BUILDING SUSTAINABLE BUSINESSES THROUGH EMPLOYEE OWNERSHIP AT SBA

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT, INVESTIGATIONS, AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

ONE HUNDRED SEVENTEENTH CONGRESS

SECOND SESSION

HEARING HELD
DECEMBER 6, 2022

Small Business Committee Document Number 117–069
Available via the GPO Website: www.govinfo.gov

U.S. GOVERNMENT PUBLISHING OFFICE
49–736 WASHINGTON : 2023

HOUSE COMMITTEE ON SMALL BUSINESS

NYDIA VELÁZQUEZ, New York, *Chairwoman*
JARED GOLDEN, Maine
JASON CROW, Colorado
SHARICE DAVIDS, Kansas
KWEISI MFUME, Maryland
DEAN PHILLIPS, Minnesota
MARIE NEWMAN, Illinois
CAROLYN BOURDEAUX, Georgia
TROY CARTER, Louisiana
JUDY CHU, California
DWIGHT EVANS, Pennsylvania
CHRISSY HOULAHAN, Pennsylvania
ANDY KIM, New Jersey
ANGIE CRAIG, Minnesota
SCOTT PETERS, California
BLAINE LUETKEMEYER, Missouri, *Ranking Member*
ROGER WILLIAMS, Texas
PETE STAUBER, Minnesota
DAN MEUSER, Pennsylvania
CLAUDIA TENNEY, New York
ANDREW GARBARINO, New York
YOUNG KIM, California
BETH VAN DUYNE, Texas
BYRON DONALDS, Florida
MARIA SALAZAR, Florida
SCOTT FITZGERALD, Wisconsin
MIKE FLOOD, Nebraska

MELISSA JUNG, *Majority Staff Director*
ELLEN HARRINGTON, *Majority Deputy Staff Director*
DAVID PLANNING, *Staff Director*

CONTENTS

OPENING STATEMENTS

WITNESSES

APPENDIX

BUILDING SUSTAINABLE BUSINESSES THROUGH EMPLOYEE OWNERSHIP AT SBA

TUESDAY, DECEMBER 6, 2022

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON OVERSIGHT,
INVESTIGATIONS, AND REGULATIONS,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:30 a.m., in Room 2360, Rayburn House Office Building, Hon. Dean Phillips [chairman of the Subcommittee] presiding.

Present: Representatives Phillips, Davids, Houlahan, Craig, Meuser, Van Duyne, Donalds, Fitzgerald, and Flood.

Chairman PHILLIPS. Good morning. I call this hearing to order. Without objection, the Chair is authorized to declare a recess at any time. And I would like to begin by noting some important requirements for this meeting. Standing House and Committee rules will continue to apply during hybrid proceedings. All Members are reminded that they are expected to adhere to these rules, including decorum. House regulations require Members to be visible through a video connection throughout the proceeding so please keep your cameras on.

Also, please remember to remain muted until you are recognized to minimize background noise. In the event a Member encounters technical issues that prevent them from being recognized for their questioning, I will move to the next available Member of the same party. I will recognize that Member at the next appropriate time slot provided they have returned to the proceeding.

And with that, I am going to move to my opening statement. For many, owning and operating a successful small business is the embodiment of the American Dream. Of course running a small business is not for the faint of heart. It requires hard work and brings new challenges every single day. But the payoff can be immense, successful entrepreneurs create jobs, invest in their communities and drive our country forward. This Committee serves as the voice for entrepreneurs in the U.S. Congress. It is our responsibility to ensure that this dream is as accessible to as many Americans as humanly possible. And that is why I am such a proponent of the concept of employee ownership.

I grew up in a family in which business was a means to an end. And the end was not just making as much money as possible, rather, sharing as much with the employees and the communities that made it possible.

I have had opportunities to visit employee-owned companies in my district, like Rainbow Treecare, and learning more about employee-owned structures has been very enlightening to me. Employee-owned companies take various forms, but they are united by the fact that they align with the interest of workers and the owners. When an employee-owned business grows, the workers and the communities benefit directly. I have seen the countless benefits of this model back home in Minnesota, home to 265 employee-owned businesses, the most per capita of any State in the Union. In many cases, workers at these businesses boost higher pay, greater job security and better benefits, such as higher retirement savings.

In addition to helping workers, the employee ownership model also provides a way for retiring small business owners to pass their businesses along to the people that know it the very best, their employees. Employee ownership is an innovative way to address this retirement wave that is forthcoming.

Moreover, converting to an employee-owned structure is an effective succession plan to preserve a firm's continuity, foster employee commitment, and build lasting economic value in a community. Given the long list of benefits associated with this model, it is vital that we ensure that these businesses have access to the federal initiatives meant to support all small firms. Unfortunately, despite the efforts of Chairwoman Velázquez, myself and Members of this Committee, ESOPs and co-ops continue to be virtually locked out of key Small Business Administration programs. Take the SBA 7(a) loan guarantee program for example. In the last 4 years, SBA has only approved 17, that is right, just 17 7(a) program loans to insist in ESOP in requiring 51 percent or more of a business. The loan numbers for co-ops are even worse.

ESOPs and co-ops are often kept out of the 7(a) program because of their unique ownership structure and SBA's unwillingness to align their programs to meet the needs of these entrepreneurs. These obstacles have led the SBA in a previous hearing before the Committee and in a recent proposed rulemaking to acknowledge that its current policies are not achieving its goals of increasing employee ownership. Congress took steps to address these issues in 2018 with the passage ever Chairwoman Velázquez's Main Street Employee Ownership Act. The bill included provisions to ease burdensome guarantee restrictions and ultimately encourage more SBA-backed lending to cooperatives and to ESOPs. But unfortunately, the SBA has failed to follow congressional intent and many of the challenges the bill sought to address continue to vex employee-owned enterprises to this very day.

It is clear that Congress must do more to support employee-owned small businesses. And that is why last month, Chairwoman Velázquez and I introduced two bills that would build on the Main Street Employee Ownership Act. And finally, finally eliminate burdensome requirements put in place by the SBA.

Today, I look forward to examining the potential impact of this legislation as well as other actions that Congress and SBA can take to encourage more employee ownership. I am also excited to hear from our panel today about the benefits of employee ownership, the ongoing challenges that these firms face and the ways that this Committee can better support them all.

With that, I would like to yield to the Ranking Member, Ms. Van Duyne, for her opening statement.

Ms. VAN DUYNE. Thank you very much, Chairman Phillips, for holding this hearing. And we can all agree that a business' structure and foundation are critically important to their success and longevity. However, amending requirements at the SBA should always be viewed with caution. And it cannot be done without considering all possible ramifications and potential unintended consequences.

I look forward to discussing the employee ownership model this morning. However, we must also address that we are currently in the fourth quarter, and the small businesses that I speak to in north Texas have been battling significant market conditions that threaten their success. They continue to struggle with rampant inflation labor shortages, ongoing supply chain disruptions, and a growing regulatory burden. And it is no wonder why small business optimism continues to decline in this country. The National Federation of Independent Businesses, NFIB, the small business optimism index, lists October as the 10th consecutive month below the 49-year average. It is also no surprise that increasing costs continue to remain one of the more pressing issues facing small businesses. With 7.7 percent year-over-year inflation, how could it not be? The total energy index has risen a staggering 17.6 percent over the last 12 months. And many small businesses simply can't sustain in this environment. And as a result of this inflationary time period, the Federal Reserve has moved to increase interest rates repeatedly, thus challenging small businesses even further.

Labor shortages continue to be a top concern for our constituents and their businesses. Not only does finding workers pose a major problem, but finding the right skilled workers is seemingly impossible. The latest NFIB report shows 46 percent of owners reported job openings that were hard to fill. Ninety percent of business owners searching for employees found few or zero qualified candidates to fill their open positions. And how can we expect small businesses to succeed if 90 percent of owners are having a hard time finding qualified candidates to fill their positions? Unfortunately, even when our community businesses do have workers, they often struggle with stocking their shelves. Supply chain disruptions continue to impact many small businesses on a daily basis. In October, 31 percent of business owners reported supply chain disruptions have had a significant impact on their businesses. If inflation which has caused rising interest rates, labor shortages in supply chain disruptions weren't enough, the regulatory burden imposed by the Biden administration is also taking a toll.

According to the American Action Forum, during the first 2 years of the Biden administration 443 final rules we are creating with a whopping cost of $309.1 billion, along with a staggering 193.1 million new paperwork hours.

This is a stark difference compared to President Trump's first 2 years in office. While the previous administration created final rules, they actually saved small businesses $3.4 million and had half of 1 percent of the paperwork hours. Small businesses continue to face these challenges daily and these are the issues this Committee should be focused on trying to solve.

Pro-growth policies that support deregulation in the reduction in spending levels must be, first and foremost, on the congressional agenda as they have a true real-world impact on the nation's small businesses, entrepreneurs and startups.

I look forward to today's conversation. And I would like to welcome all of today's witnesses. And thank you, Mr. Chairman. I yield back.

Chairman PHILLIPS. Thank you. The Ranking Member yields back. And I would like to take a moment to explain how this hearing is going to proceed. The witnesses will have 5 minutes to provide a statement. And each Subcommittee Member will have 5 minutes for questions. Please ensure that your microphone is on when you begin speaking and that you return to mute when finished.

Just an announcement, Members of Congress are expected in the Rotunda at 10:45 for the Gold Medal ceremony. So I plan to introduce each of our witnesses, try to get at least through a couple of the opening statements and then we will probably have to break and then reconvene around 1 p.m.

So with that, I would like to introduce Ms. Mo Manklang who serves as a policy director for the U.S. Federation of Worker Cooperatives. The USFCW is a national grassroots membership organization for worker cooperatives. Its membership consists of 350 businesses and organizations. And they represent the estimated 1,000 worker co-ops and their 10,000 workers across the country. Additionally, Ms. Manklang is a founding board member of the Philadelphia Area Cooperative Alliance and serves on the board of directors for the Sustainable Business Network of greater Philadelphia. She is a graduate of Drexel University, and we welcome Ms. Manklang.

Or next witness is Mr. Corey Rosen, who is the founder of the National Center for Employee Ownership. NCEO is a nonprofit organization with a mission to help employee owners thrive. Mr. Rosen has authored numerous books articles and research papers on employee ownership and has been recognized as one of the world's leading experts on employee ownership. Prior to founding NCEO he taught politics at Ripon College, and worked in the Senate for 5 years where is he helped initiate and draft legislation on ESOPs and employee ownership. Mr. Rosen received his Ph.D. in political science from Cornell university. We thank you for joining us today, Mr. Rosen.

Our third witness is Mr. Keith Butcher. Mr. Butcher is the founder and partner at Mosaic Capital. Mosaic Capital is a small business investment company that is licensed and regulated by the SBA. The fund focuses on acquiring companies through an employee stock ownership plan buyout. He also serves as managing director with Butcher Joseph & Company, which is an ESOP-focused investment bank. Prior to founding Mosaic, Mr. Butcher served as an executive president of Purcell Tire and Rubber Company, and as an executive director with Morgan Stanley. He received his B.A. in international business and finance from Bradley University and his Doctor of Jurisprudence from Wake Forest University School of Law. We thank you, Mr. Butcher, for being here today.

I now yield to the Ranking Member to introduce our final witness.

Ms. VAN DUYNE. And our final witness would like to be introduced by Congressman Flood, who he is from his home district.

Chairman PHILLIPS. I recognize Congressman Flood.

Mr. FLOOD. Thank you, Chairman Phillips. Thank you, also, Ranking Member Van Duyne.

