CHALLENGES AND BENEFITS OF EMPLOYEE-OWNED SMALL BUSINESSES

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CHALLENGES AND BENEFITS OF EMPLOYEE-OWNED SMALL BUSINESSES

WEDNESDAY, FEBRUARY 12, 2020

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The committee met, pursuant to call, at 11:30 a.m., in Room 2360, Rayburn House Office Building. Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Finkenauer, Golden, Kim, Davids, Delgado, Craig, Chabot, Balderson, Hern, Hagedorn, Stauber, Burchett, Spano, Joyce, and Bishop.

Chairwoman VELÁZQUEZ. Good morning. The Committee will come to order.

I thank everyone for joining us this morning, and I want to especially thank the witnesses for being with us today.

Our Committee has a longstanding tradition of working in a bipartisan manner on behalf of America's 30 million small businesses. We work together to make the programs at SBA more effective and seek ways to encourage entrepreneurship and job growth on Main Street.

And because small businesses are such an important part of our economy, what we do here impacts the lives of nearly every American.

At a time when income and wealth inequality are at record levels, real wages for middle class workers are nearly stagnant, retirement security is no longer guaranteed, one way to combat these problems is through the employee-owned business model. Employee-owned companies can take on many forms, but the central premise is that interests of the employees and owners are aligned. As a business generates more revenue and profits, a direct connection is drawn between an employees' work and how much he or she is compensated, thereby creating a culture of ownership.

This business model helps workers and communities raise their standard of living and quite literally feel more invested in the success of the enterprise. The best-known kinds of employee ownership are the Employee Stock Ownership Plan, also known as an "ESOP", and cooperatives. There are many benefits to employee ownership that can address some of the economic issues facing workers today. ESOPs report higher wages, better employee benefits, and stronger job security, especially during periods of economic distress.

In addition to better wages and benefits, worker-owned firms are also known for reinvesting more in their local community than conventional businesses, and for democratizing management and decision making. Because the workers themselves make the company's strategic decisions, there is little danger of a worker-cooperative unexpectedly leaving town or being sold to outside investors. This ensures the economic vitality of local communities.

In recent years, the option of converting a business to an employee-owned model has grown in popularity, though there are challenges in financing and completing such a conversion. For example, businesses seeking to transition to an employee-owned model frequently face difficulty in obtaining adequate capital to cover the costs, which are often prohibitive.

That is why last Congress, I led and helped pass the Main Street Employee Ownership Act, which sought to minimize those capital access barriers and encourage more SBA-backed lending to cooperatives and ESOPs. By easing some burdensome guarantee restrictions, it was my hope that we could continue to make the employee-owned model more affordable for local businesses, creating opportunities for more entrepreneurs, while financially empowering employees with a stake in their workplace. The legislation was also intended to help millions of baby boomers who own private businesses and plan to retire create a succession plan that helps them "cash out" while keeping jobs and investment in the local community.

However, we have heard from numerous employee-owned businesses and lenders that accessing the SBA lending programs has been nearly impossible because of current SBA policy. At today's hearing, we will hear about the good work that employee-owned businesses, like the cooperatives who are booming in popularity all over my district in Brooklyn, are doing for their employee-owners and local communities.

We will also explore the negative impact of SBA's failure to follow Congressional intent when implementing the Main Street Employee Ownership Act. We know there are still many challenges ahead as we seek to encourage greater employee ownership of business, challenges that are often unique to either cooperatives or ESOPs.

And as we continue our work here in the Small Business Committee, we need to hear about those challenges, too. So, I look forward to hearing from our distinguished panel of witnesses today about the benefits of employee ownership of business, but also the challenges these unique businesses face in starting up and expanding.

Again, I want to thank the witnesses for being here today, and I now yield to the Ranking Member, Mr. Chabot, for his opening statement.

Mr. CHABOT. Thank you, Madam Chairwoman.

In the lifecycle of a business, many important and crucial decisions are made. Some of these decisions lead to brilliant success; others could mean failure. One of the most significant decisions a business must make is how to structure its organization. From sole proprietorship to C corporations, there are a multitude of options available that could benefit both the company and the company's employees.

Today, we will explore one structure that has assisted thousands of companies all across the country. The employee-ownership model provides employees with an opportunity to own a stake in the company that they work for. One form of employee ownership is the employee stock ownership plan, or ESOP as the Chairwoman mentioned for short. A company that is organized as an ESOP provides its employees with the opportunity to obtain ownership shares through a qualified defined contribution plan. Research shows that ESOPs provide important retirement options for employees seeking to save for their retirement.

This Committee has a long history of examining employee ownership to determine both benefits and also some of the shortfalls. For example, Chairwoman Velázquez authored the Main Street Employee Ownership Act of 2018, which was designed to enhance the ability of the SBA, the Small Business Administration, to work with businesses interested in employee ownership. Ultimately, that legislation was favorably reported out of this Committee and was signed into law as a part of the National Defense Authorization Act for fiscal year 2010.

Today, we add another chapter to this Committee's long history of discussing employee ownership. In particular, I am interested in hearing about what is working and what is not working as businesses move through the employee ownership conversion process. Additionally, I would like to hear about the economic benefits of employee ownership.

My hope is that this hearing will shed more light on this very important business structure.

And I want to thank all the witnesses for being here and participating this morning. I look forward to all your testimonies.

And Madam Chairman, I yield back.

Chairwoman VELÁZQUEZ. Thank you, Mr. Chabot. The gentleman yields back.

And if Committee members have an opening statement, we would ask that they be submitted for the record.

I would like to explain the timing rules. The witness gets 5 minutes to testify and members get 5 minutes for questioning. There is a lighting system to assist you. The green light comes on when you begin, and the yellow light means there is 1 minute remaining. The red light comes on when you are out of time, and we ask that you stay within that timeframe to the best of your ability.

I would now like to introduce our witnesses today.

Our first witness is Mr. Daniel Goldstein. Mr. Goldstein is the CEO and president of Folience, a company that for over 130 years was primarily a family-owned print and broadcast media company. Their ESOP was started in 1986 and became 100 percent ESOP-owned in 2012. Today, 570 employee-owners work in Folience media business, ambulance manufacturer, and high-end horse and livestock trailer manufacturer.

We welcome Mr. Goldstein.

And Ms. Finkenauer, would you like to add anything to my introduction of Mr. Goldstein?

I yield to the congresswoman.

Ms. FINKENAUER. Thank you. Thank you, Madam Chairwoman, and thank you for holding this hearing today. We are so excited to have you all here, and thank you for taking time out of your busy schedules.

Now, we obviously know employee ownership is good for business, it is good for people, and it is good for communities like the one I represent in Northeast Iowa. When employees have a stake in the company, these businesses have deep roots in the area where they are located. These businesses are more likely to stay local and invest in their communities. Employees are literally bought into the business, often increasing overall productivity and success. Employee-owned businesses can also offer strong wages and retirement security to people who work there. I am lucky to have some excellent employee-owned businesses in my own district. VGM Group, a member service organization for post-acute care headquartered in Waterloo was named Iowa's 2019 Best Large Employer by the Des Moines Register. Timberline, an electrical contract manufacturer in Marion, has brought innovation and growth to the area.

Folience, in Cedar Rapids, once a family-owned print and broadcast media company, has become an employee-owned company of 570 workers. Today, I am pleased to introduce my constituent, Daniel Goldstein, president and CEO of Folience, who helped transform the company. Since Daniel joined Folience in 2016, he has helped diversify its revenue base through acquisitions. Today, Folience owns media businesses, an ambulance manufacturer, a high-end horse and livestock trailer manufacturer, and more. Daniel brings 20 years of executive leadership to his current position. He is a passionate advocate for employee ownership, and is on the Board of Governors of the ESOP Association, the Board of Trustees of the Employer Ownership Foundation, and the Board of the Employee Ownership Expansion Network. You are a very busy guy, Daniel, and it means a lot to me that you took all this time to come here to D.C. We look forward to hearing your insights today. Welcome to D.C., and thank you again for your leadership.

With that, Madam Chairwoman, I yield back.

Chairwoman VELÁZQUEZ. The gentlelady yields back.

Our second witness is Mr. R.L. Condra. Mr. Condra is the vice president of Advocacy and Government Programs for the National Cooperative Bank, a national financial institution dedicated to providing banking solutions for co-ops and their members. Mr. Condra also serves on the board for Cooperation Works, a national network of organizations focused on co-op development. Prior to joining the private sector, Mr. Condra served as professional staff on the Senate Committee on Agriculture, Forestry, and Nutrition for Chairwoman Blanche Lincoln.

Welcome, Mr. Condra.

Our third witness is Mr. John Abrams. Mr. Abrams is the founder, president, and CEO of South Mountain Company, a 45-year-old integrated architecture, engineering, building, and renewable energy company committed to triple bottom-line businesses practices. Located on Martha's Vineyard, South Mountain has been a worker cooperative for 32 years, was one of the first beneficial cooperatives in Massachusetts, and is currently in transition to second generation leadership. Mr. Abrams is also the author of the book, Companies We Keep: Employee Ownership and the Business of Community and Place, which was published in 2008.

Welcome, Mr. Abrams.

I would now like to yield to our Ranking Member, Mr. Chabot, to introduce our final witness.

Mr. CHABOT. Thank you, Madam Chair.

Our final witness will be Mark Gillming, who is the senior vice president and secretary of Messer Construction Company, which is headquartered in America's greatest city, Cincinnati, Ohio. Messer has multiple locations around the country, including in several members' districts or close to them on this Committee, Mr. Burchett's in Tennessee, and Mr. Bishop's district in North Carolina. Messer Construction went through an ESOP conversion back in 1990 and is still prospering today. Mr. Gillming is a long-time employee of Messer Construction, having started his career there in 1985, 35 years ago. Coincidentally, the same year that I was first elected to Cincinnati City Council. He currently runs all of Messer Construction's professional development operations and has multiple degrees from the University of Cincinnati, including not one, but two, distinguished alumni awards.

Mr. Gillming, we very much appreciate you being here today and all the other witnesses as well.

I yield back.

Chairwoman VELÁZQUEZ. Thank you very much.

Mr. Goldstein, you are now recognized for 5 minutes.

STATEMENTS OF DANIEL GOLDSTEIN, PRESIDENT AND CEO, FOLIENCE; R.L. CONDRA, VICE PRESIDENT OF ADVOCACY AND GOVERNMENT PROGRAMS, NATIONAL COOPERATIVE BANK; JOHN ABRAMS, CEO AND CO-OWNER, SOUTH MOUNTAIN COMPANY; MARK GILLMING, SENIOR VICE PRESIDENT, MESSER CONSTRUCTION CO.

STATEMENT OF DANIEL GOLDSTEIN

Mr. GOLDSTEIN. Thank you, Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee.

I am Daniel Goldstein, CEO of Folience, a Cedar Rapids-based company in business since 1884, and 100 percent owned by our employees since 2012.

I also represent the ESOP Association, a non-profit whose purpose is to protect and grow employee stock ownership plans, or ESOPs.

6.6 percent of the U.S. workforce has ownership in an ESOP. That is more than 10.6 million employees. ESOP employees outnumber the workforce of the entire U.S. auto industry by more than half a million. We outnumber the combined workforce of the Federal and state government by 3 million.

ESOPs contribute substantially to our economy, and we believe they hold a solution for many of the intractable issues facing our economy.

As you know, one of the biggest challenges ahead is the looming retirement in the next 10 years of baby boomers who own 2.5 million small businesses. Known as the "Silver

Tsunami," it will be the largest transfer of business ownership in the shortest period of time in our Nation's history.

The businesses, and their employees face difficult futures if supportive policies are not adopted. I have seen what can happen if a succession plan is not made and the role employee ownership can play in preventing catastrophe.

Let me tell the story of a typical small town. Sumner, Iowa, population 2,000, has one major private employer. Life Line

Emergency Vehicles designs and builds ambulances that provides 180 good-paying jobs. Ten years ago, the founder passed away leaving control of Life Line to his 69-year-old widow. When I met her, she was 75 and had no heirs prepared to take over the business.

Most in this situation face three choices: sell to private equity, to a competitor, or close and sell off the parts.

Folience gave them another option—sell to their employees through an ESOP. Folience's ESOP purchased Life Line, and those 180 employees became owners of Life Line and every other business in the Folience portfolio.

Despite the many well-known benefits of employee owned businesses—benefits, those seeking to launch ESOPs face multiple, unnecessary obstacles, and I would like to focus on three.

The first is an absence of clear Federal regulatory guidance, particularly on business valuations. Second, a shortage of lending capital for ESOP formation or acquisitions. And, third, education. There is low public and professional awareness about ESOPs.

Today, I ask Congress to task Federal agencies with solutions to all three.

First, I submit that the biggest obstacle to forming and expanding ESOPs is the chilling effect of the U.S. Department of Labor. DOL has perpetuated an absence of formal regulatory guidance, while simultaneously pursuing a litigious approach to oversight. The effect has been a deep chill on the market. Every year, hundreds of business owners attend educational events the ESOP Association hosts to learn about ESOPs. And once exposed to the lack of clear

guidance, many turn away out of fear that some unknowable misstep will invite never-ending DOL scrutiny.

Forty-five years after ESOPs were established with the passage of ERISA, the Department of Labor has yet to finish its rulemaking process. They started. They nearly finished in 1988. But they never issued regulations. But here is the travesty. It is impossible to prove how many American workers have lost the opportunity to become employee-owners as a result of this chilling effect.

The solution can start very simply. Congress should require DOL to define one thing: what constitutes adequate consideration when an ESOP trustees values the price to be paid for a company. This one simple piece of guidance could be a gamechanger for employee ownership.

Second, to start addressing lending shortages, the SBA must streamline lending for the ESOPs, as outlined in the Main Street Employee Ownership Act. Unfortunately, in implementing the legislation, the SBA excluded ESOP loans from the Preferred Lending Program, instead continuing to require headquarters approval for all ESOP loans.

We ask that the SBA be unambiguously directed to include ESOP loans in the Preferred Lending Program.

Third, the Main Street Act tasked the SBA with promoting awareness of ESOPs and employee ownership. The ESOP Association knows that some in the agency already take this task seriously, but they are too few and they lack adequate support, structure, and resourcing.

Business owners must know the ESOP option exists and be able to obtain useful, unbiased information. To that end, we ask that the SBA be directed to resource a specific office, such as the Office of Small Business Development Centers, with active public education and information efforts. These three actions will provide a clearer path to launching and expanding ESOPs.

Thank you for the privilege of sharing the testimony.

Chairwoman VELÁZQUEZ. Thank you, Mr. Goldstein.

Mr. Condra, you are now recognized for 5 minutes.

STATEMENT OF R.I. CONDRA

Mr. CONDRA. Thank you. Good morning, Chairwoman Velázquez, Ranking Member Chabot, and members of the Committee. I am honored to discuss the benefits and challenges of employee-owned businesses. Thank you for bringing this topic out to the light and providing a forum for discussion it so richly deserves.

Today, I will discuss how a prohibitive policy requirement by the Small Business Administration is hindering the growth of the cooperative business sector. If this issue is resolved, lending institutions like the one I work for will be able to make loans that will help to grow small businesses, create quality jobs at increased wages, and provide healthy food and grocery options for communities throughout the country.

My employer, the National Cooperative Bank is a national commercial bank headquartered in Arlington, Virginia. With $2.8 billion in total assets, NCB delivers banking and financial services throughout the Nation to cooperative organizations complemented by a focus on economic development in low-income communities.

A cooperative is a business that is organized, owned and governed by the people who use its products or services. Those people are called member-owners, and they own the business. They have a voice in its operations through a board of directors that members elect, and the profits from the cooperative flow back to the member-owners. Employee-owned cooperatives, also known as worker cooperatives, give employees an ownership stake in the company in which they work.

Cooperatives have evolved since the 1960's when the SBA recognized them as buying clubs. There are now over 40,000 cooperatives in the U.S., and the top 100 generated $222 billion in annual revenue in 2018. Some notable cooperatives include REI, ACE Hardware, Ocean Spray, Land O'Lakes, and Congressional Federal Credit Union.

Since the Great Recession, worker cooperative numbers have doubled, and have become a business option for young people, women and minorities. According to the 2019 Worker Cooperative Economic Census, 50 percent of owners in worker co-ops are Latino and African American, and 62 percent of women make up the majority of the workforce.

Municipalities have also recognized that co-ops are a viable business option and have taken steps to promote the growth and development of worker cooperatives in cities such as New York, Philadelphia, Madison, Minneapolis and Austin.

Over the past 40 years, my bank, NCB has provided loans of more than $2 billion to cooperative businesses and independent retailers including over $77 million to consumer-owned food co-ops. Per our loan policies and guidelines, NCB does not require a personal guarantee for consumer and worker-owned co-op loans due to the unique structure of our cooperative borrowers.

In contrast, the SBA requires a personal guarantee from anyone who owns 20 percent or more of a business and will not guarantee a loan under the program if there is no such individual. This agency requirement makes it impossible for cooperative businesses to access the agency's lending programs. For decades, the co-op sector has asked the SBA to level the playing field for cooperatives to no avail from the agency.

In 2018, Congress passed the Main Street Employee Ownership Act that directed the SBA to recommend and implement practical alternatives for cooperatives that will satisfy the agency's loan guarantee requirements.

We were greatly disappointed to learn the SBA did not provide practical alternatives as the law required. Instead, the agency relied on its existing requirements that continue to block cooperative businesses from much needed access to capital.

Further, SBA's recommendation regarding an existing business to be sold and converted to an employee-owned cooperative would create new barriers. The agency recommends that a selling business owner provide a full, unlimited personal guarantee for the life of the loan. Imagine a small business owner selling their business to a buyer, but also having to put up their home as a guarantee for the buyer's own loan until it is paid off.

The SBA's guarantee requirement is also contrary to industry practice for cooperatives. As mentioned, my bank does not require a personal guarantee, and CDFIs that specialize in co-op lending do not require one. The Department of Agriculture's Business and Industry loan program does not require a personal guarantee for loans to cooperatives.

In addition, the SBA has shown flexibility with respect to the guarantee in similar situations in the past. Thus, the SBA does not require a personal guarantee when a loan is made to an ESOP business.

The SBA has stated that cooperatives can satisfy the requirement by providing an "entity guarantee" to be the guarantor of the loan. We were recently approved by SBA using an "entity guarantee" for a food cooperative loan in Fredericksburg, Virginia. To my knowledge, this will be the first food cooperative loan in the history of the agency. While we are excited that SBA approved this loan, we have strong concerns that the "entity guarantee" is not a long term solution for cooperative businesses for the following reasons:

SBA is not prepared for an "entity guarantee" submission with its application process; the borrower adds more debt to the loan than is needed; the lender adds more risk to the loan than is needed; and only wealthy communities with the ability to raise cash will be able to use this process.

I am here today to discuss how the SBA's taxpayer-funded loan programs should be fair and available to everyone, including cooperative businesses.

I look forward to answering your questions. Thank you.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Abrams, you are now recognized.

STATEMENT OF JOHN ABRAMS

Mr. ABRAMS. Ms. Velázquez, Mr. Chabot, members, thank you so much for having us. It is an honor.

South Mountain, the company I founded nearly a half century ago, is an integrated architecture, engineering, building, and solar company. We do all the parts, from beginning to end. For 33 years it has been a worker co-op. Nearly 2/3 of the 37 employees share ownership today. We balance the triple bottom line of people, planet, and profit—quality, performance, and mission are all more important to us than growth.

The company is built on humble beginnings. I had an older friend and mentor who followed our work in the early days. One day we were showing him a house in progress, and he said, "It is beautiful work. It is artful." And then he said, "Are you making any money?" "No," I chuckled. "We seem to lose money on every project we do." And he said, "Well, Abrams, you've got a unique idea here. Subsidized housing for the rich."

And that bombshell inspired me to learn about business—what it is, the impact it can have, and how to make fair profits—and that pursuit has become a passion. Now we make subsidized housing for those who need it. We devote ourselves to service to each other, to the communities we work in, to strengthening our local economy.

In 1987, two long-time employees told me they preferred to spend their careers at SMC rather than going off on their own, but they needed more of a stake than an hourly wage. Not long after, I agreed to restructure as a worker co-op, to make a system that would welcome them, and other committed employees over time, to ownership.

To be honest, at the time I thought this was more symbolic than substantive. Nothing could have been further from the truth. Worker ownership has been more far meaningful and valuable than I ever imagined. There is no question in my mind that it has been a critical factor in our modest long-term success.

I believe that owning our work is as essential to a good life as is owning our homes.

Former Treasury Secretary Laurence Summers once remarked, "In the history of the world, no one has ever washed a rented car." Ownership is powerful. When employee-owners are making the decisions, it is more likely that companies will stay rooted in place and be positive forces in the community.

Economist Richard Wolff says, "If our workplaces had been democratized long ago, would the workers have stopped raising their own wages? Hardly. Would they have destroyed their own jobs by moving production overseas? Doubt it. Would they have employed technologies that pollute the local environment? No, they live there. Would they have allowed some to earn astronomical salaries while the rest got no raises? No way. Our economic history over the last thirty years would have been radically improved if we had had a different way of organizing our enterprises, with a more cooperative community-focused method that is democratic at its core."

Growing the worker cooperative approach has the potential to positively affect the economy, our democracy, the quality of working peoples' lives, and I do not think it is a stretch to say that the benefits of the democratic workplace may even aid and influence the essential repair of our battered civic landscape. It could change, in effect, the chemistry of our culture. If you spend your days working in an environment of collaboration, mutual respect, and shared power, it is bound to spill over into other parts of your life—better parenting, kinder relationships, more civic engagement.

