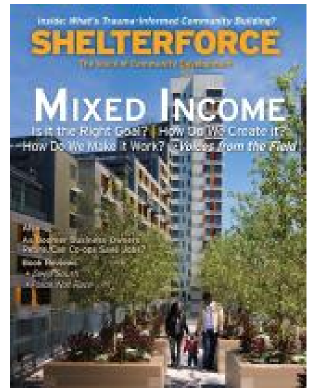

The Next Boom for Worker Co-ops?

Baby boomers are the largest percentage of business owners, and they're headed toward retirement. The worker cooperative movement wants to keep the jobs they've created from disappearing.

By Keli A. Tianga Posted on May 3, 2016

Worker-owners and employees of A Yard and a Half landscaping company. (Courtesy of A Yard and a Half)

Susanne Ward and her husband, Patrick Reilley, moved from California to Maine in 1992 with plans of starting their own business. They decided on a used bookstore and coffee house, as they felt both good coffee and good books were in short supply in their new neighborhood.

Located in the city of Rockland, Rock City (named for the limestone quarries that fueled the city's growth in the 1800s) became a focal point in town for the artistic crowd, but Ward and Reilley struggled to find quality coffee that was reasonably priced. Within three years, they'd moved into a bigger space that could house the bookstore, café, and a space to roast their own coffee blend, which they began wholesaling. In 1999, they opened a roastery a few blocks south of the café outside of Rockland's historic district, producing and selling their blend, which also supplied Rock City.

For Ward, Rock City's employees were family, and even though some kind of employee ownership plan had been in the back of her mind as a "nebulous thing," she recalls, it never seemed like the right time. "As my husband would say, 'We have to operate in the black.'"

In 2010, in the midst of the Great Recession, Patrick passed away. The printed book market was also shrinking, rapidly. "I knew that by myself I couldn't handle it all," recounts Ward. She sold the bookstore portion of the business to one of her employees, and continued to run the roastery and café, both of which exceed full-time operations, with the café's kitchen and bakery serving breakfast and lunch, and hosting live music on weekends.

Five years later, things are better for Rock City, though certainly not perfect. And at age 64, Ward is ready to retire. With help from Rob Brown of the

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Cooperative Development Institute (CDI) in Maine, she is now working on the details of transiting Rock City to worker ownership.

“I had three goals I wanted to achieve, and I think a co-op can do those,” she says. “Obviously, my own financial security has to be the No. 1 priority. Then survival of the business, as it’s a really important part of our small town. And to keep it in the hands of the people who’ve made it a success.” Ward says the majority of her 23 employees have worked with her for at least 5 years, some close to 20, and for the most part, they are people who wouldn’t be able to own their own business without this opportunity. “I have no children. They’re my family,” she says.

In part due to her personal and economic setbacks, Ward’s transitioning of Rock City to a worker co-op is now a game of catch up. “If my business had been profitable, I would have done something immediately,” she says, “but I had to wait until we got ourselves back on our feet, and myself back on my feet.”

Ward says she will be an employee-owner for at least two years after Rock City’s conversion—likely general manager—as her employees are at the beginning of the curve of learning and understanding the business. “They don’t know what it’s really like to run a small business on the coast of Maine, in a business that’s largely seasonal,” she says.

Rock City had a general meeting at which Brown made a presentation. The employees were excited, and have since chosen to form committees to get more involved in the process. Ward says she has also been putting into action some things she believes will help ensure the survival of the business, including a crowdfunding campaign to replace their roaster with an earth-friendly one.

Ward’s advice to retiring business owners is, “Don’t wait. … Start five years before you want to retire, then you have time for shepherding your employee-owners without being so anxious to leave. Not that I don’t love my business—I’m just tired!” she laughs.

Getting Retirees on Board

Advocates of worker cooperatives are hoping the advice of people like Ward will resonate with more and more boomer business owners.

Defined as businesses that are owned and operated by—and for—their workers, worker cooperatives are different from other business entities in that the worker-owners control the business and are its primary beneficiaries.

For people working on behalf of those who have largely been left out of the nation’s economic recovery, the cooperative model presents one solution to the challenge of creating and retaining low- to mid-skill jobs with good pay, benefits, and security. For workers, co-ops provide “outsource-proof” employment, because a successfully run business, owned and run by residents of a community, generates a cycle that creates and encourages growth that workers want to continue. In times of profit, employees may choose to distribute it among themselves, or invest it back into the business. In turn, when business is slow, cooperatives often will vote to accept short-term pay cuts across the board rather than permanent layoffs. According to the Sustainable Economies Law Center, cooperatives also promote employee health and happiness because worker-owners’ business decisions are more likely to prioritize safe business practices, fair wages, and other employee-focused benefits over profit.

