

# SUCCESSION PLANNING FOR PURCHASING COOPS AND THEIR MEMBERS

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project  
**{EQUITY}**



## SUCCESSION PLANNING FOR PURCHASING COOPS AND THEIR MEMBERS

Employee ownership as a strategy for keeping businesses independent when family succession is not an option



### About Project Equity

Our mission is to foster economic resiliency in low-income communities by demonstrating and replicating strategies that increase worker ownership. We envision a future where communities (re)gain economic self determination and today's working poor have good jobs that keep them out of poverty and enhance their lives. We see cooperatives and employee ownership as key elements of this future. For more information please visit [project-equity.org](http://project-equity.org).

**“We envision a future where communities (re)gain economic self-determination and today’s working poor have good jobs that keep them out of poverty and enhance their lives.”** – Project Equity

### Author

Alison Lingane, Co-founder

### Acknowledgements

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Thank you to the many purchasing cooperative executives and other individuals who shared their time and expertise through interviews and conversations. Thank you also to the National Cooperative Business Association for brokering introductions, and for hosting the annual Purchasing Cooperative Conference.

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# Foreword



Lance Rantala, CEO, Blue Hawk

As CEO of BLUE HAWK, a purchasing cooperative that is the largest buying entity in our space (HVACR - heating, ventilation, air conditioning and refrigeration), I serve our 230 wholesaler members with over 1,420 locations across 49 states. At BLUE HAWK, we believe that independent business owners have an important place in America and need to be preserved and protected. By helping companies compete with the national players, our purchasing cooperative helps companies stay independently owned.

One of our challenges is that the majority of the owners of our member businesses are approaching retirement age. These are people who have spent their lives building their businesses, and have most of their assets in their companies.

A major issue is that most of our members nearing retirement age do not have family members ready to take the reins. In the absence of family succession, we encourage our member companies to look within the purchasing co-op for other member buyers, and I maintain confidential 'buy' and 'sell' lists of our member companies. Truthfully, today, my 'sell' list is outpacing my 'buy' list.

That's where employee ownership comes in. If retiring business owners had a clear roadmap for and resources to help them understand employee ownership succession, it would fill a needed gap and help retiring owners find a good exit, while simultaneously maintaining independent business ownership.

As a purchasing cooperative ourselves, we know that wherever coops are, they help the local community—employing local people, using local suppliers and reinvesting time and money back into their communities. Cooperatives are better because their business model creates greater economic, social and environmental sustainability by putting people at the heart of the economic decision-making. Worker-owned cooperatives are a form of cooperative in which the workers are the members, and it's a form of employee ownership that embodies the same cooperative principles under which BLUE HAWK operates.

The need for focused succession planning among purchasing co-op member companies is clear. And at BLUE HAWK, we are excited for worker cooperatives and employee ownership succession to be 'on the menu,' especially for those businesses that don't have family ready to take over.

In appreciation,

A handwritten signature in black ink, appearing to read 'L. Rantala', written in a cursive style.

# Introduction

When the National Cooperative Bank was asked to support this important work by Project Equity, we knew the timing was right.

There are too many family-owned and independent businesses that are in need of succession planning. With our years of experience, we've seen the influence purchasing coops have and believe their support in transitioning businesses to employee ownership could be a valuable option for business owners.

In Cooperation,

Charles E. Snyder  
President & CEO  
National Cooperative Bank

Independently owned and operated businesses are the lifeblood of local economies. With baby boomers nearing retirement, a significant portion of privately owned businesses will be changing hands. Depending on the geography, estimates range from fifty percent to two-thirds of privately held businesses with employees that are owned by baby boomers.<sup>1</sup> Transitions to employee ownership can keep these businesses independent for the long term, and are a great option when family ownership succession is not a possibility.

Purchasing cooperatives play an important role in supporting independent business ownership. As with other highly engaged small business networks, they can also play an important role in helping business owners learn about and consider employee ownership succession.