Today, we are among the highest scoring of the 3,000+ certified B Corps (among them are socially responsible icons like Patagonia, Ben and Jerry's, Seventh Generation), and we annually make the B-Lab "Best for the World" list. During the past 7 years, six first-generation employee-owners have retired who, collectively, represent 180 years of employment. Six people, 180 years. That kind of stability is rare in business today.

We are deeply engaged in transitioning to our next iteration. As a new group of owners take the reins, I am grateful that we will only have to change leadership, having dealt with the ownership part many years ago.

We often assist companies transitioning to employee ownership. It is not uncomplicated, and all companies making this move need technical and legal assistance. The need is great. The Main Street Employee Ownership Act of 2018 was a big step forward, but there is far more to do.

The value and benefits of employee ownership continue to fly under the radar, and you cannot take this important step without knowing the option exists and understanding what it means. So perhaps the greatest need is extensive education and publicity. The stories of employee ownership successes need to be shared and celebrated. Employee ownership "ambassadors" should be funded to visit companies considering transitions, to teach, to train, to advise, to inspire. Widespread technical assistance should be made available. Employee ownership should be the number one business succession planning option. But it is not. I hope this Committee will build on the great work that it has done so far, and I am grateful for the opportunity to make this request.

I would be happy to answer questions. Thank you.

Chairwoman VELÁZQUEZ. Thank you, Mr. Abrams.

Mr. Gillming, you are now recognized.

STATEMENT OF MARK GILLMING

Mr. GILLMING. Chairwoman Velázquez, Ranking Member Chabot, and distinguished members of the Committee, thank you for inviting me to testify before you today to share my story of as our retired CEO phrased it, "inclusive capitalism," and the impact it has had upon hundreds of my fellow employees at Messer Construction. Thank you for holding this hearing to learn more about ESOPs and the legislation that can encourage more small businesses to become employee owned.

My name is Mark Gillming. When I began working at Messer Construction, it was a Cincinnati-based, medium-size, family-owned construction company with a long history and a good reputation. But, like most companies in construction, it had little in the way of employee benefits. By 1990 company-funded retirement benefits totaled only $1.5 million on behalf of about 99 participants.

In 1988, the last son of the company founder died, and we found ourselves with an uncertain future. The grandchildren of the founder wanted access to their wealth, and having no connection with the employees, were not committed to maintaining employment at the company. In 1990, the Messer employees were able to buy their future from the Messer family using the ESOP structure. I was one of the employees that participated in that purchase, and we could not have purchased the company if not for the important tax advantages that the ESOP model afforded us.

Our country's investment in ESOPs allowed 99 Messer employees to purchase their future, and the engagement that opportunity created has resulted in growth. Today, operating from 10 regional offices, Messer performs more than a billion dollars in construction annually.

And, here is the measure of how that change our ESOP brought to our retirement savings. Messer now provides quality jobs and predictable retirement for over 1,200 individuals and has company-funded retirement assets for those employees totaling more than $400 million.

Through our engagement with the Employee-owned S Corporations of America (ESCA), we have come to know of hundreds of companies with stories similar to ours, and the data from ESCA's quality research shows that ESOP companies are more robust, more sustainable, and provide higher levels of diversified retirement benefits than non-ESOP companies. The Messer ESOP is in place and working well for us. However, Messer manages a vendor supply chain of small local subcontractors who are increasingly at risk from forces both external and internal. For that reason, Messer supports ESCA's work to promote bipartisan legislation, H.R. 2258, that would encourage more employee ownership by providing incentives to S Corporation business owners to sell to an ESOP when they are looking to transition out of the business. This will allow more American workers to build meaningful retirement savings that those of us at Messer have realized through employee ownership.

It was more than 20 years ago that Congress passed legislation creating S ESOPs, and in addition to what I have shared with you about Messer, data shared by ESCA continues to show that S ESOPs are a remarkable success story from young workers to retirees.

Just a few highlights from recent surveys that Committee members will find of interest:

Close to 90 percent of ESOP retirees said their savings and ESOP benefits are enough to meet their retirement needs. Less than half of non-ESOP retirees said the same.

56 percent of millennial workers at ESOP companies said they had at least 6 months' salary saved for retirement, while 66 percent of their non-ESOP counterparts said they had no savings at all. The opportunity to become an employee-owner has helped Messer Construction recruit and retain millennial workers in a tight labor market. These individuals share the vision of working as an owner and not just an employee and embrace the challenges and opportunities that come with being an employee owner.

Messer is a clear example of the power of inclusive capitalism that results from supporting S ESOPs. I invite you to visit us or an employee-owned company in your district or state so you can see firsthand the pride employee-owners take in their work and the confidence that employee-owners have in their future.

Ms. Chairwoman and Committee members, I thank you for this opportunity to address the Committee and share Messer's story, and for your consideration of legislation that will allow more hard-working Americans to share in the American dream at work.

Chairwoman VELÁZQUEZ. Thank you, Mr. Gillming, and thank you all for the insightful information and stories that you have shared with us.

I will now recognize myself for 5 minutes.

Mr. Goldstein, the Main Street Employee Ownership Act now allows the 7(a) preferred lenders to process ESOP loans under delegated authority streamlining the process for small firms. Unfortunately, the proposed rule implementing the law says those loan cannot be processed under delegated authority. What is the impact to the ESOP community with SBA taking this position and contradicting the clear language of the statute?

Mr. GOLDSTEIN. Thank you.

While Folience has not utilized the SBA's 7(a) loans, and I probably would not given the delay in how long it takes to get them approved, I can speak to the importance of timing in completing ESOP deals. There are two principles that I have learned from my experience. The first is that time is the enemy of all deals, and the second is that accessing capital is the greatest bottleneck in timing.

So when Folience acquired Cimarron Trailers in 2018, we had a 12-day delay due to a financing issue, and just 12 days called into question changes in inventory, work in progress, working capital, finished goods delivered, and a variety of other criteria that mean that the adequate consideration, the fair price of the deal had to be recalculated. And as you look at moving the local approval of SBA loans to preferred lending providers who have local knowledge of the companies, they will have more direct knowledge to make more timely decisions which will get more funding to create more ESOPs.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Condra, how many businesses that you work with have been good candidates for the 7(a) loan program but could not get one because of the personal guaranty requirement?

Mr. CONDRA. Thank you for that question. And some of my answers today will refer to food cooperatives, like Park Slope in your district in Brooklyn.

Chairwoman VELÁZQUEZ. Yes.

Mr. CONDRA. Because the food co-ops and worker co-ops are in the same boat with SBA. And food co-ops are a more mature sector at this point. But we get multiple inquiries every month from cooperatives. There is a nonprofit called the Food Cooperative Initiative that provides technical assistance through startup food coops. There is currently 125 in different phases, and in employee-owned, in the worker co-op sector, 25 new worker co-ops are created every year. And all that being said, we do not know what the need is, the total need out there is because it is common knowledge among the industry that you cannot access the SBA programs. And also, additionally, a letter was sent to you in December from the Village of Williamsburg outside of Buffalo, New York. They were counting on SBA for this alternate requirement for the guarantee and they sent you a letter saying that now they are hindered from moving forward because there is not an option for them.

Chairwoman VELÁZQUEZ. So I know that in the USDA Business and Industry loan program they offer a waiver from the personal guarantee requirement for co-ops, and that is a $25 million max loan program. So do you think a waiver provision like the one the USDA has would work at the SBA?

Mr. CONDRA. I think it is a good option. I need to get more knowledge about that waiver process to learn more but that is just another example of thinking outside the box of how SBA could do this along with the other alternatives that the sectors recommended. And they said no to all of that. And I just want to remind you as well that SBA met with their counterparts at USDA to talk about alternatives and USDA recommended a number of those and the agency said no to those as well.

Chairwoman VELÁZQUEZ. Okay. Thank you.

Mr. CONDRA. Yes.

Chairwoman VELÁZQUEZ. Mr. Abrams, well, the new administrator that was recently confirmed is coming before this Committee at the end of February. Rest assured that we are going to ask the question about this.

Mr. CONDRA. Thank you.

Chairwoman VELÁZQUEZ. Mr. Abrams, I know that in a co-op, employee-owners have a seat at the table when important business decisions are being made. Can you tell us how this process enhances employee morale and drives strong wages and benefits for employee-owners?

Mr. ABRAMS. I think it is at the heart of——

Chairwoman VELÁZQUEZ. Do you have your mic on? Is it on?

Mr. ABRAMS. I believe so.

Chairwoman VELÁZQUEZ. Okay.

Mr. ABRAMS. Can you hear me?

Chairwoman VELÁZQUEZ. Yes.

Mr. ABRAMS. Okay.

I really think it is at the heart of what makes these businesses successful, that the employees know that they have a seat at the table, that they know that their voice is heard loud and clear, and that in the end they are going to make the decisions about policy. And I think when the people who are making the decisions bear the burden of the consequences of those decisions but also benefit from the rewards of those decisions, we just get better decisions.

Chairwoman VELÁZQUEZ. Thank you.

My time is up. So now I recognize the Ranking Member, Mr. Chabot.

Mr. CHABOT. Thank you, Madam Chair.

Mr. Gillming, I will go with you first.

Your company was being sold or transitioning from the family that owned it and 99 employees purchased it. And obviously it has gone very well. What are a couple advantages, benefits would you say versus any downsides?

Mr. GILLMING. I do not see any downsides.

Mr. CHABOT. The mic.

Mr. GILLMING. I do not see any downsides. It has been a great experience for us. But what it has meant is we became employee owners and there were 99 of us when we started out. We were all in this——

Mr. CHABOT. Was there any magic in that number at the time or anything?

Mr. GILLMING. No, it just——

Mr. CHABOT. It just seems like such an interesting number, 99. Not 100, not 98, but 99.

Mr. GILLMING. It is just where we were.

But what it has meant is that it changed some, you know, we had a great culture to begin with but it made it even better because I no longer was worried about, well, I want to succeed so I want to see one of my coworkers not do so well. I am interested in seeing them succeed because a rising tide raises all boats. And the culture just got better. And it becomes cohesive. And when you are an employee-owner and making decisions as an employee-owner, you know, those small decisions become big decisions and you are making them. How we treat our owners, how we treat our subcontractors is so important.

Mr. CHABOT. I remember at a previous hearing we had one of the witnesses that talked about that they had gone to an ESOP, and it may have even been Messer, I am not sure, but they talked about things like some employees in the past may have walked off with tools or office supplies or things like that. Other employees, hey, that is my stuff you are doing. And they would amongst themselves stop bad things from happening. Is that accurate?

Mr. GILLMING. Good observation. We had two mid-year career hires that came in, and about 6 months after they had been there they were talking. They said, do you know what is different? They turn the lights out when they leave the conference room.

Mr. CHABOT. Excellent. Excellent.

Mr. Abrams, I will go to you next.

In your testimony you mentioned that your decision to restructure as a worker cooperative was really critical in South Mountain Company's success. How did it contribute to the success of your company in particular?

Mr. ABRAMS. Well, for one thing, I think the origin——

Mr. CHABOT. I am not sure if the mic is on.

Mr. ABRAMS. Sorry about that.

Mr. CHABOT. That is all right.

Mr. ABRAMS. The origin of that decision was inspired by employees coming and saying this is where we want to be. But, the usual path is to achieve some level of competence and then go out and start businesses in your own. The fact that they wanted to be there meant that we needed to have a structure that would keep them there. And that was repeated time after time.

So first of all, I see a level of dedication that I do not see in other businesses, and this fact that people want to make their careers there and stay till the end, till retirement.

Mr. CHABOT. Thank you very much.

Mr. Condra, could you walk us through with what a small business would experience if they approached your office to inquire about becoming an employee-owned ESOP?

Mr. CONDRA. Let's give an example, a landscaping worker co-op. If it was in a certain state, we would immediately direct them to cooperative development center, and that center would provide the technical assistance and the needs for how they do that. That co-op would then, if they were moving forward, create a planning committee. They would create a business plan. They would form a board. And they would go through the steps just like any other business would. And then at the end of the day they would provide an application to our bank. One thing to note on that is USDA provides technical assistance grants to these development centers in rural areas. So if you are in rural Ohio, you can go to a development center and get some assistance. If you are in Cincinnati wanting to form a worker co-op, there is not any Federal technical assistance to provide that.

Mr. CHABOT. Thank you very much.

Mr. Goldstein, before I run out of time here, in your written testimony you had described a chilling effect caused by "policy of regulation by litigation by the Department of Labor." Could you tell us in a little more detail what small businesses are going through with the Department of Labor with respect to what you were talking about?

Mr. GOLDSTEIN. Yes, absolutely.

The most important element in an ESOP formation or acquisition is price. And adequate consideration is the process by which the trustee determines the fair price to be paid for that transaction. The trustee is representing the buyers; the buyers being the employees. For over 45 years, the DOL has refused to define what this process is and over the last 10 years there has been aggressive litigation which has scrutinized and challenged ESOP valuations. The chilling effect is that because there is no clear guideline on this and there is the fear of litigation that there are a lot of transactions that otherwise would not happen. There is evidence that you can see with the SEC of issuing robust guidelines for public companies that are being bought by other public companies or by private companies and the process is evaluated by the SEC. A letter of no action is given if that process is determined to have been followed. So all we are asking is that the DOL issue guidelines that adequately define this process, the adequate consideration.

Mr. CHABOT. Thank you very much.

I appreciate all the witnesses, and my time is expired, Madam Chair.

Chairwoman VELÁZQUEZ. The gentleman's time has expired.

And now we recognize the Chairman of the Subcommittee on Contracting and Infrastructure, from Maine, Mr. Golden.

Mr. GOLDEN. Thank you, Madam Chair.

Mr. Goldstein, I think following up on that a little bit, could you try and walk the Committee through how an ESOP trustee might currently determine the value of ESOP stock?

Mr. GOLDSTEIN. Sure. Absolutely.

The ESOP trustee uses a valuation firm. They may look at other comparables with small private companies. There is not a good amount of information so they may have to extrapolate the information from public companies. They may have to look at what is the best next comparable that is available from transactions that are known but that is not from all transactions. There is no checklist of items to examine. There is no suggested metrics to use. There is no system of comparison. The DOL has used litigation which some say has set precedent but that precedent can be very individual to the actual transactions. So the metrics used for acquiring a manufacturing company will be very different than those used acquiring a technology or service company.

Mr. GOLDEN. Thank you.

Do you have a preference or some input about how you think the Department of Labor should define the term "adequate consideration" in this context?

Mr. GOLDSTEIN. Yes. Again, if they were to give clear guidelines that unequivocally can be followed by a trustee to ensure that a process is going to be followed, it eliminates that fear that once a transaction has been done it will be under scrutiny that can be costly and take a lot of time and could be undone years later. And that is really what is causing a lot of these transactions to not happen. The employees of the companies that do not become employee owned are the ones that lose because the business owners will find another buyer. They will find private equity or strategic. It is those employees that are losing because there is not an adequate consideration regulation that is clearly identified.

Mr. GOLDEN. So you just want clarity and consistency.

Mr. Abrams, because you assist companies that transition to employee ownership, I know you know a lot about some of the technical and legal assistance that is necessary in the process. And I wanted to ask what more might be done to help promote companies transitioning to employee ownership. What kind of assistance to people generally need to pull this off successfully?

Mr. ABRAMS. That kind of publicity would be welcome and could be effective. In terms of technical assistance for making the conversion, the most important thing is that people know that there are companies and consultants that are doing this work. There are accountants that are well-versed in co-ops and others, mostly, they are not. So to know who to go to, what attorneys to go to, all of this information is important. But I think even more important, at the beginning, employees often feel like this is an owner leaving and they need to understand that it can be inclusive and the owner can stay and work with them through the transition.

Mr. GOLDEN. Thank you.

Just going back to Mr. Goldstein, you mentioned in your testimony that you thought small business development centers might be a good place, a focal point for educating people about this particular option and maybe helping people through the transition. I cannot remember if it was you specifically or someone else who also mentioned about small business development centers, that some regions are doing this kind of work, others are not. I was not sure if that was anecdotal or if anyone had any feedback about that.

Mr. GOLDSTEIN. Yes. What I have seen is that it is anecdotal. There are different regions of the company that may have a more proactive approach to giving information about employee ownership. And what is most important is that any business owner that is looking at this transition in the "Silver Tsunami," the 2.5 million small businesses that need to change ownership in the next decade or two, that they have access to that information, unbiased, and that they are not going to be misled by professional service providers that are going to steer them away from that. They need to see that that is an option, which is going to keep companies and jobs in communities.

Mr. GOLDEN. Thank you very much.

Madam Chair, I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

And now we recognize the gentleman from Ohio, Mr. Balderson, Ranking Member of the Subcommittee on Innovation and Workforce Development, for 5 minutes.

Mr. BALDERSON. Thank you very much, Madam Chair. And good afternoon, panel. I thank you all very much also for taking the time to be here today.

Throughout this hearing we have heard numerous times about the benefits that exist in employee-owned businesses. Some of these benefits include higher wages, better working conditions, and more flexible working hours. However, one aspect that is vital to employees and employers alike is health care. Would you all please elaborate, and you can start with Mr. Goldstein and just go down the line there, on some of the challenges of this healthcare space, and are the associated health plans part of the solution?

Mr. GOLDSTEIN. Certainly. ESOPs do address income inequality through competitive pay and benefits, and we offer both to our employees. Certainly, increasing costs can be a challenge to any business. I would like to stress that the other benefit is the retirement accumulation which ESOPs address, which is wealth inequality. And it is important to point out that the difference between income inequality and wealth inequality is that income inequality will get the employee and their family through their next pay period; wealth inequality, if you address that, gets them and their family through a funded retirement. So it is very important that they have the benefits which we offer and also that they are accumulating these retirement benefits.

Mr. BALDERSON. Okay. If you all could just be more specific on the healthcare piece of it. I am trying to dial in on the associated healthcare plans and some of the tools that are out there, whether it is the HSAs, the health savings accounts.

Mr. GOLDSTEIN. Yes. So we do offer the high-deductible plans with HSA. Of course, it is important to educate an employee so that they are contributing to the HAS as they take those high-deductible plans. We use wellness programming to improve the wellness of the employees so that it is proactive and not just reactive. We do lots of wellness challenges. That is an important part of taking care of our employee population.

Mr. CONDRA. So I am discussing worker cooperatives, which are separate from the ESOPs. Examples for worker co-ops in my mind are construction, retail, custodial, daycare, hourly paid wages for the smaller ones. So it would be up to the co-op if they were able to bring in their own insurance or that nature. There are larger worker cooperatives such as Equal Exchange and Home Care Associates that have over 1,700 owners which they would have their own healthcare plans.

Mr. BALDERSON. Thank you.

Mr. ABRAMS. Our employee-owners feel that health insurance is absolutely essential for them and their families, so we provide 100 percent coverage of everything imaginable, all deductibles paid. It is a high priority. Meanwhile, the Amicus co-op, which is a purchasing co-op of 50 solar companies nationwide, is working to bring insurance to lower those costs because most of their members are worker-owned and they are looking for ways to provide these benefits at lower cost.

Mr. BALDERSON. Thank you.

Mr. GILLMING. We provide healthcare benefits for our employees as well. The employees pay a portion of it. The company pays a portion of it. But because we are employee-owners, there is realization that this falls right to the bottom line and expenses are important. So we have the benefit programs, you know, the wellness programs trying to reduce it and I am one of the healthcare trustees for our company. So I am aware of what we do every year of going back out to the market to see what we can do to provide the best healthcare for our employee owners that we can at the best pricing.

Mr. BALDERSON. Okay.

Mr. GILLMING. So going to the high-deductible plan was one of those ways to help provide that as well.

Mr. BALDERSON. All right. Thank you all very much.

Madam Chair, I will yield back my remaining time. Thank you.

Chairwoman VELÁZQUEZ. Thank you. The gentleman yields back.

And now we recognize the gentleman from North Carolina, Mr. Bishop.

Mr. BISHOP. Thank you, Madam Chairman. Thank you, panel.

And Mr. Gillming, in particular, I represent Charlotte, part of Charlotte, which is one of Messer's expansion markets. And I am curious whether ESOP ownership impacted your decision-making concerning expanding to markets like Charlotte.

Mr. GILLMING. It absolutely has. As we continue to grow, we are not growing because we want to do more work. We are growing to provide additional opportunities for individuals within Messer to continue to grow. It does not have to be a narrow pyramid where I have to retire for someone to take my place.

I was asked in 2002 to go move to Louisville to run the Louisville region. When I left the Cincinnati region, someone had to take my place. In 2010, I was promoted again to cover multiple regions. Someone had to take my place, so we do it for the growth of our employees and we look for very active, vibrant communities because our people become part of the community. So that is obviously one of the reasons we are in Charlotte.

Mr. BISHOP. I am grateful for that and I congratulate Messer on your success, all your employees.

Picking up on Mr. Balderson's point, earlier in this Congress I introduced H.R. 5224, the Increasing Health Coverage through HRAs Act. And that legislation would codify, that is, give permanent effect in statutory law to the new IRS, DOL, HHS rule that allows employees to use health reimbursement arrangements funded by employers to purchase individual market coverage and correspondingly allows employers to fund those accounts and deduct the amounts as pay but it does not increase taxable pay to the employees. And then employees can obtain and maintain their own coverage that way. Early estimates are that this option will increase by 800,000 the number of Americans with health insurance coverage.

