Who Should Own Your Business AFTER YOU?

Why hundreds of Colorado business owners SELL TO THEIR EMPLOYEES

This booklet helps business owners in Colorado evaluate employee ownership. It shows how selling to your employees can mean flexibility and fair market value for you, security for your workforce and community, and the deep satisfaction of knowing the people responsible for your company's success after you have left.

COLORADO
Office of Economic Development & International Trade
Employee Ownership Office

Center for Community Wealth Building
An Inclusive Economy That Works for All

RMEOC
Rocky Mountain Employee Ownership Center

Democracy at Work Institute
USFWC

NCEO
NATIONAL CENTER FOR EMPLOYEE OWNERSHIP

Why do some business owners sell their companies to their employees?

AS A BUSINESS OWNER, YOU WILL SOMEDAY HAVE TO DECIDE WHO SHOULD OWN YOUR BUSINESS AFTER YOU.
Some people sell to family members, to investors or to other businesses. But over the past four decades, thousands of owners have decided to make their employees the next owners of their companies. Colorado is home to more than 220 employee-owned companies.

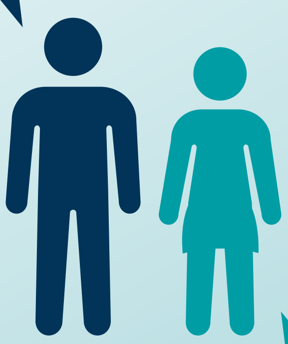
The most common path to employee ownership in the United States is an employee stock ownership plan, or ESOP. In an ESOP transaction, you sell your shares at fair market value to a trust, and the trust holds the shares for the benefit of your company's employees.

Another form of broad-based employee ownership, worker cooperatives are fast gaining in popularity. Often favored for their simplicity and democratic approach, worker coops number in the hundreds in the US with many more found overseas, including the world's worker coop, the Mondragon Corporation, located in Spain's Basque region.

In Colorado, we recognize the following structures as employee-owned: Employee Stock Ownership Plans, Worker-Owned Cooperatives, Employee Ownership Trusts, Employee Stock Purchase Plans, LLC Membership, Phantom Stock, Profits Interest, Restricted Stock, Stock Options, Stock Appreciation Rights, and Synthetic Equity.

The decision you make affects you, your family, your community, the people your company does business with, and your workforce. Striking the right balance is hard, and no one can understand that challenge better than people who were in your situation. ■

But what does an ESOP transaction look like? See page 4 to find out.



Interested in worker-cooperatives? Start on page 8.

Employee Ownership Advances in Colorado

In 2019 and 2020, Colorado Governor Jared Polis established the Employee Ownership Commission and Employee Ownership Office, respectively, housed within the Colorado Office of Economic Development and International Trade (OEDIT). Through Executive Order B 2019 005, the Commission creates a statewide network of technical support, educational programs for business and communities, and increased accessibility to employee-owned business structures. In addition to the support of the Commission, the office has its own dedicated staff.

The office offers programming, funding, and resources for businesses interested in becoming employee-owned. In 2021, H.B. 21-1311 established the Employee Ownership Tax Credit, providing $10 million annually in tax credits to fund professional service costs incurred when converting to employee ownership. The office also offers the Employee Ownership Grant, awarding $3,000 to businesses to reimburse conversion costs.

In addition to funding, the office launched three peer networks for Colorado's current and aspiring worker cooperatives and ESOPs.

The office operates an "Employee Ownership Navigator" to provide advice to business owners about ownership models, assist with business succession planning, as well as connecting them to local technical assistance and service providers by conducting one-on-one consulting sessions.

Two of the technical assistance providers that work closely with the Employee Ownership Office are the Rocky Mountain Employee Ownership Center (RMEOC) and the Center for Community Wealth Building (CCWB). These organizations help business owners define what type of employee ownership will be the best fit for their vision and support them along the pathway to that new structure. This support includes education for the new employee owners, to assure they are ready to step into their ownership roles, and ongoing technical assistance to help them achieve success.