This paper is the result of research carried out in 2016 by Project Equity—a national nonprofit focused on supporting businesses to transition to broad-based employee ownership, and is written for purchasing cooperative CEOs and executive leadership, as well as for a broader audience interested in employee ownership as a strategy for keeping local businesses rooted in their communities. Its goals are to share research about business succession challenges among purchasing coop members, and to help purchasing coop executives better understand how they can proactively utilize employee ownership succession as a strategy to keep their member businesses locally-owned over the long term.

Project Equity partnered with National Cooperative Bank (NCB) and the National Cooperative Business Association (NCBA-CLUSA) in this research, which was supported financially in part by NCB.

## Our Study Includes

- Employee ownership solutions for succession
- Industry fit
- Steps for transitioning to employee ownership
- How purchasing coops can help with succession planning

## A Note From the Author

We hope the information and accompanying recommendations can be helpful not only to purchasing cooperatives but also to other networks dedicated to independent businesses. We look forward to feedback that can help strengthen these recommendations.

Best regards,



Alison Lingane  
Project Equity Co-founder

## Examples of purchasing cooperatives

### BUSINESS TO CONSUMER

#### **Amicus Solar Cooperative**

Amicus is a purchasing cooperative with 41 member businesses, whose member owners are regional solar PV installation and development companies.

#### **Carpet One Floor & Home**

Carpet One is a purchasing cooperative of 1,000 retail stores worldwide, whose members are independent, family businesses, selling floor coverings of all types.

#### **True Value Hardware**

True Value is a purchasing cooperative made up of about 4,500 independently operated hardware stores worldwide.

### BUSINESS TO BUSINESS

#### **Blue Hawk**

Blue Hawk is a purchasing cooperative of HVACR distributors (heating, ventilation, air conditioning and refrigeration), with 230 members representing more than 1,420 locations nationwide.

#### **Independent Distributors Cooperative (IDC-USA)**

IDC-USA is a purchasing cooperative owned by 77 local independent industrial bearing and power transmission distributors with over 200 locations nationwide.

#### **Independent Welding Distributors Cooperative (IDWC)**

IDWC is a purchasing cooperative made up of 140 independent welding and gas distributors with over 600 locations nationwide.

## PART 1: A PROBLEM AND AN OPPORTUNITY FOR SUCCESSION OF PURCHASING COOP MEMBERS

### What are purchasing cooperatives?

A purchasing cooperative is a business owned by similar independent businesses that come together to aggregate their demand for goods and services to procure lower prices from selected suppliers.<sup>2,3,4</sup> Participant businesses—or more accurately, shareholder members—of purchasing coops typically also gain access to best practices, improved insurance or financing, or even shared services like IT, marketing, transportation, rebate management, payroll and other business activities. As important, purchasing coops provide a forum for sharing expertise among business peers through the member network. According to the University of Wisconsin’s Research on the Economic Impact of Cooperatives, there are over 700 purchasing cooperatives in the U.S., representing over 6,000 member businesses.<sup>5</sup>

Most purchasing coop members are independently owned, and many are family businesses. Notable purchasing coops in the retail space include ACE Hardware, True Value and Carpet One, and there are many business-to-business purchasing coops that are less well known providing vital services to local businesses around the United States.

### The problem: Succession issues among purchasing coop members

Depending on the geography and industry, baby boomers own between half and two-thirds of privately held companies with employees. Many purchasing coops find that their membership mirrors this, with a significant portion—or even a majority—of member businesses owned by baby boomers.

The problem is that, increasingly, the children of baby boomers do not want to take over these businesses. In the early 1980s, it was estimated that about 30% of family businesses were passed to the 2nd generation. By 2004, that number was down to 15%.<sup>6</sup> Add to that the increasing acquisition pressure—especially in some industries—from ‘big box’ companies buying up market share, and the need for focused effort to keep local businesses independently owned quickly becomes apparent.