And so my first question for the entire panel is, do you think the availability of new benefits, flexibility like that, puts smaller companies, especially employee-owned forms of businesses in a better position to compete for top talent? Anybody who wishes to volunteer for that?

Mr. GOLDSTEIN. As was previously said, we do go out to the marketplace every year and look at what are the available options, pricing, looking at ensuring that we do not disadvantage any one population as we have different companies that we bring together. And so absolutely increasing the options is always advantages as we look at how to best provide benefits at the most cost-effective method to our employees.

Mr. BISHOP. Thank you very much.

Madam Chairman, I yield back.

Chairwoman VELÁZQUEZ. The gentleman yields back.

And now we recognize Mr. Spano, from Florida, for 5 minutes.

Mr. SPANO. Thank you, Madam Chair. And thank you all for being here today. Thank you for your testimony. Appreciate it very much.

As many of my colleagues know, I am personally familiar with many of the challenges that small business owners face. Before coming to Congress, I owned my own small business for 13 years. In the entire time that I owned that business I used an employee-owned model. I found that by giving employees stake in the business, it not only allowed them to feel more invested in the business, but it motivated them to succeed. They had skin in the game, so to speak. But it also gave them a taste of what it was like to be entrepeneurs.

One of the most daunting aspects of small business ownership is getting started. You see so many businesses fail. And I think entrepeneurs take enormous risk in their business and often with little experience when they first start. So the employee-owned model can correct this problem in my opinion because it allows people to develop the skills of business ownership with substantially less risk essentially than making a go of it on their own. It better equips these folk to start businesses with that knowledge.

Some of the most rewarding moments in my experience as a business owner is to see some of the folks that have been owners in my business then step out and start their own business. I have enjoyed that on several occasions. But, so I strongly believe that that employee-centered model can really make for better businesses and more productive employees.

One theme that I have been noticing is that because employees are directly involved in ownership decisions of the business, that organizations tend to make decisions that benefit the employees, which makes sense. The question I have, however, does this impair a business potentially from making tough decisions sometimes that may be necessary for the health and growth of the business? For instance, if you have a market that is dynamic and changing rapidly and there need to be quick changes, potentially downsizing and so forth, how do you get to the point where you get employees who are, by nature, self-interested to come together and make a decision?

And I will just open the floor to anybody who wants to answer that.

Mr. ABRAMS. In 2008, in response to the financial crisis, we set out six layers of actions and the last on the list was actual layoffs. We never got there, fortunately. But I will never forget when we did get to the point where we decided that we would have a 20 percent across the board reduction in pay, and at the end of that company meeting a number of people came up to me and thanked me. And I said, "Wait a sec. Your pay just got reduced by 20 percent." And they said, "So did yours, and you lost more than I did." And they were just in it together. So that is a pretty tough business decision to make. And everybody was on board.

Mr. SPANO. Would anybody else like to offer an answer to that question?

Mr. GOLDSTEIN. I cannot speak to the start of our business because that was in 1884; however, I can tell you that in 2016 when I was brought in, it was with the realization that while we had a 130-year-old profitable newspaper that was still independent, if we are going to be around for the next 130 years we had better diversify our revenue base. And that is why we went through building an employee-owned platform that brings transition of other private companies into our company. And today, we are 570 employees, two-thirds in manufacturing and one-third in media. And there are plenty of difficult decisions and allocation of resources, capital, staffing that go along the way in building that.

Mr. CONDRA. I would say on the worker co-op front, we have seen this since the Great Recession, is that young people are wanting to start their own businesses. Some do not want to work for a corporation. They want to own their own business and they are happy to share that. Especially with conversions, you know, the worker co-op model is not for everyone. Some people want to go to work, work 8 hours and go home. They do not want the responsibility of making the decisions or they stress on the pressure. But some people, it is natural for them and those are the ones that prosper.

Mr. GILLMING. The only thing I would add is, you know, when the recession hit, obviously, it hit construction really hard. We did the same thing. We all came together and we knew we were in it together. But the other thing within our company is the realization that good ideas come from people. They do not come from titles. So a lot of what we do and continue to advance ways to build buildings for our owners and deliver them, quality projects at quicker schedules come from the ideas. And it may be somebody that just started with us last year.

Mr. SPANO. Thank you.

I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. The gentleman yields back.

And now we recognize the gentleman from Tennessee, Mr. Burchett, for 5 minutes.

Mr. BURCHETT. Chairlady, I hope I did not cut in front of one of the other members down there. Did I do that? Now we are good? Okay, great. I do not want that to be reflected in anything I do in this bipartisan that might hurt me in the re-election bid. So I just want to clear the air with that.

Thank you all for being here. And thank you, Madam Chair, for always being courteous to me.

Mr. Gillming, is that how you say your name?

Mr. GILLMING. Yes.

Mr. BURCHETT. Messer Construction, of course, has a big operation there in Knoxville in my area and they do quality work. And thank you for being here, brother.

As an employee-owned company, what do you think the biggest challenge is that faces Messer Construction?

Mr. GILLMING. The biggest challenge that we face is that Congress will change the laws that they created in 1998 that allowed for S ESOPs, because that allows us to continue to build towards our retirement and all of us working together and knowing that when we get up every morning and go to work, we are working for ourselves and we are building for the future for not only us but for our families.

Mr. BURCHETT. Yes. I am kind of a gearhead and I visited a place called Jasper Motors and they have a little operation in Knoxville. I was at a radio station and I said, I am going to go down there and check those boys out. And sure enough, they were one of you all, an ESOP. How do you say it, ESOP, ESOP?

Mr. GILLMING. ESOP.

Mr. BURCHETT. Anyway, they educated me pretty quick on that. It is always good to talk to folks that actually work for a living. Not that we up here do not do any work but the reality is we do not.

You said Messer's supply chain of local contractors earlier, you said that they were facing some numerous challenges. Do you think that the subcontractors and subcontractors across the country could benefit from an employee-ownership model? And what do you think that would look like?

Mr. GILLMING. Well, I absolutely do. And we are seeing that happening. There is a firm in Cincinnati, a long-time HVAC mechanical contracting firm that has just gone through the transition at Peck, Hannaford and Briggs and it is time for the third generation now to move out. But what happens then to the employees? So they had the foresight to say there is a structure here and our retired CEO helped consult with them about some of the ways to help do that. And the options that are there. But it allowed that company now to continue on and for all of their employees to still have employment.

Mr. BURCHETT. Very good. And I will give the rest of you all some face time because I realize your wives and/or sons and daughters are watching you all right now.

So, what do you see Congress can do to further help support employee ownership?

We can just go down the line. And I have got 2 minutes and 23 seconds, so you all divide it up amongst yourselves.

Mr. GOLDSTEIN. I will be quick. Thank you first of all for pointing out that this is bipartisan, and so hopefully these changes can be made.

I will go back to if this Committee could bring up the issue of adequate consideration. The greatest challenge facing the formation of new ESOPs and acquisition of private companies to transition them to employee ownership, which is what Folience is doing, is this issue of not having a clear definition of adequate consideration. So if you could bring that to the Department of Labor, please.

Mr. BURCHETT. I believe you just did, but we will. Thank you.

Mr. CONDRA. Congressman, my answer, and it will be to this Committee, is access to capital. If a group wants to start a worker co-op in rural Tennessee, they go to their local bank. The bank sends it to USDA and gets a loan guarantee and they are off to the races. If that same group wants to start a worker co-op in Knoxville, they go to their local bank, same thing, everything, SBA denies that application due to the personal guarantee requirement. So it is access to capital at this point.

Mr. BURCHETT. All right.

Mr. ABRAMS. My answer would be that very few business owners know that a worker co-op is a viable entity of choice. More people need to know.

Mr. BURCHETT. Let me go back real quick. Guy in the middle right here, I am sorry, I am not looking at the names, here.

Do you think the banks want to do that business or do you think they are coming up here and doing the old side step and saying, oh, you know, do not allow them to do that, brother? Oh, we cannot do it. It is those bureaucrats in Washington.

Mr. CONDRA. No. There is not a process at SBA to provide a cooperative loan. The banks want to do this. I mean, this is what we specialize in. And it is just not us. It is other national interests.

Mr. BURCHETT. Thank you all so much.

Chairlady, as always, this is a very bipartisan Committee, and actually, it is one of the few Committees where I think something is actually getting done up here.

Chairwoman VELÁZQUEZ. Thank you.

Mr. BURCHETT. So thank you, ma'am, for your work. And appreciate you all coming out.

Chairwoman VELÁZQUEZ. The gentleman yields back.

And now we recognize the gentleman from Minnesota, Mr. Stauber, Ranking Member of the Subcommittee on Contracting and Infrastructure for 5 minutes.

Mr. STAUBER. I thank you, Madam Chair. And thanks for your testimony.

I, too, am a small business owner with my brothers. This is our 30th year. The ups and downs of small business. And for me, you know, my colleague just asked, like, what can we do? It is critically important that we take care of our small businesses in this country. They are the engine of our economy and I say you have never been a small business until you have had to reach into your back pocket and pay for something unexpected to capital or what have you like my brothers and I have. It is not fun. It is not easy. So I think the Committee members recognize the importance of small business.

Mr. Abrams, did you talk about adequate consideration? Would you define that to me? Or maybe Mr. Goldstein, you said that. Okay. Would you define that?

Mr. GOLDSTEIN. Yes, absolutely.

Adequate consideration is the process by which a trustee determines a fair price in a transaction. So you have a seller and a buyer. They have to agree on price. The buyers, the employees being represented by the trustee. And the problem is that a lot of transactions are not being done because there is not a clear definition of that process. And so sellers and trustees are too worried to get into that transaction, whether it will be tied up in litigation and scrutiny and potentially unwound years after.

Mr. STAUBER. Well, I am going to publicly ask you to help not only this Committee but me, personally. I would like to connect with you afterward with my staff assistant because I want to get down to that because that appears to be a major problem concerning in the ability to make the transaction. The bottom line is the best legislation comes from you folks, and to hear this in the Small Business, and I have only been here 13 months, but some of the ideas that are coming from our small business men and women are unbelievable and they seem to be so common sense. And so as I read your notes, each of your notes before this, I just want to tell you, number one, thanks for coming up and testifying. And we are here, and should be here, to make sure that Main Street America, and as I say, Main Street Minnesota, succeeds. Because the engine of our economy.

I really do not have any other questions other than that, but thank you for your attendance and your testimony.

Chairwoman VELÁZQUEZ. The gentleman yields back.

And I am going to recognize myself for 5 myself. If any other members to wishes to ask questions you are welcome.

Mr. Condra, we hear you on the issue of access to capital and the problem that we have at this point with SBA's interpretation, but we are going to tackle that issue.

My other question is that part of the Main Street Employee Ownership Act directed the SBA to provide outreach and educational materials to participating lenders. It also directed SBA to establish a Small Business Employee Ownership and Cooperative Promotion program. As a lender on the ground, can you give us an update on whether you have seen any of these provisions being implemented?

Mr. CONDRA. We have had zero communications on the creationist program. We have heard indirectly that SBA just started implementing it in October with the 900+ SBDCs that they were now required to promote the cooperative model and training and everything. It is a little bit frustrating because the co-op organizations and development centers throughout the country have already done a lot of this work with the materials, the resources. They could be advisors on this. And for us not to know anything about it, I am afraid the SBDCs are going to start recreating the wheel. And also, they will be duplicating efforts. And the fact is that there has been a lack of communication. So when the administrator comes to see you, you might want to suggest that they communicate a little bit better with the co-op sector.

Chairwoman VELÁZQUEZ. Sure. And today, I am holding a roundtable with the SBDCs Network across the country, so I will be raising this issue with them.

Mr. CONDRA. This program is one of the biggest accomplishments of the legislation. Now we have 900 centers promoting the cooperative model. I mean, it is a huge thing.

Chairwoman VELÁZQUEZ. It is important that we get it right. And it is important for the Small Business Administration to understand the role that they could play.

Mr. CONDRA. Absolutely.

Chairwoman VELÁZQUEZ. So Mr. Goldstein, I understand your company began acquiring other companies in the media industry, and so my question to you is, how have employees at the companies that you acquired reacted to learning that they are now employee-owners of the company?

Mr. GOLDSTEIN. Absolutely. And just a correction. We are acquiring companies that are not in media so that we are now in manufacturing.

So two of my favorite days in my career were getting up in front of Life Line Emergency Vehicles and Cimarron Trailers and letting them know that, yes, their company has been sold, but now they become employee-owners. And something that is very important is that we give each of our employee-owners a license to act. And I can pass these out afterwards. There is literally a card that people hold in their pocket. And one example of what this means to employees is that when I was showing the Cimarron leaders during that due diligence period, so nobody knew who they were, around Life Line Emergency Vehicles, one of the employees on the floor came up to us and they knew, of course, that I am CEO. He pulled his license to act out of his card and he said, “I would like to stop you for a moment to talk about an idea.” So I stopped the group. We talked about the idea. I said, “I need to continue the tour. Jeff, that is a great idea. Let’s get back on that.” I did not realize what an impact this had on Ben and Tony from Cimarron. They said, “That is the kind of culture that we want to join, where each employee understands the rights and responsibilities of ownership.”

And that is what I think you have been hearing from my colleagues.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Gillming, we know that over the next 10 years, more than 2.4 million baby boomers who own private businesses will retire. Can you talk about how ESOPs allow for a smooth transition for owners looking to retire from a business without being forced to sell it or close it down all together?

Mr. GILLMING. Absolutely, Chairwoman.

What it allows for, as Mr. Abrams said, that there is a transition, because the owner does not have to leave. There can be a transition period where the individual or individuals that started the company are still there and helping the new owners transition in as they take on that responsibility. But I have also seen what it means for individuals that were employees that are now employee owners and helping. They make the decisions. And when you show them, yes, you are a part of this. And, then, you know, at the year-end when they see that, hey, if the company is profitable it is good for all of us, it is just a powerful wheel that continues to roll and build momentum.

Chairwoman VELÁZQUEZ. Mr. Abrams, would you like to comment?

Mr. ABRAMS. I certainly agree it is wonderful to see owners come to the realization that the people who built the business with them for all those years actually can take over and become new owners. I think watching transitions from a sole proprietorship or a partnership to a worker co-op is so heartening because it is big change and it makes a big difference and those doors do not close.

Chairwoman VELÁZQUEZ. Any other? Mr. Goldstein?

Mr. GOLDSTEIN. Yes, absolutely. The employee-owners, I have heard things said, for example, in Chickasha, Oklahoma, that nobody ever retired from the trailer industry but now we expect that people will. We have employees in our commercial printing plant that have been employees for 44 years. Employee ownership makes a difference. It is addressing wealth inequality. It is allowing families to fund their retirement. It is very important to this country.

Chairwoman VELÁZQUEZ. And the impact that it has in the local economies and also the communities. And it is just an unbelievable, empowering feeling to know that they are invested in the success of those companies because they are owners.

Well, thank you so much for your powerful testimonies. And we have now heard about many of the benefits of employee ownership a business can generate for employee-owners, their families, and their local communities. And yet, despite all those benefits and despite our work in the 115th Congress to address some of the obstacles to employee ownership, it is clear we still have more work to do and progress to achieve. And I heard you loud and clear on the Department of Labor. We will be dealing with that issue, too.

If we intend to promote a secure retirement for America's entrepreneurs, we must continue to find ways to ease their path to employee ownership. Time and again, it has proven to be the most effective retirement plan for those small business owners who want to retain the independence of their business while empowering their employees by turning them into employee owners.

As I did last Congress with the Main Street Employee Ownership Act, I look forward to working with my colleagues from both sides of the aisle to continue minimizing those barriers to employee ownership, help preserve the independence of thousands of small businesses, and save thousands of more jobs.

I will ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record.

Without objection, so ordered.

And if there is no further business to come before the Committee, we are adjourned. Thank you.

[Whereupon, at 12:50 p.m., the Committee was adjourned.]

APPENDIX

| The ESOP Association

Written Testimony of Daniel Goldstein
President and CEO of Folience

To be presented to:
U.S. House of Representatives Committee on Small Business, hearing on
"Challenges and Benefits of Employee-owned Small Businesses"

February 12, 2020

The ESOP Association
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Thank you, Chairwoman Velazquez, Ranking Member Chabot, and members of the committee.

I'm Daniel Goldstein, CEO of Folience, a Cedar Rapids, Iowa-based company that has been in business since 1884, and 100 percent owned by our employees since 2012.

I also represent The ESOP Association, a non-profit whose purpose is to protect and grow employee stock ownership plans, or ESOPs.

A total of 6.6 percent of the U.S. workforce has ownership in an ESOP—*more than 10.6 million employees.*

In context, ESOP employees outnumber the workforce of the entire U.S. auto industry[1]—by more than half a million.

We outnumber the combined workforce of the federal and state governments[2]—by three million.

ESOPs contribute substantially to our economy—and we believe they hold a solution for many of the intractable economic issues facing our nation.

As you know, one of the biggest challenges ahead is the looming retirement in the next 10 years of baby boomers who own nearly 2.5 million small businesses. Known as the "Silver Tsunami," this will be the largest transfer of business ownership over the shortest period of time in our nation's history. Even more concerning, is that the Wilmington Trust has estimated that nearly 60% of these businesses currently have no succession plan.[3] These businesses, and their

[1] U.S. Auto Alliance, https://autoalliance.org/economy/
[2] https://www.governing.com/gov-data/public-workforce-salaries/states-most-government-workers-public-employees-by-job-type.html
[3] https://www.cnbc.com/2019/12/10/as-baby-boomers-retire-main-street-could-face-a-tsunami-of-change.html

nearly 25 million employees, face difficult futures if plans and supportive policies are not adopted.

I've seen what can happen if a succession plan is not made. And, from our own experiences at Folience, I can help demonstrate the role employee ownership can play in preventing catastrophe.

Let me tell the story of a typical small town.

Sumner, Iowa has a population of 1,961 and has one major private employer. Life Line Emergency Vehicles designs and builds ambulances and other emergency vehicles for first responders. It provides 180 good paying jobs.

In 2010 the founder and controlling owner passed away, leaving leadership of Life Line and its ownership to his 69-year-old widow who had not worked in the company.

When I met her in 2016, she was 75, CEO and President, and had no children or heirs prepared to take over the business. The business had to be sold.

Most in this situation face three choices: sell to a competitor, sell to private equity, or close and sell off the parts. This is very similar to the situation faced by those millions of businesses owned by retiring baby boomers.

Folience gave them another option—sell to their employees through an ESOP. Folience's ESOP purchased Life Line, and as those 180 employees vested in the ESOP through their work, they became owners of Life Line; they also became owners in every other business in the Folience portfolio.

Despite the many well-known benefits of employee owned businesses—benefits that include greater job security, better local economic stability, greater access to job training and development, higher pay, and more opportunities to accumulate retirement savings—those seeking to launch or expand their ESOPs face multiple, unnecessary obstacles.

As the leader of an employee owned business, I see three major obstacles to the expansion of employee ownership in our economy:

1. An absence of clear federal regulatory guidance, particularly on business valuations for purposes of securing an ESOP loan.
2. A shortage of lending capital for ESOP formation or acquisitions.
3. And, finally, education—there is low public and professional awareness about ESOPs.

Today I ask Congress to task federal agencies with solutions to address all three.

First, I submit that the biggest obstacle to the formation and expansion of ESOPs is the chilling effect of the U.S. Department of Labor's actions. DOL has perpetuated an absence of formal regulatory guidance, while simultaneously pursuing a litigious approach to oversight. The effect has been a deep chill on the market.

Every year, hundreds of business owners who want to learn about ESOPs attend educational events hosted by The ESOP Association. And once exposed to the lack of clear guidance, many turn away out of fear that some unknowable misstep will invite never-ending DOL scrutiny.

Those fears are not unfounded.

Today, more than 45 years after ESOPs were established with the passage of ERISA, the Department of Labor has *yet* to finish its rulemaking process. They started. They nearly finished in 1988. But they never issued final regulations.

Instead of issuing clear regulation, the Labor Department has practiced regulation by litigation, pursuing ESOP companies in a series of one-off cases that sometimes drag on for years, and often never reach a formal end or resolution. The result: ESOP companies have been left to interpret a patchwork of settlement agreements or decisions that sometimes were predicated on such unique circumstances they provided little or no generally applicable guidance at all.

Operating without clear guidance is a risk ESOP companies should not be forced to bear; it is a risk that adversely affects the entire industry offering legal, accounting, and other professional services and that are instrumental in helping companies form new ESOPs; it is a risk that negatively affects the wealth and security of the 10.6 million employee owners DOL has been tasked with protecting.

It is a risk our nation cannot afford if we hope to survive the gathering wave of the Silver Tsunami.

The direct cost to the ESOP community of the DOL's regulatory inaction has been enormous: Companies embroiled in Labor Department actions have been forced to scale back investments, acquisitions, and other wealth building efforts to pay for the legal and administrative costs of fighting these claims. Those who lost most were the employee owners who failed to realize the greatest gains possible from their shares of company stock.

Further, the Labor Department's success rate in these cases has been extremely low, leading one to question this investment of time and energy.

The indirect cost of the Labor Department's actions is even higher: By adding undue risk to the process of forming and running an ESOP, the agency is discouraging companies from becoming employee owned. This does not benefit employees, and it denies our economy of potential buyers of businesses at a time when we will need them most.

