Thinking Globally, Acting Locally
Subnational strategies to promote employee ownership
John Logue

What are the prospects for employee ownership in the future? Past articles in our continuing series have looked at Louis Kelso’s economic theories, future U.S. legislative prospects, the Mondragón cooperatives in the Basque country, and a collection of bold new ideas for spreading capital ownership drawn from the Capital Ownership Group (COG), a Ford Foundation online think tank on broadening capital ownership worldwide. Also drawing on the COG discussions, John Logue focuses on what can be done by public and private organizations at the state and local level.

Broadening ownership is a global issue, but there are strong reasons why its implementation requires action at the local or regional level: state and provincial legislative measures can encourage expanded ownership; regional and local programs are efficient providers of technical assistance to those seeking to implement employee ownership; and public and private local action can encourage the creation of collaborative company networks, training cooperatives, and employee-owned suppliers.

COG’s subnational discussion group canvassed existing subnational governmental, non-profit and for-profit initiatives, selected best practices worthy of dissemination, and proposed innovations in order to promote the expansion of employee ownership. This summary looks at what public and private subnational actors can do to promote employee ownership through (1) state legislation, (2) technical assistance, (3) local actions, (4) investment funds, (5) company networks, and (6) using the economic power of employee-owned firms in their communities.

Subnational Public Policy

Subnational political units can encourage employee ownership within their jurisdictions. The United States and Canada have taken the lead in this area. In the United States twenty-eight states have passed some sort of legislation encouraging employee ownership since 1974. Such measures run the gamut from policy declarations to substantial financial commitments. They include tax credits, exemption of Employee Stock Ownership Plans (ESOPs) from state securities regulations, legal recognition of workers’ cooperatives, earmarked loan funds and loan guarantees, interest rate subsidies, funding for or the direct provision of technical assistance, establishing state employee ownership centers, and using employee ownership in privatization of state services.

New initiatives proposed in the COG subnational discussion include:

- States could provide tax credits to companies for setting up more participatory ESOPs with benefits on a sliding scale varying with the percentage employee-owned.
- States can encourage electrical consumer co-ops in electricity deregulation.
- States can enact legislation giving employees the right to purchase facilities being shut by companies abandoning that line of business, or, more aggressively, giving employees right of first refusal on plants being put up for sale.
- States can enact preferential bidding for government contracts for employee-owned firms, as is done for cooperatives in France and Italy.
- A preference for employees in privatization can be provided as Virginia, North Carolina, Russia and some Eastern European countries have done with varying degrees of success.
- Partial employee ownership can be created within some most public enterprises by simply paying employees a small capital wage in stock and underpinning ownership with dividends when the enterprise is profitable.
- States can require that citizens have partial ownership rights when companies exploit publicly owned natural resources. For example, the Alaska Permanent Fund distributes oil royalties to citizens. Why not do the same for other profitable public services—publicly owned utilities, parking garages, etc.—at the state or local levels when those streams of income are sufficient to be divided?

Technical Assistance and Support Organizations

Organizations which provide information, technical assistance, and training for employees seeking to purchase companies help broaden and deepen ownership. They can be governmental units, not-for-profit organizations, sectoral organizations, for-profit consulting firms, or national programs implemented locally.

State programs. During the latter part of the 1980s and early 1990s, seven state employee ownership programs (Hawaii, Massachusetts, Michigan, New York, Ohio, Oregon, and Washington) were established. A quasi-state entity—the Steel Valley Authority—provides similar services on a regional basis in Southwest Pennsylvania. These programs focused on outreach and assistance to union locals in plants facing shutdown and to retiring owners who might be interested in selling their companies to their employees. A study of three of these programs—New York, Ohio, and Washington—found them to be quite effective in increasing the rates of ESOP formation in their states.

Reviving state programs which have been defunded and creating new ones is clearly a viable ownership-broadening strategy.

Non-profits. A dozen or so regional not-for-profits promote employee ownership in the United States, Canada, Mexico, and the United Kingdom and a number of local non-profits do the same. In addition, a few general purpose economic development
organizations have developed special employee ownership competence.

