

RETAINING RURAL BUSINESS THROUGH EMPLOYEE OWNERSHIP

THE RURAL SUCCESSION CRISIS

A generation of business owners are retiring and many lack a succession plan. According to the U.S. Census Bureau, in 2016 there were over 110,000 Minnesota and Wisconsin businesses with employees that are owned by people 55 years or older. **Lack of succession planning by these business owners will lead to the loss or relocation of thousands of jobs and instability in local economies across the Upper Midwest.** This trend is particularly problematic in rural communities where the ability to retain and expand existing businesses is often the best strategy for economic development.

A possible solution to this dilemma can be found in employee ownership, particularly in the form of worker cooperatives. Becoming employee-owned can keep businesses' doors open, save jobs, and anchor benefit in a community. It is a triple-win solution for the owner, the employees, and the community.

EMPLOYEE OWNERSHIP: A BUSINESS SUCCESSION SOLUTION

WHAT IS EMPLOYEE OWNERSHIP?

Businesses with fewer than 100 employees that are employee-owned are typically organized as worker cooperatives. A worker cooperative is owned and controlled by its employees. It is a value-driven business that puts worker and community benefit at the core of its purpose. The two central characteristics of worker cooperatives are:

- Workers own the business and participate in its financial success on the basis of their labor.
- Workers vote for their representation on the board of directors, with the principle of one worker, one vote.

In addition to their economic and governance participation, worker-owners engage in day-to-day operations through participatory management structures.

There are 465+ worker cooperatives in the United States, employing around 6,400 people and generating over \$505 million in annual revenue. The number of worker cooperatives has grown steadily over the past ten years and increasingly includes longstanding businesses that have been sold to their employees by their owners. Any business can be a worker-owned and -controlled business.

BENEFITS OF EMPLOYEE OWNERSHIP

Below is a list of some of the benefits that employee ownership can generate for selling owners, employees, and local communities.

- Financially rewarding exit path with potential tax savings for the selling owner(s)
- Lasting legacy for the selling owner(s)
- Reward for employees who helped build the business
- Potential to improve business performance and increase employee engagement, productivity, and retention
- Retention of services, jobs, wealth, and tax base in the local community



EXAMPLES OF EMPLOYEE-OWNED BUSINESSES

A library of stories about employee owned businesses can be found at:
<http://becomingemployeeowned.org/stories>

NORTHWIND SOLAR

WISCONSIN

Northwind Solar is a solar power system design and installation company organized in 2007 in Stevens Point, WI. In 2016, the company began the process of transitioning to a worker-owned cooperative. The owners saw employee ownership as an opportunity to solicit long-term commitment from key employees and build wealth on their behalf. They also hoped becoming a worker cooperative would improve the company's governance, management, and decision-making. The co-op has grown its revenue and membership since completing the transition in April of 2017.

HAPPY EARTH CLEANING CO-OP

MINNESOTA

Happy Earth was founded in 2010 by Marion and Jesse Dunbar. In 2018, the Dunbars decided they were ready to move on from the business but they wanted to protect their employees and the company culture they had built. Together with a small group of employees, they completed a course on launching a cooperative offered by Cooperative Development Services through the City of Minneapolis. On January 1, 2020, five employees purchased the business, making it the first employee owned cleaning cooperative in Minnesota. The cooperative has 20 employees. All employees are eligible to join after six months of working at the company.

ISLAND EMPLOYEE COOPERATIVE

MAINE

The Island Employee Cooperative is made up of three stores: Burnt Cove Market, The Galley, and V&S Variety and Pharmacy. With approximately 60 employees, the business is the largest worker cooperative in Maine and the second largest in New England. The three stores were opened by Vern and Sandra Seile, who sold the businesses to their employees in 2014.

They had built up the businesses over 43 years and were concerned that an outside buyer might consolidate jobs and operations. In addition to securing their legacy in the community, the Seiles were able to take advantage of the 1042 rollover, which gives a tax benefit to business owners who sell to their employees.