The Labor Department must stop its policy of regulation by litigation and instead provide the clear guidance necessary so that ESOP companies, boards, and trustees may operate their ESOP trusts in a manner consistent with clearly defined rules.

But here is the travesty: It is impossible to prove how many American workers have lost the opportunity to become employee owners as a result of this chilling effect. And, due to the rapidly escalating retirements of baby boomer business owners, there is urgency to reduce the chilling effect this lack of regulatory clarity is causing.

A solution can start very simply: Congress should require DOL to define what constitutes "adequate consideration" when an ESOP trustee values the price to be paid for shares of company stock.

Ambiguity regarding the term "adequate consideration" has been at the heart of many DOL actions, and it is our belief this ambiguity has depressed the legitimate efforts of businesses to launch ESOPs while complying with the law.

Congress has made clear, through legislation such as the Main Street Employee Ownership Act, that it wishes to encourage the formation of ESOPs. For that to happen, the

Labor Department must fulfill its mission and provide clear regulations that good corporate citizens can follow when selling their companies to their employees.

This one simple piece of guidance could be a game changer for new employee ownership.

Second, to start addressing lending shortages, the SBA must streamline lending for ESOPs, as outlined in the Main Street Employee Ownership Act. Unfortunately, in implementing the legislation, the SBA excluded ESOP loans from the Preferred Lending Program, instead continuing to require headquarters approval for all ESOP loans.

The Preferred Lending Program decentralizes loan decision making and results in faster loans, and it clearly was Congress' intent to make loans for ESOPs easier and faster.

We ask that the SBA be unambiguously directed to include ESOP loans in the Preferred Lending Program.

Third, the Main Street Employee Ownership Act tasked the SBA with promoting awareness of ESOPs and employee ownership. The ESOP Association knows that some on the front lines of the agency already take this task seriously, but they are too few and they lack adequate support, structure, and resourcing from senior management within the agency.

Business owners must know the ESOP option exists, and must be able to obtain useful, unbiased information. To that end, we ask that the SBA be directed to resource a specific, centralized office —such as the Office of Small Business Development Centers—with active public education and information efforts about ESOPs.

These three actions will provide a clearer path to launching and expanding ESOPs.

Thank you for the privilege of sharing my testimony today. I look forward to answering any questions you have.

Testimony of R.L. Condra

Vice President of Advocacy and Government Programs

National Cooperative Bank

House Committee on Small Business

Hearing on "Challenges and Benefits of Employee-owned Small Businesses"

February 12, 2020

Testimony of R.L. Condra
Vice President of Advocacy and Government Programs
National Cooperative Bank

Good morning Chairwoman Velázquez, Ranking Member Chabot and members of the Committee. I am honored to discuss the benefits and challenges of employee-owned businesses. Thank you for bringing this topic out to the light and providing a forum for discussion it so richly deserves.

Today, I will discuss how a prohibitive policy requirement by the Small Business Administration (SBA) is hindering the growth of the cooperative business sector. If this issue is resolved, lending institutions like the one I work for will be able to make loans that will help to grow small businesses, create quality jobs at increased wages, and provide healthy food and grocery options for communities throughout the country.

My employer, the National Cooperative Bank (NCB) is a national commercial bank headquartered in Arlington, Virginia. With $2.8 billion in total assets, NCB delivers banking and financial services throughout the nation to cooperative organizations complemented by a focus on economic development in low-income communities.

A cooperative is a business that is organized, owned and governed by the people who use its products or services. Those people are called member-owners, and they own the business. They have a voice in its operations through a board of directors that members elect, and the profits from the cooperative flow back to the member-owners. Employee-owned cooperatives, also known as worker cooperatives, give employees an ownership stake in the company in which they work.

Cooperatives have evolved since the 1960's when the SBA recognized them as buying clubs. There are now over 40,000 cooperatives in the US and the top 100 generated $222 billion in annual revenue in 2018. Some notable cooperatives include REI, ACE Hardware, Ocean Spray, Land O'Lakes, and Congressional Federal Credit Union.

Since the great Recession, worker cooperative numbers have doubled, and have become a business option for young people, women and minorities. According to the 2019 Worker Cooperative Economic Census, 50% of owners of worker co-ops are Latino and African American, and 62% of women make up the majority of the workforce.

Municipalities have also recognized that co-ops are a viable business option, and have taken steps to promote the growth and development of worker cooperatives in cities such as New York, Philadelphia, Madison, Minneapolis and Austin.

Over the past 40 years, NCB has provided loans of more than $2 billion to cooperative businesses and independent retailers including over $77 million to consumer-owned food co-ops. Per our loan policies and guidelines, NCB does not require a personal guarantee for consumer and worker-owned co-op loans due to the unique structure of our cooperative borrowers.

In contrast, the SBA requires a personal guarantee from anyone who owns 20% or more of a business, and will not guarantee a loan under the program if there is no such individual. This agency requirement makes it impossible for cooperative businesses to access the agency's lending programs. For decades, the co-op sector has asked the SBA to level the playing field for cooperatives to no avail from the agency.

In 2018, Congress passed the Main Street Employee Ownership Act that directed the SBA to recommend and implement practical alternatives for cooperatives that will satisfy the agency's loan guarantee requirements.

We were greatly disappointed to learn the SBA did not provide practical alternatives as required by law. Instead, the agency relied on its existing requirements that continue to block cooperative businesses from much needed access to capital.

Further, SBA's recommendation regarding an existing business to be sold and converted to an employee-owned cooperative would create new barriers. The agency recommends that a selling business owner provide a full, unlimited personal guarantee for the life of the loan. Imagine a small business owner selling their business to a buyer, but also having to put up their home as a guarantee for the buyer's own loan until it is paid off.

The SBA's guarantee requirement is also contrary to industry practice for cooperatives. As mentioned, my bank does not require a personal guarantee, and CDFI's that specialize in co-op lending do not require one. The Department of Agriculture's Business and Industry loan program does not require a personal guarantee for loans to cooperatives.

In addition, the SBA has shown flexibility with respect to the guarantee in similar situations in the past. Thus, the SBA does not require a personal guarantee when a loan is made to an ESOP business.

The SBA has stated that cooperatives can satisfy the requirement by providing an "entity guarantee" to be the guarantor of the loan. We were recently approved by SBA using an "entity guarantee" for a food cooperative loan in Fredericksburg, Virginia. To my knowledge, this will be the first food cooperative loan in the history of the agency. While we are excited that SBA approved this loan, we have strong concerns that the "entity guarantee" is not a long term solution for cooperative businesses for the following reasons:

- SBA is not prepared for an "entity guarantee" submission with its application process,
- The borrower adds more debt to the loan than is needed,
- The lender adds more risk to the loan than is needed and
- Only wealthy communities with the ability to raise cash will be able to use this process.

I am here today to discuss how the SBA's tax payer funded loan programs should be fair and available to everyone including cooperative businesses. I look forward to answering your questions. Thank you.

south mountain
COMPANY

February 12, 2020
John Abrams

TESTIMONY FOR HOUSE COMMITTEE ON SMALL BUSINESS
"Challenges and Benefits of Employee-owned Small Businesses"

South Mountain, the company I founded nearly a half century ago, is an integrated architecture, engineering, building and solar company. We do all the parts, from beginning to end. For 33 years it has been a worker cooperative; nearly two thirds of the 37 employees share ownership. We balance the triple bottom line of people, planet, and profit - quality, performance, and mission are all more important to us than growth.

The company is built on humble beginnings. I had an older friend and mentor who followed our work in the early days. One day we were showing him a house in progress, and he said "Beautiful work. Artful. And then, "Are you making any money?"

"No," I chuckled, "we seem to lose money on every project we do."

"Well, Abrams, " he said, "You've got a unique idea here. Subsidized housing for the rich."

That bombshell inspired me to learn about business - what it is, how to do it, the impact it can have, and how to make fair profits - this pursuit became a passion that has lasted to this day. Now we make subsidized housing for those who need it. We devote ourselves to service - to each other, to the communities we work in, to strengthening our local economy.

In 1987, two long-time employees told me they preferred to spend their careers at SMC rather than going off on their own, but needed more of a stake than an hourly wage. Not long after, I agreed to restructure as a worker co-op - to make a system that would welcome them, and other committed employees over time, to ownership.

To be honest, at the time I thought this was more symbolic than substantive. Nothing could have been further from the truth. Worker ownership has been more far meaningful and valuable than I ever imagined. There's no question in my mind that it has been a critical factor in our modest long-term success.

I believe that owning our work is as essential to a good life as it is to own our homes. As former Treasury Secretary Laurence Summers once remarked, "In the history of the world, no one has ever washed a rented car." Ownership is powerful. When employee owners are making the decisions, it is more likely that companies will stay rooted in place and be positive forces in their local community.

Economist Richard Wolff says, "If our workplaces had been democratized, long ago, would the workers have stopped raising their own wages? Hardly. Would they have destroyed their own jobs by moving production overseas? Doubt it. Would they have employed technologies that pollute the local environment? No, they live there. Would they have allowed some to earn astronomical salaries while the rest got no raises? No way. Our economic history over the last thirty years would have been radically improved if we'd had a different way of organizing our enterprises - with a more cooperative community-focused method that is democratic at its core."

Growing the worker cooperative approach has the potential to positively affect the economy, our democracy, and the quality of working peoples' lives. It is not a stretch to say that the benefits of the democratic workplace may even aid and influence the essential repair of our battered civic landscape - it could change, in effect, the chemistry of our culture. If you spend your days working in an environment of collaboration, mutual respect, and shared power, it is bound to spill over into other parts of your life - better parenting, more civic engagement, kinder relationships.

Today we are among the highest scoring of the 3,000+ certified B-Corps (among them are socially responsible icons like Patagonia, Ben and Jerry's, and Seventh Generation) and we annually make the B-Lab "Best for the World" list. During the past seven years six first-generation employee owners have retired who, collectively, represent 180 years of employment. Six people, 180 years - that's a kind of stability that is rare in business today. We are deeply engaged in transitioning to our next iteration; as a new group of owners take the reins I'm grateful that we will only have to change leadership, having dealt with the ownership part many years ago.

We often assist companies transitioning to employee ownership. It is not un-complicated, and all companies making this move need technical and legal assistance. The need is great. The Main Street Employee Ownership Act of 2018 was a big step forward, but there is far more to do.

The value and benefits of employee ownership continue to fly under the radar, and you can't take this important step without knowing the option exists. So perhaps the greatest need is extensive education and publicity - the stories of employee ownership successes need to be shared and celebrated. Employee ownership "ambassadors" should be funded to visit companies who are considering transitions - to teach, train, advise, and inspire. Widespread technical assistance should be made available. Employee ownership should be the number one business succession planning option.

But it's not. I hope this committee will build on the good work it has begun and I am grateful for the opportunity to make this request.

I'd be happy to answer any questions you may have.

WeAreBuilding.

MARK R. GILLMING
SENIOR VICE
PRESIDENT

MESSER INC.
CINCINNATI, OH

TESTIMONY BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS

HEARING ON "CHALLENGES AND BENEFITS OF EMPLOYEE-OWNED SMALL BUSINESSES"

FEBRUARY 12, 2020

Chairwoman Velázquez, Ranking Member Chabot, and distinguished members of the Committee, thank you for inviting me to testify before you today to share my story of as our retired CEO phrased it, "inclusive capitalism", and the impact it has had upon hundreds of my fellow employees at Messer Construction. Thank you for holding this hearing to learn more about ESOPs and legislation that can encourage more small businesses to become employee-owned.

My name is Mark Gillming; When I began working at Messer Construction it was a Cincinnati based, medium size, family-owned construction company with a long history and a good reputation; but like most companies in construction it had little in the way of employee benefits. By 1990 company-funded retirement benefits totaled only $1,500,000 on behalf of about ninety-nine participants.

In 1988 the last son of the company founder died and we found ourselves with an uncertain future. The grandchildren of the founder wanted access to their wealth and, having no connection with the employees, were not committed to maintaining employment at the company. In 1990 the Messer employees were able to buy their future from the Messer family, using the ESOP structure, I was one of the employees that participated in that purchase and we could not have purchased the company if not for the important tax advantages that the ESOP model afforded us.

Our country's investment in ESOPs allowed ninety-nine Messer employees to purchase their future; and the engagement that opportunity created, has resulted in growth. Today, operating from 10 regional offices, Messer performs more than a billion dollars in construction annually. And, here is the measure of the change that our ESOP brought to our retirement savings. Messer now provides quality jobs and predictable retirement for over 1200 individuals, and has company-funded retirement assets for those employees totaling more than $400,000,000.

Through our engagement with the Employee-owned S Corporations of America we have come to know of hundreds of companies with stories similar to ours; and the data from ESCA's quality research shows that ESOP companies are more robust, more sustainable and provide higher levels of diversified retirement benefits than non-ESOP companies. The Messer ESOP is in-place and working well for us; however, Messer manages a vendor supply chain of small local subcontractors who are increasingly at risk from forces both external and internal. For that reason, Messer supports ESCA's work to promote bipartisan legislation - H.R. 2258 - that would encourage more employee ownership by providing incentives to S Corporation business owners to sell to an ESOP when they are looking to transition out of the business. This will allow more American workers to build meaningful retirement savings that those of us at Messer have realized through employee ownership.

It was more than 20 years ago that Congress passed legislation creating S ESOPs and, in addition to what I have shared with you about Messer, data shared by ESCA continues to show that S ESOPs are a remarkable success story from young workers to retirees. Just a few highlights from recent surveys that Committee members will find of interest:

- Close to 90 percent of ESOP retirees said their savings and ESOP benefits are enough to meet their retirement needs. Less than half of non-ESOP retirees said the same.

- 56 percent of millennial workers at ESOP companies said they had at least six months' salary saved for retirement, while 66 percent of their non-ESOP counterparts said they had no savings at all.

The opportunity to become an employee owner has helped Messer Construction recruit and retain millennial workers in a tight labor market. These individuals share the vision of working as an owner and not just an employee and embrace the challenges and opportunities that come with being an employee owner. Messer is a clear example of the power of inclusive capitalism that results from supporting S ESOPs. I invite you to visit us or an employee-owned company in your district or state; so you can see first-hand the pride employee-owners take in their work, and the confidence that employee-owners have in their future.

CONCLUSION

Ms. Chairwoman and committee members, I thank you for this opportunity to address the committee and share Messer's story, and for your consideration of legislation that will allow more hardworking Americans to share in the American Dream at work.

Addendum 1 to the Testimony of Mark R. Gillming

February 12, 2020

Direct Impact of the Messer ESOP upon individual Retirement Savings

The measure of success of any retirement strategy is the replacement income that an individual employee can expect between the age of retirement and the age of death. Peter Strange, who retired from Messer several years ago put together this example in early 2016 and I feel it is worth sharing again. Mr. Strange joined Messer in 1968 as a project engineer and advanced through the company to the position of Vice President, Operations, in 1984. At the end of 1989, after 23 years of service, Mr. Strange's company-funded retirement savings would have provided an estimated monthly income (at a 6% annuity rate) of approximately $250 dollars per month.

The Messer ESOP was implemented in 1990. By comparison, employees who entered Messer as Project Engineers in 1990 and remained with the company through 2015 (twenty-five years) have company-funded retirement savings that would, on the same basis, provide an estimated monthly income of $5,500 per month.

Three footnotes:

1. Both calculations are performed as if the employee retired on the calculation date; while in fact both Mr. Strange and the employees joining in 1990 had/have substantial periods of time remaining in their careers, allowing for further growth in their retirement savings. As a result of increased company growth and profitability following the implementation of the Messer ESOP, those additional years would result in a widening of the retirement savings gap.
2. The estimated cost of repurchasing retirees' shares is projected into the Messer annual valuation model, assuring that sufficient liquidity will be available when required.
3. As a result of the Messer board of directors' actions with regard to dividends, at the end of 2015 the Messer ESOP trust assets include a balanced portfolio investment equaling more than 25% of the value of the allocated Messer shares; providing diversification for the participants and liquidity for share repurchase.

Addendum 2 to the Testimony of Mark R. Gillming

February 12, 2020
Return on Investment

The Positive Economic Impact of America's Support for Employee Ownership

The example below was presented in Testimony Peter Strange presented in 2016. While some things have changed slightly by 2020, the basic premise is still valid and worth sharing. For decades, the US tax code has contained significant support for the creation and success of employee stock ownership plans. In 1998, the tax code was modified to allow ESOPs to own stock in Subchapter S corporations – a significant benefit to further creation and growth of ESOPs. A number of studies have validated and quantified the big picture benefits of ESOPs and compared ESOPs to alternative organization structures. The results of these studies include:

- ESOP companies grow faster, providing higher levels of employment.
- ESOP companies are more resilient, retaining that employment through economic downturns.
- ESOP companies provide company-funded retirement benefits that result in retiree account balances that are materially greater than competing models.
- ESOP companies have a lower failure rate than non-ESOP, private companies, resulting in lower risk to employer backed benefit plans.
- ESOP companies now represent a high level of economic critical mass, driving our national economy forward.

The question remains, "What is the direct return in tax dollars for the investment that our country makes in an ESOP?" This simple study of one ESOP company, Messer Construction, quantifies that positive return.

Messer's ESOP was created in 1990 and Messer became an S Corporation taxpayer in 1998. While there are dozens of variables that might be studied, we have elected to focus upon two straightforward questions:

1. What is the level of investment that our fellow taxpayers made in support of the Messer ESOP?
2. What is the direct return in tax dollars resulting from that investment?

OUR APPROACH:

We studied the following data over the fifteen year period prior to creation of our ESOP and the fifteen year period following creation of our ESOP:

- Average growth rate as measured by dollars of revenue.
- Average profitability per revenue dollar.
- Average annual employee count, based upon average revenue dollars per employee.
- Average salary per employee.
- Actual retirement account balances in the company-funded retirement plans as of 2004.

After we gathered the data for the two study periods we applied appropriate inflationary adjustments so that all dollars were measured as of 2004, the end point of the study.

We used the following assumptions:

- A corporate federal tax rate of 35% (Based on 2004 data).
- A personal federal tax rate of 25% (Based on 2004 data).
- That, absent the creation of the ESOP, Messer would continue to grow at its historical growth rate during the period between 1990 and 2004.
- That, being an excellent company, Messer would adopt a generous 401k program – 100% company match of the first 2.5% of employee savings, resulting in a total 401k contribution of 7.5% per year, per employee.
- That the employer and employee contributions to a 401k would be tax deductible.
- That funds held in trust, whether in the ESOP or the 401k plan would grow at at-least the rate of inflation, after 2004.

OUR RESULTS

Investment received through tax deferral:	**($14,203,345)**
Additional taxes paid:	**$41,807,481**
Net benefit in federal taxes:	**$27,604,136**

A multiplier of 2.94 in same year dollars!

THE MATH:

Question 1. The tax investment:

For the sake of consistency, we have analyzed the data as if Messer and the Messer ESOP had been the beneficiaries of the full ESOP benefits, including the S Corporation tax deferral, beginning in 1990. All calculations have been normalized to 2004 dollars – the end of the study period.

Messer was a profitable, growing company over the fifteen years prior to forming its ESOP. The result of the positive tax code benefits for ESOPs is that Messer's income tax payments would be deferred until participant retirement. Over the fifteen years prior to 1990, Messer revenue grew at an average annual rate of 2.26% over inflation. Projecting continued growth and profitability at that rate for the fifteen years following formation of its ESOP, and assuming that Messer implemented a strong 401k retirement plan, the calculated tax deferral would have resulted in an investment by US taxpayers of $14,203,345 in 2004 dollars.

Question 2. Direct return in federal taxes paid – or to be paid.

With the implementation of our ESOP Messer's growth trajectory changed. Over the fifteen years following creation of the ESOP Messer grew at 5.76% over inflation. The marginal growth driven by our ESOP resulted in employment growth of an additional 233 employees over the fifteen year period. Applying the calculated average gross pay to those employees as they entered the payroll, and applying the assumed individual tax rate to those marginal employee earnings results in additional federal tax payments of $38,719,967 in 2004 dollars.

The actual account balances for the Messer retirement plans at the end of 2004 totaled $71,036,326. The calculated total balances in 2004 for a 401k plan that would have resulted from the pre-ESOP growth rate in employment and the assumed total annual contributions of 2.5% from the company and 5% from the employee would be $58,686,273. With the assumption that the funds held in either trust would grow until retirement and mandatory withdrawal at at-least the rate of inflation, the federal government will receive tax at the assumed personal rate on the difference between the two trust funds, or $12,350,053. At 25% personal tax rate the result is additional federal tax payments of $3,087,513 in 2004 dollars.

Adding the two sources together results in total calculated additional federal taxes resulting from the Messer ESOP of $41,807,481 in 2004 dollars.

CONSERVATISM IN THE CALCULATIONS:

The two direct tax sources calculated above materially understate the actual benefits of the ESOP to our local, state and national economies. Additional metrics that **could be added** include:

- The multiplier effect of the added spending by the additional employees, resulting in additional federal tax from the profit on their purchases.
- The savings in federal benefit costs post-retirement resulting from the more robust ESOP retirement accounts.
- The taxes received at the state and local level as a result of the additional employees and their post-retirement spending.
- The fact that hundreds of employees who receive robust retirement benefits will spend far more post-retirement as compared to receiving the 401k level benefits.
- The fact that the ESOP is fully funded by the company, resulting in all Messer employees, at every income level, having a marginal 5% (the employee contribution to the 401k) to spend during each year of employment.
- The fact that Messer has continued to grow, resulting in ever more employment, ever more retirement benefits – and ever more federal income tax payments.
- The fact that, since 2004, the Messer ESOP has actually grown at a rate more than double the rate of inflation, which will lead to tax payments by participants at withdrawal far greater than those indicated in 2004.
- The fact that Messer has in place, alongside its ESOP, a substantial, voluntary 401k retirement plan, not included in our retirement savings calculations.
- And many more benefits at both the enterprise level and at the employee level.

