A CASE STUDY

Should local governments double down on their support of **employee-owned worker models?**

race forward

LOCAL AND REGIONAL GOVERNMENT ALLIANCE ON RACE & EQUITY

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Introduction

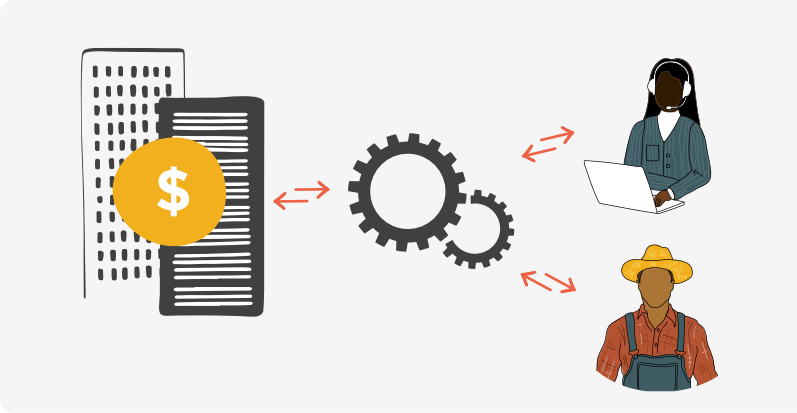
With small and medium businesses supporting nearly half of the U.S. workforce, local and regional government actors are focused on alternative solutions to fluctuations in the economy—compounded by the effects of COVID-19—in underserved communities which are disproportionately of color (Small Business Trends, 2021). Amid ongoing uncertainty and their budget constraints, local communities and major stakeholders are asking: How can we craft effective and equitable small business recovery plans? This case study examines the potential for employee ownership models to address the racial wealth gap, the types of employee ownership models available to local governments and community stakeholders, the strengths/weaknesses of each model, and recommendations made by advocates and strategies for implementation.

The Types of Employee Ownership Models

The employee ownership model provides workers with additional pathways to economic mobility and long-term financial stability as a means of tackling the country's growing racial wealth divide gap. The three main model categories for employee ownership within companies are Employee Stock Ownership Plans (ESOPs), Worker Cooperatives, and Employee Ownership Trusts (EOTs).

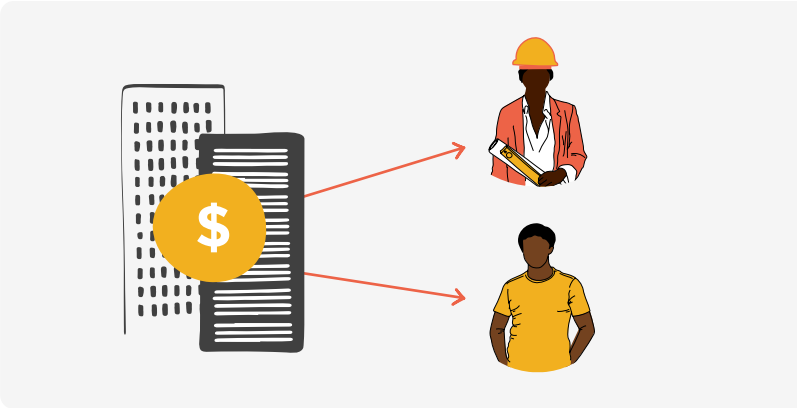
Employee Stock Ownership Plans (ESOPs)

ESOP is the most commonly found form of employee ownership in the U.S. An ESOP is a retirement plan that is created to transfer shares of a company to a trust that is either partially or fully owned by the employees. Employees will receive the benefits once they retire, but the benefit of this model is that employees feel that they are working towards their own investment.



Employee Ownership Trusts (EOTs)

An EOT is similar to an ESOP, with the main difference being that ESOPs can be sold and acquired, with the employees losing their benefits. Employees have access to increased pay and benefits, but do not have tangible input in the strategic direction of the company.



Worker Cooperatives

A Worker Cooperative is a business owned and controlled by employee-owners who can elect to serve on the Board of Directors, promoting more democratic and equitable processes.

