

Roy Messing  
MBA, CEPA  
Program Coordinator  
Ohio Employee Ownership Center  
Kent State University

# Transitioning Private Business to an Employee/Worker -owned Co-op A Community Development Tool

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# Program Overview

- Current Business Status & Outlook
- Owner's Exit Options
- Benefits of Employee Ownership
- Helpful Tools
- Resources

# Some Statistics...

**4.6 million**

**family-owned/closely-held  
businesses**

# Some Statistics...

Employ

76%

of U.S. workforce

# Some Statistics...

Small and medium-sized  
businesses create

**65%**

of net jobs in U.S.

# Some Statistics - (the wave)

- ⦿ During the next 20 years close to 80 million baby boomers will be retiring.
- ⦿ More than 70 percent of privately owned businesses will be changing hands within the next two decades.

# Some Statistics –(the wave)

- The largest intergenerational transfer of wealth in history ... a staggering \$10 trillion

A "business transfer tsunami"

# Some Statistics...

Today

15%

of small businesses make it to  
2nd generation



# Some Statistics...

5%

make it to the 3rd

# Some Statistics...

COSE study found that about

**80%**

Do **NOT** have a succession plan

COSE = Council for Smaller Enterprises in Cleveland, Ohio

# Recipe for Disaster.....

- Fewer companies transitioning to “next” generation
- Aging Ownership Population
- Few Owners have plans in place
- Where does the business go from here?

# Worst Case

Family loses business investment

Business Shuts

Employees Lose Jobs

Communities Lose Tax Base

Quality of Life and Services Suffer

Domino Effect

# Owner's Options

Do Nothing

Sale or Transfer to Outsiders

Sale or Transfer to Insiders

# Do Nothing Transfer

- Only two things are certain in life

Death & Taxes

# If the Owner does nothing

- ⦿ The Courts decide,
- ⦿ Uncle Sam gets his share, and
- ⦿ All others left to pick up the pieces

# Potential Outside Buyers

- ① Strategic Buyer Within Industry
- ② Strategic Buyer in Aligned Industry
- ③ Financial Buyer



# Outside Sale Result

- ① Strategic buyers tend to close local businesses and consolidate operations
- ① Financial buyers tend to have limited industry experience and a limited “investment horizon”

# Potential Inside Buyers

- ① Family Members
- ① Partners
- ① Management
- ① Employees
- ① Combination of the Above

# So Why Employee/Worker-Owned Cooperatives?

Limited Family Transitions

Partners close in age

Limited Management Experience

Scope in size/scale of business

“Non-Sexy” Industry

# Why Employee Ownership?

- Retiring owner → Succession planning
- Flexibility for owner
  - Sell all or part
  - Retire or remain active
  - Ready market for selling a company that otherwise may not have one
- Generate cash for owner
- Create equity
- Avoid shutdown
- Prospect of improved corporate performance
- Take advantage of tax incentives

# Ohio Employee Ownership Center

- Center located at KSU, Founded in 1987
- 91 companies to become employee owned
- Saved or created 15,000 jobs in Ohio
- Anchored \$344 Million of personal wealth

# Cost per job saved/retained - Effective Economic Development

- OEEOC from 1987 – 2010

\$719

- Ohio Tax Credit Plan, Dec. 2010

\$3,666

- Ohio Jeep Plant, 2000

\$65,000

# ESOP vs. Co-op

## Employee Stock Ownership Plans (ESOPs)

- ESOPs are qualified employee retirement trust plans that invests primarily or exclusively in the securities of the employing company and which can borrow money
- Thus ownership is indirect
- The ESOP borrows money from the bank to buy stock from selling owner. The company repays loan with pretax income
- ESOPs in sub-chapter S corporations are tax free
- Because ESOPs are Federally regulated pension trusts, ESOPs are expensive to set up and maintain
- ESOPs aren't cost-effective for ownership succession in businesses with fewer than 20 or 25 employees

# ESOP vs. Co-op

## Employee Co-ops

- Employee co-ops (or worker co-ops) are like other co-ops: they are owned directly by employee members who pay a membership fee and who receive patronage allocations
- Patronage dividends are allocated on the basis of their labor input into the co-op
- Patronage dividends are taxable to the members, not to the co-op
- The co-op can borrow money from the bank to buy stock from selling owner
- Because employee co-ops are inexpensive to set up and maintain, they are highly cost-effective in ownership succession in small businesses



# Why Co-ops Now?

- Bulk of OEEOC work with ESOPs
- Private Business conversion to Employee Ownership takes time
- ESOPs were not an economic fit for smaller companies
- Co-ops had legal limitations

# 1998 & 2005 Changes in Ohio Cooperative Law

- Expanded focus beyond agriculture
- Allowed labor to be a contributed source
- Provisions allowed for balancing of interests
- Retained Patronage as Sweat Equity, not treated as debt
- Allowed for transition of private business to employee/worker-owned cooperative

# Why Select Machine Transitioned to an Employee/Worker-owned Co-op

- No other logical successors within the business
- Employees were part of “the family”
- Outside offers would close the facility
- Impact on the community

# Our Resources

- Seminars
- Conferences
- Webinars
- Web Site
- Technical assistance
- Referrals for Service Providers

# Our Resources

- Web Site [www.oeockent.org](http://www.oeockent.org)
- *Owner's Guide to Business Succession Planning*
- *Selling Your Business to Your Employees*
- Video/DVD – *Business Succession Planning*
- Ohio's Employee-Owned Network

# Our Resources

- ⦿ Technical Assistance
  - Basics of business ownership succession planning
  - Selling to your employees to an ESOP or a co-op
- ⦿ TA and training for existing employee owned companies

# Website & Contact Information

[www.ocockent.org](http://www.ocockent.org)

Roy Messing

330.672.0333

[rmessin2@kent.edu](mailto:rmessin2@kent.edu)