Addendum 3 to the Testimony of Mark R. Gillming

February 12, 2020

ESCA Survey Results

John Zogby Strategies has conducted two surveys related to employees at ESOP firms versus non-ESOP firms.

In the first survey, questions regarding retirement and financial security were asked of retirees from ESOP companies as well as Non-ESOP companies. The survey found:

- Non-ESOP retirees were three times more likely to say they have major financial concerns about retirement than ESOP retirees.

In the second survey, millennials were asked questions regarding preparation for retirement, retirement savings and expecting to be financially better off than their parents. The survey found:

- 91% of millennial employee-owners at S ESOP companies felt they had enough information to prepare for retirement compared to only 44% of employees at Non-ESOP companies.

- 67% of millennial employee-owners expect to retire by the age of 65, if not earlier. In comparison, only 37% of young workers at Non-ESOP companies expect the same.

- 72% of surveyed millennial employee-owners feel there is room for them to grow at their current companies.

- 56% of surveyed millennial employee-owners had at least six months salary saved for retirement while 66% of millennials at Non-ESOP companies had nothing saved for retirement.

- 66% of millennial workers at S ESOP companies expect to be better off than their parents, compared to 41% of their peers at Non-ESOP companies.

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American Sustainable Business Council

American Sustainable Business Council 1worker1vote **Testimony**
for "The U.S. House Small Business Committee hearing
"Challenges and Benefits of Employee-owned Small Businesses,"

Wednesday, February 12, 2020

OWNERSHIP4ALL

Chairwoman Velasquez, Ranking Member Chabot. The American Sustainable Business Council and 1worker1vote are pleased to submit this joint testimony for your hearing on the Challenges and Benefits of Employee-owned Small Businesses.

We want to thank the House Small Business Committee for taking up the important issue of worker ownership and for seeking to encourage the U.S. Small Business Administration to realize the opportunities of the Main Street Employee Ownership Act of August 2018.

This latest hearing provides Congress, starting with the House Small Business Committee, the opportunity to support and empower hybrid, shared-ownership business models, including social enterprises, member and shared-services cooperatives, worker and union cooperatives, fair trade and triple-bottom-line (people, planet, profit) companies of all sizes and origins across nationwide borders, markets and silos.

ASBC through our "**Ownership4All**" campaign believes that we have an incredible opportunity to move the needle on worker ownership especially after the 2018 passage of the bipartisan Main Street Employee Ownership Act, which ASBC, 1worker1vote and our members and allies helped pass and were publicly recognized by the bill's congressional sponsors for our efforts. More than a specific jurisdiction, this bill targeted opening up the US SBA to hybrid ownership models for SBA loan access.

To heal the inequities of our economy, metrics show that broad-based, worker ownership social enterprises and ecosystems through shared high road principles and practices are more stable, inclusive, equitable, democratic, and competitive with fewer job losses, especially during downturns

ASBC and the 250,000 triple bottom-line businesses that our network represents are pleased to work with the Committee and all those that want to uplift and scale shared-ownership policies in both state capitals and in Washington, D.C.

The ASBC/1worker1vote "**Ownership4All**" campaign pursues a number of tactical policy goals:

Tax Policy parity with ESOPs for hybrid and diverse ownership models including worker and union cooperatives, as well as other emerging, hybrid shared ownership structures (HSOS)in federal laws. There are several models of worker ownership, and this variety contributes to the fragmentation of the law. Tax laws treat cooperatives differently than ESOPs, and S Corp ESOPs are treated differently than C Corp ESOPs. The laws must be changed to make tax treatment more uniform for all worker ownership models so hosting communities and their emerging worker-owners can choose the model and approach best for them.

A first step would be to implement a leveled tax policy playing field offering an S-Corp ESOP-like corporate income tax exemption, and the ability to deduct both interest and principal on a worker cooperative loan. This way, ESOP/employee ownership successes in wealth creation can be extended to worker coops, union-coops, and other hybrid worker ownership structures. Hybrid worker ownership structures will become the norm, not the exception, as this practice community expands.

Enabling paths to transition: The transition to worker ownership requires technical help in the form of business and market assessments, legal assistance in structuring the transition, and training employee purchasers to run the business. On a regional basis, this can be integrated into shared services cooperatives within structures of existing organizations already working closely with ASBI and 1worker1vote (e.g. The Ohio Employee Ownership Center, the Vermont Employee Ownership Center, the Rocky Mountain Employee Ownership Center, Coop Cincy and Coop Dayton). **A shared-services cooperative approach would help lower compliance costs for small businesses.**

Access to capital: Many traditional banks don't know enough about worker-owned businesses to feel comfortable lending to them. Legislation can create ways to raise funds, either through changes to tax law or an increase in government loans.

Equalize the EB5 immigrant investor visa $500,000 benefit to allow worker and union coops and other hybrid shared ownership structures (HSOS) to provide equal visa access to documented and undocumented union coop worker owners by similarly validating the ownership equity value in their enterprises as "skin in the game" entrepreneurial capital, similar to any other investor.

In conclusion: We stand ready to continue to work with the House Small Business Committee, and all members of Congress that want to seize the opportunity to build a more equitable and just economy by advancing worker/employee ownership

Research proves that combining an equity stake with participatory ownership culture (essentially the definition of a worker cooperative) creates better businesses. The basic democratic principle valued in nation-states and shared-ownership models is one-person-one-vote. An equity share is the right to vote and provides the basis for a new power-paradigm-changing culture that builds community wealth and stability, civic-solidarity, self-reliance, and more secure retirements.

Background:
1worker1vote, a leader in the development of hybrid worker ownership models and practices, and the American Sustainable Business Council, representing over 250,000 triple bottom-line people/planet/profit business members, launched the **"Ownership4All" campaign in 2016** that played a recognized background role in the August 2018 bipartisan passage of the Senator Kristen Gillibrand-led "Main Street Employee Ownership Law":

- Historic Federal Law Gives **Employee-Owned** Businesses Access to SBA Loans - Nonprofit Quarterly
- ASBC Statements in Support of the Main Street **Employee Ownership** Act - Common Dreams
- August 2018 – Worker ownership in the USA – a new law for #coops and #employeeownership - Ed Mayo is Secretary General of Co-operatives UK

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Committee on Small Business
Challenges and Benefits of Employee-owned Businesses
Capital Impact Partners Comments

February 18, 2020

On behalf of Capital Impact Partners, I am pleased to submit written testimony on "the Challenges and Benefits of Employee-owned Businesses" to the Committee on Small Business.

Capital Impact Partners is a national, nonprofit Community Development Financial Institution (CDFI) that is dedicated to creating new opportunities in places where options are limited. Our mission is to transform underserved low-income communities into healthy, sustainable communities by making strategic, high-impact investments that create and maintain quality jobs while delivering essential products and services to residents.

Capital Impact Partners has a long and successful track record of supporting cooperative businesses. Since our founding in 1984, we have provided over $300 million to more than 200 cooperative businesses that serve low-income people and communities. Our work with cooperatives is a key component of our broader efforts to ensure that low-income communities have access to quality health care and education, healthy foods, and affordable housing.

Capital Impact Partners believes that worker cooperatives are a critical tool for wealth creation, quality jobs, and reinvestment in the historically disinvested communities where we work. The 2019 "State of the Sector" report recently released by the US Federation of Worker Cooperatives highlights that worker-owners are 60% people of color and 62% woman. Worker-owners make an average of $19.67 per hour, well above the minimum wage in every state. Even more compelling is the fact that the average patronage refund (or profit sharing) per worker-owner is $8,241- this is wealth would not exist without ownership in the company.

In an effort to grow worker co-ops nationwide, Capital Impact Partners is involved in the Workers to Owners Collaborative, a national group convened by the Democracy at Work Institute focused on creating a sustainable ecosystem. We were very enthusiastic about the passage of the Main Street Employee Ownership Act spearheaded by Chairwoman Velazquez. With the impending sale of millions of small businesses owned by baby boomers, there is a huge opportunity to grow worker co-op conversions to scale with a focus on equity and low-income communities. In order to quantify this opportunity, Capital Impact released a publication in 2018 entitled "Co-op Conversions at Scale" which demonstrated a solid market opportunity for transactions over $800,000 in target geographies and sectors in addition to recommendations for the field.

In October of 2018, Capital Impact Partners organized a national convening around financing worker co-op conversions to engage more mission-focused financial instructions and ultimately increase the number of capital providers in the ecosystem. "Financing the Preservation of Legacy Businesses" was held in New York City with over 70 attendees from financial institutions (CDFIs, credit unions, and local banks) learned about the conversions ecosystem, underwriting, risk, business valuation, and technical assistance. The keynote speaker was Chairwoman Nydia Velazquez who highlighted the impact of employee owned businesses on her district and the potential for national impact. There was also a representative from Senator Kirsten Gillibrand's office who led a lunch discussion on future policy initiatives and the implementation of the Main Street Employee Ownership Act. This event demonstrated that there is a new cohort of financial institutions that are eager to finance worker cooperative conversions and are motivated by the opportunities created by the Main Street Employee Ownership Act.

Capital Impact also supports the growth of the worker co-op ecosystem through our annual Co-op Innovation Award grant. This award supports innovative and replicable strategies for expanding cooperatives in communities of color and/or historically disinvested communities. The six past grantees have leveraged their combined $200,000 in awards to secure more than $2.9million in additional funding from foundation, investors, and government. We know that unlocking government support and funding is critical for scale, as demonstrated by USDA investment in the growth of the rural electric and agricultural cooperative sectors in the U.S.

While Capital Impact Partners is very excited about the potential for scale, the SBA personal guarantee requirement creates an unnecessary barrier to lending. Capital Impact Partners has never required a personal guarantee from a cooperative borrower; we do not believe that one member should have to use their home or personal assets as collateral for the co-op as a whole. This is particularly prohibitive to low-wage workers in industries that have seen growth in worker ownership in recent years including home care, childcare, professional services, and retail.

The cooperative sector has been working for years with the SBA to implement practical alternatives to the personal guarantee and we were hopeful that the Main Street Employee Ownership Act would be a catalyst for change. We were disappointed that the SBA hearings in March of 2019 did not result in policy changes that would remove the personal guarantee requirement and give worker owners fair access to SBA loan products. The Department of Agriculture's Business and Industry loan program does not require a personal guarantee and Capital Impact has been able to utilize this program to finance food cooperatives.

Through our years of underwriting small business cooperatives, Capital Impact Partners has developed an in-depth understanding of the cooperative ownership structure. Our strong track record of lending to cooperatives demonstrates that these businesses often are more successful, impactful, and resilient than traditional businesses. Capital Impact Partners appreciates the Committee on Small Business conducting a congressional hearing to support cooperative businesses and their ongoing attention to removing barriers that would increase financial resources and promote growth of the model.

Alison Powers
Manager, Cooperative and Community Initiatives

Introduction

I am the founder and former executive director of the National Center for Employee Ownership, a nonprofit membership, research, and information organization that is widely considered the leading source of information on employee ownership. As a former academic, I founded the organization on the belief that objective, reliable information about this topic was essential.

Prior to founding the NCEO in 1980, I was a Congressional staff member and wrote the Small Business Employee Ownership Act of 1979. That bill was based on the way ESOPs were used then. At that time, most ESOPs were funded by loans directly to the ESOP trust. The SBA would not make a loan to the trust, so ESOPs were excluded from these loans. Loans were not being made through preferred lenders then either. The Main Street Employee Ownership Act changed the rules to make these loans more available. The SBA was not eager to implement the program, however, and did not want to issue an SOP for the program until pressured to do so by Congress. Even then, it was almost never used because potential borrowers found local SBA offices did not know about the program or did not like the idea if they did. Rules for SBA loans for business transition in general were also not friendly to the way ESOPs were actually used in real life, particularly requirements for sellers to exit the business entirely and for some equity to be held outside the ESOP.

The Main Street Employee Ownership Act was intended to change this, but because of the way the SBA has interpreted the law, it is still rarely used. For those of us involved in working on what this new law should and hopefully would do, this has been very frustrating.

The law also directed the SBA to set up and report on outreach programs intended to educate business owners on ESOPs and employee ownership. While some SBA offices have done very good work on this, most have done nothing, and there has been no report.

Aside from the Main Street Employee Ownership Act issues, the SBA's 8(a) set-aside rules make it impossible for majority ESOP-owned companies to qualify, even if they are run and/or primarily owned (through the ESOP) by qualifying individuals. As a result, companies with lots of qualifying individuals who now could become owners and have the substantially better retirement benefits that has been often seen in ESOPs, cannot qualify for these programs.

This testimony briefly reviews why the SBA should be promoting ESOPs and then discusses changes in the loan program, set-aside program, and outreach program that could help support this important, bipartisan idea.

The Economic Significance of Employee Ownership for Small Business

As baby boomers are retiring, the number of small businesses going through a transition is increasing significantly. Some will be sold to private equity, some will sell to a large company, some will pass on to family members or managers, and many will just liquidate in place. For many business owners, none of these options is optimal. Concerned not just about the value they will get for the business, but the values they want to preserve, finding a way to keep the business an independent, active member of the community, and continuing to provide good jobs for the people who built it, is a primary goal. Many of these owners also want to keep some active role in the company, something a sale usually does not allow.

ESOPs were created by Congress as a means to provide these owners with a tax-efficient, flexible solution, one that has been well described in other testimony to their committee. At the NCEO, we estimate that at least 150,000 to 175,000 closely-held businesses (the large majority meeting the definition of a small business) are good ESOP candidates, but only about 6,000 businesses in America are currently owned by an ESOP. Congress has been generous with tax incentives for ESOPs, with every bill passing with virtually no opposition. But ESOPs remain relatively unknown and/or misunderstood in the target community. The SBA could play a major role in changing that.

That would be a boon for these owners, their communities, workers, and the economy. Recent research based on data from the Bureau of Labor Statistics shows that people in employee stock ownership plans (ESOPs) have significantly higher incomes, net worth, job tenure, and access to a wide array of benefits than those not in these plans. This holds particularly true for women and people of color. These same groups, of course, are the target of small business set aside programs. Yet the vast majority of ESOP owned companies cannot participate in set aside plans, even if they are run by and/or primarily benefit target populations. (You can see a report on the data on ESOPs and financial well-being at www.ownershipecon.org and broader data at http://www.nceo.org/articles/studies-employee-ownership-corporate-performance; at the end of this article, I have appended a table of key studies).

Issues with SBA ESOP Loan Program

There are two prominent issues for companies wishing to use the revised SBA ESOP loan program. The first is that the loans still must go through the SBA, not the preferred lenders the drafters of the bill had intended would now be able to make these loans. This can slow the process substantially and add uncertainty because the SBA may end up not approving the loan. Many potential borrowers tell us they are unwilling to take these risks.

Second, the SOP for the program requires an unrealistic equity position outside the ESOP.

Specifically:

b) Changes of ownership:

i. Resulting in a new owner (complete change of ownership): **<u>At a minimum, SBA considers an equity injection of at least ten (10) percent of the total project costs</u>** (all costs required to complete the change of ownership, regardless of the source of funds) to be necessary for such transactions. Seller debt may not be considered as part of the equity injection unless it is on full standby for the life of the SBA loan **<u>and it does not exceed half of the required equity injection</u>**;

This effectively means that the ESOP must be structured with at least a 5% equity investor. This raises serious barriers:

Most ESOP transactions now are for 100% transfers. Because earnings attributable to an ESOP in an S corporation are not taxable, this allows the company to elect S status and, under federal tax law, effectively pay no tax (the tax is eventually paid by employees when they get distributions of their earnings). S corporation law, however, requires that any distributions made to owners be paid pro-rata to all owners.

So assume that an outside investor could be convinced to purchase a 5% equity interest. That owner will get a K-1 statement requiring that he or she pay taxes on their share of the company's earnings. S corporations will typically pay an earnings distribution equal to this amount. So the ESOP must get ***19 times*** that amount in its distribution, even though it does not pay the tax. That is not a workable scenario for any company. No investor will simply agree to pay the taxes on their own unless they were provided a substantial discount on the shares, but doing that would violate ERISA valuation rules because the ESOP cannot pay more than other investors for the same class of stock, and S corporations can only have one class of stock.

Because ESOPs are funded by the employer, and employees rarely have the discretionary funds or risk tolerance to invest in company stock, the equity rules are unrealistic. The rules assumes that if employees do not invest, and outside investor would. Finding an outside investor is a tremendous challenge, however, as few people want to buy a minority stake in a closely held company. If the company is an S ESOP, that minority investor would also (because of S corporation rules) require a distribution of earnings to pay taxes, but the ESOP has to get a pro-rata share of these distributions. So a 90% ESOP with a 10% investor would get a distribution nine times what the investor gets.

Because of all this, it is simply not usually worth the bother for companies to pursue SBA loans as a result.

A better solution is to allow the seller note to qualify for the entire equity commitment. Our research shows that ESOP companies default on acquisition loans at a rate of two per thousand per year, a rate that no doubt is considerably better than SBA loans in general. The law was intended to make it easier for companies to use the SBA program for ESOPs. The procedures now in place, however, continue to make it very difficult.

Issues with SBA Set-Aside Rules

SBA rules for minority, veteran (including service-disabled veteran), and woman-owned businesses are widely used for various state and federal agencies to determine eligibility for set-aside programs. ESOPs operate by companies funding an employee stock ownership plan trust to hold shares beneficially for employees, with participation rules much like other qualified retirement plans. The trustee is considered the legal shareholder. Under SBA rules, a trust does not qualify as an owner under the set-aside rules even if the trustee is a member of the qualifying group or the stock is primarily held by members of the qualifying group.

If an existing company that qualifies under the rules converts to an ESOP owning more than a majority of the shares, by definition, it loses its set-aside status. If a company that is majority owned by an ESOP applies for a set-aside program, it will be denied.

This can create a serious anomaly. A company may still be run by a member of a qualifying group and may be employing members of that group (who may, through their ESOP accounts own a majority of the stock), but it will be denied qualification, even though the research shows it is likely providing substantially better retirement benefits, more stable jobs, better pay, and more benefits. So company A, owned entirely by one qualifying individual, gets the substantial benefit of a set-aside, while company B, run by a member of a qualifying group and sharing its ownership widely with said group, does not. This seems contrary to the program's intent to make the benefits of capitalism more widely available to qualifying individuals—many of whom would never be in a position to start their own qualifying companies.

We believe that changing these rules deserves serious consideration. In one approach, trusts could be "looked through" to determine if a majority of the company's shares are held by qualifying individuals. Companies would be required to submit a report annually to maintain qualification.

As alternative approach would be to rule that any company that is majority ESOP owned and is run by a CEO or other top officer who is of the target population and has a board with a majority from the target population would qualify. We believe this does two things. This meets the objective of set-aside programs to support businesses run by qualifying busihesses on the assumption that they are more likely to hire people from those populations and adds the benefit of broad ownership for those people. The rules could provide that companies would have to meet both criteria.

Finally, the rules could simply provide for a grandfathering of qualifying companies that convert to an ESOP for a defined number of years.

Creating a More Effective Outreach Program

While some SBA offices, most notably the Washington, D.C. and San Francisco district offices, have been very proactive in developing an outreach program, there is still relatively little being done.

That is an enormous wasted opportunity. Because of tax benefits already in place, many more ESOPs would be created if business owners knew how they work. Business brokers generally are averse to ESOPs because the ESOP is an internal buyer and the brokers make their money by finding outside buyers. Most accountants are not familiar with ESOPs and don't encourage their clients to consider them.

A local office can create an effective outreach program for very little cost and time. Existing organizations, such as the NCEO, Project Equity (especially for worker cooperatives), the ESOP Association, and various state-level programs all have ready-to-use materials the office can reproduce or hand out. These organizations can provide speakers for webinars and for seminars. SBDCs can use meeting facilities at their institutions to host event. The SBA's main role can simply be to do the mailings to either get people to the webinars or seminars or to send out material. The D.C. office can provide a practical, effective model.

Astonishingly, despite the new law, the SBA web site's section on selling your business does not even mention ESOPs or worker cooperatives, nor is there a single article on what an ESOP or worker cooperative is. We have reached out to help with content, nut with no response.

In short, for a marginal effort, the SBA could comply with the terms of the Act, and we urge it to do so. We also urge the SBA to comply with the Act and issue a report on its outreach efforts.

