DOWN HOME CAPITAL

How Converting Businesses into ***Employee-Owned Enterprises*** *Can Save Jobs and Empower Communities*

BY **PATRICK MCHUGH**, *ECONOMIC ANALYST*

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INTRODUCTION

North Carolina has the potential to turn a grave challenge into a transformative economic opportunity. Thousands of businesses could disappear over the coming years as baby boomer entrepreneurs enter retirement, threatening to deal a heavy blow to communities across the state. However, by helping many of these firms convert into employee-owned companies, we can keep their doors open, give workers an ownership stake into their economic future, and buttress local economies.

Henderson, North Carolina.

Employee ownership has an underappreciated track record of success in North Carolina. Employee-owned cooperatives and employee stock ownership plans have proliferated over the last several decades, and these firms now form part of the economic backbone of the state.

Employee ownership has quietly emerged as one of the most cost-effective economic development strategies our state has ever seen. This report outlines the scope of the opportunity in front of us and the dire consequences if we let it slip by. Happily, there are ways for state and local governments to partner with the private sector and nonprofit organizations to build a more resilient, equitable, and locally-controlled economy in North Carolina.

WHY FOCUS ON CONVERSIONS?

With thousands of North Carolina entrepreneurs approaching retirement, converting companies that might otherwise disappear into employee-owned enterprises is a particularly pressing opportunity. This section shows that employee ownership is already a proven success in North Carolina, discusses why conversion to employee ownership can address one of the major causes of preventable job losses in North Carolina, and shows how it can help our state turn the retirement of the baby boom generation from a stark economic challenge into a great opportunity. Conversion to employee ownership can deliver substantial economic benefits to outgoing owners, employees, and communities.

Employee Ownership Already a Success in North Carolina

Employee ownership already has a major footprint in North Carolina, far larger than many casual observers may recognize. Spread all across North Carolina, employee-owned companies range in size from corporate behemoths to small firms with only a handful of employees. Employee ownership can be found in a wide range of industries, including manufacturing, distribution, finance, engineering, retail, and construction.

FIGURE 1: Employee-Owned Companies Spread Across North Carolina

MORE THAN 100 Number of NC-headquartered firms partially- or wholly-owned by their workers through employee stock ownership

OVER 750,000 Number of current and former workers benefitted by stock ownership plans*

OVER $4.4 BILLION Dollars paid out to workers in 2013[1]

**Data on these plans are based on where the employers are headquartered, not according to where each employee lives, so it is not possible to say precisely how many North Carolina workers currently participate in employee stock ownership structures. However, the these data still give some sense of the magnitude of employee ownership in North Carolina because, while many of the participants in North Carolina based plans actually work in other states, North Carolina workers employed by companies headquartered in other states are not reflected in these data.*

TYPES OF EMPLOYEE-OWNED ENTERPRISES

Worker-Owned Cooperatives are business entities (corporations, LLCs, and trusts) with binding bylaws and operating procedures that determine how ownership and management is shared among some or all of the employees of a company.

Employee Stock Ownership Plan (ESOP) is a type of benefit plan that allows employees to acquire ownership stakes in their company. ESOPs vary widely in the share of a company's stock that is held by employees, process for employees to acquire stock, the degree of governance input that employee-owners wield within the firm, how employee-owners share in the profits a firm generates, and the conditions under which employee-owners can cash in their shares.[2]

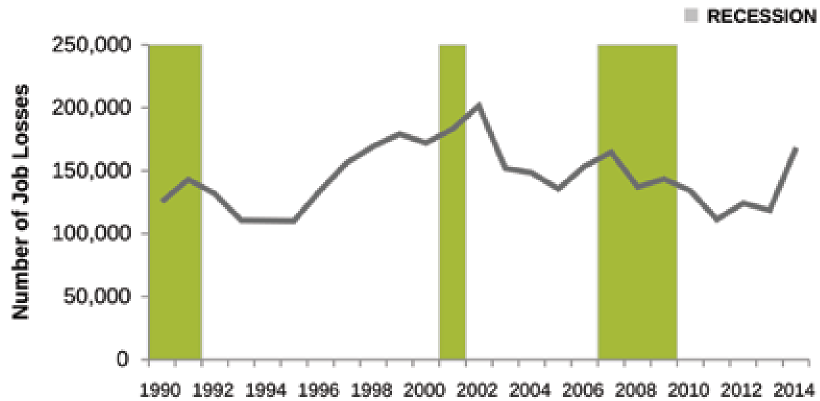
(For a more detailed discussion of cooperatives and ESOPs, see Types of Employee-Owned Enterprises section below)

A Way to Avoid Preventable Job Losses

Company deaths are a major cause of job losses in North Carolina, particularly during periods of economic growth. "The failure to plan for business succession in small and medium-sized companies is the leading preventable cause of job loss in the United States."[3] Company closures account for more than one-quarter of all jobs that disappear in any given year, and during some comparatively good economic times can account for nearly 40 percent of all job losses.

"The failure to plan for business succession in small and medium-sized companies is the leading preventable cause of job loss in the United States."

FIGURE 2: Millions of Jobs Lost to Business Closures over Last 15 Years



Source: U.S. Census. Longitudinal Business Database. North Carolina job losses for all firms and establishments

Company closures have resulted in over 2.2 million jobs having been lost since 2000, or roughly one-third of all job losses. Of course, not all of these losses could, or even should, be prevented. Companies come and go for a variety of reasons, some perfectly natural in the healthy evolution of the market. However, many of these companies were viable enterprises that closed simply because new owners with sufficient capital and business experience could not be found to take over when the old owners wanted to retire or move on to new endeavors.