**“Most of us in the purchasing coop world exist to help independent or family-owned businesses remain independent.”**

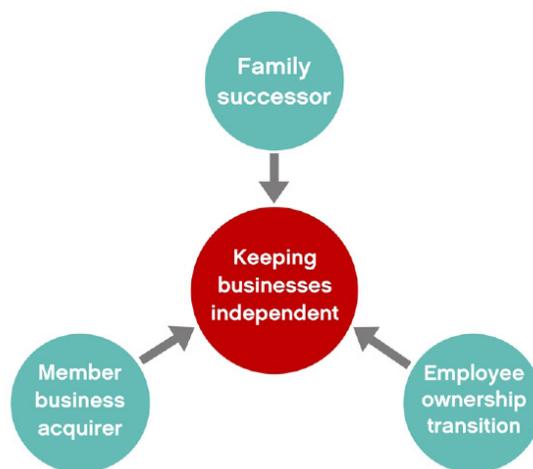
– Jack Bailey, long time CEO of IDC-USA

How can a local business stay independently owned when the next generation doesn’t want to take it over? Selling to employees is a powerful strategy to keep businesses rooted in local communities for the long-term.

## Who do purchasing coop member companies sell to when their owners retire?

As few as one-half of purchasing coop member businesses are on a path to staying independently owned. How many of these could be kept independent through broad-based employee ownership transitions?

Castle Wealth Advisors' Gary Pittsford, who has decades of experience supporting businesses with ownership transitions, estimates that as few as one-half of businesses in purchasing coops are on a path to staying independently owned.<sup>7</sup> Those that do stay independent either sell to family (Pittsford estimates that purchasing coop members sell to family slightly more than the national average, or about 25-30% of the time), sell to a peer within the purchasing coop, for example, an ACE Hardware store selling to another ACE store owner (20-30%), or sell to one or two key employees (15-20%).



The rest either close down or sell to a corporate buyer. How many of these could be kept independent for the long-term through broad-based employee ownership transitions?

### → First step

Assess the financial feasibility, look at leadership transition options and gauge employee interest.

## The opportunity: Worker cooperative transitions

A transition to a worker-owned cooperative is similar to a management buy-out, but instead of just a few key managers purchasing the business, most or all employees are offered an equal ownership stake. The transition has three basic components:

- **Entity set up:** the creation of a business entity that is a worker-owned cooperative. Depending on the situation, this can be accomplished by converting the existing business entity, or forming a new cooperative entity.
- **Sales transaction:** a sales transaction executed between the current owner(s) and the new worker cooperative to sell the existing business (or its shares or assets) to the worker coop and execute a Purchase & Sale Agreement. Each employee 'buys in' to the coop and receives a single voting equity share and becomes a 'worker-owner.' The sales transaction is typically financed by loans to the business (or less commonly by selling non-voting equity shares).
- **Roles and culture transition:** Ensuring smooth transitions including the leadership transition of the CEO / GM role, a transition to an ownership culture among the employees, and a transition to democratic employee governance. We recommend enlisting support from an organization or consultant specializing in this work.

# Part 2

The first step is to assess the feasibility, including financial feasibility, looking at leadership transition options and gauging employee interest. Business owners can expect to receive market value for their company when they sell to their employees, and may be able to tap significant tax advantages.

There are organizations that support businesses through each of these steps, and that can also connect to lenders with experience in these types of transactions. For more about worker coop transitions, including financing the sale of a business to its employees, visit [project-equity.org/businesses](http://project-equity.org/businesses).



## → Industry fit

Project Equity has identified factors that could make a given industry a stronger or weaker fit for employee ownership transitions.

## PART 2: WHAT ROLE CAN PURCHASING COOPS PLAY?

Purchasing cooperatives—or any other network of independently owned businesses—can play an important role in helping their member businesses stay independent by engaging them around succession through worker coop / employee ownership transitions. First, purchasing coop executives can understand what it means to be a good ‘fit’ for employee ownership, including industry trends and business size. Then, they can encourage thoughtful, proactive succession planning, especially among those members whose owners are nearing retirement age.