Appendix: Key Studies on the Economic Impact of Employee Ownership

Type of Plan	Performance Measure	Study Period	Performance Impact	Source

ESOPs, Private Companies	Annual growth post-ESOP relative to pre-ESOP, indexed for comparable company data	1988-1997	Sales growth: +2.4% Employment growth: +2.3% Productivity growth: +2.3%	Joseph Blasi, Douglas Kruse, and Dan Weltmann, "Firm Survival and Performance in Privately-Held ESOP Companies," *Sharing Ownership, Profits, and Decision-Making in the 21st Century* (Advances in the Economic Analysis of Participatory & Labor-Managed Firms, Volume 14), 2013, pp.109-124.
	Annual growth post-ESOP relative to pre-ESOP, indexed for comparable company data	1982-1986	Sales growth: +3.8% Employment growth: +3.4%	Michael Quarrey and Corey Rosen (both of the National Center for Employee Ownership), Harvard Business Review, Sept/Oct 1987
ESOPs, Public Companies	Tobin's Q (the ratio of the company's stock value to its book equity value)	1980-2004	ESOPs led to an 8.12% increase in Tobin's Q relative to the industry median.	"Employee Capitalism or Corporate Socialism? Broad-Based Employee Stock Ownership," E. Han Kim of the University of Michigan and Page Ouimet of the University of North Carolina, paper for American Finance Association 2010 Annual Conference
	Return on assets, profits, return on equity,	1998-2004	Compared to comparable companies: Return on assets: +5.5% Net	Robert Stretcher, Steve Henry, and Joseph Kavanaugh, "The ESOP Performance

	and sales growth		profit margin: +10.3% Return on equity: +5.6% Sales growth rate: -0.8%	Puzzle in Public Companies," Journal of Employee Ownership Law and Finance, Fall 2006
	Tobin's Q, long-term investment, operating risk, productivity, and growth	1995-2001	Compared to all non-ESOP companies: Median Tobin's Q: -9.0% Median annual sales growth: -3.0% Total factor productivity: -4.7%	Faleye,Olubunmi, Vikas Mehrotra, and Randall Morck, "When Labor Has a Voice in Corporate Governance," National Bureau of Economic Research Working Paper, No. 11254, 2005
Employee Ownership and Millennial Financial Health	Millennials saying they are in employee stock ownership plans report substantially higher income, wealth, and access to benefits than those not in plans	2017	33% higher median wages 92% higher net household worth 2.6 times more likely to receive tuition benefits Workers of color, low income workers, and single parents all also have substantially better outcomes	Nancy Wiefek, National Center for Employee Ownership, Employee Ownership and Economic Well Being, 2017
Public Companies with ESOPs Lay People Off Less in Recessions	Public companies with ESOPs provided much more job stability in previous two recessions	2017	Companies with no employee ownership plans cut jobs by 3% for each 1% increase in the unemployment rate; companies with ESOPs by just 1.7%. Companies with ESOPs are 75% as likely to go out of business	Fidan Kurtulus and Douglas Kruse, How Did Employee Ownership Firms Weather the Last Two Recessions? Employee Ownership, Employment Stability, and Firm Survival:1999-2011, Upjohn Institute, 2017

ESOPs and Employee Compensation	Salaries and retirement benefits compared to comparable employees in comparable companies using all ESOP companies in Washington State and a sample of comparable non-ESOP companies	1997	Wages 5% to 12% higher Total retirement assets 2.6 times greater Diversified retirement assets roughly comparable	Peter Kardas and Jim Keogh of the Washington Department of Community, Trade, and Economic Development, and Adria Scharf of the University of Washington, "Wealth and Income Consequences of Employee Ownership," National Center for Employee Ownership, 1998
	Public companies with ESOPs compared to comparable non-ESOP companies	1980-2004	Effect on employee compensation in ESOP companies owning: Less than 5%: + 0.8% More than 5%: + 5.2%	"Employee Capitalism or Corporate Socialism? Broad-Based Employee Stock Ownership," E. Han Kim of the University of Michigan and Page Ouimet of the University of North Carolina, paper for American Finance Association 2010 Annual Conference
	Participation in other retirement plans for ESOP participants; value of company-contributed assets to retirement plans in ESOPs versus non-	2004-2007	ESOP participants are at least as likely to participate in a second retirement plans as comparable non-ESOP participants are likely to be in any retirement plan. Company contributed assets to retirement plans in	Loren Rodgers, National Center for Employee Ownership, analysis of Form 5500 filings for all ESOPs and data from the Employee Benefit Research Institute (2010)

	ESOP companies.		ESOP companies are 2.2 times greater than company-contributed assets to retirement plans in non-ESOP companies.	
	Public companies with ESOPs have 4% greater overall compensation.	1991-2011	ESOPs in public companies had 4% greater overall compensation than public companies without ESOPs.	Fidan Kurtulus and Douglas Kruse, "How Did Employee Ownership Firms Weather the Last Two Recessions? Employee Ownership, Employment Stability, and Firm Survival:1999-2011," Upjohn Institute, 2017
Employee Ownership and Layoffs	2002, 2006, 2010, and 2014 General Social Survey.	2002-2014	Working adults who reported being in employee ownership plans were one-third to one-fourth as likely to report having been laid off in the prior year as those not in these plans.	Data compiled by Joseph Blasi and Douglas Kruse, Rutgers University.
Stock Options and Corporate Performance	Performance of public companies with broad-based stock option plans (more than 50% of full-time employees receive grants) compared with comparable	1997-2002	Companies with broad-based plans saw productivity rise 20% to 33% above comparable firms after plans were implemented, with medium-sized firms at the higher end of the scale.	James Sesil and Maya Kroumova, "Broad-Based Stock Options Before and After the Market Meltdown," Rutgers Working Papers, 2002.

	companies without plans.			
	Before-and-after performance of public companies with broad-based option plans (same definition as above). Companies in three-year post-plan period compared to before and after data for comparable companies without plans.	1985-1987 and 1995-1997	Productivity: +14.8% Return on assets: +2.5%	Joseph Blasi, Douglas Kruse, Maya Kroumova, and James Sesil, Broadly Granted Stock Options Improve Corporate Performance
	Industry-adjusted return on assets in the 44% of S&P Super 1500 companies that had option plans where more than half the value of the awards went to the bottom 90% of the work force.	1997-2004	"A move from the 25th percentile of per-employee delta [that is, increased option grants per employee] to the 75th percentile of per employee delta implies an increase of 0.17% in ROA and a 0.15% increase in cost-adjusted ROA. Since the average per employee delta in our sample is about $760, a $1000 increase represents a little over a doubling of pay to performance sensitivity." Only companies with fewer	Yael Hochberg and Laura Anne Lindsey, "Incentives, Targeting and Firm Performance: An Analysis of Non-Executive Stock Options," *Review of Financial Studies* vol. 23, no. 11 (November 2010)

			than the median number of employees saw improvement, however, and in companies with narrowly focused awards actually, options had a negative impact on performance.	

Note: To be included, studies must look at employee ownership companies compared to similar non-employee ownership or all non-employee ownership companies. Company performance studies must compare pre-ESOP to post-ESOP performance relative to the competition. The studies selected represent the most recent studies that have the largest and most representative samples. There has been no attempt to include only positive studies. For details on all of the major research on this topic, see our publication Employee Ownership and Corporate Performance for a detailed summary.

NCBA CLUSA
The National Cooperative Business Association • CLUSA International

Testimony of Doug O'Brien
President and CEO, National Cooperative Business Association CLUSA
House Committee on Small Business
Hearing on "Challenges and Benefits of Employee-owned Small Businesses"

February 18, 2020

Chairwoman Velazquez, Ranking Member Chabot, Members of the Committee, thank you for the opportunity to provide written testimony to the U.S. House of Representatives Committee on Small Business about the benefits of cooperative businesses and the challenges co-ops face.

The National Cooperative Business Association (NCBA CLUSA) is the apex association of cooperative businesses across all sectors of the economy, including worker co-ops. Our mission is to protect and defend the cooperative business model and promote the use of cooperatives to help people capture economic opportunity and address economic and social challenges.

The issue of employee ownership is timely and critical to the future health of our economy and local communities. More and more people are looking to the cooperative business model as a key strategy to establish and maintain small businesses in their community - including Baby Boomers who are looking for options to sell their businesses and workers who are interested in having a stake in the business and the local economies. We also see more and more people coming together to form new businesses of nearly every type and seeking to use the cooperative business model so the workers can own, control, and benefit from the businesses where they work. One of the biggest hurdles these small business owners and workers face is the lack of an unfriendly policy environment, including the lack of access to SBA loan programs.

With the right policy support, cooperatives have gone to scale and helped transform several industry sectors in the United States. Today, one in three Americans is a member-owner of at least one cooperative business, cooperatives that exist in every congressional district in the nation. Many of you are familiar with the cooperative sectors that have gone to scale – agriculture marketing cooperatives, rural electric cooperatives, and credit unions, which are financial cooperatives. These co-op sectors have gone to scale because of the drive and collaboration of its members, as well as because of a robust scaffolding of sensible federal policy that reflects the special nature of the cooperative business structure. For nearly 100 years, Congress has enacted federal laws to help people establish these unique businesses that are owned, controlled, and benefit the members – the people who use the business. Some key examples include the Capper-Volstead Act and the Farm Credit Act for the agricultural sector; Federal Credit Union Act for consumer finance; and the establishment of the Rural Electrification Administration for rural utilities.

Of the 65,000 cooperative businesses in the United States, about 465 are worker cooperatives[1]. While worker cooperatives can certainly grow to scale, like the Cooperative Home Care

[1] Democracy at Work Institute, State of the Sector Report 2019.

Associates which now has more than 2,000 employees, the average size of a worker cooperative is 50 employees, and the median size is ten. Worker co-ops compete in the market like any other business. What distinguishes cooperatives is that they are member-owned and controlled businesses, so they operate in the best interest of its workers who are focused on the long-term viability of the business.

Employee ownership has numerous benefits. By giving workers an ownership stake in the company, cooperatives are an excellent model to promote economic mobility. As the decision-makers of the company, worker co-ops ensure each voice is heard equally. This results in higher productivity than non-cooperative businesses, higher wages for workers and less workforce turnover. Moreover, worker cooperatives have proven to be more resilient than non-cooperative businesses in economic downturns, in no small part because as owners, the workers have a vested interest in the long-term success of the business. According to research at the University of Missouri – Kansas City, 21 percent of conventionally-owned U.S. businesses fail after the first year and 51 percent of conventionally-owned U.S. businesses fail after five years. Globally, once worker cooperatives are created, "the expected survival of worker cooperatives meets or exceeds that of conventional firms."[2]

Our nation faces an immense opportunity. According to the U.S. Census, Baby Boomers are about 40 percent of the U.S. population, totaling approximately 74.9 million people. Over the next decade, 10,000 Baby Boomers will turn 65-years-old *every day.* And while many Baby Boomers work past retirement age, our economy can anticipate a massive shift as most of the people in this generation move out of the workforce. Moreover, Baby Boomers are the owners of over half of all small businesses in the United States. While some owners may choose to simply close their business, a better option – for the owner, the workers, and the community the business has served – is to convert the ownership of the business to a cooperative. Converting to cooperative ownership ensures that not only the owner earns the profits of their hard work, but that the workers who have contributed to the success of the business for so many years have the opportunity to improve their own economic standing and become owners of the business. Importantly, these conversions also ensure that necessary goods and services are still available to communities across the country who have come to depend on their local small businesses.

In recognizing the economic opportunity generated by a wave of retirements, the House Small Business Committee led the passage of the bipartisan Main Street Employee Ownership Act in 2018, the first major employee ownership law in decades. The law states,

> *It is the sense of Congress that cooperatives have a unique business structure and are unable to access the lending programs of the Administration effectively due to loan guarantee requirements that are incompatible with the business structure of cooperatives.*

The law required the Small Business Administration to, "**study and recommend practical alternatives** for cooperatives that will satisfy the loan guarantee requirements that are incompatible with the business structure of cooperatives," in coordination with lenders,

[2] Olsen, Erik K., "The Relative Survival of Worker Cooperatives and Barriers to their Creation". University of Missouri Kansas City (2013).

stakeholders and Federal agencies, and provide recommendations from the report and, "a plan to implement such recommendations."

NCBA CLUSA appreciates SBA's engagement through two listening sessions – one in-person and one virtual – to hear recommendations from the employee ownership community. Unfortunately, the report was not only disappointing in its recommendations and conclusions, but also potentially recommended additional hurdles for businesses to convert to worker cooperatives.

The report highlights the Small Business Administration's meeting with the U.S. Department of Agriculture, another federal agency that features extensive loan programs and the obligation to manage the risk of the loan portfolio. USDA's Business and Industry (B & I) Guaranteed Loan program is like SBA's 7(a) program with two exceptions:

First, in the SBA's own words, "Unlike SBA, USDA does not require each loan to be guaranteed by at least one individual or entity." Instead, USDA requires collateral from the cooperative and, in some cases, requires the co-op to sign an agreement to withhold profit-sharing until the guaranteed loan is repaid. In recognizing the strength of shared risk, USDA does not require a personal guarantee when a cooperative stake does not exceed 20 percent. That is, in co-ops of five or more, USDA does not require individuals to fulfill a personal guarantee requirement. Cooperatives are not seen as an exception at USDA, simply a different model to which USDA has outlined requirements so that cooperatives may equally participate in federal programs.

Second, a business is eligible for a USDA B & I loan guarantee only if it is located in a community with a population of 50,000 or less. That means that businesses that are located in urban areas do not have access to the sensible lending requirements used by USDA and that make it possible for co-ops to access these critical loans. This leaves cooperatives as, what we believe to be, the only business formation that the Small Business Administration does not serve. This problem will be exacerbated after the 2020 Census, in which some cities will narrowly surpass the 50,000-population threshold.

USDA's Business and Industry Guaranteed Loan program typically supports mid-size businesses to start-up, expand, or invest in things like machinery. USDA limits maximum percentages of guarantees based on the loan amount, and the borrower must meet various requirements before receiving a guarantee. While the maximum loan amount under this program is $25 million – though can be up to $40 million with the Secretary of Agriculture's approval – the average loan guaranteed through this program is $3 million.

According to the Small Business Administration[3], under the 7(a) program, SBA guarantees loans ranging from $25,000 to $5 million. Cooperative lenders report significantly lower loan amounts, with most lenders ranging from $1,000 to $2 million available to cooperatives; the National Cooperative Bank lends up to $12 million. A start-up loan for a worker cooperative typically ranges from $10,000 to $30,000. Generally, these cooperative lenders require collateral on loans, but in recognition the cooperative model, do not require personal guarantees.[4]

[3] https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf
[4] https://institute.coop/sites/default/files/resources/DAWI%20-%20Investing%20in%20Worker%20Ownership.pdf

In the meeting between USDA and SBA, USDA recommended two options to SBA to ensure that cooperative businesses could fairly access SBA financing. First, that SBA waive the personal guarantee requirement when a loan is fully collateralized. Second, that SBA waive the personal guarantee and instead require the cooperative agree to withhold profit-sharing until the guaranteed loan is repaid. Disappointingly, SBA's response to these recommended alternatives to the personal guarantee from a Federal agency was that the options were not a personal guarantee. This response made clear that SBA was not interested in Congress' clear direction that the agency recommends alternatives to the personal guarantee.

Moreover, while SBA describes the personal guarantee as the lynchpin of the 7(a) program, SBA provides waivers to the requirement on guarantees for loans to Employee Stock Ownership Plans (ESOPs). SBA can guarantee loans made to the employee-owned business when employees own a majority stake in the company, as opposed to being limited to guaranteeing loans to the employee trust. Cooperatives, necessarily being 100-percent employee-owned, are not afforded this same benefit by SBA.

Since the SBA has clearly indicated it will not modernize its regulations to serve cooperative businesses as Congress has intended, we recommend Congress act to ensure that cooperatives have access to this critical loan program. We understand that Congress must balance the needs of small businesses while limiting the risk to taxpayers. Both USDA and stakeholders presented potential strategies that meet both of these needs. For example, guaranteeing loans to cooperative businesses without requiring a personal guarantee. SBA could implement this policy by using the business requirements and indicators that USDA uses in its Business and Industry program to ensure taxpayers are protected.

The structure of cooperatives makes the businesses more resilient, innovative, and sustainable. Yet the Small Business Administration sees the structure as an obstacle. With each member having an equal stake in the cooperative, there is no singular owner entirely on the hook. It is the shared risk among worker-owners that makes the business significantly less likely to fail than other types of business models.

Small business owners and workers face an amazing opportunity with the potential growth of worker cooperative. To help people capture this opportunity, we strongly believe the most important thing Congress can do is ensure that cooperatives have access to the SBA lending programs. NCBA CLUSA urges Congress in the strongest terms to level the playing for cooperative businesses at SBA so that these businesses owned by people in the community have an opportunity to thrive.

Again, thank you for the opportunity to provide written testimony. NCBA CLUSA stands ready to support your work on this critical issue.

CRF
USA

Capital for Communities –
Opportunities for People

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Testimony submitted to

The House Small Business Committee

by Frank Altman

Chief Executive Officer, Community Reinvestment Fund, USA

Chairwoman Velazquez, Ranking Member Chabot and Members of the House Small Business Committee, I want to thank you for convening the hearing on February 12, 2020 to discuss the challenges and benefits of employee-owned businesses. I appreciate the opportunity to contribute to the committee's hearing by submitting this testimony and offering my insights as CEO of Community Reinvestment Fund, USA regarding why and how we can support employee-owned businesses.

CRF is a national Community Development Financial Institution (CDFI), and a leader in channeling resources from the capital markets to support community economic development and helping mission-driven organizations improve efficiency and build capacity. Our mission is *to empower people to improve their lives and strengthen their communities through innovative financial solutions*. For the past 32 years we have worked with community partners, investors, foundations, and financial institutions to deliver nearly $2.5 billion in loans, investments, and bonds, resulting in the creation or preservation of 85,000 jobs, the financing of nearly 19,600 affordable housing units and funding for a wide range of community facilities. Since its inception, CRF has financed more than 2,000 small business loans, over 600 of which were made to businesses owned by women or people of color. To date, CRF has deployed resources in more than 1,000 communities in 49 states and the District of Columbia and served more than 1.8 million people.

In the midst of the Great Recession, when faced with the dramatic contraction in bank lending, CRF sought a new tool to connect underserved small business owners and firms located in distressed communities with access to a responsible credit product specifically designed to serve companies unable to secure conventional bank loans. We acquired one of 14 national non-depository SBA 7(a) licenses to offer this government guaranteed loan to support our mission of lending to small businesses located in low- and moderate-income (LMI) areas or owned by people of color, women and/or veterans. Over the past seven years, CRF has developed significant expertise in the 7(a) product as one of only three CDFIs that operates a Small Business Lending Company (SBLC). CRF has made more than 468 7(a) loans totaling $241,975,773. These loans support 7,771 jobs. CRF is a Preferred Lender under the SBA 7(a) program and has been ranked among the top SBA 7(a) lenders nationally. In addition to being an active SBA lender, we also developed an end-to-end, proprietary loan origination software (known as SPARK) specifically designed to help lenders improve their efficiency and ease in making 7(a) loans. This software is being used by CDFIs, banks, lender service providers as well as marketplaces.

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As a SBA 7(a) lender, we are particularly interested in the efforts of this Committee to promote and support cooperatively owned businesses and we would like to offer our perspective on how to expand access to credit for cooperatively owned businesses. We reviewed and were disappointed with the Small Business Administration's (SBA) recent report to Congress, "Cooperative Lending – Personal Guarantee Requirement" that was required under the bipartisan Main Street Employee Ownership Act you sponsored and worked to advance in the National Defense Authorization Act of Fiscal Year 2019 (Public Law No. 115-232). This legislation specifically asked SBA to "study and recommend practical alternatives for cooperatives that will satisfy the loan guarantee requirements of the Administration."

Access to capital is the lifeblood of small businesses across the country. The focus of CRF's lending and programmatic activities is to enable underserved small business owners and firms located in disinvested communities to access the credit they need to be sustainable and successful. As we all know, the wealth gap and growing income inequality have created an enormous divide in our nation between the "haves" and "have nots". By 2015, America's top 10 percent already averaged more than nine times as much income as the bottom 90 percent. And Americans in the top 1 percent averaged over 40 times more income than the bottom 90 percent. (https://www.thebalance.com/income-inequality-in-america-3306190) We strongly believe that one way to address this divide is provide ways for employees to become owners of the companies in which they work. Ownership provides the chance to accumulate wealth that can be passed down to future generations.

We are at an inflection point in our country and have a rare opportunity to expand employee ownership to workers at firms owned by aging baby boomers who are seeking to sell their businesses. This trend, known as the "*silver tsunami*" could result the massive sale of small businesses over the next several decades. According to one source (https://www.genequityco.com/insights/baby-boomer-business-owners-the-retirement-conundrum), there are some 12 million baby boomers business owners and 70 percent of them will be retiring over the next few decades. This source estimates that if 40% of them close their businesses or sell them to a family member or employees, we could see 480,000 businesses come on the market each year for the next 15 years. If these firms were to be converted to cooperative ownership, they could provide a path to building wealth, especially for low- and moderate-income workers. But to truly take advantage of this opportunity, we need to increase the financing tools available to cooperatives and, in particular, those like the 7(a) loan product that offer a government guarantee.

The Main Street Employee Ownership Act directed the SBA to come up with ways to increase the availability of the 7(a) product a financing option for cooperatively owned businesses. Unfortunately, the SBA was not able to provide any practical alternatives to the personal guaranty despite clear direction from Congress.

We strongly believe we can find a workable alternative to allow greater use of the 7(a) loan product as financing tool for cooperative businesses. This opening aligns with a vital provision included in the 2017 Tax Cuts and Jobs Act known as the Opportunity Zone Act which offers investors significant tax deferral benefits for both their initial investment in an Opportunity Zone Fund as well as any subsequent appreciation on their investment. CRF is looking carefully at the Opportunity Zone provision as a means of getting capital into operating businesses located in designated low-income areas. These tax benefits could be "game changers" for firms seeking equity and growth capital. However, a key challenge Opportunity Zone Funds face is how to provide an exit for investors after the 10-

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year term of the tax benefit has expired. Unlocking the ability for 7(a) loans to finance cooperatives would make it easier for business owners to sell their companies to their employees. This tool could expand the pool of potential buyers for these businesses and would be especially powerful when those employees have not been able to accumulate wealth through savings and/or homeownership.

