LEADERSHIP / RETIREMENT

Why an Increasing Number of Retiring Entrepreneurs Are Selling the Business to Their Employees

The most rewarding exit of all is getting the cash out you've earned while taking care of the people you grew the business with.

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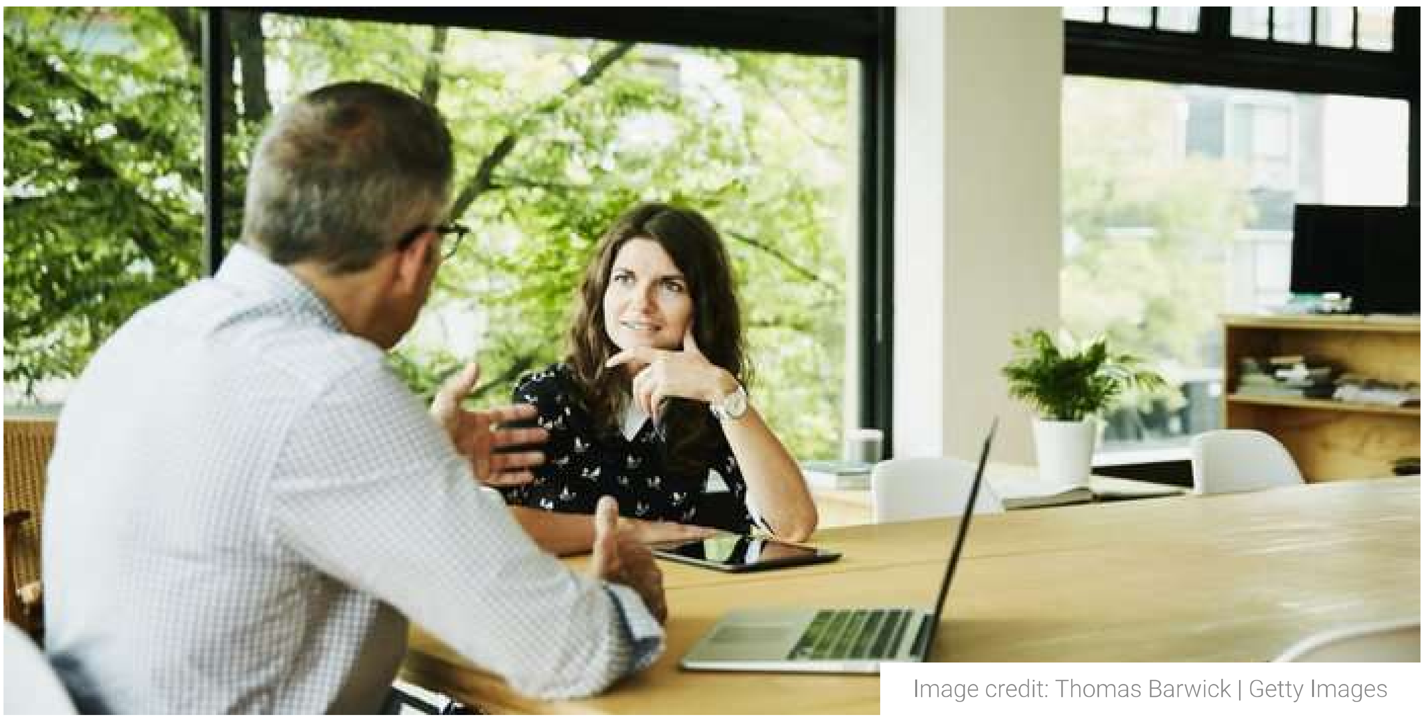

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February 21 7 min read

A Note From The Editor

Baby boomers own about half of all privately-held companies with employees in the United States. The 2.4 million business owners who belong to this aging demographic (one-third of whom have already passed 65) will need to develop sound and sensible exit strategies.

As they look to the future, there is an elegant solution that all retiring business owners should consider: employee ownership. In a crowded marketplace, transferring full ownership to the workers may represent their best chance to sell their businesses at fair market value, to familiar buyers with strong motivation to keep the firm thriving.

Related: Selling Your Business to Your Employees

Make no mistake: employee ownership is not some pie-in-the-sky, utopian scheme with no grounding in real-world economics. It is a reliable and time-tested model that is generating jobs and reinvigorating communities across the globe.

If you’re a boomer business owner planning for succession, you can’t afford to overlook the employee ownership option.

The Silver Tsunami and what it means to you.

Roughly 10,000 baby boomers turn 65 every day, dramatically impacting the course of our economy. Market analysts refer to this cascade as the Silver Tsunami, and as boomer-generation proprietors retire, a torrent of businesses are going up for sale.

Ideally, Gen Xers and millennials would be lining up to purchase these companie, or legions of sons, daughters, nieces or nephews should standing by, ready to take over and keep the family tradition going. But that isn’t the reality, and for you as a boomer business owner, the scarcity of potential replacements is a big problem. It’s also a problem for American communities, which depend on their small business owners to provide jobs and create locally-rooted wealth.