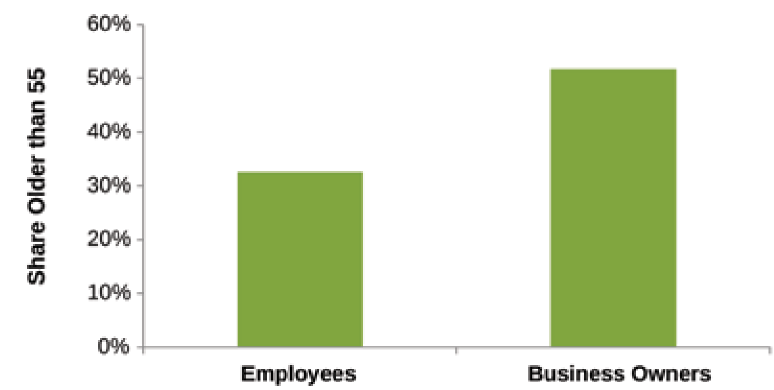
Losses due to business closures have seriously hampered North Carolina's economic recovery, offsetting a huge share of the new jobs that have been created. In fact, the number of jobs lost to business closures since 2010 is larger than the net job gains made in North Carolina during that period. If just 10 percent of the jobs lost to business closures since 2010 had been saved, there would be at least 65,000 more jobs than exist today, which could have driven the state's unemployment rate below 4 percent.

Contend with the Silver Tsunami

As the baby boom generation enters retirement (often referred to as the Silver Tsunami), a huge number of businesses will need to find new ownership. In 2013, more than half of all U.S. business owners were older than 50,[4] up significantly from pre-recession levels.[5]

Estimates vary, but it is likely that upwards of 4 million companies owned by baby boomers will be sold or dissolved by 2030,[6] leading to the transfer of roughly $10 trillion in business assets.[7] While the Great Recession forced many baby boomers to delay their plans to sell and retire, we are on pace to see more small businesses change hands in 2016 than any year since the start of the Great Recession.[8]

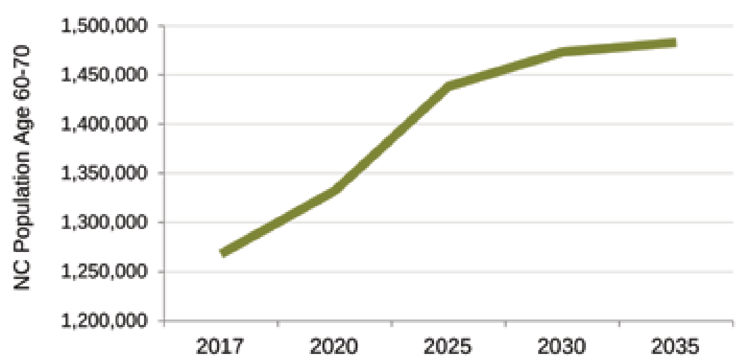
FIGURE 3: Business Owners Entering Retirement Age Much Faster than Employees



Source: U.S. Small Business Administration. "Demographic Characteristics of Business Owners and Employees, 2013."

Converting these businesses into employee-owned enterprises provides a way to keep the doors open and keep ownership rooted in local communities, ultimately turning a profound economic challenge into an opportunity to make families and communities more economically resilient.

FIGURE 4: Retirement Age Population Set to Grow (Projected Number of North Carolinians Age 60-70)



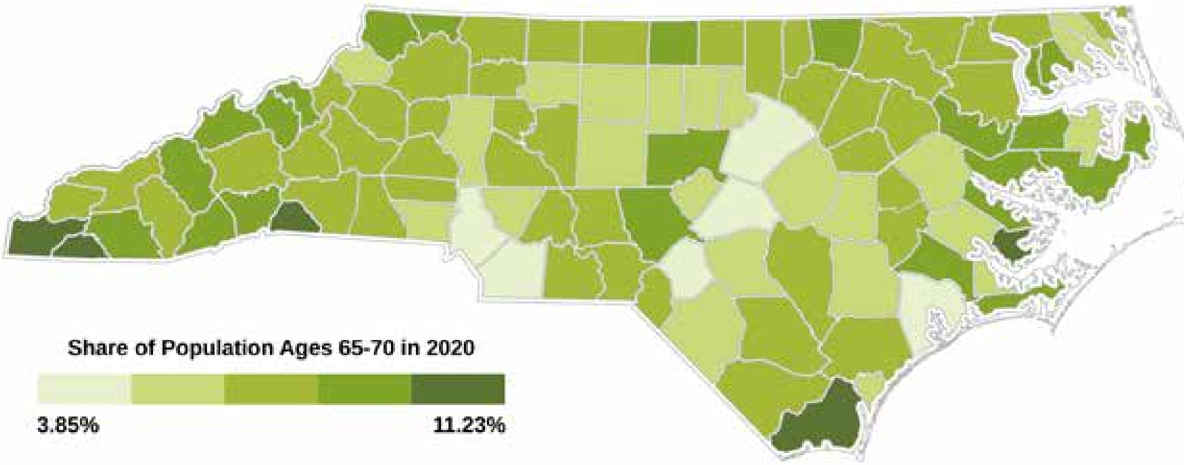
SOURCE: Office of State Management and Budget. County/State Population Projections https://www.osbm.nc.gov/demog/county-projections

With relatively few businesses being kept in the family, more and more retiring business owners are looking to sell to their employees.[9] However, even though roughly half of all small business owners plan to leave their businesses over the next 10 years, 72 percent have not taken steps to plan their exit.[10]

North Carolina is more exposed to the challenges of the Silver Tsunami than many other states. Official projections expect the number of North Carolinians at or nearing retirement (age 60 to 70) to grow by more than 200,000 over the next 15 years, with this age cohort nearing 1.5 million by 2030. Policy and media discussions often focus on the real challenge of replacing experienced workers, but the Silver Tsunami also threatens the survival of thousands of North Carolina businesses that are owned by people who will be looking to retire in the coming years. Converting these businesses into employee-owned firms can help to keep viable enterprises open and locally controlled.

This economic challenge is particularly stark for some parts of the state that can least afford to lose viable local companies. As can be seen in Figure 4, the share of the population set

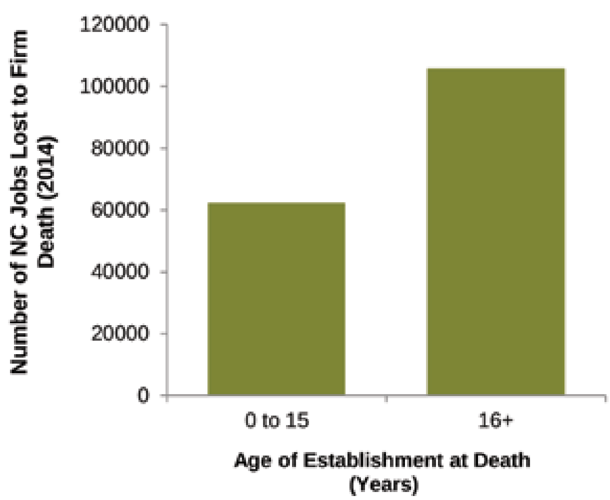
FIGURE 5: Silver Tsunami Could Heavily Impact Many Economically Distressed Communities



to enter retirement is higher in many of the less urban parts of North Carolina that have struggled economically over the past two decades.