The Role of Local Government and Stakeholders

The role of local government is always critical in the creation and expansion of employee ownership models. When governments provide incentivization and targeted resources to entrepreneurs and small businesses, they can help remove barriers that make it difficult and, in some cases, impossible for employee-owned businesses to access resources and services. These initiatives provide multiple pathways for employee ownership models to form and expand in local economies. Each pathway requires its own investment and intervention points.

Here are some of the approaches favored by local governments:

Supporting Employee Ownership Transitions

The most commonly used and well-known strategy for implementing employee ownership of a local business is municipal support for ESOPs, EOTs, and Worker Cooperatives. Over the past decade ecosystems of support organizations and lenders, from CDFIs to local investment funds, to help finance this approach have emerged. Municipalities have sustained long-term success by developing technical assistance programs and expanding access to capital resources that focus on converting longstanding, community-serving businesses that often serve as valuable cultural assets to employee ownership, in partnership with community organizations and business development centers. **This is considered an underutilized approach due to the lack of interest from owners unwilling to broach the topic; nearly 83% of business owners do not have a succession plan** (Legacy Business Registry, San Francisco Planning).

Supporting startup worker cooperatives

There are two ways municipalities can support startup worker cooperatives—a low-touch development (generally broader, fast impact approach) and a high-touch development approach (impacts fewer people and is considered a relatively expensive/slow-paced model). A **low-touch development** approach encourages entrepreneurs and/or unemployed workers to come together and develop a worker cooperative themselves. The launch of the cooperative is driven solely by the employees, who take on the full responsibility for associated costs and seek outside

assistance in the form of business coaching, access to technical assistance, and capital. A **high-touch development approach**, frequently referred to as the incubation model, is driven by non-profit and/or municipality involvement in the development of business processes, recruitment/training of workers, and the ability to take on part of or all fiscal responsibilities prior to launch to help worker-owners become successful. **The success rate of both approaches depends heavily on a City's ability to receive support from municipal budgetary appropriations, legislation, advocacy efforts, and, most importantly, strong partnerships with community leaders.** In many cities, budgetary limitations have forced advocates to become more proactive in the implementation of resolutions to create a third pathway to supporting startup worker cooperatives, often referred to as an endorsement approach. This resulted in the creation of task forces to shape recommendations for policy and program interventions and subsequent buy-in for worker cooperatives from city agencies, community partners, and other institutions in Austin, TX, and Philadelphia, PA (Sutton, 2019).

Supporting Secondary Cooperative Models

A cooperative of member-businesses model (network) offers an alternative to employee ownership models. The network can use its collective bargaining power to increase access to financing, reduce costs on shared needs, provide education/technical assistance, and research and development support as needed (Luviene, 2010). This infrastructure-building model allows municipalities focused on strengthening their existing small businesses to engage a single entity that represents multiple enterprises with influential political capital, which amplifies small business negotiating power in the policymaking process (The Role of Secondary Cooperatives). In most cases, this approach is favored by industries with organizing power such as the food/restaurant and care industries. **While favored by these hard-hit industries, municipalities would have to use considerable time and resources to build the network infrastructure for secondary cooperatives, and it can take years to see an impact.**

Strategies for Implementation

Below you'll find several policies and practices that support the development and growth of worker ownership. These pathways provide several low-cost, high-impact ideas that can address both rural and urban challenges that local economies face in building stronger, more equitable futures for their residents.

Access to Information and Resources

Establishing local, regional, and national hotlines

Hotlines are one of the most proactive approaches to supporting business owners in their transition plans. Owners are able to call in and speak with the appropriate employee ownership experts in "real-time."

EXAMPLES

> New York's Owner to Owners initiative provides business owners with access to information for employee ownership transitions via a hotline.

> Workers to Owners Collaborative, a national group working to transition small businesses to employee ownership, provides Cities with access to information and technical assistance services.

