Case Study: North State Grocery

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Piscataway, New Jersey

October 2021

Working Paper Case Study

Abstract: This case study examines employee share ownership at North State Grocery, where the Employee Stock Ownership Plan (ESOP) solved a transition challenge in a company owned by two siblings. Thanks to the ESOP, long-term employees, including frontline staff such as cashiers and bakery workers, build a larger cushion of retirement savings than is typical in frontline retail jobs. Given the number of family-owned businesses in search of succession strategies today and given the importance of improving compensation including retirement benefits for frontline retail workers, North State Grocery's story may offer lessons for other business owners, in retail and other sectors, to consider.

North State Grocery, Inc., owns and operates a chain of 22 grocery stores under the trade names "Holiday Market" and "Sav Mor Foods" in Northern California and Oregon. The company is 100% employee-owned through an employee stock ownership plan or ESOP, which holds the company's stock in a trust on behalf of the employees. Thanks to the ESOP, long-term employees, including frontline staff like cashiers and bakery workers, can build a significant cushion of retirement savings, an opportunity that is unusual in frontline retail jobs.[1]

Richard Morgan, Sr., opened his first store in Cottonwood, California, in 1961. The original store was located on Front Street, the historic road that locals say is "wide enough for a 12-horse team or a herd of cattle." The company headquarters remains on Front Street to this day. Richard Sr. diligently grew his business, originally called Morgan's Holiday Market, over the decades, expanding stores across the region. Morgan Sr.'s son Richie began working at the company when he was 12 years old for 50 cents a day.

In 1989 Richie Morgan and his sister LaVonne Morgan started their own company, North State Grocery Inc., to follow in their father's footsteps. From the start their company was "family run and very open book. Everybody knew everybody on a first name basis," recalls Richie. "We already kind of had an employee-owned company atmosphere. We just didn't have the ownership structure" before 2006.

[1] The retail industry employs 32 million Americans, making it the largest private sector-employer in the economy. The sector is populated with low-wage service jobs, many without retirement benefits; the mean annual salary for cashiers is $25,740, a poverty level wage for a family of four. Sixty percent of retail employees do not participate in any retirement plan at all, according to the BLS (https://www.bls.gov/iag/tgs/iag44-45.htm).

When Richard Morgan, Sr., decided to retire in 1998, North State Grocery Inc. was by then a large company in its own right. Richie Morgan and LaVonne Morgan bought their father's business and folded his nine remaining stores into their operations.

As time moved on, challenges that are all too common in family businesses started to arise. One family member can have a passion for the business and another may not; this was the case at North State Grocery. LaVonne Morgan, one of the sibling co-founders, wanting to pursue other passions, needed to be cashed out.

The ESOP Solves Several Problems at Once

The management team started exploring their options in 2003. While selling the company to an outside party represented a possible solution in theory, Richie did not want to see North State Grocery sold. They quickly realized that an Employee Stock Ownership Plan or ESOP would solve several problems at once. The ESOP would enable Richie's sister to cash out her shares while allowing Richie to remain in the executive role—balancing the siblings' differing goals. At the same time, the transaction would also buy out a supplier who had a small ownership stake but with whom company leaders wanted to part ways. There were also tax benefits,[2] and the ESOP would enable the company to remain locally owned. The more he learned about employee ownership and its many advantages, the more Richie became "really a believer in the ESOP idea." The "ESOP made the most sense for everybody."[3]

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[2] ESOPs provide unique tax advantages to selling business owners. The selling party may eliminate or "indefinitely defer" capital gains on the proceeds of sale under Internal Revenue Code Section 1042. For the company there can be tax advantages as well; an S Corporation where the ESOP owns 100% of company stock can be federal income tax-exempt.

[3] While ESOPs are found across all industries, the preponderance, 22 percent, are in the manufacturing sector. Just 6% of ESOPs are in the retail sector. That said, "[s]upermarkets are common among the largest employee-owned companies," according to the National Center for Employee Ownership, which includes ten supermarkets on its "Employee Ownership 100" list.

In 2006 LaVonne's shares, and the supplier's shares were purchased by the company then re-sold to the ESOP, making 46% of the company employee owned. "I think that's the beauty of an ESOP," Richie Morgan says. "When you have one family member who's passionate about the business, but maybe they don't have the capital to buy the other person out and allow that person to exit," the ESOP makes such a transaction possible. With the ESOP you can "put the company entirely in the hands of the people who are passionate, along with the employees." In 2016 the company purchased the remaining shares from Richie and became 100% employee owned.

The Company

Today the company consists of 22 retail grocery stores employing roughly 1,100 people.