Not only do many of these communities face losing a larger share of their existing business owners, the losses would be harder to replace than in urban areas that are experiencing more robust job growth and new business formation. As shown in Figure 5, many of the economically distressed rural counties in North Carolina also have a larger share of their population that is nearing retirement. As such, the retirement of baby boomers could lead to the closure of businesses in communities that can least afford to lose viable enterprises.

FIGURE 6: Older Establishments Account for Majority of Job Losses Due to Business Closure



SOURCE: U.S. Census. Longitudinal Business Database. North Carolina job losses for establishments in 2014

While it is difficult to precisely estimate how many businesses are run by people at or nearing retirement age, we do know that a huge share of the jobs lost to business closure happen in relatively mature enterprises. North Carolina is particularly reliant on older businesses. While only 3 percent of all businesses nationwide have been around for more than 15 years, these legacy companies make up 6 percent of all North Carolina firms.[11] In 2014 alone, more than 100,000 jobs were lost when establishments that had been around for at least 16 years closed their doors.

Without a proactive strategy for transitioning ownership, North Carolina stands to lose thousands of viable companies over the coming years, but converting these firms into employee-owned enterprises can keep them open and locally-controlled.

Bipartisan Way to Address Stagnating Wages

Support for expanding employee ownership can be found across the political spectrum. At the same time that progressive leaders in places like Madison, Wis., and Oakland, Calif., look for ways to give workers more agency in their places of work, Republican Gov. Terry Branstad of Iowa has made expanding employee ownership a key pillar of his economic development agenda, saying "ESOPS (Employee Stock Ownership Plans) can keep companies—and the jobs they provide—in local communities. ... They are a transition plan for business owners and a growth strategy for communities."[12]

"ESOPS (Employee Stock Ownership Plans) can keep companies–and the jobs they provide–in local communities.

They are a transition plan for business owners and a growth strategy for communities."

While most economists and political leaders agree that the growing divide between what American workers earn and the profits that their labors create is a problem, there is far less consensus on how to address the issue. By giving workers a way to directly benefit when their companies grow and prosper, employee ownership represents that all-too-rare tool to address income inequality that can garner support from across the political spectrum.

BENEFITS TO THE COMMUNITY

The benefits of worker ownership do not stop at a business's front door. This section reviews a variety of reasons that employee-owned firms are often more competitive, less prone to relocate, and ultimately build more prosperous and resilient local economies. On top of these advantages, supporting conversion to employee ownership can be a more cost-effective economic development strategy than attracting new companies.

Locally-Owned Economies are More Prosperous

Local ownership is fundamental to building prosperity and economic vitality. All other things being equal, communities with more local business ownership tend to achieve faster economic growth than areas where comparatively few of the firms are locally-owned.[13] When firms are locally-owned, the profits are more likely to be spent or reinvested locally, keeping that capital flowing and creating opportunities within a community.

Local ownership can also play a vital role in keeping businesses from pulling up stakes and moving away. When a company is primarily owned by outside entities, decisions about whether to move are often determined purely by financial considerations. Businesses owned by outside entities regularly relocate to secure financial incentives from other jurisdictions, or when a modestly higher rate of return can be achieved by locating the business elsewhere, even if the business is profitable and viable in its current location.

Employee-owners are more likely than outside capital to consider the toll of uprooting their families, moving away from friends, finding new places of worship, forcing their children to start anew in unfamiliar schools, and many other human costs of relocating a business. As such, employee ownership can make it less likely that economic pillars of local communities will disappear simply because a slightly better short-run deal may be found elsewhere.

Employee-Owned Companies Often More Competitive

Employee ownership can actually make companies function more effectively. Particularly for firms where workers take an active role in managing the enterprise, workers are more likely to work harder and to find innovative solutions to the challenges that businesses face,[16] which in turn tends to make these firms more productive and competitive.[17]

Of course, no business is immune to market forces, but companies that make the most of their employees' skill and diligence are more likely to survive the competitive pressures of the modern marketplace. As such, expanding employee ownership can help make the business foundations of local communities more competitive and durable.

Worker-Owned Companies are Often More Resilient

Worker-owned companies are often better at getting the best out of their people, keeping talented workers, and innovating in the face of new challenges, all of which tends to make them more durable enterprises. Results of different studies vary, but most analysis has found evidence that employee ownership makes firms more productive and profitable.[18] Broad incentives like profit sharing and ownership plans often have larger positive impacts on job performance than narrow incentives like performance bonuses.[19] Employee ownership tends to make employees work harder and reduces turnover.[20] All of these virtues help worker-owned companies survive at higher rates than privately-held companies more broadly.[21]

> If just 10 percent of the jobs lost to business closures since 2010 had been saved, there would be at least 65,000 more jobs than exist today, which could have driven the state's unemployment rate below 4 percent.

Build a more Inclusive Local Economy

Converting existing companies into employee-owned enterprises can help empower historically marginalized communities and families. It is no secret that white men own a disproportionately large share of businesses that exist in many communities, and it is particularly true of the retiring generation of baby boomer entrepreneurs. Analysis of business transactions show that more than 85 percent of business purchasers over the age of 65 are Caucasian, compared to less than half of young adults buying businesses.[22]

Supporting conversion to employee ownership is one way to accelerate this process and give more people and families the opportunity to take ownership over their economic destiny. Employee ownership can often allow groups of workers who could not individually afford to purchase a business to access needed capital. Conversion to employee ownership

THE MAST GENERAL STORE: An employee-owned community institution

Inheritors of a tradition as American as Mom and apple pie, the Mast General Stores has been operating as an employee-owned firm since 1995. The Mast General Store sells goods and services, but it also functions as a meeting space for locals and passers-though. Since John and Faye Cooper rescued and reopened the Valle Crucis location in 1980, the store has grown and the business expanded into several new locations across the Carolinas and Tennessee.[14] Converting to employee ownership made perfect sense for business with deep roots in the local community. The company is proud to place ownership in the hands of "those who are helping to keep the traditions of the old general store alive everyday...the employees."[15]

also deepens pools of business experience, knowledge, and networks in communities that often struggle to access all three of these vital ingredients to successful business ownership. Ultimately, helping one company to become worker-owned can make it easier for the friends, family, and neighbors of those new proprietors to start successful businesses of their own.