Finally, the office will offer a loan program to support employee ownership conversions or existing business sales to employees. The program uses funds from the State Small Business Credit Initiative, deployed through the Cash Collateral Support program, and managed by the Colorado Housing and Finance Authority (CHAFA). ■

EMPLOYEE OWNERSHIP PROFILE:

Colorado Pool and Spa Scapes

Colorado Pool and Spa Scapes celebrated a conversion to an employee stock ownership plan in April 2021. Initially, the founders started bringing in long-term employees as partners. As the company grew, it became apparent that approach could not be sustained with more career and long-term employees joining the team. They found employee ownership to be the solution.

Based in Avon and Glenwood Springs, Colorado Pool and Spa Scapes specializes in custom pool design, construction and renovation, portable hot tub sales and installation and pool and hot tub service, repair and maintenance.

Chief Financial Officer Paula Cross says, "I was raised in an entrepreneurial home and I believe that entrepreneurial spirit can be enlivened with the employee ownership option," says Cross.

"It can make some of the best employees and help make decisions at every level of the organization. It can bring that potential of our employees up to a higher level."

Read the full article at tinyurl.com/COscapes. ■

Frequently asked ESOP questions

To be sure you have fully explored your options, you should plan on six to twelve months from the date you decide to sell your business until the documents are signed. During that time, you'll hire a team of advisors, determine the size and financing of the transaction, design the employee benefit package, and manage communications with the workforce.

Staff at the National Center for Employee Ownership (NCEO) talk with owners at all stages of the transaction, and some of their most common questions are...

Q. How much will an ESOP pay in taxes?

A. The ESOP buys the stock at fair market value, as determined by an independent appraiser. ESOPs can also provide you tax benefits in the form of a deferral of capital gains. Third-party strategic buyers may pay fair market value up front, but owners who sold to an ESOP often find that their after-tax take-home is higher in an ESOP sale.

Q. Do employees pay for their shares?

A. It's possible but rare. Generally, company contributions to the ESOP support the buyout of the selling owner's shares while also providing a benefit to employees.

Q. What will my role be in the company?

A. It's flexible Some sellers stop working the day the sale is completed, or even before. Others provide for a long-term, orderly transition, and some remain as CEO or board member.

Q. Does employee ownership make a difference?

A. Typical ESOP companies outperform competitors and provide above-average above average compensation, benefits, and employment security.

Q. Do I have to sell 100% of my shares?

A. You can sell all or some of your shares. Unlike most other buyers, an ESOP can buy a portion of your shares or can buy in stages.

Q. Are ESOPs complicated?

A. No matter what anyone tells you, there is no simple, hassle-free way to sell your business. ESOP transactions require the support of experienced advisors because an ESOP is an employee retirement plan subject to substantial federal regulation. They also give sellers more control over the inherent risks of a business sale, and they may cost less and close more quickly than a sale to the third party. ■

See page 6 for information on the structure, price, and process of the sales transaction.

EMPLOYEE OWNERSHIP PROFILE:

Hercules Industries

Hercules Industries was family-owned since 1962. When it came time for the owners to transition out, they heard presentations from buyers and investors, but none of the presentations impressed the owners and none felt like the right fit.

That is, until the former owners lit up when they heard about employee ownership, specifically an employee stock ownership plan (ESOP). The choice was clear as the owners knew that an ESOP would be a wonderful way to transition the legacy to the employees who helped build it.

Hercules is a steel fabricator and wholesale distributor in the HVAC space. They made the transition to employee ownership in 2019, offering an ownership stake to their community of hard-working and loyal employees.

So in 2017 we set up a long-term leveraged transaction which involved senior debt, seller financing, and seller warrants. Now the community and our employee-owners know these jobs aren't going anywhere. And the proof is in the pudding—in the first year since the sale, our stock price is up 488%.

"We have a rich culture of coming together. Going through the pandemic as employee owners made that feel very real," said Dan Luzietti, Chief Financial Officer at Hercules. "It renewed our entrepreneurial spirit. It sounds funny for a 60+ year old company to say that, but employee ownership offered an energizing spirit behind what we had to overcome. It was a pleasant surprise."