CRF would welcome the chance to work with the Committee to explore a range of possible access to capital options for employee-owned small businesses and share our experience as a seasoned SBA 7(a) lender with a strong community development mission. Please do not hesitate to contact me with questions about this testimony and how we could provide information or be of any assistance as the Committee considers this important issue.

COOPERATIVE FUND
of New England

February 25, 2020

The Honorable Nydia Velazquez
Chairwoman
Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Steve Chabot
Ranking Member
Committee on Small Business
2069 Rayburn House Office Building
Washington, D.C. 20515

Hearing on "Challenges and Benefits of Employee-owned Small Businesses"

Dear Chairwoman Velazquez and Ranking Member Chabot:

Thank you for your work, as leaders of the House Small Business Committee, to create economic opportunities for everyone and for the opportunity to share this testimony.

As the Executive Director of the Cooperative Fund of New England (CFNE), a 45-year old community development financial institution (CDFI) dedicated to financing New England's cooperative business sector, I ask for your continued support for passage and implementation of federal policy promoting employee-owned companies. Cooperatives and ESOPs are critical to providing shared economic opportunities to people who lack such opportunities at the individual level.

Since 1975, CFNE has deployed over $60 million in loan capital and business development technical support to help small business co-ops across our region create and preserve thousands of jobs and hundreds of thousands of shared small business ownership opportunities. With assets over $32 million and a $26 million loan portfolio, including 100 active loans, CFNE has significant and growing experience deploying and managing public and private resources to cooperative enterprises. Our activity in 2018 and 2019 set new organizational records for loan volume deployment, reaching over $7.5 million each year- 50% more than our previous high. This is just one reflection of the growing interest in cooperative business to meet varying community needs, including the small business succession crisis, the lack of decent jobs in many underserved communities, and the lack of affordable healthy food in "food deserts".

As a CDFI we are able to use underwriting criteria customized to the shared ownership structure of co-ops to not only support business launch and growth, but maintain a historic loss rate of under 1.5%. One key difference between CFNE's underwriting criteria and those of conventional lenders is that we rarely require personal guarantees to secure our loans, instead identifying other sources of collateral, including business assets and social investments. The fact that the Small Business Administration still requires guarantees 1) prevents the critical 7(a) loan guarantee program from financing co-op small businesses, and 2) prevents most other lenders, who often rely on SBA 7(a) programs, from financing cooperatives.

The SBA has financing tools that, if tweaked, would work for the broad co-op business sector, including both the Microloan program and the currently closed Intermediary Lending Pilot (ILP) Program. While both of these programs allow intermediary lenders to use their own underwriting criteria, both have extremely low loan size caps ($50,000 for Micro and $200,000 for ILP) and the ILP program hasn't received loan capital funding since 2012. CFNE has been an ILP participant since 2011, recycling its $1 million ILP loan to deploy $1.7 million to 18 worker and producer owned co-ops in our region.

Congress could use existing SBA tools to level the playing field for co-ops. One such path would revive and reorient the ILP Program to lenders of employee-owned businesses and increase the loan caps both from the SBA to intermediaries (currently at $1 million) and the cap on loans from the intermediaries to the businesses (currently at $200,000). Furthermore, the SBA could follow the lead of the US Treasury's CDFI Fund by deferring principal repayment until maturity, to avoid diminishing loan capital over the life of the loan. Finally, tying this program to a technical assistance grant program, like occurs in the SBA Micro program, the SBA would allow intermediaries the resources to foster small business development in urban and rural underserved communities.

Evolving or complementing existing SBA financing programs to allow federal support to small business co-ops would remove a significant hurdle to development of shared ownership opportunities for communities excluded from the benefits of conventional economic development. Thank you for considering how your committee can advance this issue.

Sincerely,

Micha Josephy

Micha Josephy
Executive Director

CooperationWorks!
THE COOPERATIVE DEVELOPMENT NETWORK

Testimony for the House Committee on Small Business

Hearing on "Challenges and Benefits of Employee Owned Businesses"

Alex Stone, Executive Director
CooperationWorks!
February 28, 2020

Chairwoman Velazquez, Ranking Member Chabot, and Members of the Committee:

I appreciate the opportunity to provide written testimony to the U.S. House of Representatives Committee on Small Business.

CooperationWorks (CW) is the national network of cooperative developers. Our members work in all 50 states and across co-op sectors to provide technical assistance to groups starting cooperative enterprises. Between 2008-2017, CW members assisted in the incorporation of over 1,000 businesses, created or saved nearly 15,000 jobs, and created over 4,000 cooperative housing units. Many CW members specialize in converting existing businesses to worker cooperatives. This succession strategy results in the retention of local businesses that would otherwise close or sell to outside investors. In recent years, many members have seen an uptick in these inquiries.

We know that employee-owned businesses are more resilient than their traditionally owned businesses. According to the National Center for Employee Ownership, they are better able to weather economic downturns, less likely to lay-off workers, and more productive than their traditionally owned counterparts. Transitioning to employee ownership increases productivity by 2-5%. Employees of these businesses earn 5-12% more in wages and typically have over twice as much retirement savings compared with workers of traditionally owned businesses. Defaults on loans of employee-owned businesses are minimal – only 2 in 1000.

Currently, nearly half of America's small businesses are owned by Baby Boomers nearing retirement, 85% of whom have no succession strategy in place. Collectively, these 2.3 million businesses employ almost 17% of workers, support a payroll of nearly $1 trillion, and have sales of over $5 trillion. The next decade presents a massive, unique, and necessary opportunity for employee ownership – or the daunting possibility of hundreds of thousands of small businesses closures that provide key services in communities across the country. With strong support through access to capital, technical assistance, and policy, conversions to employee-owned businesses stand to revitalize Main Streets across America, boost productivity, and provide stable, fulfilling employment to tens of millions of Americans.

The Main Street Employee Ownership Act of 2018 directed the Small Business Administration to support employee ownership by improving access to capital and providing technical assistance through their national network of Small Business Development Centers. Specifically, the SBA was directed to find ways to:

- Finance the sale of businesses to their employees
- Work with Small Business Development Centers across the country to provide training and education on employee ownership options
- Report on SBA's lending and outreach to employee-owned businesses

In 2019, the SBA held two listening sessions to learn about and evaluate practical alternatives to the personal guarantee that currently prohibits worker cooperatives from accessing the 7A loan program. Many in the cooperative development community provided feedback, citing current programs such as the USDA's B&I program that lends to co-ops successfully with no personal guarantee and suggesting alternatives to the personal guarantee that would adequately collateralize the loan. To our disappointment, the SBA's report not only rejected these alternatives but suggested the implementation of a new barrier to converting to employee ownership – the full, unlimited personal guarantee of the selling owner for the loan of the purchasing owners.

The SBA was also mandated to work with its national network of Small Business Development Centers to provide training and education on employee-ownership options. Comprehensive technical assistance is a necessary component of growing a successful, scalable sector of employee-owned businesses. Unfortunately, the TA offered by the SBDCs for traditionally owned businesses does not constitute adequate information or services for the those looking to transition to employee ownership. Many CW members, who already provide this TA to converting businesses, have reached out to SBDCs in their state or region to form partnerships in training, education, and outreach. While many have met with enthusiasm, it has also become quite clear that the SBA has not yet instituted a top-down, network-wide program to educate their TA providers. With thousands of Baby Boomers turning 65 and looking toward retirement *every day*, there is no time to waste in implementing a strong technical assistance program that can provide the needed support to selling owners and purchasing employees.

Despite a clear mandate from Congress to make their lending program available to cooperatives, the SBA has refused to take reasonable action to do so. Despite a clear mandate to provide training and educate on employee ownership opportunities, the SBA has not taken necessary, timely steps to implement such a program. We now ask Congress to take the necessary steps to ensure that worker-owned cooperative small business have fair access to SBA's lending program. We also ask for support in ensuring that the SBA has a clear, actionable, and timely plan to properly train their network of SBDCs to provide technical assistance for employee ownership options.

The next decade brings incredible opportunity for employee-owned small businesses to thrive. In doing so, they will contribute to a stronger, more resilient economy where workers are more productive, earn and save more, and have greater job stability and security. We look forward to working with Congress and the Small Business Administration to ensure that cooperatives have fair and necessary access to the capital, training, support, and education that will enable them to thrive.

Once again, thank you so much for this opportunity to submit testimony on the benefit and challenges of employee ownership.

In Cooperation,

Alexandra L Stone

Alexandra Stone
Executive Director
CooperationWorks!

February 18, 2020

Statement for the Record:
House Committee on Small Business Committee
February 12, 2020
Hearing on "Challenges and Benefits of Employee-owned Small Businesses"

United States House of Representatives
Committee on Small Business
Chairwoman Nadia Velázquez
Ranking Member Steve Chabot
2361 Rayburn House Office Building
Washington, D.C. 20515

Chairwoman Velázquez and Ranking Member Chabot,

The Employee-owned Contractor Roundtable (ECR), a coalition of federal government contractors that are ***wholly-owned through an employee stock ownership plan (i.e., 100% ESOPs)***, appreciate the opportunity to provide comments on the recent hearing your Committee held on employee-owned businesses. ECR members represent several sectors of the economy and provide services for their government clients ranging from tractor engines and timing belts to advanced combat simulators and sonar detection technologies. ECR members are located across the entire United States and play a critical role ensuring a healthy industrial base for the federal government.

We appreciate the Committee holding this hearing. ECR strongly believes in employee-ownership and opportunities to highlight and educate members of Congress about employee-ownership in the economy is very beneficial. We hope that in the future the Committee would consider an executive from ECR as a witness. We believe an ECR member would not only bring the perspective of an employee-owner to the Committee, but also a company that is a federal contractor. Given the Committee's federal jurisdiction one of the ECR members could have shared their unique perspective regarding how the Small Business Administration, Congress, and federal procurement policy could be amended to incent, and solve challenges, facing 100% ESOPs that work with the federal government. Promoting 100% ESOPs in federal contracting is a win-win for American businesses, workers, and the federal government. ECR believes Congress, SBA, and federal agencies can do more to promote and incentivize 100% ESOP federal contractors. Finally, procurement policy change would align with the longtime national policy of incentivizing and growing employee ownership.

ESOPs were established by Congress in the 1970s and allow employees to have an ownership interest in their company by providing each employee-owner with a portion of the company's stock on an annual basis. As employee ownership in America has grown, employee-owned businesses have consistently provided their communities, the economy, their workers and their customers with unique and tangible benefits. The benefits to the federal government from contracting with an ESOP are unique and 100% ESOPs, in particular, provide excellent service to their federal partners. Since its inception, lawmakers have worked hard to expand employee-ownership and encouraged more companies to convert to be employee-owned.

This is hardly surprising as 100% ESOPs consistently report better job growth, fewer job reductions during economic downturns, disproportionately higher employee retirement savings and narrower wealth gaps between workers and management. 100% ESOPs tend to not be acquired or sold, meaning jobs stay in the communities where the companies reside. These benefits stem from the inherent dynamics that arise when employees have a real stake in the business they contribute to on a daily basis. According to several independent economist led surveys, employee-owners show greater job satisfaction and stay in their positions longer than their peers at non-ESOP companies. Workers then pass on to the federal government superior service when federal contracts are awarded to an ESOP company.

Because of the advantages ESOP's provide the U.S. economy, the federal government has supported and promote ESOPs through tax policy. This support, however, has unfortunately not translated to federal contracting practices. ***We believe it is time to modernize federal contracting regulations to align with national policy objectives by advancing initiatives to support and expand employee ownership within federal government contracting. We would encourage the Committee , to consider policy options that promote 100% ESOPs within SBA programs and federal procurement policy, and analyze ways that the ESOP structure may enable small business to grow and compete, overcome challenges in federal procurement, and provide opportunities to expand the benefits of employee ownership to more small businesses and individuals.***

Benefits of Employee Ownership
When a company is owned by its employees, important socioeconomic dynamics arise that benefit workers, the company, the community and the national economy. Because ESOPs are regulated by a strict legal code that requires ownership to be broadly held across employees, from the mailroom to the boardroom, companies that are ESOP-owned – and particularly those that are majority or 100% ESOP – consistently report better job growth, fewer job reductions during economic downturns, boosted employee savings, and are less susceptible to job outsourcing or foreign interference. Principal among the data points that underscore the specific value ESOPs contribute to national economic interests are:

- Despite the financial stresses caused by the most recent economic downturn, **ESOPs kept more far more jobs than other private companies.** According to a 2012 study by Alex Brill, *employment among employee-owned firms increased more than 60% from 2001-2011, while the private sector as a whole had flat or negative growth in the same period*[1].
- **ESOPs reduce wealth inequality in the American workforce.** A 2016 study by Jared Bernstein shows that by increasing wage-earning employees' share of their business capital, *ESOPs reduced the wealth concentration among the top 10 percent of employees by 2.5%*[2].
- **ESOPs provide safe, secure retirement savings vehicles for millions of employee-owners**: At a time when 35% of private sector workers don't have access to traditional 401k benefits or a retirement savings vehicle, including 41% of millennials,[3] ESOPs not only provide 100% retirement savings

[1] "*An Analysis of the Benefits S ESOPs Provide the U.S. Economy and Workforce*," *Brill, Alex, Matrix Global Advisors, 07/26/2012*
[2] "*Employee Ownership, ESOPs, Wealth, and Wages*," Bernstein, Jared, 01/2016
[3] "*Retirement Plan Access and Participation Across Generations*," Scott, John, Pew Charitable Trusts, 06/21/2019

coverage for all their employee-owners, but an overwhelming number of businesses wholly-owned through an ESOP also provide a 401K.

- **ESOPs stabilize employment, root productive capital in communities, and increase the assets and incomes of working families:** A 2017 study by the National Center for Employee Ownership (NCEO) found that ESOPs provide better net income and other benefits to key demographic groups targeted by current federal contracting programs. The report[4] found that women, workers of color, and low-income individuals benefit greater when working at an ESOP company compared to a non- ESOP company. Additionally, the Rutgers School of Management and Labor Relationships recently found in a study that employee ownership narrows the gender and racial wealth gaps, which again, are key demographic groups targeted by current Small Business Administration (SBA) contracting goals. The chart below outlines the key findings from that study.

Wealth Comparison by Gender and Race	Median Wealth of Single Workers in the U.S.	Median ESOP Account Value of Low/Moderate-Income Workers in Rutgers Survey
African-American Women	$200	$32,000
African-American Men	$300	$180,000
Latina Women	$100	$143,500
Latino Men	$950	$200,000
White Women	$15,640	$172,000
White Men	$28,900	$323,500

Building the Assets of Low- and Moderate-Income Workers and their Families, 2019.
https://smlr.rutgers.edu/sites/default/files/rutgerskelloggreport_april2019.pdf

Congress Should Incentivize 100% ESOPs in Federal Contracting as a solution to a number of issues impacting small business growth concerns and the shrinking federal supplier base.
During the hearing, it was clear that there is broad bipartisan support for ESOPs and more should be done in federal policy to incent the creation of more employee-owned businesses, especially ESOP businesses that do work with the federal government. That is why we believe that incentivizing 100% ESOPs in federal procurement is good policy and can benefit both the federal government and small businesses. A recent report[5] by Bloomberg shows that the number of federal contractors available to the federal government is shrinking, causing a dearth of options and a lack of flexibility for procurement managers (PM) and contracting officers (CO). For small businesses looking to grow, there is no avenue to real growth that provides small business owners with the ability to control their company's future without i) capping employment or negatively impacting their workforce, ii) stop pursuing federal contracting opportunities or iii) facing the prospect of selling to their larger competitors, private equity, or hedge funds. In this last scenario, often times, when small business facing graduation from their size standard, or from small business set-aside work, are forced to sell, they have to sell from a position of weakness where the selling price doesn't accurately reflect the company's true enterprise value. In such cases, it is the employees that are negatively impacted, while simultaneously the government loses a prospective partner to do business with. This is wrong.

[4] "*Employee Ownership & Economic Well-Being,*" Wiefek, Nancy, The National Center for Employee Ownership, 06/15/2017
[5] "*Federal Supplier Base Continued to Shrink in Fiscal 2018,*" Murphy, Peter, Bloomberg Law, 05/23/2019

We believe that your Committee, and Congress as a whole, should look at advancing provisions that would leverage the benefits of the ESOP model to provide a growth pathway through small businesses set aside work and allow 100% ESOPs to more regularly partner with the federal government. We believe the Committee should look at, among others, policies that would:

- **Provide 100% ESOPs the ability to compete for small business set-aside contracts (barring women/veteran-owned, 8a, etc.) with carefully thought out guardrails:**
  - Given the numerous benefits of ESOPs, we believe the ESOP model can be used as a growth mechanism to allow small businesses more time to compete as a small business before they grow from small to mid-size.
  - Providing a competition incentive for only 100% ESOPs to compete for small business set-aside work beyond the NAICs classification would facilitate more providers to the federal government, give small businesses a pathway from small-to-midsize while benefiting their employee-owners, and allow businesses the opportunity to achieve a size that would enable them to compete against large businesses.
  - To ensure fairness, larger ESOPs would be sized out of this benefit with a top-end guardrail and we are eager to work with the Committee on various other guardrail ideas to ensure parity and protections for small-smalls.

- **Allow 100% ESOPs the ability to re-compete for contracts already won**
  - 100% ESOP contractors do timely and high-quality work for the federal government, and often times, contracting officers want to continue to partner with ESOP businesses on specific contracting vehicles. However, if the ESOP contractor grows and then exceeds the NAICs code to service the contract, or the follow-on contract is moved from full-and-open to small business set-aside, the 100% ESOP contractor is precluded from even bidding on the contract, even if the company had a satisfactory or above CPAR scores on the first iteration.
  - By making this change, a 100% ESOP company would have the ability to compete for a contract should the contract be moved to the set-aside category from a previously full and open competition contract. (i.e., busting employee headcount standard by hiring staff to meet the contract requirements.)
  - This change also addresses the issue of small businesses eclipsing their size standards when servicing a contract; this provision would allow a 100% ESOP company the ability to recompete for a follow on contract if they had to increase employee numbers in order to service a contract they had already completed.

- **Amend SBA affiliation rules to allow companies to spin out 100% ESOPs and enter into mentor-protegee protégé agreement with the new entity**
  - Change SBA affiliation rules to apply to 100% ESOPs and allow 100% ESOPs to spin off standalone operating divisions into a new 100% ESOP business.
  - Allow the parent 100% ESOP to enter into a mentor-protegee relationship with the new 100% ESOP spinoff for up to three-years to ensure viability and success.
  - This would promote the growth of more 100% ESOP businesses and level the playing field for ESOPs in SBA affiliation rules.

- **Defining 100% ESOPs as always non-traditional (OTA)**
  - Defining 100% ESOPs as non-traditional in OTAs would provide short term growth support for 100% ESOPs as they enter mid-tier status.
  - Incentivizing 100% ESOPs through OTAs would benefit the entire supply chain by allowing 100% ESOPs to partner with small and large businesses.
  - Given the ESOP structure, being defined as non-traditional would allow ESOPs to meet their fiduciary responsibilities to grow, remove unnecessary risk, and allow the federal government to partner with businesses that are constantly reinvesting in themselves to meet procurement challenges. It would also level the playing field as non-profits are currently defined as "non-traditional."
  - As ESOP companies are already actively using OTAs, they already meet the cyber security and integrity standards needed to complete OTA work.

- **Hold SBA accountable in establishing an ESOP working group**
  - When Congress passed the *Mainstreet Employee Ownership Act in 2018*, it tasked SBA with establishing an Interagency Working Group on Employee Ownership. This working group was meant to coordinate various agencies in a way to develop recommendations to support and increase the number of employee-owned businesses and increase coordination between federal agencies and employee ownership organizations.
  - SBA should immediately work to stand up this working group and coordinate with other agencies to develop policy recommendations that promote ESOPs.

Conclusion

Again, we appreciate your Committee looking at the challenges and policy opportunities for employee-owned companies. We hope this is also the first of additional hearings on how Congress can incent employee-owned companies and in particular we would encourage you to look at the challenges facing 100% ESOP contractors and how Congress may be able to change procurement policy.

Thank you for the opportunity to submit this testimony and the members of ECR look forward to hearing the solutions put forward by Congress to address this critical issue. If you need to contact us, please reach out to Matt Pearce at mpearce@vennstrategies.com.

Respectfully,

The Employee Owned Contractors Roundtable

LEAF

Local Enterprise Assistance Fund

Chairwoman Velazquez, Ranking Member Chabot, Members of the Committee, thank you for the opportunity to provide written testimony to the U.S. House of Representatives Committee on Small Business about the benefits of cooperative businesses and the challenges co-ops face.

The Local Enterprise Assistance Fund (LEAF) is a national Community Development Financial Institution (CDFI) whose mission is to promote human and economic development by providing financing and development assistance to cooperatives and social purpose ventures that create and save jobs for low-income people. Since its founding over 30 years ago, LEAF has invested and leveraged over $98 million, resulting in the creation or retention of more than 7,600 jobs.