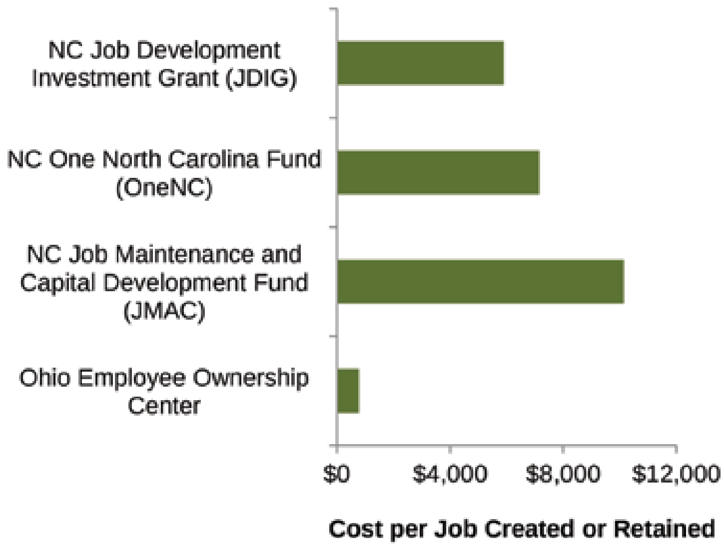
Enable Serial Entrepreneurs

While converting businesses into worker-owned enterprises can be particularly important when current owners are looking to retire, this need not be the only impetus to explore conversion. Conversion to worker ownership can allow entrepreneurs to try their hand at starting even more viable businesses. Entrepreneurs with a knack for identifying market opportunities can be a huge community asset, but they need mechanisms to cash out of existing enterprises and to free up their time to launch new businesses.

Retaining Jobs Often Cheaper than Attracting Them

Focusing on protecting and preserving existing jobs often yields a greater return on local communities' investments. Economic development effort and media attention is often lavished on attracting new companies and facilities, but it is often more cost-effective to

FIGURE 7: Investing in Employee Ownership Can be More Cost Effective than Traditional Economic Development Incentives



SOURCE: Data for JDIG, OneNC, and JMAC incentive programs provided by NC Commerce, 2016 Economic Grant Report. Cost estimate from Ohio Employee Ownership Center taken from Overview of the OEOC and its Impact on Ohio's Economy.

save what already exists than to bring in something new. Particularly when it comes to viable and locally-owned enterprises with deep roots, efforts to save those firms can often yield more substantial long-term community benefits.

When companies bring new jobs to an area, there's no guarantee that all of those jobs will actually go to existing residents. Economic analysis has shown that the majority of new jobs created in most communities are taken by new arrivals or people commuting in from neighboring jurisdictions.[23] People moving into a community often bring economic benefits, but they also create costs for local governments, particularly if they have children than will attend local schools. Commuters can bring needed consumer dollars, but they also strain infrastructure systems without paying property taxes in the community where they work. As a result, financial incentives to attract new companies often have modest, or even negative, fiscal return for local governments.

Compared to traditional economic development incentive programs, expanding worker ownership is an incredible bargain. As shown in Figure 7, the Ohio Employee Ownership Center has amassed a track record of creating and saving jobs through employee ownership at a fraction of the cost associated with North Carolina's flagship economic development incentive programs.

North Carolina's three largest discretionary grant programs—the North Carolina Job Development Investment Grant (JDIG), One North Carolina Fund, and Job Maintenance and Capital Development Fund (JMAC)—all require several thousand dollars in state and local funds per job created or retained. The Ohio Employee Ownership Center provides technical assistance to companies as they become employee owned at a fraction of the cost of the traditional incentive programs that exist here in North Carolina.

BENEFITS TO FUTURE WORKER-OWNERS

Worker ownership can provide a partial antidote to one of the fundamental economic pathologies of our time: the widening gulf between wages and the value of what American workers produce. For the past 30-plus years, workers in the U.S. have kept increasing their productivity, but their actual income has not grown accordingly.

Economists and policymakers may disagree about why wages are not growing along with the value of what is being created, but the fact itself is indisputable. Expanding ownership and reducing dependence on wages alone is one way to address this building crisis. Cooperatives and Employee Stock Ownership plans provide mechanisms to give more people an ownership stake in their economic future, as well as a way to close the gap between the value of what working North Carolinians create and what they take home to support themselves and their families.[24]

Higher Income

Employee ownership can help workers and their families build financial assets and gain increased economic security.[25] Expanding ownership share (often through ESOPs) does not merely substitute stock for other forms of pay, but actually increases what employees take home at the end of the day. Given the increasing disconnect between base wages and productivity, there is good reason to believe that expanding employee ownership would work to meaningfully reduce income inequality.[26]

Weather Economic Downturns with Fewer Layoffs

Worker ownership also tends to change how companies deal with economic downturns. Worker-owned companies are less likely to lay people off in response to an economic shock. It makes perfect sense that companies where workers are partial owners and have a say in how the enterprise is managed would find ways to weather economic storms that do not result in firing people.[26] Instead, these companies tend to find more fluid solutions like reducing hours or temporarily reducing pay[27] to avoid massive layoffs.

