

# SOLUTIONS FOR SHARED PROSPERITY

# BUILDING WEALTH THROUGH

# EMPLOYEE OWNERSHIP



BY NAZARETT PEREZ, VIVIEN CAETANO, AND KATY DAVIS

**Employee ownership provides workers the opportunity to build wealth and can increase engagement from employees both in and out of the workplace, and yet few small businesses take advantage of it. Helping more small businesses become employee-owned and foster a culture of employee ownership has the potential to strengthen the economic well-being of workers across the United States and create thriving communities.**

For decades, wealth and income inequality in the United States have been growing, with the median income of upper-income households more than seven times that of lower-income households.<sup>1</sup> 13 million families in the U.S. are in debt, with little to no assets or capital to weather a financial shock, invest, or attain financial security for retirement. This wealth disparity is even more dramatic for people of color compared to white households. White households have a median net worth of \$189,100, while median net worth for Black and Latino households stands at \$24,100 and \$36,050, respectively.<sup>2</sup>

Small businesses, meaning those with fewer than 500 employees, employ 47% of U.S. workers and are uniquely positioned to help their employees build wealth.<sup>3</sup> Increasingly, profitable small businesses are closing not because of cash flow problems or low revenues, but because the owner is retiring or ready to move on. Given this, as a large share of small business owners are at or nearing retirement age, some expect a surge in business sales and closures in coming years.<sup>4</sup> If sold to the right buyer, these businesses could continue to offer stable jobs for employees and create value for communities.

**2.9 million small businesses are run by owners nearing retirement.<sup>15</sup>**



When small business owners are approaching retirement or seeking an exit, one potential buyer is the business' own employees. Unfortunately, selling to employees is not necessarily a salient or easy option for a small business owner. Conversion to employee ownership requires a considerable amount of time and capital, as well as expertise on how to meet complex legal and financial requirements.

Across the United States, there are advocates, non-profits, and businesses working to help small businesses redistribute wealth via employee ownership. Structures like Employee Stock Ownership Plans (ESOPs) and worker cooperatives have measurably improved employee psychological well-being and financial health, and provided a path to grow their wealth.<sup>5</sup> Some businesses have incorporated a gainsharing approach that brings employees into performance improvement and allows them to share in the resulting profits.<sup>6</sup> ideas42's **Shared Prosperity Catalyst** initiative explores ways to reduce poverty and inequality in the United States, with a focus

on the excess costs of poverty. Through this initiative, ideas42 has learned about the ways innovative problem-solvers are trying to reduce the financial and legal barriers of employee ownership and help shift employees into the role of owners and decision-makers—putting them on a path to better economic well-being.

## Shortcomings of the options available to business owners

***Small business owners considering retirement can be unaware of succession planning options, and the most salient options don't typically build employee wealth.***

When business owners are ready to move on, the most readily available options are often selling the business to a family member, business partner, larger company, or private equity firm. Each potential buyer has different motivations. Family members or a business partner may want to actively run a small business. Other buyers may purchase a business for strategic reasons, such as wanting to consolidate, reduce competition, or leverage infrastructure the business has created. Business owners rarely approach these options with an explicit intention to build employee wealth. And while some small business owners engage in succession planning research that may expand their options beyond this set, it's not typical.

***The majority of small business owners does not have a succession plan.<sup>13</sup>***



***Alternative structures for employee ownership are often not feasible for small businesses or their employees***

Employee Stock Ownership Plans (ESOPs), Employee Ownership Trusts (EOTs), and Cooperatives are some of the ways business owners give employees ownership of a business.<sup>7</sup> However, making the transition to these structures requires advance planning, outside financing, and legally restructuring the business. Many businesses also need to undergo a change in management, leadership, and work culture. Although these alternative structures are not necessarily more expensive than selling to an outside buyer,<sup>8</sup> the considerable financial, administrative, and legal barriers involved can prevent small businesses from taking them on. Some structures require employees to provide a personal asset as a guarantee, such a home. This is not feasible for many employees and can pose a significant risk for the employees themselves.

## Innovative solutions to facilitate employee ownership among small businesses

Small business owners need support and tailored solutions that help reduce the barriers they face when converting to an employee-owned model. **ProsperWorks**, **Obran Cooperative**, and **Democracy at Work Institute (DAWI)** are three organizations that offer innovative solutions for employee wealth-building and reflect a real understanding of the challenges that small business owners encounter.

## Reducing Financial Barriers to Conversion

Buying a business is expensive. Even when a business owner has an intention to sell to their employees, employees are rarely able to afford it on their own and have a hard time accessing the financing that would make it possible. **Obran** addresses this challenge by purchasing businesses from their owners and converting them to an employee ownership structure. Obran is able to do this because it has existing relationships with mission-aligned institutions that finance the conversions, eliminating the need for employees of small businesses to find outside financing. After the sale, employees can opt into becoming employee-owners of Obran itself, a worker-owned conglomerate corporation.

**ProsperWorks** tackles these financial barriers from a different angle. ProsperWorks seeks to make it easier for employees to obtain financing from banks or small business-friendly lenders like community development financial institutions (CDFIs). Financial institutions aim to lend money to businesses they expect will succeed. However, it can be difficult to assess whether a business will succeed as an employee-owned business before it has converted into employee ownership. Because our perception of risk is influenced by the information presented to us,<sup>9</sup> this lack of information can make financing a conversion feel riskier than other small business loans. ProsperWorks addresses this by producing timely, relevant information for financial institutions that make the businesses' potential for success salient. Its software guides business owners and employees through collaborative processes that replicate those of employee-owned companies and collects data on the impact of employees' efforts on business outcomes. This data can be used to demonstrate to financial institutions that the company will continue to succeed when it's employee-owned.