It is my pleasure to introduce Mr. Scott Lockard of Hampton Enterprises. Scott Lockard is a lifelong Nebraskan. He grew up in Stella, Nebraska, studied construction engineering in Omaha and has worked with Hampton Enterprises, a company based in Lincoln since 2007. Earlier in his career, Mr. Lockard worked as a project manager on the construction of Pinnacle Bank Arena. The basketball arena for the University of Nebraska Cornhuskers. Since then, Mr. Lockard had progressed quickly through the ranks within the company he works. He currently occupies a position of president of construction. Mr. Lockard's experience in construction gives him unique insight into some of the economic headwinds facing small businesses across the country. He can also speak with authority about the challenges of wrestling with inflation, supply-chain issues and labor shortages. His perspective will be valuable to the Members of this Committee.

Mr. Lockard, I look forward to your testimony.

Mr. Chairman, I yield back.

Chairman PHILLIPS. Thank you, Mr. Flood.

With that, I would like to recognize Ms. Manklang for 5 minutes for your opening statement. Ms. Manklang.

STATEMENTS OF MO MANKLANG, POLICY DIRECTOR, UNITED STATES FEDERATION OF WORKER COOPERATIVES; COREY ROSEN, FOUNDER, NATIONAL CENTER FOR EMPLOYEE OWNERSHIP; KEITH D. BUTCHER, PARTNER, MOSAIC CAPITAL; AND SCOTT LOCKARD, PRESIDENT, HAMPTON ENTERPRISES.

STATEMENT OF MO MANKLANG

Ms. MANKLANG. Hello. Thank you very much. As Representative Phillips said, my name is Mo Manklang. I am here to represent the U.S. Federation of Worker Cooperatives. Thank you so much to the Subcommittee, especially Subcommittee Chairman Rep. Phillips for creating a space to address this important issue.

As policy director, I have a ground-level view of challenges and successes of our employee-owned businesses. And I am attuned to the needs of the growing field. Worker co-ops are increasingly recognized and a valued solution to economic challenges. They strengthen companies, they reward workers and they prevent job loss in the case of converted businesses.

Over the next decade, this converts massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, eminently facing closure or sale. This gives the workers opportunity to fill the shoes of originating owners as Representative Van Duyne mentioned a little bit earlier.

The worker coop model offers many benefits to its Members, there is typically small and strong small businesses. Typically in what it is paying its workers, paying an average of $19.67 per hour often in insecure industries like retail, manufacturing, food service, home care and childcare. Worker co-ops allow people like Mr. Lockard on this panel to benefit directly from the value that they create, allowing them to build skills, to grow professionally. And worker co-ops also have a higher success rate than typical small businesses.

In 2018, we were proud and we were energized by the passage of the Main Street Employee Ownership Act, which passed with overwhelming bipartisan support. This legislation aimed to improve access to capital and technical assistance, including financing the sale of business to their employees, working with small business development centers to provide training and education on employee-ownership options and reporting on the SBA's lending and outreach to employee-owned businesses.

This clear mandate from Congress that recognized employee ownership was really important for this highly underserved sector that has really long sought reasonable access to these programs. Unfortunately, we haven't seen any meaningful support from the SBA since the passage of Main Street Act with regard to financing outreach or education.

In the 5 years that I have been on staff with the Federation, I have only been able to find 2 cases ever of worker co-ops being able to actually access 7(a) loan programs. It was our hope and expectation that we would see this number rise, and that we would see more worker co-ops being able to access these vital resources provided by the Small Business Administration.

This is about an even the playing field with other small businesses, in particular, regarding the personal guarantee requirement which has created a distinct disadvantage for co-ops. Asking a single member, or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives which shares the financial burden across multiple co-op members who are all deeply connected to the business.

We see two big issues in regard to support of employee ownership, it is education and it is opportunity. Education is needed for business owners, service providers, financial institutions and the SBA itself. We know at least two different worker co-ops who were actively discouraged from pursuing a co-op model in their startup days, which we believe was because of a lack of understanding of model. Financial institutions that are unfamiliar with co-ops and ESOPs deprioritize their applications during the COVID-19 pandemic with many of the worker co-ops who applied for the Economic Injury Disaster Loans and the Paycheck Protection Programs were denied or ran into significant challenges in accessing these business saving resources. And we simply also need access to opportunity. We understand the importance of ensuring that people have skin in the game, but they have deep commitment to ensuring the success of the business, the repayment of their loans. The shared ownership structure of worker coops actually make employee-owned businesses more dependable, more resilient, better able to weather economic downturns, and less likely to lay off their workers as we have seen over the past several years.

There are many examples of co-op loan programs that resulted in lower default rates that SBA loans with no personal guarantee. For instance, Intermediary Lending Pilot Program, which actually was a SBA program, but not the 7(a), resulted in 17 worker co-op loans with a zero default in 16 of those businesses still operating.

Workers co-ops need the full access to the full range of SBA's tools to foster and create stable, higher retention jobs that empower people and provide workplace flexibility. We know that the SBA has programs and assets that will spark significant growth in the worker co-op sector and save jobs and keep businesses rooted in their communities.

On behalf of a co-op community, we thank the Small Business Committee for their attention to this issue. And we looked forward to working with you to ensure a prosperous future for all small businesses across the U.S.

Chairman PHILLIPS. Thank you, Ms. Manklang.

Now I will recognize Mr. Rosen for 5 minutes. And after Mr. Rosen's opening statement, we are going to go into recess for the Gold Medal ceremony and reconvene at 12 noon sharp.

Mr. Rosen, you are recognized for 5 minutes.

STATEMENT OF COREY ROSEN

Mr. ROSEN. Thank you very much. I really appreciate this opportunity to talk to you today.

45 years ago I was a Staff Member for the Senate Small Business Committee working on a bill to create the Small Business Employee Ownership Act, which would authorize the SBA to make loans to ESOPs. The SBA didn't really do anything on that, much like it hasn't done very much on the Main Street Act. In 2018, I had the privilege of working with Members of both this Committee's staff and the Senate Committee's staff to try to fix these problems and we thought that the legislation that was passed would, in fact, do that. But again, the SBA for reasons I really don't know has decided that it doesn't want to pursue any of this.

Why should it? Well, there are about 6,500 privately held ESOP companies in the United States, and those companies have a long track record. First, they have an impressive political track record. The tax benefits for ESOPs have been supported unanimously by Members of both parties. It is one of the few political ideas that can claim that. Secondly, these companies perform well. With respect, for instance, to Representative Van Duyne's comment about turnover, ESOP companies have about 70 percent lower voluntary turnover than comparable companies in the food industry, according to a study we did this year. And they have turnover rates in general, about half of those of comparable industries.

At a time when retirement is increasingly unavailable to people—fifty percent of the private-sector workforce participates in no retirement plan at all. They have a median account balance of zero. The mean account balance for participants in ESOPs is $132,000, and most ESOP companies have a 401(k) plan on top of it. ESOP companies grow faster, and they lay people off one-third to one-fifth the rate of comparable companies. And really importantly for this program, the default rate on ESOP loans is two per 1,000 per year.

Let me repeat that: two per 1,000 per year. This is a program you think the SBA would love to finance with a default rate like that.

So what are the problems? Why aren't there more ESOPs given the tax benefits and performance benefits? Well, one is, and Mo alluded to this in respect to co-ops too, that companies simply don't know they can do this. There are all sorts of misperceptions about what ESOPs are and how they work. And we know from efforts at State level programs to create more outreach on ESOPs, a handful of States that do that, that when information is provided to people, a lot of companies will do ESOPs without any further intervention because of all the benefits that these plans have. And we envision that the Small Business Administration would conduct these outreach programs, which could be done at an extraordinarily low cost via partnerships with the nonprofit and for-profit sector. But they didn't do anything on it, even though the law specifically required it. They also threw up all sorts of obstacles: the personal guarantee, the equity guarantee. They require that there be a separate valuation when ERISA already requires an extremely detailed valuation for an ESOP company. Requiring a separate valuation takes a great deal of additional time, and for reasons I can explain in questions if you are interested, raises additional fiduciary risk.

We were expecting, and the law said, that the SBA should make these loans available through the 7(a) preferred lender program, but the SBA didn't do that. So companies say, "Well, do I really want to go through this detailed bureaucracy with the SBA to try to get one of these loans?" And for many people it is just not worth it.

The SBA is asking companies to get a letter of determination before they do these, and that is not practical either. All of these things have made the SBA Main Street Employee Ownership Act a failure. And the regulations that it proposed to try to fix this problem don't even address it.

Thank you very much. I really appreciate this opportunity.

Chairman PHILLIPS. Thank you, Mr. Rosen.

With that, our Committee will recess and reconvene at 12 noon sharp. And with that, we will see you in an hour.

[Recess.]

Chairman PHILLIPS. Everybody, I will call the meeting back to order and begin with Mr. Butcher, who I will recognize for 5 minutes for your opening statement. Mr. Butcher.

STATEMENT OF KEITH D. BUTCHER

Mr. BUTCHER. Well, thank you and good afternoon to everyone. My name is Keith Butcher, and I am the founder of—one of the founding partners of Mosaic Capital Partners, which is a small business investment company that is licensed by the SBA, and also the founder of an ESOP M&A advisory firm called Butcher Joseph & Company.

I started my career in 1998 as a young lawyer and worked on my first ESOP transaction back then, in 1998-1999, an ESOP buyout. And coming from a small town in Nebraska, it really was a fortunate opportunity for me to see it in action and to watch a company transition from a family business, family-owned business to the employees. And, frankly, I didn't even know this structure existed back then when I entered my law practice from law school.

Over the last 25 years, I have devoted my practice to employee ownership. I have worked on 300-plus transactions, enabling companies to transition into employee ownership of every size, of every place in the United States, and frankly, almost any industry you can imagine. And through that process, I have watched how valuable this can be for communities and for employees.

I come to this meeting with a little different perspective, I think, than the prior speakers, because I view Mosaic Capital as a success of the SBA in entering the employee ownership world and creating impact on it.

And so the first thing that I would say is, if we assume that it is truth that employee ownership and all the benefits of it align with the SBA's mission, then to me, there is just a massive opportunity for the SBA, and that it is more of—I focus more on the opportunity in front of us.

And that opportunity presents itself because we have this epic number of baby boomer entrepreneurs who have to do something with their businesses. Over the next 10 years, a massive number of businesses are going to need business succession, and they are going to have to figure out who is going to take the lead for these businesses.

The vast majority of them, but for a solution from the SBA or some other capital provider, are going to get sold to consolidators. And if there is a market for their business, that is what will occur. And it is going to happen in a—private equity has become a massive pool of capital, and they are going to consolidate into those industries.

And so, the opportunity is for the SBA to do what it does best, which is, it creates capital programs and it provides solutions in a really risk-adjusted fashion to be able to enable those markets to go.

I give the example of Mosaic Capital. We received our license in 2014. We have invested roughly $150 million into enabling 12 companies to move into employee ownership. We created 1,400 employee owners. And ultimately, we project that we will produce something in the range of $130 million to $150 million of retirement value for these employees, all of that enabled by the SBA, allowing us to go through the process and issuing us a license, because it is the ultimate public-private sort of partnership.

What I see with the 7(a) program is, is that there is the capability at the SBIC program level for companies of those sizes—the 7(a) program would be a lower size one. It would be sort of $15 million and below valuation companies.

And if the 7(a) program would embrace that market, then it would be a viable solution to consolidators. To date, it is not. Corey said it earlier. There are 6,500—I think for 20 years, I have been telling people there are 6,500 companies that are ESOP-owned. And the reason for the lack of net growth is lack of capital availability.

It is the reason we created Mosaic, so that we could create a market-competitive transaction. We enter a traditional M&A market process and we win over other options, because owners want to do this if it is a good idea for their families. And they ultimately are stewards for their families and they have to have a good risk-adjusted alternative.

The same thing is true of smaller businesses, where if we had the 7(a) program, if they would embrace this structure, then you would allow professionals out there to be able to offer up to these business owners a viable solution that would compete with other options, which today, it is really a seller note work your way out of the business market, and it is not competitive.