We lend to community-owned natural food cooperatives that create high quality jobs and provide communities with access to healthy food; manufactured cooperative housing parks that provide affordable homes in low-income communities; and worker-owned and community-based businesses that create quality jobs for low- income communities.

LEAF's loans support an economic model rooted in shared ownership where communities, workers, and residents have a direct and equal say in their businesses and housing. Cooperatives have an element of social benefit that is impossible to quantify. For example, residents of a newly purchased housing cooperative have exclaimed, "Now I know no one can kick me out of my home!" and, "Before we became a co-op, I knew only one neighbor; now we are a community and I know all my neighbors." We regard these empowered statements as the true indication of cooperatives' effect on businesses, communities, and individuals.

Food cooperatives are a type of business LEAF finances that creates strong community benefits. Food co-ops typically have community meeting space, hold cooking classes, and engage schools in teaching children how to help cook and form healthy eating habits from a young age. Through LEAF's financing, over 30 such food co-ops have opened their first store or expanded to provide 100,000 households access to quality food at a store they own and control with their neighbors. Since 88% of these loans have gone to food co-ops in "food deserts," and profits stay in the community since they are distributed to the local owners, these stores serve as a local economic driver as well.

Food co-ops we have financed have created over 1,600 living wage jobs. Research conducted by The ICA Group shows that these food co-ops jobs are markedly better in job quality and benefits than similar jobs created in conventional, investor-owned grocery stores. For example, for similar positions, food co-ops pay on average $2 more per hour than conventional grocery stores. They also purchase 14% more from local producers, recycle 50% more food waste and plastics, and donate 3 times as much of their profits to local nonprofits. Purchasing from smaller, local suppliers is a hallmark of food co-ops. Purchases from the cooperatives LEAF has financed support more than 3,770 small family farms and 4,510 small businesses.

In the worker co-op space LEAF makes loans to enterprises that cannot access traditional financing. By the end of 2017, we had financed dozens of small worker-owned businesses representing over 1,000 worker-owners. An analysis of a National Bureau of Economic Research dataset on worker ownership shows that income-based disparities are lower in employee-owned companies than in the average U.S. company. Further research has also demonstrated levels of employment tend to be more stable in worker co-ops, including during economic downturns, than in outside-investor-owned businesses. Since cooperatives' owners are community residents, they have been shown to be more likely than other larger businesses to employ sustainable business practices that do not harm the local environment, pay higher wages for comparable work as profits do not need to leave the business to satisfy equity investors' expectations, and purchases are more likely to remain and circulate within the community. For example, a recently financed construction worker co-op specializes in using recycled wood from local demolitions and pays $4/hour more than the exact same job in the area.

In recognizing the economic opportunity generated by a wave of retirements, the House Small Business Committee led the passage of the bipartisan Main Street Employee Ownership Act in 2018, the first major employee ownership law in decades. The law states,

> *It is the sense of Congress that cooperatives have a unique business structure and are unable to access the lending programs of the Administration effectively due to loan guarantee requirements that are incompatible with the business structure of cooperatives.*

Moreover, the law required the Small Business Administration to, "**study and recommend practical alternatives** for cooperatives that will satisfy the loan guarantee requirements that are incompatible with the business structure of cooperatives," in coordination with lenders, stakeholders and Federal agencies, and provide recommendations from the report and, "a plan to implement such recommendations."

LEAF appreciates SBA's engagement through two listening sessions – one in-person and one virtual – to hear recommendations from the employee ownership community. Unfortunately, the report was not only disappointing in its recommendations and conclusions, but also potentially recommended additional hurdles for businesses to convert to worker cooperatives.

The report highlights the Small Business Administration's meeting with the U.S. Department of Agriculture. USDA holds the same obligation to protect taxpayer dollars as SBA. USDA's Business and Industry Guaranteed Loan program is similar to SBA's 7(a) program with two exceptions. First, a business is only eligible if it is located in a community with a population of 50,000 or less. It is important to note that under the current exclusionary practices of SBA, cooperative businesses in non-rural areas are unable to access federal support afforded to all other types of businesses. This leaves cooperatives as, what we believe to be, the only business formation that the Small Business Administration does not serve. This problem will be exacerbated after the 2020 Census, in which some cities will narrowly surpass the 50,000-population threshold.

Second, and in the SBA's own words, "Unlike SBA, USDA does not require each loan to be guaranteed by at least one individual or entity." Instead, USDA requires collateral from the cooperative and, in some cases, requires the co-op to sign an agreement to withhold profit-sharing until the guaranteed loan is repaid. In recognizing the strength of shared risk, USDA does not require a personal guarantee when a cooperative stake does not exceed 20 percent. That is, in co-ops of five or more, USDA does not require individuals to fulfill a personal guarantee requirement. Cooperatives are not seen as an exception at USDA, simply a different model to which USDA has outlined requirements so that cooperatives may equally participate in federal programs.

USDA's Business and Industry Guaranteed Loan program typically supports mid-size businesses start-up, expand, or invest in things like machinery. USDA limits maximum percentages of guarantees based on the loan amount and the borrower must meet various requirements before receiving a guarantee. While the maximum loan amount under this program is $25 million – though can be up to $40 million with the Secretary of Agriculture's approval – the average loan guaranteed through this program is $3 million.

According to the Small Business Administration[1], under the 7(a) program, SBA guarantees loans ranging from $25,000 to $5 million. Cooperative lenders report significantly lower loan amounts, with most lenders ranging from $1,000 to $2 million available to cooperatives, and the National Cooperative Bank lending up to $12 million. A start-up loan for a worker cooperative typically ranges from $10,000 to $30,000. Generally, these cooperative lenders require collateral on loans, but in recognizing the cooperative model, do not require personal guarantees[2].

In the meeting between USDA and SBA, USDA recommended two options to SBA to ensure that cooperative businesses could fairly access SBA financing. First, that SBA waive the personal guarantee requirement when a loan is fully collateralized. Second, that SBA waive the personal guarantee and instead require the cooperative agree to withhold profit-sharing until the guaranteed loan is repaid. Disappointingly, SBA's response to these recommended alternatives to the personal guarantee from a Federal agency was that the options were not a personal guarantee.

Moreover, while SBA describes the personal guarantee as the lynchpin of the 7(a) program, SBA provides waivers to the requirement on guarantees for loans to Employee Stock Ownership Plans (ESOPs). Moreover, SBA can guarantee loans made to the employee-owned business when employees own a majority stake in the company, as opposed to being limited to guaranteeing loans to the employee trust. Cooperatives, necessarily being 100-percent employee-owned, are not afforded this same benefit by SBA.

Since the SBA has clearly indicated it will not modernize its regulations to serve cooperative businesses as Congress has intended, we believe Congress should use its legislative authority to provide a personal guarantee waiver to cooperative businesses and use the business measurements and indicators that USDA uses in its Business and Industry program to balance the needs of small businesses with the need to protect taxpayer dollars.

The structure of a cooperative that makes the business a more resilient, innovative, sustainable and pro-worker business is what the Small Business Administration sees as an obstacle. With each member having an equal stake in the cooperative, there is no singular owner entirely on the

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[1] https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf
[2] https://institute.coop/sites/default/files/resources/DAWI%20-%20Investing%20in%20Worker%20Ownership.pdf

hook. But once again, it is the shared risk split evenly among worker-owners that makes the business significantly less likely to fail than sole proprietorships.

While the worker co-op sector faces a number of challenges, including a lack of incorporation articles in many states, and a lack of familiarity of the ways in which cooperative businesses can thrive by public officials and some lenders, we know from first-hand experience that the overall largest barrier to worker cooperatives forming across the nation is that co-ops are blocked from accessing SBA financing like every other type of business. LEAF urges Congress in the strongest terms to level the playing for cooperative businesses at SBA.

Again, thank you for the opportunity to provide written testimony. LEAF stands ready to support your work on this critical issue.

100% Employee Owned

Small Business Committee Hearing: "Challenges and Benefits of Employee-Owned Small Businesses"

Written Testimony before the
U.S. House of Representatives
Committee on Small Business

Bill Parks
Founder and President of NRS, Inc
a 100% ESOP.
Professor Emeritus,
Department of Business and Finance,
University of Idaho

February 7, 2020

NRS

100% Employee Owned

Thank you Chairwoman Velazquez, Ranking Member Chabot, and members of the committee for considering this written testimony. I appreciate this chance to present my perspective as a former owner and a former professor of finance.

As the founder and former owner of the North-Idaho based company, NRS, I propose three changes to the current legislation surrounding Employee Stock Ownership Plans (ESOPs). ESOPs allow a company's employees to own shares in that company, ultimately moving the ownership of the company to the employees. In addition to the current ESOP incentives of avoiding capital gains tax, I suggest opening ESOPs to S corporations, allowing owners the ability to purchase replacement assets within one year of receiving the funds rather than the transaction of that purchase, and permitting replacement securities to be in the form of indexed mutual funds. These proposals will eliminate the need for an expensive, and likely ineffective, subsidy for banks.

I have both academic and practical experiences that have helped me find solutions to this problem in our small business and retirement system. As a retired professor of finance, I have proven academic knowledge that is highly applicable in the real world. I demonstrated this application by founding NRS in 1972. NRS is now a respected brand in the outdoor industry and a 100% ESOP where I still retain the title of Founding President.

I support Senate Bill S. 177, a bill helping to expand employee ownership, would allow much-needed revisions to ESOP eligibility to occur. I have concerns with House Bill HR 2258, which I will explain momentarily.

Under current legislation, ESOP formations are limited to C Corporations. Although S Corporations have become the dominant form of small and medium-sized businesses, current legislation requires S Corporations to become a C Corporation before becoming an ESOP. This process is not only labor-intensive, time-consuming, and expensive, but it is also impractical. To correct this issue, S. 177 substitutes the phrase "Domestic Corporation" for "C Corporation", removing this limitation altogether. I commend this effort.

Unfortunately, neither HR 2258 nor S 177 incentivizes owners to sell to employees. Instead, it incentivizes the banks to lend to more ESOPs. These proposed incentives will have little effect. The HR 2258 bill amends section 200 of the tax code by offering a tax exemption of half of the interest the bank receives (and only banks) from a qualified securities acquisition loan. These are the loans used by an ESOP to buy out the former owner. Some banks claim this would increase the number of ESOPs created.

Banks consider the viability and risk of potential ESOPs before lending. With or without HR 2258, banks will continue to finance many potential ESOPs because the proposed ESOPs' finances are stable enough. This provision of HR 2258 offers banks with existing ESOP loans a 50% tax exemption on the interest from those loans as well as all additional potential ESOP loans as an inducement to take more risk on less secure ESOPs. This provision would substantially increase the revenue cost to the legislation and the subsidy provides no assurances ESOP formations would dramatically increase. The following proposals are a more direct approach.

Originally, the supposed incentive to sell to the employees was that the owner(s) could defer capital gains taxes if they purchased replacement securities within one year of the transaction. What lawmakers didn't understand was that banks and outside lenders will only loan a fraction of a company's value. Therefore, to complete an ESOP transaction, the employee-owned company would owe the former owner(s) for the remaining value of the company in the form of IOUs, called seller's notes. For example, the previous owner(s) would have, at most, 30% of the firm's value in cash and the remaining 70% in seller's note. However, to satisfy the incentive, an owner must purchase 100% of the value of the company in replacement securities within one year. This result of the previous law is neither practical nor possible for the majority of owners who could sell to an ESOP.

Investment bankers and others soon came up with a solution: Long-term bonds with variable interest rates called 1042 securities (named after the IRS code section). The benefit of these bonds is that they won't mature in the owner's lifetime. After the owner's death, the security will no longer be subject to capital gains tax. The reason the bankers created the securities was so they can be heavily leveraged and still hold their value if interest rates rise.

Unfortunately, these bonds cost more to hold than they return because the interest rate received on the bonds will be lower than the interest rate charged for financing them. The former owner will, in effect, be paying the penalty every year to hold the bonds. Over time, inflation will further reduce the bonds' value.

Extending the deadline for purchasing replacement securities makes selling to an ESOP more desirable. Rather than having the legislation say that securities must be purchased "within one year of the transaction", it can simply be changed to "within one year after receiving the funds". Removing the requirement to buy all replacement securities before the owner receives all the funds would partially equalize the benefits of selling to the employees or a strategic buyer.

The advantages of selling to an ESOP have never been more than philosophical. What is needed is a definite reason to sell to an ESOP. Hence, the sale to the employees should be more desirable than a strategic transaction. Something not generally available should be offered.

Current ESOP legislation expects owners who sell to an ESOP to suddenly become an investment expert because they need to buy stock or bond replacements for their company stock. Owners usually concentrate on a single company or industry for most of his or her career life. This expectation is not just unrealistic but could be dangerous to the owner's financial health. Owners should have an alternative. Warren Buffett and virtually all retirement specialists recommend most people invest their retirement funds in index mutual funds due to their very low carrying cost, excellent diversification, and lack of expertise needed to make a purchase decision. Owners should be allowed to contribute proceeds from an ESOP sale to an indexed mutual fund and thereby defer the capital gains tax liability. That unique benefit would, at last, provide a reason for an owner to sell to employees even at a lower price.

NRS

100% Employee Owned

By allowing owners the ability to purchase index mutual funds, they would receive a unique benefit that selling to a competitor would not provide. Rather than expecting owners who sell to an ESOP to suddenly become an investment expert because they need to buy stock replacements for their company, owners could use an alternative. Virtually all retirement advisors and plans recommend investing in mutual funds, particularly index mutual funds. Index mutual funds would provide a reason for an owner to sell to employees even at a lower price.

Employee ownership is justified through its ability to encourage local business through stabilized communities, secure employee retirement, and increased employee morale and productivity. Without the three changes I proposed above, owners will continue to pay a substantial penalty for selling to an ESOP. Through the support of S. 177, ESOP eligibility could be increased to S Corporations by substituting the phrase "Domestic Corporation" for "C Corporation", helping to remove these limitations. By changing the legislation to read "within one year of receiving the funds" rather than "within one year of the transaction", the penalty owners pay for selling to an ESOP is significantly reduced. Similarly, if owners can purchase low-cost index mutual funds as replacements, these replacement investments will be in line with those retirement investments recommended by virtually all investment advisors. These combined amendments will, for the first time, give owners a real incentive to sell to their employees.

Thank you, Chairwoman Velázquez, Ranking Member Chabot, members of the committee for considering my written testimony. I would look forward to answering any follow up questions. I share your goal of promoting ESOP formations and improving retirement savings in our country.

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Small Business Committee Hearing
Challenges and Benefits of Employee-owned Small Businesses
February 12, 2020
Written testimony submitted Feb 28, 2020

To the Members of the House Small Business Committee:

Thank you for attention to the wellbeing of worker-owned businesses. The Sustainable Economies Law Center believes that worker-ownership is a tool for economic justice that can effectively combat wealth inequality while also building strong businesses, rewarding workers, and saving jobs.

Worker buyouts of baby boomer-owned businesses (a process often referred to as "cooperative conversion") could save millions of at-risk jobs as these business owners reach retirement age. The Small Business Administration is in the best position to support and protect the 24.7 million workers across the country currently employed in baby boomer-owned companies. We hope that the recent hearing leads toward meaningful action to ensure that worker ownership is a viable option for entrepreneurs in this small business closure crisis.

In order to succeed, worker-owned cooperatives need access to the full range of the SBA's tools in order to create high-retention jobs that empower workers. Programs like the 7(a) loan program are necessary to accelerate the already rapid growth of worker cooperatives. While we have been disappointed with the SBA's report on cooperative options and its lack of action regarding the Main Street Employee Ownership Act, we remain hopeful that cooperatives will soon be able to access the full range of the SBA's programs.

We seek parity with other business models. The personal guarantee requirement of SBA 7(a) loans makes these loans virtually impossible for worker cooperatives to access. Cooperatives are unique in that shared investment and shared responsibility for the business is built into the DNA of the business, with every member having a stake in whether the business succeeds or fails.

While the personal guarantee requirement has thus far been a barrier for cooperatives, we are encouraged by the fact that some innovative solutions are already taking shape. Last fall, the federal Economic Development Administration approved an update to the City of Berkeley's Revolving Loan Fund Administrative Plan that has vastly expanded worker cooperative access to the City's loan program. The City of Berkeley made these changes in order to effectively offer financing for both startup and newly converted worker cooperatives, providing a much needed resource to the growing number of businesses considering the worker cooperative form, and to business owners looking to retire in a way that values their efforts, legacy, and labor.

At its core, the Berkeley model is simple: replace the unlimited personal guarantee with a limited personal guarantee that is shared only among a select group of cooperative members who are able to take on the liability, and only while they remain members of the cooperative. More specifically, the amendments to the Revolving Loan Fund will accomplish the following:

1. Worker cooperatives will be able to select a loan panel to provide the personal guarantee and credit reports required to access loan funds. This is in contrast to the previous requirement that every single member provide such a guarantee. This will result in more cooperative businesses being eligible for the Revolving Loan Fund, since it will no longer be a barrier to eligibility if a cooperative has some members with damaged credit, or who are unable to take on the risk of a personal guarantee. This innovative approach is highly commendable as other governments and financial institutions around the country seek tools to support worker cooperatives.

2. The personal guarantees of the members of the loan panel will be limited and released if a member providing a guarantee leaves the cooperative, as long as the cooperative selects another member to replace the departing member on the ownership panel. This policy recognizes that co-owners of a cooperative join and leave more frequently than in a conventional business. Such a policy will reduce the risk each member would be required to take on and eliminate it entirely for former employees who provided a guarantee while they worked at the cooperative.

The Berkeley model both manages the City's risk and creates pathways for worker-owned cooperatives to access loans that are intended to serve *all* small businesses -- cooperatives included. The Sustainable Economies Law Center played a central role in designing the Berkeley model, which has already been approved by the federal Economic Development Administration. We urge the SBA to also consider this strategy as it carries out its mandate to support worker cooperatives. We are happy to be a resource to the Committee if there are ways that we can support its work.

Thank you for your attention to this issue.

Sincerely,

Yassi Eskandari
Policy Director
Sustainable Economies Law Center

Small Business Committee Hearing
Challenges and Benefits of Employee-owned Small Businesses
February 12, 2020
Written testimony submitted Feb 25, 2020

To the members of the House Small Business Committee:

Thank you for your commitment to ensuring the spread of the worker ownership through the Main Street Employee Ownership Act. As the only national grassroots association of worker-owned cooperative businesses, we value your attention not just to this bill, but to the needs of the growing employee ownership field.

The U.S. Federation of Worker Cooperatives (USFWC) represents an estimated 800 worker cooperatives and democratic workplaces, a growing sector of the small business community in the U.S., which is, as you know, the backbone of our economy. Worker cooperatives are an increasingly lauded solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade this could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale.

We aim to work with you to support and protect the 24.7 million workers across the country, currently employed in these baby boomer-owned companies. We hope that the recent hearing leads toward meaningful action from the Small Business Administration to ensure that worker ownership is a viable option for entrepreneurs in this small business closure crisis.

In 2018, we were especially proud to see the Trump Administration adopt the Main Street Employee Ownership Act, as the first federal-level bill on cooperative employee ownership.

The worker cooperative model offers many benefits to its members:

- They are typically small and strong businesses, typically employing 8 workers, and **paying an average of $19.67/hour** often in insecure industries like retail, manufacturing, food service, home care and childcare.
- Worker co-ops allow workers to benefit directly from the value that they create, with **an average of $8,241 in patronage distributed to each worker each year.**
- Worker co-ops are diverse - with nearly 60% employing workers of color and 62.5% of the workforce identifying as female.
- According to a recent study from Democracy at Work Institute and the University of Madison-Wisconsin, the majority of worker-owners not only plan to stay in their jobs, but also **72% of them are building skills though professional development opportunities.** Indeed, almost **75% of respondents are more satisfied with their worker co-op than their previous jobs**. They are also more engaged citizens, with **70% of the workforce voting in recent elections.**
- These businesses last longer, with a **25.6% success rate for businesses 6-10 years old**, compared to the 18.7% success rate of typical small businesses. and a **14.7% success rate in businesses that are 26+ years in business**; about 3% higher than the typical small business.
- Because of their scale and prioritization of workers and their families, worker co-ops are more responsive to immediate household needs, providing better

wages, benefits, and stability. Currently the USFWC works with more than 35 of our member organizations to access dental, vision, and health insurance group rates, and organizes on their behalf to secure lower rates and better networks.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Programs like the 7(a) loan program are a vital piece of accelerating the already rapid growth of worker co-ops. While we have been disappointed in the SBA's report on cooperative options and its lack of action regarding the Main Street Employee Ownership Act, we also know that the SBA has the programs and assets to spark significant growth of the worker co-op movement.

The personal guarantee requirement of SBA 7(a) loans makes these loans virtually impossible for worker cooperatives to access, despite the reality that co-ops are based on collective investment and responsibility for the business, and thus epitomize having "skin in the game."

While the personal guarantee issue has been a barrier for cooperatives, we also know that solutions allowing for exemptions are already accepted at the federal level. The U.S. Economic Development Administration of the U.S. Department of Commerce recently approved an update to the commercial Revolving Loan Fund (RLF), which now allows Berkeley to finance the acquisition of a business by its employees. This fund creates jobs and provides assistance to women and minority owned small businesses, which we know is a priority issue for the SBA.

On behalf of the worker co-op business community, we thank the Small Business Committee for their attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

In cooperation,

Mo Manklang
U.S. Federation of Worker Cooperatives

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