## Reducing the Legal Burden of Conversion

The sale of a business is a complex process with many administrative and legal requirements, especially when the business is converting to an employee-owned model. Because of this, business owners and employees have to hire specialized advisors to navigate the process.

### PROSPERWORKS

**ProsperWorks** is on a mission to help organizations and their employees prosper together. Informed by behavioral science, the ProsperWorks digital tool brings the whole team into alignment on business outcomes, and empowers employees to take action and share in the value they create. ProsperWorks is supported by the **ideas42 Venture Studio**, an initiative of **Shared Prosperity Catalyst** that helps motivated individuals build companies that solve social challenges.

### OBRAN Cooperative<sup>o</sup>

**Obran Cooperative** is a worker-owned cooperative conglomerate corporation that aims to build a better economy and foster social change. Through its distinctive holding corporate structure, Obran finds and acquires small- to medium-size businesses to ensure that these companies and their worker-owners continue to thrive in the communities they serve.



The **Democracy at Work Institute** (DAWI) is the national think- and do-tank dedicated to expanding the worker cooperative business model to meet the needs of workers who are locked out of good jobs and business ownership opportunities. DAWI prioritizes driving impact for BIPOC, immigrant, and low-wage workers through research, innovation, education, and advocacy.

**Democracy at Work Institute** (DAWI) makes the process of understanding the requirements and finding the right people to hire easier through its Workers to Owners Collaborative. This national network of service providers in legal, lending, and business development components delivers best practices and technical assistance based on industry and region. By consolidating best practices and creating a network of service providers experienced in conversions, DAWI makes it significantly easier for businesses to find the guidance and resources they need.

An important legal requirement of conversion is creating a new legal entity for the employee-owned business. To do this, decision-makers must understand the different options, select the one that works best for them, and then find and hire lawyers to put together the necessary documentation. **Obran** is able to absorb the administrative challenges and costs of this step for small business as a larger worker-owned cooperative with an in-house counsel specialized in conversions. As a result, businesses acquired by Obran do not need to create a new worker-owned entity or find specialized lawyers, making the process significantly easier for business owners and their employees—which might make them more likely to consider the option in the first place.

### **Positioning Employees as Owners**

There are many reasons for business owners to involve employees in making decisions for their business. Employees who are included in decision-making tend to feel more valued, leading to better job satisfaction and higher productivity.<sup>10</sup> But when a small business shifts from a traditional business model that didn't include employees in decision-making to an employee-owned one, the cultural shift can be tough. Such employers may struggle to create an employee ownership culture during the conversion process.

To foster an employee ownership culture, [The School for Democratic Management](#) at **DAWI** trains management teams and employees in specific areas such as human-centered personnel, open book management, and democratic governance. The School for Democratic Management offers virtual 'democratic management' skills assessments, a webinar training series, and on-demand courses in effective communication, personnel management, and transparent financial reporting. They offer intensive crash courses, a certificate in participatory management in partnership with Rutgers University School of Management and Labor Relations, and direct consulting with businesses. They also offer a free 'Democratic Management Guide', a set of best practices in democratic management from managers and consultants across the U.S. The guide is designed to help new and established 'democratic workplaces' ensure a culture of shared ownership is successfully implemented.

**ProsperWorks**, on the other hand, uses software to help small business owners foster a culture of employee ownership throughout their day-to-day operations. Business owners are guided through a series of prompts to structure a collaborative decision-making process with their employees. Throughout this process, ProsperWorks' software shares automatic updates with employees and business owners about both decisions and outcomes and builds in opportunities for employees to share suggestions or ask questions. These features increase trust between employees and owners and facilitate the creation of a collaborative process.<sup>11</sup> Through the software-based process, business owners gain valuable exposure to collaborating with their employees on decisions that impact the business and are able to experience the benefits of including employees in such decision-making.

## Employees as owners: driving growth and resilience

Business ownership gives individuals access to the equity that can help them build wealth and strengthen their economic well-being. Employee-owners have the long-term benefit of asset building that can help them achieve other financial goals, such as saving for retirement. As an alternative, gainsharing provides employees with the financial benefit of receiving additional money in the short term, before a business becomes employee-owned. Companies that use gainsharing increase employees' compensation based on how the company is performing, allowing employees to directly benefit from improvements they make. Gainsharing gives employees a distinct opportunity to access more financial resources even before the conversion to an employee-owned company.

There is another advantage of bringing employees into the roles of owners and decision-makers: employees who influence the governance of their work demonstrate higher participation at work and in their local community, which enhances both their financial well-being and the overall quality of engagement and life in their communities.<sup>12</sup> Innovative organizations like **ProsperWorks, Obran Cooperative, and Democracy at Work Institute** (DAWI) are focusing on reducing barriers to employee ownership and fostering employee-owner cultures. In addition to strengthening the economic well-being of workers, this approach can help keep vital services and better, more meaningful jobs in communities that would otherwise be lost when small business owners exit without a succession plan. With 47% of the U.S. workforce impacted by the choices small businesses make, the potential for impact on the financial health and well-being of countless communities is significant, and a key component to building shared prosperity for all.

**Employee owners have 92% greater median household net worth compared to non-employee owners.<sup>14</sup>**



*Shared Prosperity Catalyst is a multi-year initiative focusing on creating more equitable prosperity across the U.S.. This initiative applies a behavioral lens to financial health, as well as the physical and mental health impacts of experiencing poverty, driven by an experienced team of behavioral designers, policy experts, and business builders and powered by a diverse network of academics, practitioners, and entrepreneurs with experience in the communities we aim to serve.*

*ideas42 is a non-profit behavioral design firm that uses behavioral science to help solve difficult social problems and achieve impact at scale.*

## Endnotes

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