### Determine Industry Fit

Based on conversations with purchasing coop executives across a wide range of industries, we have identified factors that could make a given industry a stronger or weaker fit for worker coop conversions.



## → Growing industry

It is important for any business that plans to sell to its employees to have strong future financial prospects.

### **Stronger fit**

#### **Succession pain**

First, there has to be a ‘pain point’ around succession. If all member businesses have owners who are young, or have owners with family lined up to take over the business, there’s not a succession challenge.

#### **Familiarity with employee ownership**

Second, it can be helpful to have some familiarity with employee ownership or worker cooperatives. One example of a purchasing coop that has made an explicit effort to educate its member businesses about worker cooperatives is Amicus Solar Cooperative. Amicus has the benefit of already having three established worker coops among its membership to serve as live examples. Purchasing coops that don’t have employee-owned members can identify and share examples from their industry or related industries. It can also be useful to highlight the similarities between the purchasing coop structure—and the benefits of membership—and the worker coop structure as a way to increase comfort with the less familiar worker cooperative form. Finally, sharing stories about other forms of broad-based employee ownership, such as majority-owned ESOPs (Employee Stock Ownership Plans) can help increase familiarity with employee ownership.

#### **Growing industry**

Next, being in an industry with positive future growth outlook is an important indicator of industry fit, because it is important for any business that plans to sell to its employees to have strong future financial prospects.

#### **Fragmented industry**

Fragmented industries are those in which no major players influence the industry’s direction<sup>8</sup>, and it typically means there is low outside acquisition pressures and low or no competition from ‘big box’ competitors. Businesses in fragmented industries can be good candidates for worker ownership for the same reason that businesses in these industries often come together in purchasing cooperatives to help them stay competitive as independents.

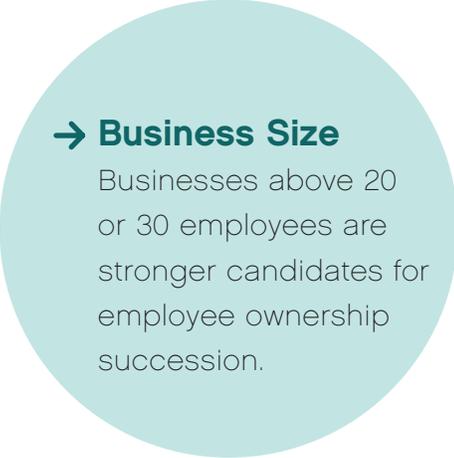
#### **Member engagement with purchasing coop**

It is also helpful to have an engaged membership within the purchasing coop so that the business owners will thoughtfully consider recommendations from the purchasing coop. That’s no different whether the recommendations from the purchasing coop address the importance of thoughtful succession planning or any other key strategic topic.

### **Weaker fit**

#### **Intense margin pressures**

Businesses in industries with low margins and intense competitive pressures can find it challenging to complete a successful ownership transition of any type. In these businesses, efforts that take focus away from the day-to-day can whittle away what little margin there is. For example, grocery has ever-increasing margin pressure, requiring stores to be nimble, creative, and able to adjust to a fast-changing marketplace. An employee ownership transition involves effort from the owners and from the employees to plan and execute, and to invest in developing an ownership culture. This time and focus is more difficult to carve out in industries with intense margin pressures.



## → Business Size

Businesses above 20 or 30 employees are stronger candidates for employee ownership succession.

### Strong outside acquisition pressures

Industries with strong outside acquisition pressures can make it hard for other succession options—including employee ownership—to compete with aggressive, cash rich buyers. In some industry sectors, there are publicly traded companies that need to show quarter over quarter growth and are also flush with cash. When these publicly traded companies can't show enough revenue growth in existing locations, they demonstrate growth through acquisition of new locations. We include some recommendations below for purchasing cooperatives in these types of industries.