When asked why one may consider employee ownership for their own business, Luzietti shares that he loves the concept of employee ownership.. ■

"Our people have rallied behind the uncertainty of the past few years. There's now a vehicle to reward the people doing the work. Back to our legacy, that is what our family ownership wanted, to share in the success of the business with their employees."

Read the full article at tinyurl.com/hercind. ■

ESOP companies OUTPERFORM

- **ESOP companies generate 2.5% more new jobs per year than these same companies would have generated if they did not have an ESOP.**
- **Employee-owners are one-third to one-quarter as likely to lose their jobs compared to non-employee-owners, according to the General Social Survey.**
- **ESOP companies default on their loans at a rate of 0.2% per year.**
- **Companies with ESOPs were 75% more likely to stay in business, according to research looking at the last two recessions.**

ESOPs create GOOD JOBS

Among workers ages 30 to 36, employee-owners do better than non-employee owners:

- **90% higher or nearly 2 times the median household wealth at age 30**
- **22% higher median income from wages**
- **46% longer median job tenure**

The relationships between employee ownership and improved economic outcomes for workers largely persist over time and when controlling for demographic factors.

ESOP SALES:
Structure, price, and process

ESOP sales range from small and simple to complex M&A transactions.

In the simplest kind of transaction, the companies buys shares from the selling owner and contributes those shares to the ESOP, which allocates them to employee accounts. Employees gradually build up an ownership interest as the owner sells more and more shares.

The most common structure is that an ESOP trust borrows money from an outside funder on standard commercial terms and uses that money to buy shares from the selling shareholders. The company makes annual contributions to cover the repayment of the loan. Common variations include seller financing, buying out the owner or owners in stages, and conversions between S and C corporation status.

ESOP transaction main steps

1. Complete a feasibility study and determining an initial valuation range
2. Hire the team of advisors
3. Develop the transaction structure
4. Conduct due diligence
5. Establish the trust and appoint the trustee.
6. Determine fair market value by the trustee and independent appraiser
7. Negotiate the transaction terms and conditions
8. Close the transaction and communicating to employee-owners.

Valuation

ESOPs are financial buyers and cannot pay a strategic price. An independent appraisal firm values the shares being purchased by the ESOP at fair market value. If the ESOP is buying a minority interest the price will likely include a minority interest discount. Most ESOP valuations also include a small discount for lack of marketability.

Governing the transaction

The ESOP trustee, generally an outside institution or an individual with specific expertise in ESOPs, ensures that the ESOP transaction meets all the legal requirements and that the ESOP does not pay more than fair market value. The trustee is obligated to work solely in the interest of plan participants. ■

PLANTING OWNERSHIP AMONG EMPLOYEES:

The Success of Employee Ownership at Applewood Seed Company

Founded in 1965 in Golden, Colorado, by Gene Milstein, he began collecting and selling Colorado wildflower seeds as a hobby from his basement. Applewood Seed has since become one of the largest producers of open pollinated flower seeds in the country.

Applewood Seed sells through a variety of distributors that in turn sell into various markets. Seeds produced by Applewood Seed Co. are distributed by private brands through mass merchandisers, grocery stores, home and hardware stores and via Internet sales.

The company collaborates with other seed companies for conservation purposes, roadside beautification and in production agriculture settings. Pollinator conservation is a growing segment of Applewood Seed's business as it pertains to ecological restoration and to increase yields on various agricultural crops. Ecosystem diversification in federal and state conservation programs is a growing segment of the business.

At the end of July 2020, Applewood Seed became a Colorado Employee-Owned Company with an Employee Stock Ownership Plan (ESOP). The primary reason the company moved to an employee ownership structure was for a guaranteed succession plan, as the owners neared retirement.

The company was also aware that their employees were one of their most valuable resources. They wanted to offer a quality benefit for their hard work and retain and empower their team. Employee ownership was their way to strengthen an already robust benefits plan and further invest in their employees to achieve new heights within the organization.

In addition to the key benefit of rewarding employees for their work ethic and dedication, leadership recognized additional benefits to the organization by way of tax savings, lower employee turnover, higher company cash flow and faster growth.