Creating Business Legacy Websites

Cities interested in preserving legacy businesses can consider expanding education and outreach by launching a webpage to educate business owners about employee ownership and refer them to technical assistance providers. Due to the difficulty in collecting data, the known universe of legacy businesses may not be available for most municipalities. An opt-in approach is highly recommended, which would allow interested business owners to input relevant information as needed.

EXAMPLES

> The City of Seattle Legacy Business program was established to address resident needs and commercial displacement due to gentrification by Seattle's Office of Economic Development (OED). This initiative intended to provide long-term support to culturally relevant small businesses by creating a brand/referral process for long-standing community-based businesses through a locally-sponsored communications campaign.

Technical Assistance

Redirect Layoff Aversion Funding

Municipalities and community partners can deploy existing layoff aversion funding from the Workforce Innovation and Opportunity Act (WIOA) to foreclosing or at-risk businesses and/or assist workers in purchasing a business from their employer with the support of non-profits specializing in employee ownership transitions.

EXAMPLES

In a piloted program, the Northeast Workforce Development Board partnered with the Cooperative Development Institute to leverage WIOA funding on a training series on business exit planning and the employee ownership option for members of Workforce Investment Boards. In partnership with the Cooperative Development Institute, the state's Department of Labor (DOL) used WIOA funds to save the state's largest healthcare company from closure.

The Concerned Capital's Transition of Ownership, a two-year piloted program in California, was designed to demonstrate an approach to the issue of job loss resulting from mergers and acquisitions or transfer of ownership, which resulted in 23 jobs saved at three businesses.

Removing Barriers to Grants, Loans, and Guarantees

Community Development Grants

Access to capital is a significant obstacle for employees seeking to buy a business from a retiring owner or for workers seeking to launch or grow employee ownership. Cities can further enable employee ownership development by providing or organizing a pool of capital to either finance buyouts, or to help develop or grow worker-owned businesses. Community Development Block Grants program income can also be used to support business outreach and education on succession planning, including transitions to employee ownership for low to moderate-income communities.

EXAMPLES

The City of Miami, FL amended its economic development loan program, funded by CDBG program income, to include financing for business conversions in 2018.

Increase Access to Existing Loan Programs

Most low to moderate-income workers and entrepreneurs don't have personal collateral or access to capital to purchase a business from an owner—especially BIPOC, low-wage workers. To address socioeconomic barriers faced by low-income communities, municipalities can develop alternatives to conventional personal guarantee requirements from their existing lending programs to ensure that workers have equitable access to existing loans.

EXAMPLES

> In collaboration with the Sustainable Economies Law Center, the City of Berkley worked with the center to develop an alternative to conventional personal guarantees by approving a limited guarantee for worker cooperatives in the form of a panel of owners representing at least 50 percent of ownership in the cooperative in 2019. **This measure was approved by the U.S. Department of Commerce's Economic Development Administration (EDA) before implementation. Therefore, it could be used as a precedent for other cities.**

Accessible Loan Guarantees Pools

This is the most cost-effective way to provide capital stimuli to worker ownership because this attractive option does not require the upfront capital outlay normally needed by a bank or credit union. Furthermore, the loan guarantee pool could set aside either the entirety of (fully funded), a portion of (partially funded), or none of (unfunded) their potential loss liability at the establishment of the fund. Lastly, loan guarantees pools can help drive the development of a business service industry to support the guaranteed loans. Consequently, this can create a demand for buyout-focused investment funds and fee-based technical assistance providers, enriching the ecosystem of support for worker ownership.

Key Industries to Watch

According to a 2018 report from the Economic Policy Institute, labor income for the bottom 90% of Americans as a share of all market-based income shrunk by 11 percentage points between 1979 and 2015 (Bivens, 2018). And yet every year, millions of Americans benefit from employee ownership and broad-based profit-sharing plans that ensure workers receive a share of the wealth that they help create.