### Member business size

Businesses above a very small size are stronger candidates for transitions to worker ownership. Though worker coop conversions can be successful with very small companies, they can be more effective with businesses above 20-30 employees. In very small businesses, the role of the General Manager (owner-operator) is outsized—relatively more important to the business than a GM in a larger company—and s/he typically wears many hats. It is also less common to have a strong management team, or even seasoned second-level managers, which makes leadership transitions more challenging. Finally, there are usually fewer processes and systems in place to support the operational transition of the outgoing GM.

### Individual licensing required

One final factor to consider is when licensing requirements sit with a single individual, who is typically the business owner. Pharmacies are one example of this (often the owner is the only pharmacist), as are construction companies (when the owner is the sole licensed contractor). Industries with this type of licensing can be trickier for worker coop conversions because the pool of GM or CEO replacement candidates is limited to those who hold the requisite license, and can exclude bringing up leadership from within. Larger companies may have multiple license holders, but smaller companies tend to have only one.

# Recommendations

## Be proactive about succession planning

Succession planning rarely feels urgent, until it suddenly becomes so, either because a business has been approached by a potential buyer and become an acquisition target, or because the owner wakes up one day and decides it's time (now!) to retire.

Most of the purchasing coops interviewed for this research had at some point held succession planning sessions at annual member meetings. And many of the purchasing coop CEOs shared a sense of frustration in their attempts to engage their members around this topic. Here are some recommendations for purchasing coop executives to consider:

### 1) Make succession planning (including the possibility of selling to employees) a regular drumbeat across all communication channels.

First, map out all of the channels you use to communicate with your member companies, for example:

- Member newsletter
- Message from the CEO
- Annual business meeting
- In house technical training
- Member surveys

Then work to weave in succession planning messages that include both stories and information to appeal to different personalities. And be sure to include clear calls to action. For example, ask members to read something and respond by filling out a two-question survey, watching a video, attending a session, or taking a call.

### 2) Share stories from owners who have sold.

Stories stick in our brain in a way that nagging reminders just don't. Include the feel good, positive motivation stories (like successful employee ownership transitions), alongside the stories with less positive outcomes (like the owner who waited too long to plan for succession).

Include the facts about impact on employees of different sale options, as business owners do care a lot about their employees. As one purchasing coop CEO shared, "Make it clear that big box acquirers or private equity consolidators say they will take care of employees, but instead most typically decimate the business."

### 3) Remember that you don't have to do it all yourself.

Engage experts who understand employee ownership succession—including worker cooperative conversions—or who can pull in individuals who do. Take advantage of organizations that can provide content for newsletters and other member communications, and people who can do the legwork of designing

## → Communication

Share stories about what happens to employees when selling to a big box acquirer.

sessions at meetings, and of scheduling, setting up and sending reminders for 1:1 consultations.

Worker cooperatives are a much less familiar form of employee ownership than ESOPs, so few succession planners have familiarity with worker coop transitions. Experienced service providers can provide a clear path and roadmap for businesses wanting to pursue this succession option. You don't have to do it all yourself!

## Opt Out Works

- Make it simple.
- It's required
- It's part of the schedule.

## The Power of Opt Out

“Once upon a time, workers had to fill out a form (opt-in) to enroll in an employers' retirement savings program; now, it's common for the workers to be automatically enrolled and given the opportunity to opt-out. The result: More workers taking advantage of employers' retirement savings plans.”

Brookings Institution  
The power of the nudge: Policy lessons from behavioral economics

### 4) Keep confidential 'buy' and 'sell' lists.

Many of the purchasing coop CEOs interviewed shared that they maintained two member lists, one in their left, and the other in their right jacket pockets: of businesses interested in selling, and of businesses looking to acquire additional locations. And that increasingly, their sell list is outpacing their buy list, given the demographics of their member business owners. For those companies on the sell list, if there's not a family member wanting to take the business over, try to match up the company up with another purchasing coop member that is looking to expand. And if that match isn't there, encourage the business to explore employee ownership.

### 5) Personally tap specific members and set up 'opt out' 1:1s for them with succession planning experts.

Set up appointments for members that are wanting to sell and don't have succession plans, or members who may be approaching a time when they're ready to sell, but haven't voiced their plans yet. For members on a confidential 'sell' list, this is especially important. Worker cooperative experts can help de-bunk some of the myths of this form of employee ownership that can be barriers to considering this as an option (see below for more on this).