Chairman PHILLIPS. Thank you, Mr. Butcher. Thank you.

And last but not least, Mr. Lockard, you are recognized for 5 minutes for your opening statement.

STATEMENT OF SCOTT LOCKARD

Mr. LOCKARD. Good afternoon. First of all, I would like to thank the Committee for allowing me to testify today and share some of the challenges that we small businesses are facing. This is certainly an unprecedented time and challenges that we face are, in some cases, crippling.

My name is Scott Lockard of Hampton Enterprises, located in Lincoln, Nebraska. We are a nearly 75-year-old small business that has two main focuses: commercial construction, as well as leasing and development. With just over 70 employees, we own and lease nearly 900,000 square foot of commercial property. We built out, lease it, and maintain it with our own staff.

Since the majority of our tenants are also small businesses, we have the unique perspective of seeing how small businesses are being impacted and affected due to the current economy.

Like many businesses around the country, labor has been a major factor to our business and industry. On the construction side, we struggle to find an adequate supply of employees who are skilled in the construction industry, or willing to learn. We offer on-the-job training, and we have worked with both vocational schools as well as local universities in order to find and train workers.

However, there continues to be a lack of skilled workers in our industry. The majority of the subcontractors that we deal with have also felt this pain. Unfortunately, since there is a scarcity of skilled workforce, typically the subcontractor market gains its employees by poaching from their competition.

This, along with the historic amount of construction work over the past few years, has led to higher-than-normal wages. We are having an increase of wages for current employees as well as starting out wages higher for new employees who are not skilled yet. This has been a huge impact to our construction cost.

Additionally, the supply chain has had significant impact to the construction industry. We have seen major projects that have delayed due to the availability of materials. We have seen switchgear and components, electrical components, that typically take 6 to 8 weeks to deliver, now take 6 to 12 months to be delivered. HVAC equipment, like rooftop units, typically would take 12 weeks from the time the order was placed, are now taking almost a year or longer in order to be delivered. This, again, is a combination of parts not being available at the factory and labor not being available at the factory to build these components.

These delays have added to the construction cost, but they also impact our ability to get our projects complete. I had one tenant that was delayed for several months because the switchgear that we needed for their space was unavailable. We tried multiple avenues to find another solution. Ultimately, we had to complete the project and wait until these components arrived, thus delaying their move-in and delaying our revenue.

We have another project where the rooftop units were ordered on time, but the delivery date has moved multiple times to the point that it ended up delaying the completion of the project. In both of these cases, not only did it add cost to the construction project, but also lost revenue for us, as the landlord, for the months of delays that they sat until the tenants were able to move in.

These are only a couple examples, but I certainly could speak all day of the impact of these delays and the short supply of material. The combination of labor shortage and supply-chain issues have increased construction costs nearly 40 percent of what we saw just 2 years ago.

Supply chain issues will be solved and, hopefully, after another 6 to 12 months we will see improvement. However, we likely won't see costs return to a reasonable range, particularly in the labor market. I question the long-term impact on our industry with these rising costs.

As a landlord, our tenants have had many struggles. We have had some retail tenants that have struggled when COVID hit, with the shutdowns that affected their businesses. It seems that the labor market has not returned to the same level it was prior to COVID.

For the most part, their customers have returned to the stores. However, supply chain issues and labor costs have affected them. Their cost for labor and product increases significantly. They are only able to adjust their cost of their goods slightly, for fear of losing customers.

In some cases, our tenants have had significant fears that they will not be able to survive, and will have to shut down. Not only would that be tragic for these businesses to close, but the impact to us, as landlords, would also be significant.

We are looking at an apartment development and adding market rate apartments in Lincoln. Our town has a housing shortage and with the current market, due to construction costs as well as rising interest rates, we have looked at our pro formas and we have had to put this on the back burner. Even though there was a huge demand for housing, the cost associated with it and rate of return is just not effective.

At the end of the day, we still hope that we can improve, and we have to have hope for where things will change. We continue to look for ways to overcome challenges that we face and keep moving forward. However, we need to see policies put in place that will reduce these challenges, not restrictions that will add cost and frustration to how we operate.

Thank you again for your time today.

Chairman PHILLIPS. Thank you, Mr. Lockard. And thank you to all our witnesses to for being with us today.

I am going to begin by recognizing myself for 5 minutes.

Starting with you, Mr. Rosen. Recently, Chairwoman Velázquez and I introduced two bills to address the barriers that have been put in place by the SBA to increase lending to ESOPs and co-ops and facilitate transfers of ownership.

So, Mr. Rosen, is it safe to say that these bills are essentially technical changes, at best, and that the SBA already has the authority to make these changes in order to streamline 7(a) lending to ESOPs and co-ops?

Mr. ROSEN. Absolutely. Having had the chance to discuss this with your staff and to look at the legislation, what these two bills are doing, basically, is just telling to do the SBA what I know from personal experience with the Main Street Act was what we expected the SBA to have done on its own initiative.

And, frankly, the ESOP community and the co-op community were shocked when the SBA came out with the operating procedures that were directly contrary to the law. So there is nothing in the current law that the SBA couldn't do to enact all these things. And I hope that they will. And maybe the legislation, if it passes, will further cement that.

Chairman PHILLIPS. And, Mr. Rosen, quickly, in your opinion, any reason why you think the SBA has failed to do so?

Mr. ROSEN. It is hard for me to speculate. I have not talked to anyone at the SBA who has told me why they don't want to do it. But there is this long four-decade-plus experience with the SBA resisting these ideas. And I can only guess that one of the reasons is that this is something new. This is an added responsibility.

The SBA has, of course, had a lot of things thrust upon it in the last couple of years. But historically, the SBA just has viewed employee ownership as kind of an outlier that they don't really want to get into. They did, in their regulation, say something very interesting, which was that it really would be better, actually, if the SBA just loaned to a few employees to buy the company, because that would be cheaper than doing all the compliance with an ESOP.

It is expensive to do an ESOP, for these small companies maybe $100,000 to $200,000 to set these plans up. Of course, selling your company any way is expensive, so that is an important comparison.

But if a group of employees tries to buy the company with after-tax dollars, a $3 million business would require $4.5 million or so in pretax profits to buy out the business, imposing enormous risk on those individuals and $1.5 million more in cost than an ESOP would, because an ESOP is all pretax.

Chairman PHILLIPS. So, Mr. Rosen, we are very like-minded. I want to get to Mr. Butcher, but I appreciate your perspective on that subject, and we are like-minded.

Mr. Butcher, as you are well aware, the formation of employee-owned businesses has relied primarily on an especially dedicated subset of sellers who are willing to forego liquidity at closing and instead self-finance a significant portion, usually of the transaction, with a note that is paid back by the company over 5 to 10 years.

So can you please share your perspective on the seller financing issue and the barriers to adoption that it presents to the expansion of employee ownership around the country?

Mr. BUTCHER. Yeah. I mean, as you stated, that is the traditional structure, particularly for the lower end of valuation. So if you are, you know, below, I would say, $25 million to $15 million of valuation, there aren't a lot of capital markets available to you. Part of the reason the SBA 7(a) program exists in the first place, right, for companies of that size. And it is so different for ESOP transactions.

So, to your point, what you end up with is really two groups of folks that will support doing an ESOP, either companies that don't have another viable option, and, so, it is kind of like a transaction of last resort, or companies where it is a true believer family entrepreneur who will forego liquidity in order to do the ESOP transaction, because they value that legacy so greatly.

And there are those folks for sure. But what that creates is a niche of a niche of a niche, and it is why it is not growing. If you enable capital, you will create a competitive alternative. It may not be complete liquidity in these transactions, and I don't think you have to in the lower middle market like that. But you will create a competitive option that will enable the mainstream of owners to make that practical decision for their family and do that instead of selling, which is what we have been doing at Mosaic.

Chairman PHILLIPS. Thank you, Mr. Butcher.

My time is expired, so now I recognize my colleague, Ms. Van Duyne Texas, the Ranking Member of this Subcommittee on Oversight, Investigations, and Regulations.

Ms. VAN DUYNE. Thank you very much, Mr. Chairman.

Mr. Lockard, I want to thank you for being here today and for being so patient with our schedule moving around. But I also want to congratulate you on being with a business that has a 75-year successful career. You are obviously doing something right.

How do you see—given the longevity of your business, how do you compare these times of uncertainty to times in the past?

Mr. LOCKARD. Well, there are definitely a lot of questions as far as what the next year, year and a half will look like for us. As I alluded to earlier, we have projects of our own that we put on hold due to construction cost and rising interest rates. They are not economically feasible for us to move forward.

We are conservative as a whole. We have weathered some pretty tough times in the past. In 75 years, we have a history of laying off one time. That was in the nineties. And we were able to bring most of those employees back into the company. We try to keep everybody as if they are part of our family. You know, we want them to have a stable job, stable employment. Values are very driven within our company.

We have had a lot of success over the past couple of years with the economy, especially on the construction side, and we have done very well to build up our company to be strong, to weather the next storm that we are going to face.

Ms. VAN DUYNE. So can you share with this company how your small business is handling the current environment, you know, during which time prices have skyrocketed and capital has become much harder to get, with the rising interest rates. And are there any projects that you decided not to go through with as a result of interest rate hikes?

Mr. LOCKARD. We have a customer who just decided not to build a new grocery store in Columbus. It was about a 55,000-square-foot facility. We were looking forward to trying to build that store for them. And the plug was just pulled on that due to construction costs being significantly higher than what they had expected.

We also have an apartment development that we were looking to build on one of our properties. Again, as I alluded to in my testimony, the market is there for housing. There is a shortage of housing. This particular development is not low-income housing. It would have been market rate. It wouldn't have made sense to do low-income housing in this development. But, again, due to construction cost and interest rates, the rate of return is just not there to where it makes sense for us at this time to move forward with that project.

Ms. VAN DUYNE. So we are losing grocery stores and housing?

Mr. LOCKARD. Uh-huh.

Ms. VAN DUYNE. So more often than not, we see the federal government hinder growth of small business instead of helping. What do you think is the biggest burden that you see coming from the government right now?

Mr. LOCKARD. Well, locally, there is always red tape to get through anything. I mean, even permits in our city. Unfortunately, it used to take 2 to 4 weeks to get a permit done, complete on time. Right now, it is taking as much as 4 to 6 months to get a building permit, which is absolutely ridiculous. I don't see a lot of just help from our local government, at least.

And then, obviously, with inflation issues, as I alluded to, they are very real, especially for our small businesses. It is not a political term in our industry. It is not a political term with our tenants. It is something that we face every day, inflation and rising cost.

And when our tenants don't have the same profitability they have, because their cost of labor and their cost for goods is up, but yet, they can't raise their prices because they are afraid they can't get any more customers, it is sending them out of business. And if they go out of business, they affect our business.

Ms. VAN DUYNE. I represent north Texas, Dallas-Fort Worth area. And small businesses are telling me all the time that they are having a really hard time trying to find labor, especially skilled labor. Are you seeing the same thing in your area?

Mr. LOCKARD. Yeah. It has been a challenge for about 6, 7 years now. It is a combination of a lot of things. One, at least on the construction side, for decades, we have told students, Hey, stay out of construction and go get a college degree, you need that in order to get ahead in life. And so we have steered people away from the trades.

Additionally, with COVID, when it hit, and, unfortunately, the unemployment benefits that were added, it was a negative impact to us and our industry. I had an electrician friend of mine who was offering jobs to electricians, but they were getting paid for unemployment and they refused to come work for him while those unemployment benefits were in place.

Now, I believe those unemployment benefits were a good thought. Unfortunately, it had a negative impact to our industry where we had a huge need for labor.

Ms. VAN DUYNE. Awesome. All right. I yield back. Thank you very much for your testimony.

Chairman PHILLIPS. The gentlelady yields back.

And now I recognize the gentleman from Nebraska, Mr. Flood, for 5 minutes.

