SMALL BUSINESS OWNERS ARE GETTING A NEW INCENTIVE: TO SELL TO THEIR EMPLOYEES

The federal government just made it a lot easier to form an employee-owned business. In an increasingly rare example of bipartisan cooperation, President Donald Trump on Aug. 13 signed a defense bill into law that included a popular provision that allows the Small Business Administration to straightforwardly loan money to employee-owned businesses that wish to buy out retiring small business owners.

As baby boomers retire, more than 2.3 million closely held businesses that they own are at risk of closing down because of an inability to find someone to take over. These companies employ about 25 million people, spend about US$1 trillion on payroll a year and make about $5 trillion in sales.

While some of these businesses will be passed down to members of the family or others, about 6 out of 10 are expected to wind up on the auction block in the next decade because the owners need to sell out in order to retire. We believe this will represent one of the largest transfers of wealth in American history.

Surveys show that only a small fraction of retiring owners have a daughter or son who wants to take over the company and is competent to do so, and only a fifth of businesses listed for sale ever sell.

That makes selling their businesses to the workers who helped create all the value in the first place one of the best options available. It not only helps secure the owner's retirement but also leaves behind a legacy in the local community.

Small businesses are sold to their managers or workers using one of three methods: an employee stock ownership plan or ESOP, a worker cooperative or an employee trust.

THE ESOP, created in 1956 by the late political economist Louis O. Kelso, is currently the most common way to do this because it gives regular workers a way to buy companies and has meaningful federal tax incentives. This allows the new owners to set up a trust, which secures a loan that the company itself will pay back over several years.

A key feature is that the company, not the workers, steps forward to provide the collateral for the loan, and as the loan is paid down, new shares are distributed to employees and managers. The workers do not purchase the shares with their savings.

WORKER COOPERATIVES, on the other hand, have traditionally been employee-owned from the beginning, with investments from staff and equal voting rights in many company decisions. Increasingly, the worker coop model is being used to purchase companies from retiring business owners.

EMPLOYEE TRUSTS are a new form of ownership, similar to ESOPs in some ways. Their goal is to ensure a company remains employee-owned in perpetuity by keeping the shares within the trust itself. The employees are beneficiaries of the trust, receiving payouts based on profits.

Employee-owned companies have shown greater resiliency in times of economic stress, leading to fewer layoffs. And research shows that these types of companies offer better pay and benefits than other types of businesses.

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