900 new employee-owners.[36] IEI remains of interest as a model, though the program may no longer be active; the state website reports the initiative “is currently being reviewed and evaluated by the Treasurer of State’s Office,” and the office did not return calls seeking comment.


In 2015, GAC Chemical Corporation founder Jim Poure sold his shares to an ESOP trust, in part through a loan from Bar Harbor Bank & Trust, which was helped by a 75 percent loan guarantee from the Small Business Administration's 7(a) program. Every year, this guarantee program generates more than $10 billion in lending.

Photo c/o GAC Chemical Corporation

# Case Studies in Financing ESOPs

CASE STUDY

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## SBA 7(A) FINANCING: A VALUABLE, UNDERUSED STRATEGY FOR ESOPs

A little-known, little-used form of financing for ESOPs is the 7(a) program of the U.S. Small Business Administration (SBA), which provides a partial loan guarantee to lenders, encouraging them to make loans to companies that might otherwise lack access.[37] Every year, according to Rob Wilson of C7(a) Financing LLC, this guarantee program of the SBA facilitates more than $10 billion in lending. The law offers special incentives for ESOP borrowers by not requiring the same loan guarantees required of other borrowers. Yet Wilson observed that the 7(a) program still remains little known in the financial services and ESOP worlds.[38]

That may be changing, Wilson wrote in the May-June 2016 issue of the *Employee Ownership Report,* published by the National Center for Employee Ownership. He reported that several recent ESOP transactions have used SBA 7(a) financing. One example is GAC Chemical Corporation of Maine. In 2015, founder Jim Poure sold his shares to an ESOP trust, in part through a loan from Bar Harbor Bank & Trust, which was helped by a 75 percent loan guarantee from the SBA.[39]

Another example Wilson discussed was the sale of an environmental consulting firm to an ESOP as an owner exit strategy. The total transaction was $5.1 million. A bank provided $3.1 million, with a 75 percent guarantee from the SBA. The seller was not required to make a personal guarantee, but did find it necessary to loan the ESOP

$900,000. The final $1.1 million came from the company's cash reserves. Because "goodwill" was a large part of the purchase price (meaning no hard assets backed that value), many lenders might have declined this loan. It was a SBA 7(a) lender that eventually agreed to do the deal.[40]

Why is 7(a) financing little used? Partly it is lack of knowledge in parties involved. Also, there are restrictions when two complex federal programs, SBA 7(a) and the Employee Retirement Income Security Act (ERISA), which governs ESOPs, are involved. To meet the "small business" limit set by the SBA, there is a $5 million limit on 7(a) loans. There are also limits on firm size—$7 million in annual revenue for industries like services, retail trade, and construction; 500 employees for firms in manufacturing and mining; and 100 employees for companies in wholesale trade industries.[41]

Wilson noted that a high percentage of ESOP transactions would still fall within the appropriate range. He added that, given the large opportunity represented, the ESOP community would be wise to pay attention to 7(a) loans.[42]

CASE STUDY

Click for info

## BARCLAY WATER MANAGEMENT: MANY PATHS TO FINANCING EMPLOYEE OWNERSHIP

*Corey Rosen, founder of the National Center for Employee Ownership, shares this story:*

The story of Barclay Water Management offers a useful illustration of the many ways employees can buy a business: 1) Buying it directly with after-tax dollars. 2) Establishing an ESOP, which uses pre-tax dollars and gives sellers better tax treatment. 3) Funding the ESOP through a combination of loans and annual cash contributions. 4) Becoming fully employee-owned by borrowing commercial loans and seller notes. It's all there in this one story.

The tale of Barclay Water Management dates back to 1932, when the company was established. Today this company provides a complete range of water treatment solutions for industrial, commercial, and institutional clients in the Northeast and Mid-Atlantic states. It was in 1982 that founder Stan Barclay began selling stock to some of the company's managers. That's the first method: direct sale to employees using after-tax dollars. Within ten years, the employees owned 100 percent of the company, with most stock held by key managers and lesser amounts by others.

As some of the managers started to look to sell, Bill Brett, the company's CEO, heard about ESOPs at a conference where Barclay was named one of the country's top small workplaces. It seemed like the perfect fit. The company, which had about 80 employees, would set up an ESOP trust that would buy shares from employees. Now the second method was in play.