Generally speaking, single-purpose employee ownership organizations require a relatively large catchment area; otherwise they have to broaden their scope of activities beyond employee ownership to prosper. In smaller states and localities, it makes sense to train economic development organization personnel in the appropriate uses of employee ownership.

**Sectoral strategies.** An alternative to a geographic focus is a sectoral employee ownership strategy. Several organizations have undertaken to promote employee ownership in the United States within particular economic sectors: daycare, homecare, temporary services, and the steel industry. Other employee ownership sectoral initiatives could be encouraged by trade associations, labor unions, and by the agricultural cooperatives in rural areas.

**Private sector consultants.** Private sector consultants out-number public and non-profit staff specializing in employee ownership in the United States by perhaps 50:1, and are largely responsible for the rapid growth of the ESOP sector. Can their efforts be channeled toward broader and more democratic employee ownership?

For example, the growing evidence that participatory employee-owned firms outperform non-participatory employee-owned companies could encourage lenders to urge participation to improve debt service coverage and trustees to insist on employee participation to maximize value for ESOP participants.

**An employee ownership extension service.** One of the most successful American innovations in economic development is the Agricultural Extension Service. For decades it has been transferring research results, knowledge and technology from the lab to the family farm. The Department of Agriculture's rural development specialists already have the mandate to support cooperative development—including worker cooperatives—in rural areas. Creating an extension service for employee ownership, to supply technical and organizational development assistance to smaller firms, could be tested and developed at the state level; and then spread by Federal matching funds.

**Maximizing leverage.** State and regional employee ownership assistance efforts could be multiplied for a tiny fraction of the cost of Federal tax expenditures for ESOPs (more than $3 billion annually in the 1990s). Only $5 million annually in Federal matching funds—less than 2/10s of 1% of the tax expenditure for ESOPs—would probably lead to the establishment of 20 to 30 state, regional, and sectoral employee ownership programs that would effectively cover the country.

**Action at the Local Level**

Why should we limit ourselves to actions by state, provincial, or regional governmental entities? Much can be done to encourage broader employee ownership by municipalities, unions, and charitable and religious organizations. Among the proposals made during the COG process:

- Municipal or local economic development authorities can establish industrial parks for employee-owned companies and for other high performance companies with joint training facilities, cooperative day-care and food service.
- Municipal governments can give preference in purchasing to employee-owned firms as is the case in Northern Italy, aiding the growth of production cooperatives there.
- The Catholic hospital system can use its institutional strength to replicate New York’s Cooperative Home Care Associates, creating better jobs and ownership for home health care aides and improving care for the homebound.
- Local churches can encourage employee ownership through their purchasing and through social justice work within their congregations.
- Sale of religious or public hospitals to for-profit chains could be made contingent on their contracting home health care, janitorial services, and other services to employee-owned firms.
- Community foundations, educational institutions and churches can receive stock from local companies (charitable contribution at stepped up basis for donor) and create a market by selling to employees.
- Unions can negotiate contract language that gives their members the right to buy facilities put up for sale or right of first refusal at the time of such a sale.
- European and American universities concerned with the use of sweatshop labor in garments carrying their logos could require their production in worker-owned businesses, a positive screen more easily enforced than the current negative screens.
- A coalition at the provincial level between traditional cooperatives (agricultural, rural electric, mutual insurance companies, credit unions, consumer co-ops, etc.) and the employee-owned sector has dramatically increased the rate of cooperative formation in Quebec. (See Luc Labelle, “Development of Cooperatives and Employee Ownership, Quebec Style,’’ *Owners at Work*, Winter 2000/2001, pp. 1, 17.)

**Employee Ownership Financing**

Should there be special financing institutions for employee ownership? Opinion is divided. Some feel that it is salutary for employee-owned firms to utilize market financing sources: commercial banks, asset-based lenders, venture capital funds, and the bond market. Others argue for a separate financing stream for the employee-owned sector. Over the years, a variety of...
public and private financing mechanisms for the employee-owned sector have been launched with mixed success.