Mr. FLOOD. Thank you, Mr. Chairman. I mentioned this during my introduction to Mr. Lockard, but I would like to reiterate how pleased I am that I have a witness from my district in Lincoln, Nebraska. It sounds like Mr. Butcher is also from Nebraska.

This is a fantastic opportunity for the Committee to hear firsthand what people on the front lines of small business are hearing, what they are seeing.

Your testimony, Mr. Lockard, tells really a troubling story. The construction and commercial real estate sectors have been some of the hardest hit, between the shutdowns on COVID-19 and the inflation that has followed.

You were talking specifically about supply chain issues. And you were talking about heating, ventilation, air conditioning in units, something that a lot of Americans don't think about every day. But in construction, when those delays happen, that is very real.

Can you just really walk us through what is behind the extreme delay in getting these units and affecting the end of a construction project?

Mr. LOCKARD. Sure. I believe it is a combination of multiple things, again: One, the construction volume is at high levels right now. So the availability for product is down just due to the demand of these products.

Rooftop units are typically custom-made for a project. They may have different components in there for humidity, humidity control, as well as energy efficiencies. So they are basically built at the time of the order. Some of those parts are coming from overseas, and are not available at the factories, as well as labor at the factories, just they don't have enough bodies to build for all the orders that are there.

The delay to us, as a contractor, and to our customers, as owners, is pretty significant. Added cost of what we call general conditions, which is supervision, dumpsters, anything that actually you need to manage the project, the longer it takes the more those costs increase.

And then the lost revenue of not having a tenant in there or having a business not being able to operate is significant.

Mr. FLOOD. Thank you, Mr. Lockard.

I would like to pivot for just a second. I am interested in this topic of ESOPs. And I have a question for Mr. Butcher and maybe one of our other witnesses.

Have you, Mr. Butcher, experienced a transaction where you are dealing instead of with an ESOP, a limited cooperative association? Have you used one of those before? I know in Nebraska, we made this possible in 2008 by passing a law. Do you have any experience with limited cooperative associations?

Mr. BUTCHER. I don't. I am familiar, actually, with the structure, but we haven't executed on it.

Mr. FLOOD. Would it be possible that one of these limited cooperative associations would be more cost-effective as opposed to setting up the Employee Stock Ownership Plan?

Mr. BUTCHER. I don't know that it would be any different. I mean, I think if you look at—and I think the cost piece, from a contextual thing, is kind of overblown in the sense that if you look at the real cost of putting these transactions in place versus the tax savings and the efficiency of that company, and just the retention of employees, particularly today, it far outweighs that initial cost.

But I think that it is more they are different types of structures and they probably apply to different kinds of companies. And I am not an expert on co-ops, but I generally see them as being on the smaller end of business, whereas ESOPs can scale really big. I mean, there are numerous multibillion revenue companies out there that are in the ESOP structure.

Mr. FLOOD. Thank you very much. You know, I appreciate this topic. I think that finding ways to make businesses work, especially in rural America, is important. And it does require some creativity and structure.

One of the benefits of cooperatives—and we have seen cooperatives scale very large in ag areas in Nebraska. And one of the benefits I see with the limited cooperative association is you have the ability to bring in that private investment to help affect the buyout and allow the rest of the employees to have the opportunity to enjoy some meaningful ownership and build some wealth.

That said, I want to thank Mr. Lockard for coming from Lincoln, Nebraska, today. His testimony about the frontline struggles of where we are at with business and the ability to deliver for customers and ultimately to grow our community is really important. And the fact that he made time to come today is really appreciated.

With that, I yield back.

Chairman PHILLIPS. The gentleman yields back. And now I recognize the gentleman from Pennsylvania, Mr. Meuser, the Ranking Member of the Subcommittee on Economic Growth, Tax, and Capital Access. You are recognized for 5 minutes, Dan.

Mr. MEUSER. Thank you very much, Mr. Chairman. And I thank the Ranking Member as well.

And thanks very much, Mr. Lockard, for being here and to our other witnesses.

So ESOPs are certainly a very interesting subject, I think a very important concept. There are some great situations where ESOPs have worked out very well, or in the intended manner. There are also a number of times that ESOPs don't work out very well, particularly if the company fails.

Right after the loans are taken out, the current owners cash out in many ways, right, and then move forward with less-than-favorable returns, and the company starts declining. Then those loans that took place as well as the new shareholders that don't do very well, right?

I mean, you know, an ESOP is based upon future growth, based upon the future. And the thing is this, and I am interested in what some of the witnesses have to say.

Mr. Lockard, I am all for it. I think the SBA loan program should work with ESOPs in a far better way. Mr. Chairman, you brought up there were 17 or something of that nature. So yeah, that doesn't make any sense at all. It should be utilized more effectively.

But the problem is—and I have had enough experience in business, when you have got urgent and important other matters taking place, such as company survival, you are not necessarily—you are thinking about next year, but you are working for survival for today, not so much on growth and such restructuring in the matter of ESOPs.

So in our Committee—and it is not a reflection of the Chairman of this Subcommittee—we have not focused on some of the urgent and important matters that small businesses are taking right now. And meanwhile, we are the only Committee that advocates—not necessarily by definition, but as far as I am concerned—for small business, 100 percent.

So energy issues that our small businesses face, gasoline, diesel, utilities. I mean, I just visited a company just recently that changed over to natural gas for the purpose of saving maybe as much as $1 million a year. You know, they are about a $40 million company, about $3 million in central overhead costs. It cut back to $1 million, because of the increased natural gas. They are up to $5 million-$6 million, thus losing $3 million off their bottom line before we get out of the gate, just for the year, and moving into 2023. That, of course, lowers profits, lowers wages, lowers tax revenues, right, because their profitability is down. But we are not talking about that.

Grocery stores. Grocery stores are hurting, right? I mean, they are in a place where they feel it is a perfect storm between workforce problems, increases in their cost, increases of their products, delivery issues. I mean, the list goes on and on with grocery stores. They are barely surviving, small mom-and-pop grocery stores to larger grocery stores.

So, you know, these are the things that are going to keep all these grand ideas of employee ownership from happening. And we have got to stop it. We need a far more competitive economy. We need to make small business tax cuts permanent. We need to reduce the assault on domestic energy. We need to bring down diesel costs, and we need to stop wasteful spending that sometimes creates incentives for people not necessarily to work—not my words, the words of many, many, many small businesses I talk to.

So, Mr. Lockard, I would like to start with you. What are your thoughts on some of my comments? Please.

Mr. LOCKARD. I appreciate your comments greatly. I think it is spot on. There are a number of things that we can do as a country to try to help small businesses, but I think you are right, the focus needs to be with what are the problems that we are facing today and attack those first.

Some things won't be solved quickly. They may take time, take a lot of strategy. But I think we do need to make small businesses and their—we need to make them successful in our country and make it easy for them.

Mr. MEUSER. Does your industry, do you anticipate, as many do, a recession, whether mild or severe, going into 2023?

Mr. LOCKARD. We do. Construction tends to kind of lag behind what the economy is doing. And, again, we have been in a boon for quite a while. But, again, due to construction costs as well as interest rates, I see that slowing down.

Mr. MEUSER. Yeah. And interest rates play a big role there, and we seem to be trying to fight inflation with interest rates when, meanwhile, that is not really affecting the price of gasoline or diesel. But that is being done by policy.

But, Mr. Chairman, I yield back. Thank you.

Chairman PHILLIPS. Thank you, Mr. Meuser.

With that, I think we are going to go to just a second round of questions. We have some time. And I will start with myself.

Returning to you, Mr. Butcher, how does Mosaic operate differently as an active participant in the M&A market?

Mr. BUTCHER. Well, I mean, we have constructed a transaction that provides the same economic reward for a seller than they would get from any other market-based transaction.

And so, for the most part, when we come, we compete direct head-to-head with private equity, with strategic buyers. Our offer just looks a little different, because our offer says, We will invest in this company to support it in transitioning to employee ownership as opposed to us owning the business, which we do not.

And so that is how—and because of that, we are able to compete head to head with those other options. Instead of being the exception transaction, we are now in the mainstream transaction. And we have found it to be really effective. And rarely have we had to match the market, which is, you know, absolute truth.

We have never been the high bidder in any of these processes, and owners will choose us at the end of the day. And we have proven that for all walks of life of people. And so it gives me great like—it gives me great hope and as sort of the future that we have proven this out.

Chairman PHILLIPS. And anything you might recommend to this Committee and the SBA about how it can better tailor its programs to generate more interest from investors to pursue ESOPs?

Mr. BUTCHER. I think a couple of things. One is—and I know there is frustration around the 7(a) program not allowing the PLP sort of channel in order to do those loans. And I guess that surprises me, because I hope everybody recognizes that the banking partners that are the major partners in the 7(a) program, they all have dedicated ESOP lending teams.

I mean, if you look at every major bank and pretty much every regional bank, they all have a lending group not doing 7(a) but doing traditional ESOP lending into supporting these transactions.

And so, it seems to me that if there was a concern around the structuring of these transactions and the complexity of them, boy, they could lean on those groups within those banks that already exist and the infrastructure is already there. And so I would love to see that.

And the other, if I had a wish, I mean, it would be great if at some point within the SBIC program, if perhaps, you know, the size limitation would get increased for these transactions, only because an ESOP have a really hard time competing for those really high-quality companies that are sort of sized up from where we are limited.

And those companies, if you want to move the needle on employee ownership, those are where there is vast amount of employees. So that would be interesting, but that is for sort of future dreaming.

Chairman PHILLIPS. Thank you very much, Mr. Butcher.

Ms. Manklang, we have not forgotten about you. The USDA's Business and Industry Loan Program does not require a personal guarantee from co-ops. Instead, it requires co-op members to sign a covenant to withhold profit distributions until the agency loan is paid in full.

So could this work for SBA loans to co-ops in lieu of a personal guarantee, in your estimation?

Ms. MANKLANG. Yes, I think so. This is one of a few different solutions provided by the USDA, which has had a really long history of working with cooperatives to great success. You know, worker cooperatives, in general, you know, the structure of it is that, you know, workers get paid a salary. They also get paid patronage.

So that is where the profit goes. And, you know, the average of that is more than $8,000 per year across all worker co-ops. And being able to pay that back right away is definitely a solution. But right now, the USDA's model is only limited to populations of 50,000 or less.

So I think the SBA is really well-positioned to create a complementary program, or a set-aside, to fill that gap for businesses outside of these areas. And I think it is about, you know, the strength of the shared risk.

You know, the USDA doesn't require a personal guarantee, and the reason for that is that co-ops are not seen as an exception at the USDA. You know, we have heard a lot of talk about like the exception of cooperatives or ESOPs, but it is really just a different business model, and a lot of times, a small business model.

And the USDA has outlined requirements that co-ops can equally participate, and because these businesses are ones that are able to address survival, to some of the points that have been brought up before by Representatives.

You know, there are longstanding businesses that are able to address the immediate survival needs, like businesses that make plans. You know, like, for instance, South Mountain Company in Massachusetts made a plan after the downturn of 2008, and they were ready. And there are people that are innovating on creating/using limited co-op associations to pivot and meet the needs of the market and create businesses and create jobs where there are none.

Chairman PHILLIPS. Great. And since my time is expired, just a quick question and a yes-or-no answer if you would.

Do you believe the SBA is doing enough outreach and education to inspire more co-op creation?

Ms. MANKLANG. No, I do not.

Chairman PHILLIPS. Thank you.

With that, I am going to recognize the Ranking Member, Ms. Van Duyne, for 5 minutes.

Ms. VAN DUYNE. I actually don't have any questions, so I yield back.

Chairman PHILLIPS. Okay. Any other Members wishing to ask an additional question?

Mr. FLOOD. Mr. Chair.

Chairman PHILLIPS. Mr. Flood is recognized for 5 minutes.