SELECT MACHINE

OHIO

Founded in 1994 by Doug Beavers and Bill Sagaser, Select Machine manufactures, sells, and distributes machined products and equipment for installation on construction and demolition equipment. When the founders started looking to sell the business, several interested potential buyers surfaced, but all of them wanted to buy the business for its customer list and equipment and consolidate production into underutilized facilities elsewhere. Shutting the plant and leaving their employees out of work was not an acceptable outcome for the founders, who then started exploring alternatives to a traditional sale. Their research led them to the conclusion that a worker cooperative was the best option for their company, so they transitioned the business to the cooperative structure in 2010.





POTENTIAL TAX BENEFIT OF SELLING TO EMPLOYEES: THE 1042 ROLLOVER

Section 1042 of the IRS Code allows a business owner to defer the tax on the capital gain of the sale of their business if they sell at least 30 percent of the business to an Employee Stock Ownership Plan (ESOP) or a worker cooperative. In order to qualify, the seller must reinvest the proceeds from the sale into “qualified replacement properties” within 12 months of the sale. The 1042 rollover has not been used widely by worker cooperatives, however thousands of ESOPs have made use of the 1042 rollover since it became available in 1984.

STAGES OF THE TRANSITION

Converting a small business to employee ownership takes an investment of resources and professional assistance to ensure success and long-term benefits. While the process is unique for each business, it generally has five stages. Below is an outline of the stages, with approximate durations and costs, though these vary widely depending on the complexity of the business and the readiness of employees to become owners.

EXPLORE Time varies \$0

- What:** Key stakeholders study the idea and decide if it is worth pursuing. Selling owner clarifies their desires, concerns, and realities related to selling the business
- Who:** The selling owner; a local advisor who can offer confidential guidance; sometimes key employees

ASSESS 3 - 6 months \$5K

- What:** A business valuation is completed and experienced professionals affirm that a financial, legal, and organizational transition is feasible.
- Who:** The selling owner; trusted professional advisors; sometimes key employees

STRUCTURE 6 - 12 months \$10K

- What:** The sale terms and any organizational or leadership changes are established; legal documents are drafted for the transaction and new entity; financing is secured
- Who:** The selling owner; a representative team of the employees; professional advisors

COMPLETE 3 - 6 months \$10K

- What:** Loans are drawn; the company legally changes hands; bylaws are formally adopted; a founding board is elected
- Who:** The selling owner; the employees; professional advisors; lenders

SUPPORT Time & cost vary

- What:** Ongoing training addresses leadership and operational gaps, and orients management to new roles
- Who:** The employee-owners; professional advisors



RESOURCES

Regional

Cooperative Development Services

Created to ensure that cooperatives have access to sound business development guidance, CDS provides a wide range of services including business planning, governance support, and referrals to other appropriate professionals. . They work primarily in MN, WI, and IA.

Nexus Community Partners

Building community wealth in the Twin Cities and supporting strong, equitable, and just communities, Nexus provides a range of professional services through their Worker Ownership Initiative and other cooperative programs.

University of Wisconsin Center for Cooperatives

With national expertise and a focus on serving Wisconsin, UWCC services include transition planning and timeline development, management and governance succession planning, and referrals to appropriate legal, accounting, and other professional services.

National

Democracy at Work Institute

As a think-and-do-tank, DAWI gathers models and best practices, coordinates existing resources, and advocates for worker cooperatives as a community economic development strategy.

Project Equity

Focused on conversions, Project Equity provides a range of in-depth services. Services include financial feasibility assessments, employee engagement support, deal structuring, and trainings on ownership culture.

The ICA Group

The ICA Group supports business owners with a suite of tools designed for understanding employee ownership including governance structures, operations, succession planning, and expansion.

Co-op Friendly Lenders

Shared Capital Cooperative

Owned and governed by its national membership and based in the Twin Cities, this national loan fund provides financing to cooperative businesses, with a focus on those in low-income and economically disadvantaged communities.

Local Enterprise Assistance Fund

A national lender, LEAF lends to cooperatively-owned businesses and social enterprises that help create living wage jobs for low income individuals and communities.

The Working World

Focusing on worker cooperatives in low-income communities globally, The Working World provides non-extractive financing with tailored business support services.



The partners in this education and research project are the University of Minnesota Extension, University of Wisconsin Center for Cooperatives and Cooperative Development Services. Grant funding is provided by the North Central Regional Center for Rural Development at Michigan State University.