**State loans and loan guarantees.** In the U.S., thirteen states have established loan funds, loan guarantees or interest rate subsidies specifically for ESOPs or explicitly authorized the use of state loan programs for ESOP companies. The effectiveness of such programs has varied. Earmarked employee ownership lending funds have generally been rolled into other economic development loan funds because these small pots of money were either underutilized or overdrawn. On the other hand, both below market interest rates and public sector lenders’ willingness to subordinate their loans to commercial lenders seems to have played a significant role in supporting employee purchases of troubled and/or divested plants and firms. Loan guarantees—which are very cheap for the public sector—seem to have been underutilized.

**A national bank with a preference for employee ownership with regional intermediaries.** Since the New Deal, the agricultural cooperative sector has been underpinned by specialized Federal lending institutions. So has home ownership. The National Cooperative Bank, established during the Carter administration as a specialty lender for housing, consumer, and worker cooperatives, has begun to support regional cooperative lending funds, like the Northcountry Cooperative Development Fund. They serve as regional intermediaries for the NCB, working with local borrowers who are too small to be serviced efficiently from Washington.

**Special purpose local or regional loan funds for employee ownership.** The Caja Laboral Popular, a financial institution which is part of the foundation for the Mondragón cooperatives in the Basque region of Spain, is a consumer cooperative—a credit union—with a special mandate for investing in worker cooperatives. With assets in excess of $7 billion, it has become one of Spain’s biggest financial institutions.

The Caja Laboral provided the financing to grow the Mondragón cooperative complex from a handful of co-ops in 1959 to its current size of about 25,000 employees in the industrial sector with sales of more than $3 billion and 26,000 employees in the retail sector with sales of more than $4 billion in 1999. Credit unions and mutual insurance companies could be encouraged to play the same role elsewhere as the Caja Laboral does in the Mondragón region.

**Private sector venture capital funds.** Several national venture capital funds have been created in the United States with a preference for employee ownership, including Churchill Capital’s Churchill ESOP Capital Partners, Keilen and Company’s KPS Special Situations Fund, and American Capital Strategies. All together, they have raised about $1 billion from conventional venture capital sources. Each has, however, found itself doing more non-ESOP transactions than employee ownership deals.

Judging from their experience, the employee ownership market is not big or lucrative enough to be a niche for venture funds specializing purely in employee ownership.

On the other hand, every venture capitalist wants to exit. Employee ownership venture funds may create more owners at the time they sell their equity than in the initial transaction. One promising idea is to encourage conventional venture capital funds to consider employee ownership as an exit strategy. This idea would appear to be potentially viable in all countries with significant venture capital markets. The real question is how to educate venture capitalists about this possibility.

One obvious possibility is to offer a small tax break.

**Regional labor-sponsored venture capital funds.** The Canadians have developed a very different means of raising venture capital. Pioneered by the Quebec Federation of Labor in the early 1980s, Canadian labor-sponsored investment funds use provincial and Federal tax credits to entice employees to place some of their retirement savings in venture funds which anchor capital locally. Rates of return are comparable to the historical average for the market, rather than the 35-40% rates of return sought by Wall Street venture funds. Quebec’s Solidarity Fund has grown into the largest single source of venture capital in Canada, and there are labor-sponsored investment funds in six of Canada’s ten provinces.

Manitoba’s Crocus Fund has added a preference for employee ownership to its investment criteria. Crocus is a friendly investor with the employees, partnering with employee owners in purchasing or growing employee-owned businesses, and Crocus’s preferred exit strategy is to sell its equity stake to the employees.

This model could easily be replicated outside Canada, and several organizations are already seeking to do that. They include Framtid i Norr, a fund being established by the trade unions in the north of Sweden, and the Industrial Heartland Investment Fund in the US. Both are designed as vehicles for union pension fund investments and for other institutional investors, rather than for individual pension investments, as in the Canadian model.

**An ESOP partnership fund?** Existing employee-owned
companies could set up their own equity fund to invest in partnership with employees in existing and new employee-owned enterprises. This employee-owned company investment pool could also become a financial institution for employee-owned firms more generally, including securitizing the debt of ESOP companies to lower interest costs and extend terms.