"Throughout a record year and continuous expansion of our company, we've experienced an incredible increase in employee engagement to accompany our growth," said Ryan Guilford, Chief Operating Officer at Applewood Seed Company.

"Our company's culture has expanded beyond an employee-employer relationship with this new sense of empowerment through the ESOP. The material impacts on the company have increased beyond our expectations through a new employee-owner mentality and employee owners thinking and acting like the organizational leaders that they are."

Applewood Seed Company has been selling flower seeds for over 55 years and in some cases, established companies like these can become rigid in their ways of operating. According to Guilford, employee ownership gave the company a whole new feeling, more energy, a sense of adaptability and higher level of employee engagement. In under a year, the employee ownership has already permeated every aspect of the company as they grow and look forward to the years to come with their new set of exceptional owners. ■

ESOPs aren't the only way to implement broad-based employee ownership at your company. Worker cooperatives are fast gaining in popularity thanks to their simplicity and democratic principles.

What is a worker cooperative?

A worker cooperative is a values-driven business that puts worker and community benefit at the core of its purpose. The two central characteristics of worker cooperatives are:

- Workers own the business and they participate in its financial success on the basis of their labor contribution to the cooperative
- Workers have representation on and vote for the board of directors, adhering to the principle of one worker, one vote

In addition to their economic and governance participation, worker-owners often manage the day-to-day operations through various management structures.

At a worker cooperative, workers have financial equity that allows them to share the real risk and reward of small business ownership. Workers also have meaningful participation in business decisions, including the ability to voice their desires and improve their work life. A worker cooperative is owned and controlled by its workers. ■

A BRIEF HISTORY OF WORKER COOPERATIVES IN THE UNITED STATES

Though we don't yet have comprehensive data on the nature and scope of worker cooperatives in the U.S., our research has verified 465 worker cooperatives in the United States. These democratic workplaces employ around 7,000 people and generate over $550 million in annual revenues. The number of worker cooperatives has grown steadily over the past 20 years, and is made up of both well-established businesses and new, growing ones, increasingly including some businesses that have been sold to their employees by their owners.

Any business can be a worker-owned and -controlled business. In the U.S., worker cooperatives tend to be concentrated in the service and retail sectors. Common industries include:

- Accommodation and food service
- Health care
- Manufacturing and engineering
- Technology
- Design

Many of the worker cooperatives in existence today were inspired by the Mondragon Cooperatives in Spain, which enabled the Basques to lift themselves out of poverty and build what is today Spain's 7th largest corporation, a worker cooperative.

Worker cooperatives are currently experiencing a surge in popularity, marked by industry and sector concentrations and the growth of a support infrastructure that includes financing, technical assistance providers and trade associations at the local, regional and national levels. Interest in worker cooperatives as a job creation and wealth-building strategy is also on the rise, with community organizations, cities, and small business advocates seeing potential in the form to build a more inclusive economy.

This recent growth in the worker cooperative sector can be traced back to the 1970s and 1980s, when all of today's largest worker cooperatives were founded, as part of an explosion in alternative economic forms. Those cooperatives that survived have thrived, and have helped seed new growth through investment of capital and expertise in a second wave of worker cooperative development starting in the late 1990s. By 2000, several worker cooperative development organizations had begun to have success using the form as means to create good jobs for low- and moderate-income workforces, from home care to housecleaning. ■

WORKER COOPERATIVE FACTS AND FIGURES

- **Number of worker cooperatives in the United States: 465-800**
- **Total number of people working at worker cooperatives in the United States: 7,000**
- **Total annual revenues generated by worker cooperatives: $550 million**
- **Average size of a worker cooperative: 50 people (the median is 10 people)**
- **Largest worker co-op: Cooperative Home Care Associates (CHCA) with more than 2,000 workers**
- **Number of worker cooperatives formed since the start of the 21st century: over 150**
- **Percentage of worker cooperatives that began as traditional for-profit enterprises: 26%**
- **Percentage of worker cooperatives that have annual revenues over $1 million: 31%**
- **Average annual profit margin for a worker cooperative: 6.4%**
- **Worker cooperatives structures: 46% incorporate under cooperative statutes, 26% operate as LLCs and the remainder are C-corporations, partnerships, and other.**

The transition process for worker cooperatives

The process takes an investment of resources and professional assistance to ensure success and long-term benefits. While unique for each business, the process generally has five stages. Durations can vary widely, depending on the complexity and readiness.