To continue employee ownership, the company would need to employ the third method: funding the ESOP with pre-tax profit contributions from the company and debt. This initial tranche enabled the ESOP to buy 22 percent of the business, which was then allocated to employees who had worked at least 200 hours in a year. Employees receive allocations based on relative pay (a flatter formula can also be used) and become vested incrementally over six years. If they choose to leave the company before the age of 65, the company will repurchase their shares of stock and convert them into cash, which is paid out over a period of time. At each point, the shares are valued through an appraisal by an outside valuation firm.

By 2016, Barclay had about 100 employees and the ESOP owned 29 percent of the shares. At this time, many of the key owners, including Brett, were ready to move on. The next step, then, was for the ESOP to buy out the remaining shares. Additional debt was needed.

First, the trust used a commercial loan, payable over five years, to buy out in full several of the shareholders. The trust gained the access to the capital through the company, which, unlike the trust, has collateral and can more easily access loans. The ESOP will repay the debt to the company, and as it does so, shares will be released to employee accounts. The transaction also nets benefits to the company and employees. The company receives a tax deduction for the annual contribution to the trust, and employees are able to become business owners at no cost. With ESOPs, becoming vested in a business is a company benefit.

Left with the task of compensating the largest shareholders, the ESOP needs to do a bit more maneuvering. To complete the buyout, the trust entered into an agreement with the remaining shareholders. The company will issue warrants on behalf of the trust to existing managers and will purchase seller's notes, which are subordinate to the commercial loan, from shareholders as well. This allows the remaining shareholders to be repaid principal and interest, for a period of six to 10 years, plus warrants, which will enable them to participate in gains as the company becomes more successful.

When shareholders eventually cash out their shares, they will get a reasonable return on the notes. Meanwhile, Barclay's former owners can choose to reinvest the income in certain other securities and defer any tax on the gain until they sell those new investments, or they can pay capital gains taxes at the time of sale.

Barclay was always a very good company with a strong pro-employee culture, but since becoming an ESOP, it has created ways for employees to get more involved in generating ideas. After the company began sharing detailed metrics with employees, many innovations in sales followed and profits tripled in one year alone. Employees came up with a whole new line of business, making sure water systems are providing safe drinking water—a key issue for hospitals. The employee-generated approach is more efficient and safer than traditional treatment methods.

While many of its peer craft brewers have been selling to multinationals, New Belgium Brewing of Fort Collins, Colorado—makers of Fat Tire Amber Ale—has chosen to become employee-owned and share wealth with workers. After becoming partially owned by an ESOP in 2000, in 2012 New Belgium transitioned to 100 percent employee ownership.

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CASE STUDY

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## NEW BELGIUM BREWING: STARTING A TREND OF EMPLOYEE OWNERSHIP AMONG CRAFT BREWERS

It was the start of something big when New Belgium Brewing of Fort Collins, Colorado—makers of Fat Tire Amber Ale—became partially owned by an ESOP in 2000. The company transitioned to 100 percent ESOP ownership in 2012. In an industry where other craft brewers were selling to multinationals, New Belgium took a significant step toward remaining independent, toward sharing wealth with employees—and toward sparking a trend among other craft brewers.[43]

When co-founder Kim Jordan and her former husband launched the company in 1991, they took out a second mortgage and used credit cards to achieve an initial capitalization of $60,000. "We then got a brewery equipment vendor to help us get financing from a leasing company and an SBA loan" to open a second brewery, Jordan told *Fortune*. Expansion was done with traditional financing; New Belgium has never had equity investors.[44]

The two founders gave 10 percent of ownership to co-workers in 1996, through a deferred compensation plan. In 2000 they merged that plan with an ESOP, which then owned 32 percent of the firm. When the couple divorced in 2009, the company bought out the shares of Jordan's husband and retired those shares. In 2012, all remaining outstanding shares—held by Jordan, her two sons, and five managers—were sold to the ESOP. A bank provided a loan for much of the purchase, and Jordan financed the rest with a loan to the company. "Now we operate as an ESOP with a B corporation designation," Jordan said. "We disburse a number of shares to all of our owner co-workers every year."[45]

Jordan stepped down as CEO in mid-2015. Will New Belgium remain employee-owned in perpetuity? In December 2015, *The Denver Post* reported that the company had hired an investment banking firm to explore a potential sale for $1 billion or more. Jordan, now board chair, said no deal is pending.[46] One source close to New Belgium reported that there is no intention now to sell, nor an active buyer trying to purchase the company.