Building Company Networks

Existing employee-owned firms tend to be islands unto themselves. One positive step is to associate them as archipelagoes, and to build linkages between them that would strengthen them individually and as a group. Three different models from three countries provide evidence that such linkages are productive.

The Mondragón Co-operative Corporation in the Basque region of Spain is perhaps the most outstanding company network in any Western economy. This network of firms owned by their employees now comprises one of the largest industrial groups in Spain with more than $3 billion in sales; it is among Spain’s top ten exporters, selling 47% of its production outside Spain in 1999. The Mondragón cooperatives’ retail group does an additional $4 billion in sales; it ranks number three in the Spanish retail sector. All in all, the Mondragón cooperative network constitutes the seventh largest closely held business in Spain and employs more than 53,000.

The average size of a Mondragón co-op is quite small—most are less than 500 employees—but the network of more than 110 firms provides large scale economies for the small enterprises, including a common financing source (the Caja Laboral Popular), joint research and development services, a broad range of joint health and social services, a strategic management group that can support managers in existing enterprises that are under strain, and both technical training for employees and a university-accredited management training program.

Manitoba’s Crocus Fund has established its own network to improve the performance of the enterprises it invests in. To achieve this end, the Crocus Fund has embarked upon an ambitious program of using networking to do three things. First, it has a CEO “club” with regular meetings where CEOs of Crocus investee companies share their experience. Second, it provides business training for employees. Third, it has developed, with the University of Manitoba, a management training program for investee companies that trains managers in high performance workplace practices.

Ohio’s Employee-Owned Network is a dues-paying association of about sixty companies staffed by the Ohio Employee Ownership Center to provide joint training services. It provides 20 to 24 days of courses to more than 500 employee owners annually. About half the programs are designed for shopfloor employees. Other courses are designed for supervisory employees, those who administer ESOP plans, and managers. One result is that participating companies learn best practices from each other and benchmark themselves against each other. (“Company Networks Improve Performance,” Owners at Work, Winter 2000/2001)

A recent study found that Ohio Network member companies systematically outperform other Ohio employee-owned companies which did not take part in networking activities.

The Employee-Owned Firm in the Community

Individual employee-owned companies can do a great deal to broaden ownership in their communities.

- Employee-owned companies can use their economic clout to broaden ownership locally. They can choose to buy from neighboring employee-owned companies and they can choose to support the development of additional employee-owned suppliers. And they can buy local firms and convert them to employee ownership, through direct ownership or creating a holding company.
- Well established employee-owned companies with ample management resources can undertake to manage an incubator for new employee-owned firms. Such firms could provide accounting, purchasing, and management support for recently established employee-owned firms. As these firms became better established, direct support would shift to mentoring.
- Many existing employee-owned companies work with local schools to provide coop jobs, internships, job training, and apprenticeships. Those school-to-work programs can be expanded by including ownership principles, participation, understanding business basics, and other knowledge and skills that create an interest in and basis for broader ownership in the future.
- Existing employee-owned companies can act jointly to create local company networks. These networks can share common facilities, jointly purchase supplies, create employee benefits like health and dental insurance, or provide other joint services to their employees.

Other possible joint steps might include establishing multi-employer ESOP plans for firms which use the hiring hall model for employment, such as construction firms, setting up a marketing label for products of employee-owned companies, and establishing an internet top domain “.esop” for electronic commerce as the co-operatives have done with “.coop.”

Dealing with the widening gap in income and wealth globally clearly requires action at the transnational and national levels. At the same time, we know that most of us live and work in an entirely different world: that of our company, our local community, our church, union local and civic organizations or, occasionally, our state or province. There is an astonishing amount to broaden ownership that can be done by each of us today where we live and work.

Together, the combination of our small steps can yield large scale change.

Summaries of the results of the Capital Ownership Group discussion can be accessed on the COG website (http://cog.kent.edu) or requested in hard copy from the OEOC, 309 Franklin Hall, Kent State University, Kent, OH 44242 or by e-mail from OEOC@kent.edu. OAW