These differences in operational philosophy can have benefits beyond just keeping people employed. Companies that retain experienced workers are often able to return to full capacity when the winds of recession stop blowing. In fact, some European countries have developed programs to encourage precisely this kind of behavior, recognizing that the entire economy benefits when otherwise healthy companies can ride out economic downturns in one piece and be ready to ramp back up when demand recovers.[29]

Make Work More Rewarding

Economic development strategies often boil down to simply creating jobs, with relatively little thought to the non-financial benefits that can arise from the right kind of work environment. Most of us intuitively recognize the distinction between simply having a job and taking pride in one's work. Simply put, employee ownership can make all the difference between drudgery and dignity. When people can shape how their work gets done and feel a sense of ownership in what is ultimately produced, a job can become more than just a way to earn a paycheck. In fact, employees in ESOP companies report being only a quarter as likely as their peers in non-employee-owned companies to start looking for a new job in the next year.[30] Employee ownership has also been shown to increase involvement in firm decisions, job satisfaction, quality of supervision, and support for training, all key indicators that a workplace is rewarding beyond mere dollars and cents.[31]

These benefits of converting to employee ownership can be vital regardless of how a company operates before the change. Transition to worker ownership can create the opportunity for expanding agency in the workplace and investment in how the business performs. Even for companies that already empower their employees to take ownership over how their work gets done, conversion to employee ownership can ensure this remains the case.

BENEFITS TO CURRENT OWNERS

Conversion to employee ownership carries a variety of advantages to the outgoing owner. This section discusses federal tax advantages for converting to employee ownership, why conversion deals can be more convenient for all concerned, and how conversion can safeguard values and human relationships that business owners have helped to build.

Tax Advantages

For owners selling C-Corporations, there are substantial potential tax advantages in selling to their employees. The Internal Revenue Service's Section 1042 Rollover allows business owners to defer capital gains taxes on earnings resulting from the sale of the company to its employees.[32]Under the provision, when owners sell 30 percent or more of the stock to workers and reinvest profits into domestically owned establishments, securities or an Employee Directed Trust, they can defer capital gain taxation on the value of the shares sold to employees.[33]

The 1042 rollover is not a tax exemption. Capital gains tax will be owed if the property into which the proceeds are invested are subsequently sold. However, the selling owner at the very least gets the use of capital that would have otherwise been taxed to reinvest. Moreover, if the outgoing owner passes away while still holding the property into which they invested the proceeds of selling their business, their heirs will not owe capital gains on the original business sale.[34]

Streamline the Sale Process

Selling to employees can also make the entire process simpler and faster.[37] As opposed to selling to an outside party that needs to be brought up to speed on all aspects of how the business functions, engaged employees are often already know why the enterprise is viable and valuable. Similarly, clients and suppliers often already know and trust the employees who are stepping up to purchase the business, easing the process of transition for all involved. Beyond simple convenience, this continuity can make it more likely that the business survives the transition.

Allow Owners to be Mentors during Gradual Retirement

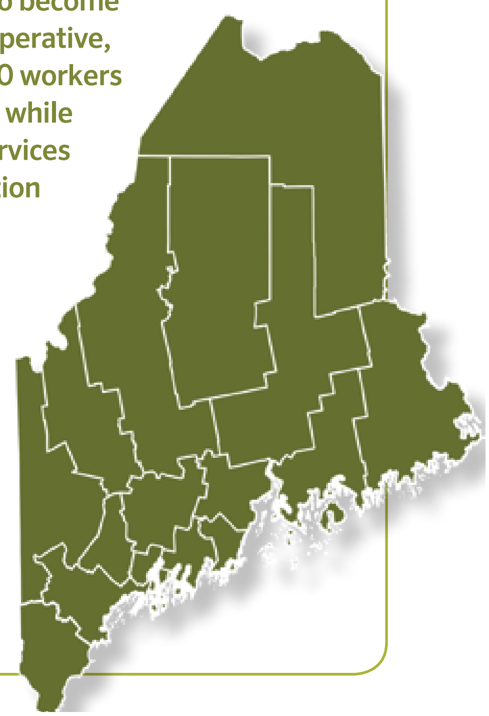
Conversions are often structured in a way that allows an outgoing owner to remain involved in the company for some time after the official sale is consummated. In many cases this is a mutually beneficial arrangement as the new worker-owners often need substantial training, introductions to vital clients and suppliers, and other knowledge that may have been riding around in the mind of the outgoing owner. Many owners appreciate the opportunity to mentor their staff into business owners, and to take an active hand in safeguarding the future of the company they have invested years of their lives into building.[38] As Dennis Quaintance mused after making a series of restaurants and hotels that he helped to found in Greensboro into a 100 percent employee-owned enterprise, "I feel like I have a new toy…This is going to be really fun."[39]

Protect Staff and Families

Selling to an outside party means putting the fate of employees into the hands of strangers. Entrepreneurs often agonize over the future prospects of their employees and hate to see subsequent owners lay off long-time employees. Particularly where the outgoing owner has formed strong relationships with their employees and their families, selling the business directly to them is a way to ensure that outside decision-makers do not upend the community surrounding their business. When New Belgium Brewing Company became 100 percent worker owned, CEO and co-founder Kim Jordan was ecstatic about perpetuating the legacy of what she had helped to build. "There are few times in life when you get to make choices that have multi-generational impact—this is one of those times. We have an opportunity to write the next chapter in this incredible story and we're really excited about that."[40]

Recent Conversion Saves Rural Retailer $1 Million: THE ISLAND COOPERATIVE

A business owner in rural Maine successfully captivated an extra million dollars in profit on account of the 1042 Rollover by exiting his companies and converting to a cooperative.[35] The owner's two grocery stores, hardware, and pharmacy consolidated to become the Island Employee Cooperative, allowing for more than 60 workers to maintain employment while the community's local services remained open. The Section 1042 Rollover enabled satisfactory negotiations and sales terms, thus promoting cooperative conversion as a valuable succession option for not only the exiting owner, but also the workers and community as a whole.[36]



TYPES OF EMPLOYEE-OWNED ENTERPRISES

Worker-Owned Cooperatives

Worker-owned cooperatives are business entities (corporations, LLC's, and trusts) with binding bylaws and operating procedures that determine how ownership and management is shared among some or all of the employees of a company. These bylaws address a range of operating parameters including:

- **Process for joining and leaving the cooperative:** Not every employee at a cooperative must be a worker-owner. Most worker-owned cooperatives have a trial period of employment before someone can become a worker-owner, and that trial period can be quite extensive. Bylaws can also govern how current worker-owners can sell their stake if they decide to leave the company, generally preventing the sale of an ownership share to an outside entity.
- **Process for sharing profits:** Bylaws also specify mechanisms for sharing out profits among the worker-owners. The specific structure depends on the cooperative (e.g. everyone shares equally, seniority is rewarded, share in profits based on hours worked or value created, etc.).