Numbering 70 million strong, baby boomers (the name given to the post-war group of Americans born between 1946 and 1964) privately own more than two-thirds of all businesses with employees. This adds up to a potential loss of millions of jobs over the next 20 years as boomers transition into retirement. For many, the notion of passing the family business down to the next generation can't be counted on. A global study co-authored by Campden Research and Prince and Associates found that only 15 percent of family businesses passed through to the second generation, and even fewer to the third.

Of the majority of owners who will not be passing the family business on to a relative, many are interested in finding another way to ensure that their employees' jobs aren't lost because of their retirement. These are the owners that co-op advocates are trying to reach.

Brown, program director at the CDI in Maine, says that Ward's situation is not unlike many other business owners in the state. "Maine has the highest concentration of small businesses in the country. There are roughly 32,000 with employees—80 percent of them have fewer than 100 employees, 50 percent of these have fewer than twenty employees." Maine has the oldest workforce in the country, and because the businesses also tend to be undercapitalized, Brown says most business owners aren't even thinking about succession planning, as they don't have much more than the value of their business.

Even with such strong headwinds, Brown believes his state, and the country, have the potential to capitalize on the demographic age shift, with help from political advocacy and the education of business owners and workers.

"We know that the average age of a business owner is older than the average age of a worker," he says. "And nationally, the largest single source of avoidable job loss is from business closings due to owner retirement."

These realities are behind a push by groups like CDI and others to use a combination of advocacy, issue education, and technical assistance to disseminate information about worker co-op conversions for businesses with retiring owners.

One of the largest such conversions to date is the Island Employee Cooperative, (IEC) also in Maine. The grocery, hardware, and pharmacy stores—owned for decades by Vern and Sandra Seile on Deer Isle, a small town of approximately 2,400 people—were the largest employers on the island. The Seiles announced their retirement in 2013, but reassured employees that they wouldn't sell to a corporate buyer, which they believed would result in large job losses. They wanted to leave a legacy. A friend of Vern Seile's, the executive director of the Independent Retailers Shared Services Cooperative, a purchasing cooperative of independent grocers in New England, had recently gone through a conversion process and explained the tax benefits to him. They enlisted the help of Brown at CDI, who met with a small number of key employees and presented them with information about a possible conversion. The group thought a worker co-op was a good idea and brought it up at a staff meeting. At that meeting, about 80 percent of staff said they were on board, and their journey began.

CDI worked on the financing, including assessment of the value of the businesses, collateral to be held, and the issue of seller financing. Three lenders, including Coastal Enterprises Inc., a CDFI specializing in rural business development and financing, and the Cooperative Fund of New England, were brought in to finance the loan deal, which totaled $5 million.

The National Cooperative Bank came in at the end of the process and took over part of the sellers' loan.

At the time of the conversion all employees were presented the option of purchasing a share of the business for $5,000, made more accessible through payroll deduction, a common process for worker-owned co-ops. "These are very much working-class people," says Gloria LaBrecque, CFNE's outreach officer for Northeast New England. "They couldn't just drop down $5,000. For many, to have a shot at owning would not be possible if not for this payment option."

"Some [employees] held out to see how it would go—but they continue to grow," says LaBreque. "The worker-owner base has remained stable, and they do anticipate growth." Ultimately, 62 jobs were saved with IEC's conversion, and Vern Seile, who now spends most of his time in Florida, is on the company's advisory council to provide help if needed.

IEC's conversion process took about a year. "In the summer of 2013, [Vern Seile] announced his retirement, things kicked into high gear in the fall, and the actual closing and transfer of ownership was done by June 2014," LaBrecque said. The busy summer season for this island-based business precluded employee training in cooperative management and governance until the start of 2015, but that training is underway and ongoing.

It's "going to take about five years for them to really immerse themselves in being a co-op, understand how that works, and the rocky road of self-governing and managing," says LaBrecque. The lending bodies also require that the co-op have technical assistance in place for the next several years.

At a meeting this past September, LaBrecque says a worker-owner of IEC came up to her with words of thanks. "She said, 'My husband and I see this is as the future for our children. Neither of us graduated high school, and now this is our life, we have a bright future.'

"This woman ran for the IEC board and got a seat. She would have never dreamed of being a business owner, no less on the board of directors of a company," says LaBrecque.

For Brown, Island's conversion process was a learning experience for CDI, and it helped the organization understand what is required for a smoother conversion process. Many of IEC's employees had worked for the owner for decades as cashiers and stock clerks, which was beneficial in terms of their loyalty and historical knowledge of the business, but not beneficial in terms of practical business operation—most of the business's 60 employees had no higher than a high school diploma—or knowledge of how a good business operates. Brown helped IEC get a workforce development grant to work with a local community college to get business training. A professor spent two weeks at the stores conducting full-time training and education on management, finances, leadership development, and customer service.