CASE STUDY

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## OHIO EMPLOYEE OWNERSHIP CENTER: BRINGING ESOPs TO DOZENS OF INDUSTRIAL COMPANIES

When the owners of Hy-Tek Material Handling in Ohio were nearing retirement, the company chose to transition ownership to an ESOP in 2007. Company income that would have otherwise been taxed instead went to fund worker ownership, helping rebuild the balance sheet. The ESOP proved to be an engine for growth, as well as a boon to employees and a powerful recruiting tool. In the nine years Hy-Tek has been an ESOP, revenue and income have increased more than 200 percent—outpacing growth from any other period in the company's 53-year history.[47]

Hy-Tek is a supplier of material-handling products for industry, such as shelving, pallets, and bins of all kinds—a far cry from the organic bakeries or solar companies often associated with worker ownership.[48] Yet Hy-Tek is typical of the industrial companies the Ohio Employee Ownership Center (OEOC) has supported. OEOC director Roy Messing says he expects more companies will transition to worker ownership in coming years, as aging owners face a market filled with many companies up for sale, making sale to employees an attractive alternative. "These businesses are getting grayer, and they are going to have to do something," Messing said.[49]

The OEOC is a nonprofit center established at Kent State University in 1987 to provide information and preliminary technical assistance about employee ownership. It has helped nearly 100 companies convert to at least partial employee ownership, with 15,000 employee-owners created, many of them through ESOPs. Some $350 million in company wealth has been directed to employees—with the average wealth created at around $40,000 per employee-owner. This has been accomplished at surprisingly low cost: around $772 per job created or retained.[50]

OEOC finances some transactions through the Common Wealth Revolving Loan Fund (CWRLF) it operates, which became a certified CDFI in 2013. CWRLF raises capital through social investment notes that offer below-market interest rates and are sold to individuals, corporations, foundations, and religious organizations. Through its specialized underwriting procedures (particularly effective for companies that lack collateral), the fund is able to offer more generous and flexible loan terms than traditional lenders. The fund also works with other partners, such as local financial institutions, to secure financing for small ESOP companies. The powerful combination of financing, specialized underwriting procedures, and technical assistance has demonstrably increased the number of ESOPs in the target footprint.[51]

Finance has a vital role to play in advancing cooperatives as a tool for job creation and reducing wealth inequality.

# CONCLUSION

This survey shows key areas poised for growth and social impact, indicating where finance can play a leadership role

**Impact investors have a potentially vital role to play in financing transitions to worker ownership.** There has been surprisingly little attention to worker ownership among impact investors, who tend disproportionately to focus on publicly traded firms. The baby boom entrepreneur transition offers a large opportunity to learn to invest in ways that more directly benefit workers.

**Financial service providers can increase their ESOP lending, including making greater use of the SBA 7(a) program.** At present, banks issue more than $10 billion in SBA section 7(a) loans, a program that enables businesses to qualify for 75 percent federal guarantees on loans. ESOPs have been eligible for such loans since 1979, but relatively few ESOP loans of this type have been made.[52] Growing bank expertise in this area to finance more conversions of existing businesses to ESOP ownership could be a critical strategy for both preserving existing small businesses and reducing income inequality.

**Local governments are poised to advance worker ownership as an engine for job creation.** A small but growing number of state and local governments are developing strategies to offer financial support to these businesses and are creating employee ownership technical assistance centers.

It is clear that community wealth building approaches centered in broad-based ownership of business are poised to grow and can be important tools for addressing the economic inequality challenges that we face. Finance cannot do it alone. Yet it is an essential partner, and potentially a powerful force in leading this work. The ESOP models highlighted here shine light on diverse ways to build the partnerships between development and finance. And, by forging these connections, finance and community development can work together effectively to build community wealth and a truly inclusive economy.

## ADDITIONAL RESOURCES

- **ESOP Financing Issue Brief,** The ESOP Association, http://members.esopassociation.org/imis/ItemDetail?iProductCode=ISSBR5&CATEGORY=BRIEF
- **ESOP Experts Online Directory,** The ESOP Association, http://www.esopassociation.org/network/esop-experts
- **ESOP Professional Services Directory,** National Center for Employee Ownership, http://www.nceo.org/pages/directory.php
- **Guide to Leveraged ESOPs,** National Center for Employee Ownership, http://www.nceo.org/Leveraged-ESOPs-Employee-Buyouts/pub.php/id/20/
- **SBIC program,** U.S. Small Business Association, https://www.sba.gov/sbic/general-information/program-overview
- **Employee-Owned S Corporations of America,** ESCA, http://esca.us/

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