The overwhelmingly positive benefits of this model have garnered an array of supporters from city and state policymakers across ideological divides—from the conservative strongholds of Iowa and Nebraska to the progressive bastions of Berkeley, California, and Newark, New Jersey—who are increasingly adopting policies to support and expand the use of employee ownership and broad-based profit-sharing (Yassi, 2019). For example, the New York City Council made one of the largest pledges of government support in history, investing $1.2M in the NYC Worker Cooperative Business Development Initiative in 2014, a definitive nod of support to the 5,000 workers in the U.S. participating in the worker cooperative model (NWC, 2016). With continued support from the de Blasio administration, New York City invested more than $15M to accelerate the increase of cooperative small businesses to create employee ownership strategies for its business sector (custodial, childcare, and eldercare). Currently, more than 90% of worker-owned businesses in New York City are led by people of color. Subsequent support from New York State aided the highest net growth in national worker cooperatives between 2017 and 2018.

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Male-dominated fields such as real estate (business development, construction) and manufacturing (warehousing, steel, computers/electronics, heavy machinery), overwhelmingly support the employee ownership model. In recent years, the tech industry has reserved ownership options for its top-tier talent (declining by 70% from 2002 to 2010), which represents a very small, often White group of workers. The creation of employee ownership model businesses can also help diversify predominately white fields (Blasi, 2019).

Benefits to Workers

Though they currently make up a small portion of the broader U.S. economy, employee-owned businesses have been reported to perform well in terms of impact — particularly for low-wage workers and communities of color.

Provide an exit strategy for owners

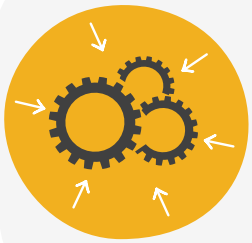
Selling the business to employees can be a way to provide continuity and preserve the culture of the business while providing stable, long-term solutions to leadership transitions.

Income Stability

Employees are also up to five times more likely to have another retirement plan, and a recent study also finds that workers participating in an ESOP hold more than twice the average total retirement balance of Americans nationally.

Job Retention

Employee shareowners are six times less likely to be laid off and in fact may help to stabilize communities by maintaining employment and expanding consumer purchasing power; during the COVID-19 pandemic, employee owned companies reported the lowest levels of job loss—11% amongst worker cooperatives (Hoover, 2020).



Employee Participation

Workers/members can participate in decisions affecting their work including pay scales, scheduling/hours, and health and safety conditions.

Provide tax benefits to the collective and individual members

Certain employee ownership structures qualify for tax benefits, which can be substantial.

Impact on Mobility and Equity

The factors that contribute to racial wealth gaps, including lower levels of retirement savings, lower levels of business and financial assets, and lower job quality (as reflected in their pay, benefits levels, and workers' voices) can be addressed through employee ownership models and is frequently championed by social justice labor advocates. "The business, economic and human case for an expansion of employee ownership, specifically for Black and Brown workers, is hard to overstate," writes Philip Reeves and Todd Leverette, in Impact Alpha, an online publication covering the world of impact investing. Reeves and Leverette are partners at Apis & Heritage Capital, an investment firm incubated by the Democracy at Work Institute to facilitate an increase in employee-led buyouts through the Legacy Business Initiative that focuses on expanding business ownership as a means to build wealth for workers of color.

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> - Philip Reeves and Todd Leverette | Impact Alpha

Pre-COVID-19, U.S. ESOPs held nearly $1.4 trillion in plan assets, with the average employee ownership stake at over $130,000. Research indicates that for underpaid workers who are disproportionately of color by large margins, ownership stakes significantly increase household wealth: "On average, employee-owners making less than $30,000 have 17% greater median household net worth and 22% higher median income from wages than their non-owner peers" (Khan, 2020). Unlike traditional employment models, these benefits extend to entry-level workers in companies governed by employee-owned models where pay is nearly double the minimum wage, with increased long-term earnings for workers when including profit-sharing benefits. Furthermore, the distribution of revenue across membership each year averages $190,890 and $8,000 per worker participating in the worker cooperative model (Palmer, 2019).