OPPORTUNITY THREADS

Peek in the door of an unassuming industrial building near Morganton, and you can glimpse a better economic future taking shape here and now. Founded in 2009 with one sewing machine, Opportunity Threads (OT) has grown into a worker-owned cooperative cut and sew company employing more than 20 people in a 10,000 sf^2 manufacturing space. Most of the worker-owners are part of the sizable community of Central American immigrants around Morganton, having worked for other manufacturing companies in the area before joining OT. In addition to sharing in the profits the company generates, worker-owners have an equal say in important management decisions, resulting in a shop that is both democratic and profitable in the highly competitive world of modern textile manufacturing.

- **Worker-owners are stakeholders in governance:** Cooperatives democratize the workplace by giving worker-owners a say in how the firm is governed. Depending on the size and operating agreements in place, this could mean that every worker-owner can vote on significant business decisions, or that worker-owners are represented on the board of directors or other management bodies.

There are currently several hundred worker-owned cooperatives across the United States, employing more than 7,000 people.[41] Worker-owned cooperatives exist in a wide range of industries including manufacturing, health care, information technology, education, retail trade, and other services. Most of these companies are relatively small with fewer than 50 employees, but a handful of worker-owned cooperatives have developed into large enterprises with hundreds of employees and millions in annual revenue. The largest worker-owned cooperative in the United States is Cooperative Home Care Associates, which employs over 2,000 people in New York providing in-home health care and personal assistance services.[42]

Employee Stock Ownership Plans

The most widespread form of worker ownership, particularly in larger companies, is achieved through an Employee Stock Ownership Plan (ESOP). An ESOP is a type of benefit plan that allows employees to acquire ownership stakes in their company. Many ESOPs are coupled with democratic decision-making and management structures, but there is no requirement that ESOPs give workers additional agency in how the company is operated. An ESOP can hold all or part of the ownership stake in a company and

VALDESE WEAVERS:
Major Employer in Western NC Becomes 100% Employee-Owned

In May of 2016, Valdese Weavers converted to complete employee ownership. Situated between Morganton and Hickory, the company employs over 1000 people, making it one of the largest employers in Western North Carolina and a global leader in designer fabrics.

Owned by the Shuford family since 1935, Valdese Weavers has been partially employee-owned since 1996.[45] This year, striving to "remain an independent, privately owned company with a strong commitment to [its] local community," the family owners decided to expand the plan and sell the remainder of interest to Valdese employees.The move also puts the company is in the hands of those who know it best, the employees who preserve and maintain it on a day-to-day basis, solidifying its standing as an economic pillar of the local economy. "In keeping with our values," Shelton continued, "the ESOP is a great way to recognize the dedication from each of our associations towards achieving a successful, lasting legacy."

vary widely in the process by which employees acquire stock, how employee-owners share in the profits a firm generates, and the conditions under which employee-owners can cash in their shares.[43]

ESOPs are part of the ownership structure for many of the leading corporations in the United States, including Starbucks Coffee, Southwest Airlines, CH2M Hill, Nucor, and New Belgium Brewing. Nationally, more than 20 million American workers own part of their company through and ESOP (or related stock ownership structure) in 2014, accounting for over one-fifth of all employees with for profit-companies.[44]

PRELIMINARY SURVEY OF POTENTIAL CONVERSIONS

The potential pool of companies that are viable prospects for conversion to employee ownership is vast. While there is no way to perfectly measure the size of this business population, the following criteria tend to be associated with successful conversion prospects:

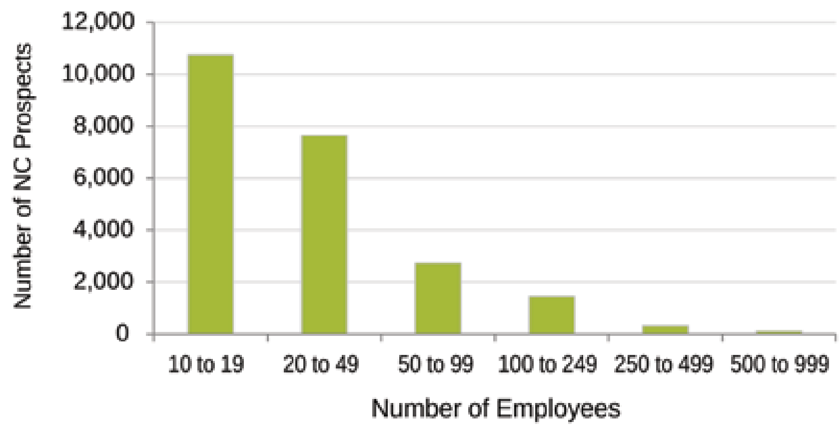
- **Privately owned:** Because conversion requires the agreement of existing owners, the process is decidedly simpler for closely or privately held companies. Moreover, the 1042 tax advantage for outgoing owners only applies to closely held companies,[46] so restricting narrowing the field to privately held companies will exclude many firms that would not be eligible for preferential tax treatment.
- **Track record of sustained business success:** Companies that have survived for more than a few years are more likely to have a durable business model, existing supplier and customer bases, and competitive advantages within their industry (e.g. skilled workers, technical knowledge, capital assets, etc.). As such, this market analysis included only firms that have been in existence for at least 15 years.
- **Good financial position:** Because companies with meager earnings prospects or over-leveraged finances are riskier propositions, this analysis only includes firms that have excellent or very good credit ratings
- **Medium-sized enterprises:** The majority of employee-owned firms in North Carolina are medium-sized enterprises with a few dozen to a few hundred employees. While it is certainly possible for very small and very large companies to prosper as employee-owned enterprises, eliminating the ends of the size distribution produces a more conservative estimate of the potential pool. As such, this analysis includes companies with 10 to 1000 employees.

Based on this conservative estimate of the population, approximately 23,000 establishments in North Carolina could be good prospects for conversion to employee ownership. While the database used for this assessment does lend itself to a precise estimate of the total number of employees who could be impacted, the size breakdown indicates that as many as 1 million North Carolina workers are currently employed by companies that could be converted to employee ownership.