Brown asserts that more workforce training programs like this can be brought to bear if tweaked to fit the worker co-op model, "helping low-skilled workers gain skills for jobs that already exist." He wants to develop a "workers to owners toolkit" in collaboration with adult education associations that can be offered to anyone who wants to know about the steps to worker ownership.

The 1980s saw a push at the state and federal levels to increase awareness of and provide tax incentives for businesses wanting to convert to worker cooperatives. "Believe it or not, Ronald Reagan was a champion of worker cooperatives," says Brown. But the issue of capital has always loomed large, as many banks perceive greater risks in financing worker cooperatives.

Camille Kerr of the Democracy at Work Institute, the only national organization focused on worker cooperative development, says that institutions with a mission or history of co-op lending, like CFNE, tend to provide the initial capital, but many conversions also have an element of seller financing, with the business owner giving a loan to employees.

Future owners can also chip in directly by purchasing shares in the company in order to become members. The price of a share can vary, as it doesn't represent the value of the company so much as "skin in the game," according to Brown. "It should be a stretch, but shouldn't price anyone out. You want all the employees to share in ownership." A general rule of thumb is usually the cost of a good used car.

All of these forms of capital are what is referred to as "first-loss" money, and if sufficient, can encourage traditional banks to come to the table, says Kerr.

But even with capital in place, it is still sometimes a stretch to get banks on board because of their lack of familiarity with the cooperative ownership structure, says Margaret Lund, a consultant specializing in shared ownership strategy. "Conventional banks are used to individual or 'mom and pop' types of owners as opposed to a group—they want to know, who is *truly* responsible?"

It is a question that representatives of community development financial institutions are familiar with answering, as funding of start-up worker cooperatives (also called "type I") have traditionally fallen squarely within their missions. There is a lot more interest in what CDFIs can do to support co-op conversions (or "type II co-ops"), but not much action yet. Lund says that though she personally knows of about a dozen CDFI-financed conversions, they would be ideal to fill the role of an outside partner to help shepherd the process along. She believes the scenario that's "healthiest is to have a traditional lender and hopefully, a community-oriented one."

Changing the Culture

Today, advocacy groups are stressing the imperative for more states to make employee ownership more enticing in an effort to stem the looming job losses as baby boomers shutter their businesses. A bipartisan effort in Iowa recently approved a package bill of incentives, including a 50 percent deduction from state income taxes for the net gain from the sale of stock to an employee-ownership model. Late in 2015, the City of New York voted to invest $1.2 million in worker cooperative development, believed to be the largest amount ever invested by a city government.

Kerr says that while worker cooperatives are not new in the United States, what is new is the strategy of the Democracy at Work Initiative and others to get business owners who are thinking about succession to consider co-op conversion. For retiring baby boomers considering this move, Kerr says the majority want to exit on a relatively short timeline. And even though the lead-up to a conversion can take several years of research and contemplation, the transaction itself usually takes only nine months to a year. The real work, as owners and employees attest, comes in the years after. "The shift from a culture of hierarchy to one of co-owners can take years, depending on where [the] culture started," she says.

"In a traditional company, you have shareholders who choose a board, which oversees management. [They are] often the same several people, they drive everything, and employees are a lot like the machines—you spend money to have them produce. [Co-ops] have workers, who because they contribute to the success of the company, have a role in decision-making and an economic benefit from the profit that they help generate. The shift is fundamental."

For Kerr, it is clear that the reward outweighs the risk. The likelihood of success is no greater—but also no worse—for a business owner selling to their employees or to an outside entity. "What are the options?" she asks. "Sell to another company whose culture might not match yours? Sell to private equity, where quite often the managing firm will try to extract wealth and shell the rest? If you want to maintain your jobs, I see this as a much better option."

Learning to Run a Business

Maintaining jobs and company culture was the goal behind the conversion of A Yard and a Half Landscaping, now a worker-owned landscaping company in Boston.

Its original owner and founder, Eileen Michaels, started her landscaping business in 1988, and ran it until 2012, when she saw retirement on the horizon. She had been looking at the worker co-op model as part of her succession planning, and proposed it to her employees. "There was some trepidation," says Carolyn Edsell-Vetter, a 12-year employee of A Yard and a Half Landscaping and now a co-owner of the company. "In principal, people thought it was a good idea, but in terms of how it would play out, there are obvious risks . . . but it was clear that it was better than selling the business. Everybody had faith that we could be our own bosses better than an unconcerned outsider."