The largest number of employees work as cashier-stockers. The second largest job category consists of employees in the bakeries and delis. Starting pay for frontline employees is $14/hour in 2021; now that California passed a $15 per hour wage law, most new employees will start at $15 by 2022.

In addition to earning wages and benefits, North State Grocery employees also accumulate ownership wealth. Company president Richie Morgan says, "our ESOP is still fairly new. Early on, employees used to have three, four, five, six, $7,000 in their accounts. Now it is not uncommon for $70,000 or $80,000 to be in there." Balances can exceed $100,000 for store employees who have remained employed there since the ESOP adoption. The actual vested ESOP balance of one nonmanagement employee who has been with the company since the start of the ESOP was, for example, $129,000 in 2019.

By comparison, nearly half of U.S. families have no retirement account savings at all and the median household has just $21,000 in savings as they approach retirement, according to Survey of Consumer Finances data.

Celeste Chafin, the inventory control manager at the Penn Valley Holiday Market, started as a checker 30 years ago. She has a high school degree and four grandchildren, and she worked at a Kmart for 10 years before joining the company. She says: "Honestly the most important thing to me is that when I retire in five years, I won't have to worry that I'm going to have to be on a fixed income because my company has taken care of me very well by giving us the stocks." She plans to use some of her ESOP funds, which will supplement her 401(k), to pay down the balance on her home.

The ESOP primarily rewards those employees who stay with the company over a long period of time. Employee owners receive shares of company stock each year, so the longer an employee works for the company, the more shares they accumulate. From 2006 to 2021 North State Grocery stock price rose from $27 per share to $527 per share. Employee stock accounts rose accordingly.

The ESOP does not benefit short term employees in the same way. "If you come to work for us today and you work three or four years, even though you'll be eligible in that second year, you're going to leave with next to nothing," Richie acknowledges. "As you're here longer, and the value of the company goes up, you just keep getting more. Then because you have more, you get more. It's a 'compounding thing.' For us it's exciting to see people build wealth."

Celeste Chafin says she would tell a new employee: "You have to stick around. It doesn't just happen right way. But it will happen for you too, and then you won't have to worry as much about your financial future." Her own most recent ESOP statement showed a balance of $158,000.

From the management perspective, another benefit of the ESOP is how it changes the conversations with employees. The company had already been sharing company financial information with employees. Now that employees are owners, they can relate the financial information to employees more directly. As an example, President Richie Morgan says, say there are trying to improve productivity in a department. “You talk to the team members about that and say ‘here's the benefit you're going to see from that.’ And you're telling them the truth.” It's no longer a situation of distrust where the employees think, “they're going to cut hours in our department so the company can make more money and why would I really want to do that?”’ Employees have more of a material interest in improving the company’s bottom line, and in supporting decisions that do so. Richie continues: Now “you have the conversation where ‘We can do this job with less people. Not only are you going to get more benefit, but if it takes six people to do the job and you guys can figure out a deal with five, you're going to have less people in your ESOP. You're sharing the value of the company with less people. So, you know, instead of ‘why don't we have more people?’ It's ‘how can we do this better?”’

In a video on the company website, an employee named Norma who worked her way up from being a courtesy clerk to assistant manager, says it’s “a good thing to be” an employee owner. “It gives you more incentive to work hard.” Shay, the store director of the Redding location says, the ESOP gives employees an understanding that “we’re working for ourselves not for some rich guy in Minnesota we don’t know.”

To Celeste Chafin the most important thing about employee ownership is the financial benefit. She says with a laugh, “I’d like to say that being an owner changes the way I think about my work, and I don’t take it for granted or anything. It’s just not something that I think about all the time when I’m doing my job. But when I get quarterly statements showing how much money my stock is worth, then I think about it. I think, ‘That’s really cool.”’ Then she adds more seriously, “I feel like this is a great place to work. I’m very thankful as an employee for what they’ve done for me with the ESOP. That to me says to me how much they really care about the people that work for them.”

Family businesses account for over 50% of U.S. GDP and provide about 60% of jobs. Yet the overwhelming majority of family-owned businesses fail to transition to the second generation. The challenges of managing a family-owned business are complex and real.

For one west coast supermarket company navigating the challenges of family ownership, North State Grocery, an employee stock ownership plan enabled the company to continue and thrive. The ESOP met the differing goals of family members, while cashing out a supplier with an ownership stake. Critically, the ESOP adoption sent a clear signal to employees at all levels of the company including the very frontlines, that moving forward they too would share a real material wealth stake in the company's success. And they do.

Given the number of family-owned businesses in search of succession strategies today, and given the importance of improving compensation including retirement benefits for frontline retail workers, North State Grocery's story offers lessons for others to learn from and follow.