At member meetings, bring in succession planning and employee ownership experts. Build 1:1 consultation times into the schedule, and set up appointments for some of your target members. Make participation opt out. Sometimes a little extra nudge and special attention beyond just suggesting that members 'attend the session' can get people to engage. Make it simple for them to engage, and harder to not engage: it's required, it's set up, it's part of the schedule. We know from research that opt out works to change people's behavior (see call out box). For an issue as important as succession planning, purchasing coops can do their members a service by making it easy for them to have these important conversations.

### 6) Integrate member retention into purchasing coop executive compensation / bonus plans.

If member retention is an issue that is affected by succession planning, aligning the purchasing coop executive team's incentive structures can influence behavior and encourage the use of succession planning through employee ownership to keep members of the purchasing cooperative independently owned.

## For industries with strong outside acquisition pressure

Some purchasing coops find themselves experiencing strong outside acquisition pressures because cash rich public companies have gone on buying sprees, or for other reasons. These purchasing coops may find that their members are being aggressively approached, and that their member companies quietly sell without any opportunity to think through the full range of options.

Purchasing coops in this situation can educate their members about what to do if they are approached by an outside acquirer, so that they can take the time to make an informed decision. Often these aggressive acquirers tell business owners that they have to sign a non-disclosure agreement (an NDA) and leave them with the impression that this means they can't talk to anybody about anything. As a result, the business owner doesn't talk to anyone about their selling option, and quickly the business gets sold to the aggressive acquirer. Business owners should seek legal counsel to understand the limits that an NDA puts on them, but typically these types of NDAs just restrict them from talking about the specifics of the potential acquirer and acquisition details and do not restrict the business owner from becoming informed about other options.

As part of a succession planning education program, purchasing cooperatives may want to include content about what to do if approached by an acquirer, educating about what to look for in an NDA (and to seek legal counsel), encouraging members to contact the purchasing coop for advice and support, and stressing the range of succession options (and the pros / cons of each) that they can consider.

# Conclusion

Ownership succession among small businesses is—and will increasingly be—a critical issue, especially for advocates of locally owned independent businesses. Worker cooperative transitions can be a powerful tool to help independently owned businesses stay independently owned and operated for the long term.

Purchasing cooperatives and other highly engaged small business networks can play an important role in raising awareness of this option among member businesses. Purchasing coops can take advantage of nonprofits and other experts in worker ownership to engage them in incorporating content and programming on this topic in member communications and meetings. This can enable the purchasing coops to focus their efforts on identifying and interacting 1:1 with member businesses whose succession planning may be the most time sensitive.

Since succession planning never feels urgent ... until it does ... purchasing cooperatives can help members engage in thoughtful succession planning so that they are ready when the time comes.

## Endnotes

<sup>1</sup> US Census, 2012 Survey of Small Business Owners

<sup>2</sup> <http://www.ncba.coop/intro-purchasing>

<sup>3</sup> <http://www.co-oplaw.org/co-op-basics/types/purchasing-cooperatives/>

<sup>4</sup> <http://www.project-equity.org/webinar-succession-planning-for-purchasing-coops/>

<sup>5</sup> Deller, Steven et al., University of Wisconsin Center for Cooperatives. Research on the Economic Impact of Cooperatives, pp 11. 2009. [http://reic.uwcc.wisc.edu/sites/all/REIC\\_FINAL.pdf](http://reic.uwcc.wisc.edu/sites/all/REIC_FINAL.pdf)

<sup>6</sup> <http://www.oeockent.org/exit-planning/>

<sup>7</sup> Project Equity phone interview with Gary Pittsford, CEO and founder of [Castle Wealth Advisors](#), 3/28/16

<sup>8</sup> <https://www.reference.com/business-finance/fragmented-industry-b117f0ba11bd2acd>

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