While employee share ownership can play an important role in narrowing wealth disparities, workers of color are not yet reaping the same benefits as white workers. For example, a recent study of the dollar value of employee shared ownership revealed that Black workers only hold 61% (i.e. approximately $12,000 in wealth) of the dollar value of white non-Latinx workers. Comparatively, just less than 11% of Latinx workers participate in sharing programs, holding a median wealth level of less than $10,000, and approximately 17% of Black workers participate in sharing programs, holding a median wealth level of less than $7,000. Furthermore, 22.4% of all white adult workers participate in some kind of employee share ownership program nationally, while only 14.3% of Black and 17.3% of Latinx adult workers do.

DOLLAR VALUE OF EMPLOYEE SHARED OWNERSHIP

61%
Black workers hold compared to white non-Latinx workers

PARTICIPATION IN SHARING PROGRAMS

<11%
Latinx workers

17%
Black workers

PARTICIPATION IN SOME KIND OF EMPLOYEE SHARE OWNERSHIP PROGRAM NATIONALLY

22.4%
White adult workers

14.3%
of Black workers

17.3%
of Latinx adult workers

An analysis of the workforce by gender revealed that only 16% of workers participating in any form of employee ownership model are women, of which 10% identify as Black and/or Latinx (Weissbourd, 2021). The low participation of women can be linked to the male-dominated fields, such as real estate and manufacturing, that have overwhelmingly adopted the employee-owned model framework. To ensure that these programs' benefits are broadly shared, state and local policymakers must do more to expand the use of profit-sharing, as well as think through how to target underserved populations of workers that would benefit the most from sharing programs.

Impact of COVID-19 on Employee Ownership

Significant job loss in the small business sector is a foregone conclusion in a recession and global health pandemic. The business, economic, and racial equity cases for an expansion of the employee ownership models are hard to overstate. Local and regional governments have a unique opportunity to double down on their support for small businesses in their adaptation of employee ownership frameworks, significantly reducing the impact of COVID-19 on their communities and shortening the road to recovery.

Employee ownership and broad-based profit-sharing programs can help to ensure that workers are rewarded for the wealth they help create, close racial wealth disparities, and strengthen local economies. While less than half of working Americans benefit from these sorts of sharing plans, state and local policymakers should continue to support their growth—even in uncertain times. For example, when worker cooperatives throughout the U.S. were surveyed about the impact of COVID-19 on their small businesses, the results showed that cooperative businesses were able to retain 68% of their workforce while reducing/furloughing just 29% of their workers (Hamilton, 2020), compared to non-employee owned businesses who laid off 40% of their workforce during the first six months of COVID-19 (BLS, 2020).

Cities across the U.S. are taking note of the positive effects of employee ownership models on local economies. As of 2021, Berkeley, Boston, Miami, Minneapolis, Madison, and Philadelphia have all funded technical assistance related to employee ownership. Los Angeles is partnering with local providers to use workforce development funds for feasibility studies to save jobs via employee ownership business models. Community wealth building groups from Cleveland to Rochester are designing systems-level interventions that include an employee ownership framework (Hoover, 2021).

IMPACT OF COVID-19 ON SMALL BUSINESSES

% OF WORKFORCE LAID OFF

29%
cooperative businesses

40%
non-employee owned businesses

Conclusions

In collaboration with community organizations, local and regional governments can provide simple guidelines and policy changes to help facilitate the adaptation of employee ownership worker models. Access to education, toolkits, and capital can provide low to moderate-income workers of color with a pathway to economic mobility. It can also help cities avoid job loss in hard-hit industries impacted by COVID-19 and beyond without a major overhaul of current local, state, and federal economic development programs. In addition to its broad bi-partisan appeal nationally, these models can be adopted across both urban and rural local economies.

+ Local and regional governments can provide simple guidelines and policy changes to facilitate the adaptation of employee ownership worker models.

+ Access to education, toolkits, and capital can:
• provide a pathway to economic mobility for low to moderate-income workers of color
• help cities avoid job loss in hard-hit industries impacted by COVID-19

+ These models can be adopted across both urban and rural local economies.

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