Industries with Particular Potential

Viable conversion prospects in North Carolina exist in virtually every industry sector. As shown in Figure 9, thousands of companies in North Carolina that have been around for years, are privately held, and are in good financial positions exist in wholesale and retail trade, professional services, health and personal care, entertainment and food, manufacturing, and construction.

FIGURE 8: **Breakdown of Conversion Prospects by Number of Employees**



SOURCE: NC Justice Center analysis of Reference USA Database, accessed November, 2016

FIGURE 9: **Breakdown of Conversion Prospect by Major Industry Group**

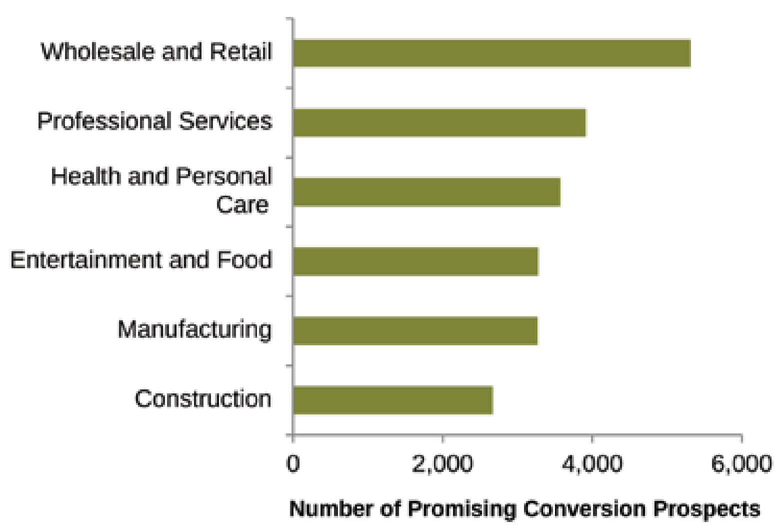


FIGURE 10: Detailed Industry Breakdown of Conversion Prospects

Manufacturing	3266
Machinery Manufacturing	444
Chemical and Plastics Manufacturing	326
Textile Manufacturing	322
Food Manufacturing	239
Furniture Manufacturing	237
Metals Manufacturing	232
Wood Product Manufacturing	226
Machine Shops & Metal Parts Fabrication	206
Printing	189
Misc Manufacturing	118
Paper Products Manufacturing	115
Electronics Manufacturing	107
Automotive and Parts Manufacturing	100
Concrete and Stone Manufacturing	97
Medical Equipment Manufacturing	94
Appliance Manufacturing	86
Apparel Manufacturing	55
Ceramics and Glass Manufacturing	50
Cabinet Manufacturing	23

Wholesale and Retail	5314
Wholesalers	1293
Groceries	923
Department Stores and Misc Retail	659
Vehicle and Equipment Dealerships	627
Home and Garden Stores	546
Freight Movers	327
Clothing and Luggage Stores	250
Personal Care Stores	185
Sporting and Hobby Stores	172
Personal Transit	127
Pharmacies	100
Warehouses and Delivery	46
Water Transportation	39
Gas Stations	20

Agriculture and Natural Resources	388
Agriculture	224
Mining and Extraction	164

Repair and Cleaning	349
Automotive Repair	231
Laundry and Cleaning	98
Repair Services	20

Construction	2664
Home Construction & Repair	668
Plumbing and HVAC Contractors	524
Finishing & Specialty Contractors	504
Electrical and Wiring Contractors	279
Transportation Infrastructure Construction	222
Stone and Concrete Construction	131
Commercial & Industrial Construction	127
Water and Gas Infrastructure	115
Roofing Contractors	94

Professional Services	3909
Banking, Insurance, Finance	664
Real Estate	551
Law	369
Veterinary and Pet Services	276
Education and Training	226
Landscaping	204
Communications	183
Engineering	183
Publishing	173
Accounting	158
Security Services	143
Cleaning and Waste Services	135
Administrative Services	134
Public Relations	127
Computer Programming	108
Management and Consulting	68
Rental	63
Scientific Research and Consulting	60
Architecture	46
Testing Laboratories	21
Interior Design	17

Health and Personal Care	3573
Physical and Mental Health Providers	2109
Child Care	715
Personal Care Services	445
Nursing	257
Social Services	47

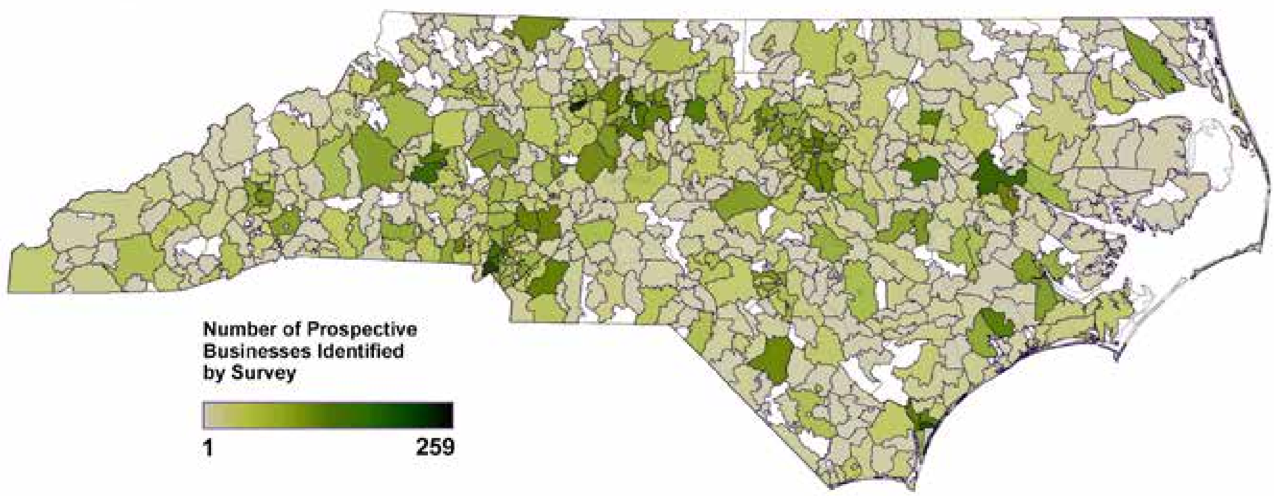
Entertainment and Food	3272
Restaurants and Bars	2536
Entertainment and Recreation	421
Accomodation	258
Catering	57

A more detailed industry breakdown underscores the breadth of the opportunity while also pointing to types of businesses that may contain the most potential for expanding employee ownership.