Even if you’re willing to consider out-of-town or corporate buyers, the odds aren’t in your favor. Only 20 percent of businesses listed for sale ever sell, and that percentage is likely to decline in coming years as boomer-owned enterprises flood the market at a record pace. Additionally, only about 15 percent of privately-held companies are passed on to a second generation.

If you don’t already have a solid succession plan in place and intend to put your business on the market and hope for the best, you’re setting yourself up for disappointment. Employee ownership could offer you an escape route from this predicament. Selling to your employees really has no downside. You’ll be tapping into a pool of ready-made buyers that were right under your nose all along.

But will your employees go for it?

Convincing your employees of the idea should be relatively easy once they know all the facts. And those facts should give you some peace of mind as well, knowing that not only will they keep their jobs, but now, as owners, they will continue to grow the business you all have spent so many years building -- while also earning some equity. Additionally, your customers will continue to be served, as well as your community.

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Common myths about employee ownership transitions.

Myth 1: My employees can't run my company.

You're probably right, and nobody would expect them to. That's the job of the general manager. Management will essentially stay the same as it is now. The primary difference is that there will now be a board of directors, which employee-owners elect, and a more participatory culture. Identifying the next CEO, whether internal or external, needs to be part of the plan.

Myth 2: My employees don't want to buy my company.

Asking your employees if they want to buy the business is different from asking if they want to become one of many employee-owners. Describing what shared ownership looks like and answering their questions about this ownership model is key to helping them decide.

Myth 3: My employees don't have enough money to buy my company.

There's no expectation that the employees bring the total amount of cash to the table to buy the business. Instead, depending on the form of employee ownership, they may bring an equity "buy in" whose combined value is typically between 1-10 percent of the total purchase price.

Myth 4: It sounds hard.

Truth be told, any business succession option takes effort. But you can get help, which makes it easier. Employee ownership isn't a speculative venture, but a democratically-oriented approach to business management with a proven track record of superior performance.

How it works.

Broad-based employee ownership plans preserve existing management structures while transferring oversight responsibilities to an elected board of directors. Worker representatives will have the chance to participate in governance and bring in outside board members to round out internal skill sets.

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The two most familiar options for employee ownership are the worker-owned cooperative and the Employee Stock Ownership Plan (ESOP), both of which already exist in abundance in the United States, Europe and Latin America. At present, about 30-40 percent of U.S. ESOP companies are 100 percent owned by the workers.

Multiple studies have been carried out measuring the viability of employee ownership, and the results have surprised even the most enthusiastic boosters of the concept. For example, a Leeds (UK) University Business School study analyzed two decades of data on worker-owned co-ops collected from across the world. In comparison to traditionally-owned private businesses, they found that enterprises organized under the employee ownership model were more profitable, productive, stable and efficient. They offered smaller gaps in pay between executive and non-executive employees and were less likely to lay off workers in times of trouble.

Other data has confirmed that worker-owned businesses in general have better survival rates than their competitors. A 2005 study that looked specifically at 100 percent employee-owned ESOP companies in the United States found they were only one-third as likely to fail as traditionally structured, publicly-traded companies. Meanwhile, three post-2000 studies in Canada revealed five- and ten-year survival rates for employee-owned enterprises, nearly double those of conventional businesses.

Significantly, a 2013 study by CECOP-CICOPA Europe, an organization that represents 50,000 worker-owned companies on the European continent, revealed that French businesses converted from traditional to worker-owned structures had much higher survival rates than all other enterprises (up to 60 percent higher before the change).

When you approach your workers with this data, they should be suitably impressed. Project Equity, a national organization based in the San Francisco Bay Area specializes in supporting businesses with employee-ownership transitions, and also has partners in different regions around the country that serve to both advocate for employee ownership and provide hands on consulting to businesses that want to explore or pursue a transition. The Industrial Commons in North Carolina, Nexus Community Partners in the Twin Cities, Center for Community-Based Enterprise in Detroit, ASSETS in Lancaster, Pa., and Project Equity in the Bay Area are available to help you carry out a feasibility study. Should you decide to move forward they can support you and your employees every step of the way. They offer technical advice and guidance that will help make the transition to the new ownership structure as smooth and seamless as possible, while supporting your exit timeline and succession.

If you choose the employee ownership option, you'll be taking part in a groundbreaking movement, which can help reinvigorate local economies while opening new avenues for exiting business owners looking to expand their retirement funds and preserve their legacies.

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OrangeUmbrella

This is a useful piece, but misleading about how ESOPs work. Employees do not buy stock in an ESOP at any level. ESOPs are funded by pre-tax contributions to a trust that buys and holds the shares. Normally, such redemptions are not pre-tax. Owners can defer capital gains on the sale proceeds. ESOPs do not requre emploees to be involved in governance in any way. For profitable companies of 20 or so more employees, they are a very ax-effective way to sell your ownership, and the ESOP can buy any percentage. The nonprofit National Center for Employee Onwership provides detials on how this works.

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