Mr. FLOOD. I would like to, once again, thank Mr. Lockard for being here. Thank you for making a trip to Washington, D.C. And I guess just one final opportunity for you to react to the testimony that you have heard today.

Your business depends on other businesses thriving enough that they can expand into new space or build a new commercial facility. When you talk to prospective clients of your company in construction, and not so much about building a building, what do they tell you are limiters on their growth? What do you hear from other Members of the Lincoln Independent Business Association? When you go to those LIBA meetings in Lincoln, what are people talking about that are really the barriers for companies like yours and theirs from growing?

Mr. LOCKARD. Right now, I think for a lot of them it is just straight uncertainty, and again, when will costs come down? Will they actually come down or is this a new normal for us?

The labor market, you know, we just voted in Nebraska to raise minimum wage over the next 3 years. That doesn't affect a business like mine as much, because all of our workers are skilled and they are not at the minimum wage level.

But my sister-in-law has a company who—it is called The Chocolate Season. They make artisan chocolates and coffee they ship across the United States. Labor is very impactful to them. So there are a lot of limiters, I would say, and most of them are just uncertain about what are things going to look like.

Mr. FLOOD. Mr. Phillips, our Chairman, talked about—his question to the last witness was, you know, is the SBA doing enough to reach out?

Let's ask a similar question: Is the SBA a relevant agency for businesses in Lincoln, Nebraska, that are looking to grow, maybe young businesses? Do you hear much about the SBA? Do you feel like the SBA loans are working or that there is enough outreach?

Mr. LOCKARD. I think, for the most part, they are working. And, I mean, obviously, even my sister-in-law, she was able to get an SBA loan for her business to start it up in Lincoln. And without that, she would not have been able to open up her business.

Other companies that I work with, they are able to get SBA loans as well. And we work with the local banks and credit agencies in Lincoln and around Lincoln, but for the most part, I think they have been very successful in getting what they need. On a few occasions, they have been turned down or hit regulation that may not have made sense to them or to us, but it caused them to not be able to get the loan that they wanted.

Mr. FLOOD. I am pleases to hear that. And I will end with this: There is a cigar bar in my district that just got an SBA loan, but in order to qualify for the SBA loan they had to do an environmental impact statement that was costly and took time away from the process and delayed the opening.

Now, this was a small—this is a small-size shop. Very fortunate to have the SBA option, but that environmental impact statement set the process back as they went through the process.

So I think there are things that we can streamline when it makes sense. And, Mr. Lockard, I am pleased to hear that you have seen good things, and I am pleased to hear your sister had success with the SBA loan.

I yield back. Thank you.

Chairman PHILLIPS. Thank you, Mr. Flood. Absent any more questions, I will move to my closing statement and ask that Mr. Flood maybe consider a congressional delegation to the cigar bar at some point.

I think two things can be true at once. These are tough times for all businesses, small businesses in particular. I am a small business owner. I have been in business my whole life. I recognize how inflation, workforce development, and permitting—and permitting—are complicated.

And I look forward to working with my colleagues on both sides of the aisle on this Committee to doing this important work. I think we are in violent agreement, and I find that a great opportunity.

I also heard some very promising comments from both sides about the importance of sharing more ownership. I think it is terribly important and particularly, as Mr. Flood pointed out, for rural America, where I want to see more businesses developed. I want to see more ownership. I want to see people work hard and be able to retire with dignity and possibility. And I think that we can do that together if we work together, and I surely look forward to doing so here in the next Congress.

I come from a family that, as I said earlier, believe business is a means to an end. The end isn't just collecting as much money as possible; rather, sharing as much as possible. And I brought with me my family's bonus and profit sharing-plan from 1941, 1941. We have been doing this for generations, because we have seen the impact it makes on individuals and the communities in which we live and our businesses operate.

And I refer to information from the National Center for Employee Ownership that indicates that in ESOPs, employees earn wages that are 5 to 12 percent higher than employees in conventional firms. The net worth of employee owners aged 28 to 34 is 92 percent higher than in nonemployee-owned firms. And the retirement savings for an ESOP employee is $170,000, which is twice the national average.

I can't imagine anybody objecting to my premise that more ownership is better in America, and we should be working together to inspire that and I look forward to so doing.

There are challenges. I think the SBA can surely be doing a better job to educate, inform, advise and encourage. It is our job to provide oversight and the resources to do so, because I think this can be a legacy-making opportunity for this Committee and the businesses that pursue them.

Aligning workers' and owners' interests is an American interest, not a Democratic or Republican one, and I look forward to inspiring that as well. So to anybody interested in this kind of work, let's keep it going. I think there is a lot of shared sentiment and great opportunity.

With that, I will ask for unanimous consent that Members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered.

If there is no further business to come before the Committee, we are now adjourned and I thank all of our witnesses and my colleagues for showing up today. Thanks, everybody.

[Whereupon, at 12:40 p.m., the Subcommittee was adjourned.]

APPENDIX

Testimony, Mo Manklang, Policy Director of the U.S. Federation of Worker Cooperatives
Small Business Committee Hearing: Challenges and Benefits of Employee-owned Small Businesses
December 6, 2022

My name is Mo Manklang, and I am here today representing the U.S. Federation of Worker Cooperatives and the estimated 1, 000 worker cooperative and democratic workplaces across the country. Thank you so much to the subcommittee for creating the space to address this important issue.

In my role as Policy Director, I have a ground level view of the challenges and successes of our employee owned businesses, and are attuned to the needs of this growing field. Worker cooperatives are an increasingly lauded solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade this could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale.

The worker cooperative model offers many benefits to its members:

- They are typically small and strong businesses, typically employing 8 workers, and **paying an average of $19.67/hour** often in insecure industries like retail, manufacturing, food service, home care and childcare.
- Worker co-ops allow workers to benefit directly from the value that they create, with **an average of $8,241 in patronage distributed to each worker each year.**
- Worker co-ops are diverse - with nearly 47% employing workers of color and 52% of the workforce identifying as female.
- According to a recent study from Democracy at Work Institute and the University of Madison-Wisconsin, the majority of worker-owners not only plan to stay in their jobs, but also **72% of them are building skills through professional development opportunities.** Indeed, almost **75% of respondents are more satisfied with their worker co-op than their previous jobs**. They are also more engaged citizens, with **70% of the workforce voting in recent elections.**
- These businesses last longer, with a **25.6% success rate for businesses 6-10 years old**, compared to the 18.7% success rate of typical small businesses. and a **14.7% success rate in businesses that are 26+ years in business**; about 3% higher than the typical small business.
- Because of their scale and prioritization of workers and their families, **worker co-ops are more responsive to immediate household needs, providing better wages, benefits, and stability.** Currently the USFWC works with our member organizations to access dental, vision, and health insurance group rates, and organizes on their behalf to secure lower rates and better networks.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act, which passed with overwhelming bipartisan support. While a small part of the overall education, outreach, and training efforts of the SBA, this legislation, if enacted, would be a tremendous boon for the employee ownership space, bringing a proven, durable model of business ownership into greater prominence. This legislation, which aimed to improve access to capital and technical assistance for employee-owned businesses, was meant to:

- Finance the sale of businesses to their employees
- Work with Small Business Development Centers across the country to provide training and education on employee ownership options

- Report on SBA's lending and outreach to employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for this highly underserved sector, particularly with regard to its lending programs. Cooperatives have long sought access to SBA lending programs, but the personal guarantee requirement has been a barrier that keeps these vital businesses from accessing this critical funding. We simply seek an even playing field with other small businesses; this requirement has created a distinct disadvantage for cooperatives whose ownership structure – shared ownership across multiple co-op members – is directly at odds with asking a single member or the selling owner to take on ultimate responsibility for the loan.

Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, or education. In the 5 years that I have been on staff at the USFWC, I have only found 1 case of a worker co-op being able to access a SBA 7(a) loan. It was our hope and expectation that we would see this number rise, and that we would see more worker co-ops access the vital resources of the SBA.

We see two big issues in regards to the support of employee ownership: education and opportunity.

Education is needed for business owners, service providers, financial institutions, and the SBA itself. We know of at least two different worker cooperatives who were actively discouraged from pursuing a cooperative model in their startup phase. Financial institutions are unfamiliar with cooperatives and ESOPs, and deprioritize their applications. This even happened during the COVID-19 pandemic, with many worker co-ops who applied for Economic Injury Disaster Loans and the Paycheck Protection Programs being denied or running into significant challenges in accessing these business-saving resources.

We also simply need access to **opportunity.** The personal guarantee is at odds with broad-based ownership structures, even though these businesses inherently have a wide base of support and buy-in from workers and their communities. We understand the importance of ensuring that people have "skin in the game" - that they have a deep commitment to ensuring the success of their business and the repayment of their loan. The shared ownership structure of worker cooperatives actually makes employee owned businesses more dependable, and more resilient – better able to weather economic downturns, less likely to lay-off workers, and more productive than their traditionally owned counterparts.

There are many examples of cooperative loan programs that result in lower default rates than SBA loans with no personal guarantee. For instance, the Intermediary Lending Pilot Program resulted in loans to 17 worker cooperatives and zero defaults, with 16 of those businesses still operating. The ownership structure of co-ops creates plenty of incentive for the member-owners to succeed. To compound the issue, the regulations currently under review regarding the CDFI fund will cut off access to vitally needed programs, further restricting access to financing. We ask that the SBA draw from the field's deep expertise in lending to cooperatives to create a common-sense solution that works for both worker cooperatives and ESOPs.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Programs like the 7(a) loan program are a vital piece of accelerating the already rapid growth of worker co-ops. While we have been disappointed in the SBA's report on cooperative options and its lack of action regarding the Main Street Employee Ownership Act, we also know that the SBA has the programs and assets to spark significant growth of the worker co-op movement. Our goal through these efforts is to support and protect the 24.7 million workers across the country, currently employed in baby boomer-owned companies, and to strengthen the worker co-op community. On behalf of the cooperative community, we thank the Small Business Committee for their attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

In cooperation,

Mo Manklang, U.S. Federation of Worker Cooperatives

Issues with SBA ESOP Loan Program Under the Main Street Employee Ownership Act

Corey Rosen, Founder, National Center for Employee Ownership

December 6, 2022

I am the founder of the National Center for Employee Ownership, a nonprofit 501(c)(3) organization focused on information services and research on all forms of broad-based employee ownership, with a special focus on Employee Stock Ownership Plans (ESOPs). We were founded in 1981 and now have a staff of 19. Our funding comes almost entirely from conferences, memberships, and publication sales. We do not set up plans and we do not lobby for or take official positions on legislation.

Prior to founding the National Center for Employee Ownership, I worked on Capitol Hill for five years, including three years on the Senate Small Business Committee staff, where, among other things, I drafted the predecessor to the Main Street Employee Ownership Act (MSEOA), the Small Business Employee Ownership Act of 1980. Prior to coming to the Hill, I taught political science at Ripon College and received a PhD in political science from Cornell. I have written a number books on employee ownership and participated in numerous research projects.

The Small Business Employee Ownership Act, like the MSEOA, was intended to make it easier for ESOPs to get SBA loans, but, as with the MSEOA, the SBA never took steps to make this practical and the law was rarely used. The MSEOA was intended to fix that. I participated in a number of discussions with committee staff at the time on the issues that needed resolution.

Unfortunately, the implementation of the MSEOA has also been very disappointing. The SBA's operating guidance on loans to ESOPs and worker cooperatives has been contradictory towards the intent and often the letter of the law. As the SBA itself has noted, only 17 loans have been made under the bill. Advisors and companies who have looked at it have decided he requirements the SBA has imposed are impractical, of reasons I will describe in this testimony. Noting in recent Affiliation and Lending Criteria for the SBA Business Loan Programs addresses any of the issues that have cause this lack of use.