Opportunities Exist Across the State

Unlike many economic development strategies, expanding worker ownership has significant potential across the state. The preliminary survey conducted here reveals that many economically distressed parts of the state nevertheless have viable, long-standing, privately-held companies that could be converted into employee-owned enterprises.

FIGURE 11: Businesses Can be Converted to Employee-Ownership Across NC



SUPPORTING CONVERSION TO EMPLOYEE OWNERSHIP

Identify candidate companies

Many business owners who may be interested do not yet know about the possibility of conversion to worker-ownership, or the benefits to themselves, their employees, and their communities. Given that business owners tend to be extremely busy, there is a role for governments, economic development entities, business associations, and other local groups to identify candidate companies and proactively ensure that their current owners know that the option exists.

Feasibility Assistance

The very beginning of a conversion process can pose significant challenges, particularly before it is clear whether a given firm is a strong candidate for employee ownership. While costs associated with later stages of the process can often be financed as part of the structure of the deal, some basic assessment, business valuation, and other consulting services are needed, and this rarely comes free. As such, finding and/or providing funding to perform some of the very early-stage analysis and stakeholder discussion can be essential to getting the process under way.

Technical Assistance

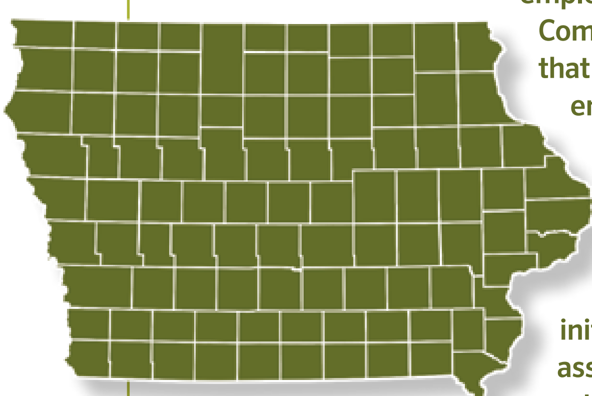
Successful conversion to employee ownership involves more than just the sale of a company. Particularly in cases where employees assume an increased role in management and business decision-making, the process of conversion often requires employees to become more involved and knowledgeable about all facets of the business. As such, new employee-owners often need technical assistance with basic business proficiencies like accounting, marketing, developing supply chains, contracting, and human resource management.

Conversion also carries unique challenges that often require outside assistance to overcome. Building a culture of ownership among employees who may have been accustomed to simply doing a specific job can take time, and often requires building new decision-making structures. Legal structures also need to be built that define how and when current worker-owners can cash out if they need to move on, the process by which new employees can become owners, restrictions on the sale of ownership stakes to outside entities, and other vital questions that determine how the enterprise will be governed.

All of these challenges can be overcome, but technical assistance can make the process more tractable and likely to succeed. As such, a robust conversion strategy requires some mechanisms for helping companies that want to convert to find and pay for outside expertise.

Iowa Employee Stock Ownership Assistance Program

The Iowa legislature appropriated $500,000 to support companies exploring becoming employee-owned. Companies that become employee-owned can receive a grant for up to half of the cost of initial feasibility assessment, up to a cap of $25,000.[47] The program was championed by Republican Governor Terry Branstad as part of a broader employee ownership initiative.[48]



Employee Ownership Center(s)

Given the potential benefits of employee ownership, but also the complexities that must be overcome, centers tasked with expanding and facilitating worker ownership have been established in several states.

Ohio Employee Ownership Center (OEOC)

Founded in 1987, the Ohio Employee Ownership Center has one of the longest and most effective track records of expanding employee ownership anywhere in the country. The OEOC has helped nearly 700 firms employing nearly 140,000 workers to explore whether employee ownership is feasible, resulting in the creation of over $340 million in employee income.[52]

These centers differ in the specific services they provide and the institutional setting in which the center is established, but all have proven that supporting employee ownership can create substantial economic benefits.

Notable examples include the Ohio Employee Ownership Center,[49] the Center for Cooperatives at University of Wisconsin,[50] and the Vermont Employee Ownership Center.[51]

Incentives for Conversion

Some state and local governments have experimented with financial incentives for current owners to sell to their employees. While the 1042 rollover provision in federal tax code creates significant financial benefits for owners of C-Corporations, it does not apply to Limited Liability Companies which make up a large share of the privately-held firms. Iowa passed legislation to exempt 50 percent of the proceeds resulting from the sale of a company to its employees through an Employee Stock Ownership Plan.[53] A bill sponsored by Republican members of the New Jersey Assembly created a similar provision to encourage expanding worker ownership.[54]

It is important to note that tax exemptions are not the only mechanism for incentivizing the sale of companies to their employees. It may be preferable to create a dedicated grant fund with administrative oversight in lieu of a tax credit, as a means of controlling fiscal costs and enhancing the likelihood that funds will only go to conversion projects with the largest potential economic benefits to employees and communities.

Augment Financing for Conversions

Many conversions to employee ownership entail some amount of debt capital to finance the deal. While there is a surprisingly large segment of the financial services industry that specializes in these types of transactions, state governments can still play a vital role in expanding the availability of debt capital in this space. States can leverage their deposits to

Indiana ESOP Initiative

The Indiana Treasurer operates a program where the state will purchase Certificates of Deposit at modestly below-market rates on the condition that selling banks use those funds to provide debt capital to ESOP conversion deals. Moreover, banks willing to participate in the program must agree to provide a discount on the terms of the loan made to ESOPs.[55]

encourage lending to ESOP transactions by purchasing Certificates of Deposit with banks on the condition that these institutions use the funds to provide debt capital to support conversions to employee ownership.

■

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