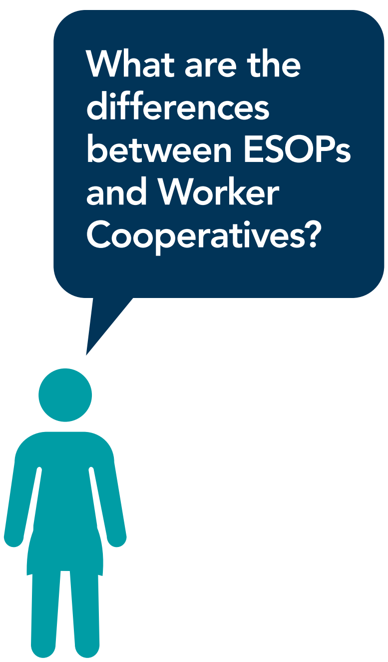
EXPLORE (timeframe varies)—the business owner studies worker ownership and decides if it is an idea worth pursuing

ASSESS (3-6 months)—the business owner works with experienced professionals to affirm an ownership transition is feasible

STRUCTURE (6-12 months)—a transition team establishes the sale terms and leadership changes

EXECUTE (3-6 months)—the transaction is financed with lender support and the company legally changes hands. In most cases, employees will require outside or seller financing to make the purchase.

SUPPORT (timeframe varies)—leadership and operational gaps are addressed with ongoing training for staff in new roles with new responsibilities. ■



ESOPs	Worker Cooperatives
Stock owned by trust, employees own indirectly	Direct ownership of stock, one vote per shareholder
Better option for larger companies (minimum 20 employees)	Good option for companies of all sizes (minimum 5-6 employees)
Significantly more expensive to set up and maintain	Affordable to set up, even from very beginning
Strong tax benefits	Modest tax benefits
Can have democratic structure but up to board and founders	Inherently democratic
Can take on most kinds of financing	More limited financing options (though getting better)

Why form a worker cooperative?

Jaime Jennings and Amber Corcoran

Fancy Tiger Crafts

Jaime Jennings and Amber Corcoran started Fancy Tiger Crafts in 2008 with the intention of making a wide variety of craft supplies and skills available to their community. Now, both Jennings and Corcoran are ready to take more time for themselves, but they weren't quite ready to abandon the business they had spent so much time building together.

With the help of the Rocky Mountain Employee Ownership Center (RMEOC), Fancy Tiger was able to transition into a worker cooperative, allowing the original owners to sell their company and have the peace of mind that the integrity of the company they created is upheld.

"We briefly thought of selling the business (to an outside buyer), but we have so much love for what we built that putting it into someone else's hands who we don't know their intentions would feel kind of wrong," says Corcoran, referring to the traditional business succession method of selling to the highest bidder.

"We had a lot of amazing employees that we counted on to help us with running the business," she says, making Fancy Tiger a perfect candidate for a co-op transition. So that's what they did.

Corcoran and Jennings liked the idea of equity for members that came with creating a co-op.

"They all put in the same risk and no one is taking on more risk than anyone else," says Jennings.

Read the full article at tinyurl.com/fancycrafts. ■

Indira Guzman

Denver Foundation

The Community Language Cooperative was founded in May 2014 and began immediately as a cooperative. It was created from three LLCs that joined together to form the co-op.

At the heart of Community Language Cooperative is an understanding of the power that language holds. By providing interpreters and translators to communicate in other languages, they can bridge any language barriers to opportunities and resources.

Indira Guzman, one of the founding members, joined the Denver Foundation on a trip to Cleveland, Ohio, to learn more about The Cleveland Model. This model is a collaboration of organizations to promote large-scale worker-owned and community-benefiting businesses. It was during this journey that inspiration struck and Guzman wanted to consider similar principles of entrepreneurship to invoke the same energy into the Community Language Cooperative.