Similarly, the SBA has not taken any meaningful steps to do the outreach the MSEOA envisioned. I understand that the pandemic and the government's response occupied the SBA's resources, but now that that is less of an issue, I hope the SBA can move forward on this. The good news on outreach is that it should not require the SBA to create a major new program or incur large expenses. There already is a substantial infrastructure of nonprofits in this field as well as companies and service providers, all of whom would be happy to provide unbiased materials explaining how employee ownership works, to organize live or virtual presentations, and to field introductory calls with potential employee ownership companies. The role of the SBA and SBDCs can focus on creating the forums for presentations, sending out mailings, and making sure small business advisors are aware of what employee ownership is and how to find support. The federal government has already provided substantial tax incentives for these plans; the trick is to make owners of companies thinking about business transition aware of them.

All of this is unfortunate because ESOPs have a remarkable track record of generating new jobs, preventing layoffs, retaining workers, keeping jobs in communities, and providing substantially more retirement wealth to employees than they would get in comparable companies. If companies are not sold to ESOPs, they will usually be sold to larger companies or private equity, and, in many cases, jobs reduced or relocated.

Background on ESOPs

Close to half of all privately-held companies in the U.S. are owned by baby boomers, meaning 2.7 million American businesses are owned by someone age 55 or older.[i] In the coming decades, all of these business will either change owners or disappear. The median state has 34,000 businesses approaching an ownership transition. The effects of this generational shift will be felt in cities, small towns, and rural areas.

At the same time, state governments are struggling with the challenge of preserving jobs and stimulating local economies buffeted by larger economic trends. States currently spend an estimated $45 billion and $70 billion a year on efforts to attract and retain jobs.[ii]

If even a fraction of these exiting owners pursued an Employee Stock Ownership Plan (ESOP), worker cooperative, or employee ownership trust as their business exit strategy, the potential positive impact on workers, communities, and state economies would be substantial.[iii] Yet, many business owners are not even aware of employee ownership as an option. In light of this knowledge gap, many of these businesses will instead shut down or sell to outside investors who may not be interested in preserving and growing local jobs.

How do ESOPs Work?

ESOPs, by far the most common employee ownership approach, are a kind of employee benefit plan that can be used to buy out an owner and transfer ownership to employees in part or in whole, all while creating a qualified retirement plan at no cost to the employees. This is accomplished through the unique transaction structure that is available to ESOPs under law: the ESOP trust can borrow money to buy the shares of the departing owner(s), with the company making cash contributions to the plan to enable it to repay the loan over time. Alternatively, the company may contribute new shares of its own stock and/or use cash to buy existing shares without a loan. Regardless of how the plan acquires stock, company contributions to the trust are tax-deductible, within certain limits. Sellers can defer taxes on the gains made from the sale by reinvesting in stocks and bonds of U.S. companies.
Shares in the trust are allocated to individual employee accounts. Generally, all full-time employees are included after a year of service. When employees leave the company, they receive their stock, which the company must buy back from them at its fair market value (unless there is a public market for the shares). Private companies must have an annual outside valuation to determine the price of their shares.[iv]

From the perspective of the selling owner, it makes sense to fund an ESOP at a higher rate than other benefit plans such as 401(k)s because the ESOP accomplishes multiple goals – in addition to being an employee benefit, it also provides a succession plan that fairly compensates the selling owner and introduces unique tax advantages for both the owner and the company. ESOPs have proven to be a sustainable form of company ownership. Not only do these employee-owned companies generally continue to thrive, this unique ownership structure often improves company performance.

Supporters across party lines in Congress have determined that ESOPs are good public policy, and as a result there are significant tax benefits to establishing and maintaining an ESOP. In order to qualify for those benefits, ESOPs *by law* must be *broad-based*. They must extend to all employees meeting minimal employment requirements (with some exceptions that apply to all benefit plans), and they cannot excessively benefit highly compensated employees.

Currently, there are around 6,660 ESOPs in the United States holding total assets of nearly $1.4 trillion.[v] These plans cover 14.2 million participants.

ESOP and Corporate Performance

At the company level, ESOPs have been associated with greater firm performance, productivity, and job stability. Employee ownership has been linked to greater employment stability in the face of an economic downturn, and firms with employee-ownership were more likely to survive the last two recessions.[vi]

It is particularly noteworthy for our purposes here that the default rate (defined as defaults that impose losses on creditors) for loans for an ESOP to purchase the shares of existing owners in vanishingly small. In an NCEO analysis of over 1700 loans to ESOPs for business transition between 2009-2013 (which includes two recession years) the default rate was *two per thousand per year*. That means that any SBA loan guarantee program will not require significant expenditures for the SBA for loan losses.

Promoting employee ownership transitions would be a smart investment even if all they did was increase business longevity and sustainability, but research conducted over the last three decades points to wider benefits. These findings are underpinned by general characteristics of ESOP companies. As a result of several factors, including the culture often created in these companies, ESOP companies tend to invest more heavily in employee education, training, and engagement for the long-term success of the company. Privately-held ESOPs generally intend their ESOPs to be permanent[vii] such that they have structural reasons to buck the trend of "short-termism" often seen in publicly traded companies and private equity firms that can have negative impacts on workers and communities.[viii]

First and foremost, these companies create retirement savings at a time when the median retirement savings among Americans without traditional pensions is *zero*.[ix]

ESOP companies tend to lay off employees at one-third to one-fifth the rate of other companies, depending on the year of the study. National surveys show that among employees at private firms both actual layoffs and the perceived likelihood of being laid off are lower for employee-owners than for nonowners.[x]

This increased job tenure translates into quantifiable benefits for workers in ESOPs. An ongoing analysis of panel data from the National Longitudinal Survey comparing younger workers with ESOPs to similar workers without such a benefit finds the median job tenure of employee-owners is 5.1 years, 46% greater than the 3.5 years for those without an ESOP. This translates into appreciably higher median household wealth for ESOP workers.[xi]

A 2022 study by the National Center for Employee Ownership found that employees in ESOP companies have dramatically better retirement assets than other employees. Drawing on objective data from 310,857 plan filings, NCEO analyzed retirement plan data from 2019 and 2020 from S corporation ESOPs and a comparison group of companies offering a 401(k) plan. Their analysis found that employee ownership provided critical financial and retirement security for employees and resiliency for these S ESOP businesses when compared to non-ESOP companies.

NCEO's key findings include:

- Businesses with an ESOP in place provided greater financial security for employees heading into and during the pandemic, and job retention at the firm level compared to comparable conventional firms.
- The average ESOP account balance going into the pandemic was dramatically higher – more than double – than the average 401(k) account balance ($132,000 vs. $64,000) at a non-ESOP company.
- Controlling for size, industry, and location simultaneously, the S ESOP advantage is an estimated $67,000 more in retirement security – especially remarkable, given that just over half (50.5 percent) of American families have a retirement account at all. Among those that do, the median account value was $65,000.
- The average employer contribution to the S ESOP was more than 2.5 times that of companies offering only a 401(k), and 94 percent of total contributions to ESOPs came from the employer, compared to 31 percent for 401(k) plans.
- Notably, most ESOP companies also offer traditional retirement benefits such as a 401(k), in addition to providing employees with an ownership stake in the business as a benefit of employment.
- Using active participants as a proxy for employment, and controlling for company size, industry, and region, being an ESOP is associated with retaining or adding an additional 6 employees from 2019 to 2020, compared to non-ESOP employers.

Barriers to Growth

There are two primary barriers to ESOPs growing faster, both of which could be addressed by the MSEOA at a very low cost.

The first is that few business owners have a good understanding (or any understanding) of ESOPs. Many assume it means employees have to buy shares (they do not) and that this is impractical (as it is). Others are told by advisors that ESOPs are only for certain kinds of industries or that they do not work very well or are too complicated (they are complicated, but selling a business sot anyone is complicated). That may all be in good faith, but, unfortunately, too often it is because advisors believe that if their client does an ESOP, they will lose the client to other advisors specialized in the field or that they can make more money by getting them to sell to an outside buyer. I have been told by some M&A advisors that they will not advise a client to do an ESOP because of this. An SBA-led outreach effort could help address this issue for very little cost.

The second barrier is financial. Most ESOPs are financed in whole or in part with a seller note. Banks will only loan up to what the collateral the company can offer is, or perhaps somewhat more. Many sellers are perfectly happy with that. But others want or need the money upfront. To get more upfront, they would need to supplement the bank loan with mezzanine debt, which normally is priced several points or more higher than senior debt (often 14% to 18%). That burdens the company with more debt than it may be able to take on. An SBA loan guarantee would enable more of the loan to be priced at senior debt levels and make more transactions practical and appealing. Given the very low default rate on ESOP loans, there is little risk to the SBA.

Given the demonstrated track record of ESOPs to significantly improve retirement security, strengthen companies and communities, and impose extremely low default risks on lenders, it is not surprising that ESOPs have an unbroken record of virtually unanimous Congressional support. What perhaps is surprising is that the SBA has made it so difficult to use a program Congress created to help ESOPs become more common, a program that would be very low cost and very low risk.

The Main Street Employee Ownership Act and the Barriers to Implementation Raised by the SBA

On August 13, 2018, the Main Street Employee Ownership Act (MSEOA) became law. The law encourages the creation of ESOPs and worker cooperatives by facilitating transactions via loans supported by the Small Business Administration (SBA). It also directs the SBA's outreach infrastructure to encourage business owners to consider employee ownership.

Under prior law the SBA could make loans to help finance ESOPs, but the loans were subject to several requirements that made them impractical in most situations. The MSEOA eliminates five obstacles that were challenges under the old law.

1. **Before the MSEOA: The loan had to be made directly to the ESOP trust.** Now: SBA-backed loans can now be made to the company to reloan to the ESOP, as long as the transaction financed by the loan results in the trust owning at least 51% of the business. The loan from the company to the trust does not need to be on the same terms as the loan from the lender to the company. If the seller retains some ownership in the business following the transaction, she or he will be required to provide a personal guarantee for the loan.

2. **Before the MSEOA: The seller could not retain any role in the management or governance of the company following the transaction.**
Now: The seller can retain a role in the company as "an officer, director, or key employee of the small business concern when a qualified employee trust or cooperative has acquired 100 percent of ownership of the small business concern."

3. **Before the MSEOA: There had to be a 10% equity investment in a business transaction loan.** Now: The law gives the SBA the discretion to waive the requirement for a 10% equity investment to accompany a business transaction loan.

4. **Before the MSEOA: The loan had to go directly through the SBA itself, a long and cumbersome process compared to the much easier approach of working with SBA preferred lenders.** Now: ESOP companies can work with banks under the preferred lender program, which provides SBA guarantees for loans up to $5 million (additional funding from other sources can be added).

5. **Before the MSEOA: SBA-backed financing could only be used to directly fund the transaction.** Now: SBA-backed loans can also be used for transaction costs.

In addition, the program provides that Small Business Investment Companies (SBICs) can make loans to ESOPs. SBICs receive two dollars in government-guaranteed debt for every dollar raised in equity, up to a limit of $150 million (see the SBA's SBIC overview for details). SBICs typically would provide unsecured debt in ESOP transactions.

Finally, the MSEOA requires the SBA to coordinate with investment funds licensed through the SBA's Small Business Investment Company program and intermediary lenders through the SBA's Microloan Program to promote employee ownership as an area to consider for investment and lending. It also directs Small Business Development Centers to provide outreach and training on ESOPs, and it directs the SBA to set an interagency task force to develop further recommendations for promoting employee ownership.

Issues with the SBA's Implementation

There are four prominent issues for companies wishing to use the revised SBA ESOP loan program. The **first** is that the lenders are unable to approve the loans under the Preferred Lender's Program, so the loans still must go through the SBA's Loan Guaranty Processing Center (LGPC) for approval. The drafters of the bill had intended for ESOP loans to be processed under the Preferred Lender's Program. Submission to the LGPC can slow the process substantially and add uncertainty. Many potential borrowers tell us they are unwilling to take these risks.