Many of the company's employees were recent immigrants who had few financial resources and little knowledge of formal business structures, so the hurdles on their journey to worker ownership were greater than average. Edsell-Vetter said their list of needed resources started at a very basic level.

"Unless you have an owner willing to pay, you have a really under-resourced group of folks [needing] fairly expensive help. [For] the accountant, the lawyer, we [employees] had to come up with the money," says Edsell-Vetter.

During the process, Edsell-Vetter says she had two full-time jobs: her days were spent as an employee of A Yard and a Half, and her evenings in the role of bootstrapping business co-owner for the company—completing paperwork, making financial projections, and writing a business plan, rules of participatory ownership, and bylaws. She credits the Cooperative Fund of New England for supporting the company with referrals to the professional services they required, and the supportive group of worker-owned co-ops in the Boston area for serving as a great information resource. "One of the principles is, 'co-op among co-ops,'" she says.

A Yard and a Half's conversion process began in 2012 and was complete by 2014. Because of the competitive, high-pressure business that the company is in, Edsell-Vetter says the owners decided to keep their existing management structure, and adapted a matrix from Namaste Solar, a worker co-op formed in 2011, for operating procedures. Edsell-Vetter says self-governance is daily work, but having the procedures to refer back to is helpful.

"When you have one owner, it's kind of the 'Wild West.' They [an owner] can be arbitrary with their decisions. Now, we have to look at precedent, and it's been interesting to change mindsets to say, 'We have to have some standard operating procedures.'"

Today, A Yard and a Half is growing, with 28 employees, 10 of whom are owners. The company just hired four new employees, who will begin a three-year candidacy period to see if they are interested in joining the cooperative. "It takes that long to decide if someone has what it takes to be a co-owner," says Edsell-Vetter. Some original employees who'd had hesitations before are now interested in co-ownership, and the company is in the middle of planning its first membership drive.

An Alternative to Co-ops

Owners who are researching succession planning undoubtedly come across the ESOP, or Employee Stock Ownership Plan, as another alternative. According to The National Center for Employee Ownership, there were more than 7,000 ESOPs covering over 13 million employees in the United States in 2015. In comparison, there are over 300 worker-owned cooperatives that employ approximately 7,000 people and generate over $400 million in annual revenue, according to research cited by the Democracy at Work Institute.

In an ESOP, a retiring business owner sells to a trust, which holds stock on behalf of the employees rather than offering them direct ownership. When an employee leaves or retires, their shares are sold and they receive the proceeds. For employees, ESOPs are more akin to a retirement plan than a participatory ownership model because in most instances, the company structure remains the same, with professionally credentialed individuals in higher-level positions and non-employees on the board of directors. With ESOPs, workers generally do not make operational or investment decisions, and as such, they may be a better option for businesses whose employees tend to be less committed to long-term employment.

For retiring owners, ESOPs have significant upfront costs as well as ongoing maintenance costs, but those costs tend to be less expensive than the legal, accounting, and broker fees involved in an outright sale, according to consulting firm ESOP Partners. Most attractive are the tax-deferral benefits, both for selling owners and retiring employees.

The Vermont Employee Ownership Center is one of only a few nonprofit resource organizations that work with both co-ops and ESOPs, as each operates in fairly separate worlds regarding scale, complexity, and investment required. "There's more education that has to happen with a co-op, but with an ESOP, [there is] a lot more money involved," says Don Jamison, executive director and co-founder of the VEOC.

Jamison says retiring owner interest in worker co-ops is bound to increase simply because there aren't enough buyers to keep up with the number of businesses that will go up for sale. VEOC and groups like it are demonstrating that beyond the altruistic case that can be made, worker co-ops can be successful and profitable. Their statewide Ownership Succession Seminar Series has gained popularity and provides real-life examples from individuals who have gone through various forms of ownership succession.

The numbers show that ESOPs have been a more popular choice than worker co-op conversion, and that is quite possibly because in many cases, the idea of employees becoming owners may be too big of a mental and emotional leap for retiring owners, and sometimes employees, to make. But with each documented success, the option is becoming a more realistic one for business owners.

Cooperatives can even be a next step after ESOPs. According to Jamison, businesses that become ESOPs tend to already be good places to work, and once established, incorporate an even greater level of inclusiveness, as employees begin to think more about how the business is run. With time, the idea of participatory employee ownership often comes up.

"You find that once an ESOP [has] been there awhile, it's often the next generation of managers who say, 'We could make something of this. Let's start thinking about employee ownership.'"

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COMMENTS

Dick Peterson
6 Jul 16, 11:39 pm

Great article.