As she worked alongside other interpreters, Guzman knew that by creating a cooperative, each member would have ownership and hold the same integrity as any other business owner would.

In other business structures, the interpreter may not receive as much benefit as the agency would, making it less accessible to communities. With the cooperative model, Guzman is happy to offer a stronger community wealth building model and offer each interpreter the majority of the profit from their work.

"The cooperative model has impacted our business in every way. The services we offer are high quality because our interpreters know they are representing themselves. We are creating a space for economic opportunity for all and having those values in our business helps everyone grow."

Read the full article at tinyurl.com/comlangcoop. ■

How you can learn more

- As the leading source of information on ESOPs and employee ownership, the NCEO is committed to helping businesses make informed decisions. We're happy to help guide you through the process of figuring out if an ESOP is right for you. **Start with the essentials:** The NCEO's *ESOP Essentials* (nceo.org/esop-essentials) membership offers six months of exclusive educational content with curated resources for selling business owners.
- **Speak with an employee-owned company in your state or industry:** We can connect you with an NCEO member in your area or industry to learn about their experience and better decide whether an ESOP will suit your succession needs. Contact Timothy Garbinsky at 510-208-1310 or TGarbinsky@nceo.org to get started.
- **Become an NCEO member:** As an NCEO member, you can call us anytime with questions at 510-208-1300. **nceo.org**
- **Interested in worker-cooperatives?** Learn how to get started with the Democracy at Work (DAWI) Institute at **institute.coop/conversion**.
- **The Colorado Employee Ownership Office** can answer questions you may have about becoming an employee-owned company. We offer confidential consultations as you learn about your employee ownership options. We can also connect you with vetted Colorado-based technical service providers like RMEOC and CCWB for initial guidance. Connect with an Employee Ownership Consultant by visiting our webpage: **https://oedit.colorado.gov/colorado-employee-ownership-office**

THE NATIONAL CENTER FOR EMPLOYEE OWNERSHIP (NCEO) is a nonprofit membership organization established in 1981 to provide practical resources and objective, reliable information about employee ownership to businesses, employees, and the public. We have more than 3,000 members, from companies and the professional advisors who assist them to academics, government officials, and others. **nceo.org**

THE DEMOCRACY AT WORK INSTITUTE (DAWI) was founded by the US Federation of Worker Cooperatives as the only national think- and do-tank expanding the promise of worker ownership to communities locked out of good jobs and business ownership opportunities, especially for BIPOC, immigrant, and low-wage workers. Through research, innovation, government relations, and education, DAWI supports worker ownership as the superior business model for creating jobs with dignity, fair compensation, and opportunities for wealth and skill-building. **institute.coop**

The mission of the **ROCKY MOUNTAIN EMPLOYEE OWNERSHIP CENTER (RMEOC)** is to build a more just and sustainable economy through employee ownership. We believe that a just economy is one that works for everyone, that is built upon inclusive and sustainable systems, and that provides equitable opportunity to build wealth. Our current economy benefits too few, at the expense of too many. But employee ownership is a powerful tool to change that. **rmeoc.org**

The **COLORADO OFFICE OF ECONOMIC DEVELOPMENT AND INTERNATIONAL TRADE (OEDIT)** works with partners to create a positive business climate that encourages dynamic economic development and sustainable job growth. Under the leadership of Governor Jared Polis, we strive to advance the State's economy through financial and technical assistance that fosters local and regional economic development activities throughout Colorado. OEDIT offers a host of programs and services tailored to support business development at every level including business retention services, business relocation services, and business funding and incentives. **oedit.colorado.gov**

The vision of the **CENTER FOR COMMUNITY WEALTH BUILDING (CCWB)** is a people-owned, inclusive, and sustainable Metro Denver economy that catalyzes prosperous and resilient communities free from racism and injustice. CCWB works to realize this vision by training co-op developers from directly impacted communities to spread the word about worker ownership; advising, guiding, and incubating startup worker cooperatives; and partnering with organizations such as RMEOC and OEDIT to advance worker ownership as a preferred option for small business startups and established business conversions. **communitywealthbuilding.org**