Second, the SOP for the program requires an unrealistic equity position outside the ESOP.

Specifically:

> b) Changes of ownership resulting in a new owner (complete change of ownership): **At a minimum, SBA considers an equity injection of at least ten (10) percent of the total project costs** (all costs required to complete the change of ownership, regardless of the source of funds) to be necessary for such transactions. Seller debt may not be considered as part of the equity injection unless it is on full standby for the life of the SBA loan **and it does not exceed half of the required equity injection**;

This effectively means that the ESOP must be structured with at least a 5% equity investor. This raises serious barriers.

Most ESOP transactions now are for 100% transfers. Because earnings attributable to an ESOP in an S corporation are not taxable, this allows the company to elect S status and, under federal tax law, effectively pay no tax (the tax is eventually paid by employees when they get distributions of their earnings). S corporation law, however, requires that any distributions made to owners be paid pro-rata to al owners.

So assume that an outside investor could be convinced to purchase a 5% equity interest. That owner will get a K-1 statement requiring that he or she pay taxes on their share of the company's earnings. S corporations will typically pay an earnings distribution equal to this amount. So the ESOP must get ***19 times*** that amount in its distribution, even though it does not pay the tax. That is not a workable scenario for any company. No investor will simply agree to pay the taxes on their own unless they were provided a substantial discount on the shares, but doing that would violate ERISA valuation rules because the ESOP cannot pay more than other investors for the same class of stock, and S corporations can only have one class of stock.

Given that finding an outside investor is a tremendous challenge, the remaining option is for employees to put up the money, but this involves a security offering and may be more than employees can afford or are willing to risk. They also would end up in this untenable tax situation.

Even if the company is not a 100% ESOP S corporation, it still is very difficult in general to find minority investors at any level, even more than 5%, in an ESOP for companies the size of businesses that qualify for these loans. It is simply not usually worth the bother for companies to pursue SBA loans as a result.

The Main Street Employee Ownership Act of 2018 allows for the SBA Administrator to waive the mandatory equity requirement. It states: "(G) With respect to a loan made to a qualified employee trust under this paragraph, or to a cooperative in accordance with paragraph (35), the Administrator may, as deemed appropriate, elect to not require any mandatory equity to be provided by the qualified employee trust or cooperative to make the loan." However, the SBA does not seem inclined to waive the requirement, based on loan submissions in 2019. A better solution is to allow the seller note to qualify for the entire equity commitment.

Research by the National Center for Employee Ownership shows that ESOP companies default on acquisition loans at a rate of two per thousand per year, a rate that no doubt is considerably better than SBA loans in general. The law was intended to make it easier for companies to use the SBA program for ESOP. The procedures now in place, however, continues to make it very difficult.

Third, the SBA has further stated that the ESOP loan cannot be disbursed until the IRS determination letter has been issued and received from the IRS, acknowledging that the ESOP qualifies under the Internal Revenue Code. The IRS determination letter can take up to 12 months to get issued and could cause significant delays in completing the transaction. An opinion letter from a qualified ESOP attorney should be permitted as a substitute for the determination letter so that the loan transaction can be completed timely. Banks do not require a determination letter, and it is exceedingly rare (as in close to zero %) for a plan not to get one.

The SBA's Standard Operating Procedure should be updated to clarify these three obstacles. Further, a policy notice should be issued so that the changes could be effective more quickly. There has been significant interest in Employee Ownership facilitated by an SBA guaranteed loan, however the obstacles above will discourage many lenders and small businesses from considering SBA financing as an option. The inability to have an SBA loan as a financing option means that many of the ESOP transactions won't get done. These simple changes will remove the major impediments and allow for more ESOP transactions to get the necessary financing.

Finally, the SBA requires its own valuation for every transaction. So does a sale to an ESOP (this is not true for coops, but you should get one). If the SBA valuation is lower, than what is a trustee to do? The seller may not then sell at the lower price. Can the trustee ignore the SBA valuation because it is done to a different and much less rigorous standard than the ESOP valuation under ERISA? And why impose this needless additional cost anyway when there is a high-quality valuation anyway?

Resolving the Issues

Other witnesses can better address issues concerning worker cooperatives. I will focus in ESOPs.

Resolving the issues raised here is straightforward. The SBA should include ESOPs under Section 7(a), drop requirements for an equity infusion, not require an unneeded wait for a determination letter, and drop the superfluous requirement for an additional valuation. Working with SBDCs, the SBA should set up an outreach program focusing on providing materials and meetings to companies and companies and their advisors. These are changes that would reduce bureaucratic impediments and make the program more what Congress clearly intended.

---

[i] NCEO analysis of the Annual Survey of Entrepreneurs, 2016.

[ii] See the work of Professor Timothy Bartik and Professor Kenneth Thomas, and the research conducted and compiled by https://www.goodjobsfirst.org/

[iii] Of course, this course of action is not suitable for every company. Generally, companies should have at least 20 employees to be able to absorb the transactional costs of an ESOP, have enough profits to purchase shares and still run the company, and have a culture open to sharing ownership.

[iv] See this booklet for an overview of how ESOPs work in practice.
https://www.nceo.org/assets/pdf/misc/Employee-Ownership-NCEO.pdf

[v] https://www.nceo.org/articles/esops-by-the-numbers

[vi] See https://www.nceo.org/Guide-Research-Employee-Ownership/id/125/ for an detailed summary of academic research findings.

[vii] For example, in the 2017 NCEO Repurchase Obligation Survey, 72% of the ESOP respondents *strongly agreed* that they intend "our ESOP to be permanent". https://www.nceo.org/ESOP-Repurchase-Obligation-Survey-2017-Full-Report/m/926/

[viii] See for example, https://www.fcltglobal.org/research/reports/article/measuring-the-economic-impact-of-short-termism

[ix] Author's calculations using the Survey of Consumer Finances (2016). For additional data on the state of Americans' retirement savings see, https://www.nceo.org/assets/pdf/articles/NCEO-S-ESOPs-Retirement-Dec-2018.pdf

[x] The General Social Survey (GSS) is a nationally representative, face-to-face survey covering a broad range of behavior and attitudes conducted by the National Opinion Research Center (NORC) at the University of Chicago. The General Social Survey does not break out ESOPs. Employee-owners are identified based on the GSS variable *ownstock*, which asks respondents if they own any shares of stock in the company where they now work, either directly or through some type of retirement or stock plan.

[xi] See the full results at https://www.ownershipeconomy.org/

MOSAIC CAPITAL
PARTNERS

Mosaic Capital Investors – Statement of Keith Butcher

December 6, 2022

Employee Ownership Aligned with SBA Mission / Impact

MOSAIC CAPITAL PARTNERS

Employee Ownership is Beneficial for all Constituents [1]

Good For Employees

- **Wages** - Employee owners earn average wages 5 to 12 percent higher than employees in conventional firms
- **Wealth** - The net worth of employee owners aged 28 to 34 is 92 percent higher than for non-employee owners
- **Retirement Savings** - The average retirement savings for an ESOP employee is $170,000, twice the national average

Good For Business

- **Turnover** - Employee engagement is higher and turnover is lower at employee-owned companies
- **Growth** - Transitions to employee ownership increase productivity by more than 4 percent
- **Stability** - Employee owners are one-fourth as likely to be laid off and their companies go bankrupt less frequently

Good For Communities

- **Jobs** - Employee ownership saves local jobs, because companies that are owned by their employees are far less likely to leave their communities
- **Local Wealth** - Employee ownership keeps wealth circulating in local communities

Good For Owners

- **Legacy** - When business owners sell their businesses to their employees, they can keep their legacy alive for generations to come
- **Savings** - Entrepreneurs and family owners can realize the value the business has built while enjoying substantial tax savings
- **Responsibility** - Business founders and families can find ready buyers in employees, avoiding sale to those who would dismantle the business

(1) National Center for Employee Ownership (NCEO) and Democracy Collaborative.

Keith Butcher, Partner, Mosaic Capital

MOSAIC CAPITAL PARTNERS

Keith Butcher has been serving the employee ownership business community for the past 25 years. He worked on his first ESOP buyout transaction in 1998 and since then has been an advisor or investor to over 300 employee owned companies.

Currently, Mr. Butcher is one of the founding partners of Mosaic Capital, a SBIC licensed investment fund based out of Charlotte, NC. Mosaic is the only SBIC fund solely focused on investing in ESOP owned companies. Mosaic invested in 12 ESOP owned companies in Fund I and has completed 2 investments in ESOP owned companies in Fund II.

Additionally, Mr. Butcher is one of the founding partners of ButcherJoseph & Co., a middle market M&A advisory firm focused on ESOP related transactions, based out of Saint Louis, MO.

Finally, Mr. Butcher is an active Board member in several companies: Custom Profile, Inc.(ESOP owned, HQ Grand Rapids, MI), Sayers Technology, Inc. (ESOP owned, HQ Chicago, IL), DAI Magister (subsidiary of DAI Global, Inc., ESOP owned. HQ Bethesda, MD), and Forest City Trading Group, Inc. (HQ Portland, OR).

Mr. Butcher received a B.A. in International Business/Finance from Bradley University, Peoria, IL and a J.D. from Wake Forest University School of Law, Winston-Salem, NC.

Silver Tsunami[2]

Of the approximately 77 million Baby Boomers in the U.S., an estimated 12 million have ownership in privately held businesses. Roughly 10,000 Baby Boomers reach retirement age every day, meaning all members of this generation will reach age 65 by 2030. As the Baby Boomer retirement era continues and ownership stakes are passed to next generation of leadership, an estimated $10 trillion worth of business assets is expected to be transferred. Ultimately, the ~$100 trillion net worth of individuals over age 55 (as of Q4 2021) will be passed on to successors and inheritors.

SBA

The SBA has a genuine opportunity to influence the massive succession of Baby Boomer businesses. The capital provided by SBA to these businesses could be used to encourage businesses to transition to employee ownership. By transitioning to employee ownership, those companies continue to reside in their communities, provide quality jobs and local stability. **(2)**

(2) Source: U.S. Census Bureau; Federal Reserve; Wilmington Trust Business Owners Outlook: Rush to Retire (Q2 2021)

SBA Capital

Business succession requires some form of capital to enable the transfer of ownership.

SBA 7(a) Program and ESOP buyouts: The vast majority of the Baby Boomer businesses would qualify for SBA size limitations. The 7(a) program is particularly well suited for the lower end of these businesses. For businesses valued less than $15 million, this program would be a natural fit to provide the senior debt funding for an ESOP buyout. Currently, there are few options for financing the sale of a small business (less than $15 million valuation) to an ESOP. Primarily, these transactions are seller financed. As a result, the only ESOP transitions that occur are those where the owner has few sale options or where the owner is truly committed to employee ownership. If the owner has the option to sell the company to a 3rd party (likely a strategic buyer at this size level) and receive liquidity upon the sale – it is a challenge for them to select a seller-financed transaction.

By truly aligning the structure of the 7(a) program with the traditional structure of an ESOP buyout and enabling the PLP program to support these transactions, the ESOP buyout becomes a viable alternative to a sale of the business.

As a result, the 7(a) program truly becomes a catalyst for growing employee ownership is America.

Finally, the resources/knowledge to underwrite these transactions already exists in the SBA's traditional partners. Most large and regional banks have some form of dedicated ESOP lending platform (for larger transactions). The dedicated teams at these banks have deep knowledge in underwriting the credit and the structure of ESOP buyout transactions. By enabling this group to add 7(a) lending to their existing ESOP lending platforms, the SBA opens up the ability for small business to access employee ownership.

Mosaic Capital

MOSAIC CAPITAL PARTNERS

As an SBIC licensed fund, Mosaic has been investing over the past 9 years to support the sale of businesses to ESOPs. Mosaic supports transactions that are larger than what the 7(a) program could support (greater than $15 million in value). Mosaic has proven over the past 9 years that business owners will choose ESOP structured succession over sales to traditional private equity or strategic buyers. Mosaic competes in the traditional M&A auction marketplace to provide owners who are considering a sale a similar economic option through the use of an ESOP structured buyout.

- Mosaic is projected to create over $130 million of ESOP value in Fund I for for than 1400 employees
  - Mosaic's first six realizations generated $36 million in cash value for its employees
  - Mosaic's remaining ESOP portfolio companies are projected to generate ESOP value in excess of $94 million

In addition to the 7(a) program's influence on growing employee ownership for companies in a value range less than $15 million, the SBIC program can be a strong influence on the next size category of businesses. The combination of these two capital programs gives SBA the power to influence the succession path for 12 million Baby Boomers who own businesses. Over the next decade, the growth of employee ownership in America would be multiples of the past decades. There is no doubt that given a viable economic option to reward their employees, many business owners would choose ESOP over selling to a 3rd party.

Good morning,

First, I would like to thank the committee for allowing me to testify today and share some of the challenges small businesses are facing. This is certainly an unprecedented time and the challenges that small businesses are facing are significant and in some cases crippling.

My name is Scott Lockard of Hampton Enterprises located in Lincoln Nebraska. We are a nearly 75 year old small business that has two main focuses, commercial construction as well as leasing and development. With just over 70 employees we own and lease out nearly 900,000 sf of commercial property which we have built out, lease and maintain with our own employees. Since the majority of our tenants are also small businesses, We have the unique perspective of seeing how small businesses are being impacted and affected due to the current economy.

Like many businesses around the country labor has been a major factor to our business and industry. On the construction side, we struggle to find an adequate supply of employees who are skilled in the construction industry or willing to learn. We offer on the job training, we have worked with both vocational schools as well as the local Universities in order to find and train workers. However, there continues to be a lack of skilled workers in our industry. The majority of the subcontractors that we deal with have also felt this pain. Unfortunately, since there is a scarcity of skilled work force, typically the subcontractor market gains employees by poaching from their competition. This, along with a historic amount of construction work over the past few years has led to labor prices increasing to historic highs. Not only are companies having to start out new employees at higher than normal wages, they are having to increase the wages of current employees just to keep them. This has had a major impact to the cost of construction.

Additionally, the supply chain has had a significant impact on the construction industry. We have many projects that have been delayed due to the availability of materials. We have seen electrical switchgear and components that typically take 6-8 weeks to deliver take anywhere from 6 to 12 months to now be delivered. HVAC equipment like roof top units typically would take 12 weeks from the time the order was placed now can take over a year to deliver. This again is a combination of parts not being available at the factory to build these HVAC units and electrical switchgear, but also labor shortages as these factories cannot find the labor to build these units. The delays have added to construction cost but have impacted schedules and the ability to complete projects.

I had one tenant that was delayed moving in for several months because part of the switchgear that we needed to complete their space wasn't available. We tried multiple avenues to find another solution, but ultimately we had to complete the project and wait until these components arrived so we could finish and have them move in.

We have another project where the roof top units were ordered on time, but the delivery date has moved multiple times to the point that it ended up delaying the completion of the project. In both of these cases it not only added to the cost of the project but we also lost revenue for the months that these projects sat without the tenants being able to move in on time.

These are only a couple of examples, but I certainly could speak all day just on the impact of these delays and the short supply of materials. The combination of the labor shortage and supply chain issues have increased construction costs nearly 40% of what we saw just two years ago. Supply chain issues will be solved and hopefully after another 6-12 months we will see that come back to normal time frames. However, we likely won't see costs return to a reasonable range, particularly in the labor market. I question the long term impact to our industry with these rising costs.

As a landlord our tenants have also had many struggles as well. We have some retail tenants that struggled when covid hit and shutdowns affected their businesses. It seems as if the labor market has not returned to the same level that it was prior to covid. For the most part their customers seem to have returned to their stores, however supply chain issues and labor costs have affected them as well. As their costs for labor and product increase significantly, they are only able to adjust their costs for their product slightly for fear of losing customers. This has led to a major reduction in their profitability. In some cases, our tenants have significant fears that they will not be able to survive and will have to shut down. Not only would it be tragic to see these businesses close, but it would also be an impact to us as their landlord. We still owe the money to the bank for the mortgage, however without a tenant in the space there would be no revenue stream for us to pay the bank back. Although there have been some grants and relief programs out there, they were only a temporary solution. The combination of inflation, supply chain issues, lack of labor and the rising cost of labor will be too much for many small businesses to overcome.

On the development side we have also seen struggles. Although we have over 900,000 sf of property already built out, we can add another 500,000 sf on the vacant land that we own. As previously stated, the rise in construction costs has made it difficult to move forward with new tenants in existing spaces or even new buildings on our vacant land. Additionally, the drastic increases in interest rates have made certain projects almost impossible to move forward.

We had been looking at a major apartment development to add market rate apartments in one of our developments. There is a housing shortage in our City and although we have built apartment buildings we don't currently own any. One of our properties has several acres where apartments would have a great benefit, especially with a current housing shortage. However, after working through estimates, looking at the rising interest rates, and running through our proformas, we have decided not to move forward with this project at this time. Unfortunately, I fear that we will see other projects from customers also go on hold or not move forward due to rising interest costs and construction costs. At this rate, it is certainly not sustainable.

At the end of the day, we still have hope that things can and will improve. We must have hope, but to us small businesses, inflation is not a political word made up to win elections. It is a real issue that we as face every day. We continue to look for ways to overcome the challenges that we face and keep moving forward. However, we need to see policies put in place that will reduce these challenges, not more restrictions that will add costs and frustration to how we operate.

Thank you again for your time and for giving me the opportunity to share with you today. I am proud of the Company I work for and the many businesses that we work with every day. I hope that my testimony today helped you understand the challenges that we face.

Committee on Small Business
Subcommittee on Oversight, Investigations, and Regulations
"Building Sustainable Businesses through Employee Ownership at SBA"
Tuesday, December 6, 2022 10:00 A.M.
2360 RHOB and Zoom

Questions for the record from Chairwoman Velázquez for Mo Manklang:

Thank you for the opportunity to address these highly important issues.

- **The Department of Treasury, CDFI Fund is soliciting comments concerning pre-approved Target Market assessment methodologies related to the CDFI certification process. Ms. Manklang can you expound on the concerns you have on how the proposed updated certification process could impact CDFI lending to co-ops?**

  The proposed CDFI Fund Target Market Assessment criteria threatens to limit a CDFIs ability to finance cooperatives that are neither in investment areas (i.e. low-income census tracts) nor majority owned by a specific "Other Target Populations" group (certain groups of BIPOC people as well as people with disabilities).. As we discuss the limitations of the SBA 7(a) program, it is vital to note that the CDFI Fund is one of the most important resources for financial products that the cooperative community is currently able to access, with at least four CDFIs established to solve for this specific capital access gap (CFNE, Shared Capital, LEAF, and Seed Commons).

  Historically, the CDFI Fund has been a critical fixture in cooperative financing. For example, since 1975 the Cooperative Fund of the Northeast (CFNE) has deployed over $80 million in loan capital and business development technical support to help small business co-ops across our region create or preserve thousands of jobs and hundreds of thousands of shared small business ownership opportunities.

  But progress was slow until CDFI funding became available. In its first 22 years, CFNE's portfolio grew to $1 million. The receipt of CDFI Fund awards starting in 1998 facilitated a 32x portfolio growth in the following 24 years, fueled in part by the CDFI Fund's certification and support. As a CDFI, CFNE is able to use underwriting criteria customized to the shared ownership structure of co-ops to not only support business launch and growth, but maintain a historic loss rate of under 1.5%. One key difference between CFNE's underwriting criteria and those of conventional lenders is that it rarely requires personal guarantees to secure its loans, instead identifying other sources of collateral, including business assets and social investments and other means of underwriting, just as cash flow analysis. It never seeks household income statements or credit checks, because it is underwriting the democratically owned co-op, not the financial state of the co-ops many owners.

People seeking (and most in need of) cooperative solutions are people who are already facing barriers to accessing small business credit due to low wealth, discrimination, and other barriers associated with:
- Personal guarantees
- Global household income statements
- Credit Checks

We have two main concerns regarding the proposed updated certification process, that will endanger an already insufficient field of options for people aiming to pursue cooperative business:

- **The proposed update to "Other Target Populations" is difficult to fulfill when there are many owners, as in a cooperative :** The OTP assessment proposal is problematic because it requires that a majority of co-op owners come from a single OTP category. Often, co-ops are comprised of people with a range of identities that fall into OTP categories, but where there isn't a majority of owners of a single OTP category. So a CDFI could be certified to finance OTP-African American and OTP-Hispanic/Latinx populations, but could not count a co-op with 40% African American owners and 40% Hispanic/Latinx owners toward its certification goals.

- **The proposed update to "Low Income Target Population" creates unnecessary and intrusive administrative burden when there are many owners, as in a cooperative:** For non-investment area non-OTP projects, the proposed assessment methodologies become overly burdensome. Co-ops are intermediaries between the CDFI and the owner-beneficiaries. Unlike financing sole proprietorships, where a CDFI likely already collects household financial information for the owner, when CDFIs finance co-ops, they underwrite the co-op's ability to repay the loan, not the individual owners' ability, and therefore have no need to collect owners' household financial data. Requiring CDFIs to collect individual household financial information for all owners (sometimes numbering in the thousands) would be exceedingly cumbersome, especially given data security issues. As a result, the burden on CDFIs and the intrusiveness into owners' personal information will result in CDFIs not financing otherwise credit-worthy, high impact LITP co-ops, thus limiting capital access for critical community development oriented businesses.

These proposed updates will effectively lock many cooperatives out of CDFI funding, wiping out one of the most accessible options for entrepreneurs looking to start a business as a cooperative, a model which has proven to be historically dependable in repaying loans. Compounded with the lack of accessible financing backed by the SBA, these regulations will greatly exacerbate an dismally limited field of options for people trying to start or convert a small business.

- **Ms. Manklang, SBA has previously offered work arounds when it comes to the personal guarantee requirement, which includes the original owner guaranteeing the loan until**

the loan is repaid or the borrowers could set up a separate entity with enough assets to guarantee the loan. Can you discuss why these two paths do not work?

SBA's recommendations for working around the personal guarantee requirement do not address the core issue at hand: with a broad base of ownership, cooperatives are an inherently different yet reliable approach to business that deserves parity with other small businesses.

In the case of an original owner guaranteeing a loan: Employee ownership is a deeply needed solution to a critical issue facing SBA: the wave of Baby Boomer business owners who will retire and transfer their business. In most cases of business transition, an original owner is likely not to be a part of the ultimate ownership structure after the transition, so it is unreasonable to impose financial risk for a business that the original owner may not be involved in. Additionally, it is antithetical to the "one-member-one-vote" structure of cooperatives to require a financial burden of one person.

In the case of setting up a separate entity with enough assets to guarantee the loan: The median size of a worker cooperative has 6 owners. While the creation of a separate entity has worked for an Employee Ownership Trust with hundreds or thousands of members, it is not feasible for a small, startup or growing business to set up a separate entity solely for the purpose of guaranteeing a loan. This would create unnecessary burden for these entrepreneurs, both administratively and financially, and pull focus from the work of their American dream.

Every day, the USFWC works with small business owners and entrepreneurs who are locked out of access to resources from the very entity that was created to help them start, grow, and expand. Cooperatives boast higher pay, job security, and better benefits – a triple win for business owners. They are looking simply for parity with other small businesses - we call upon SBA to address the unmet needs of this swiftly growing sector.

Committee on Small Business
Subcommittee on Oversight, Investigations, and Regulations
"Building Sustainable Businesses through Employee Ownership at SBA"
Tuesday, December 6, 2022 10:00 A.M.
2360 RHOB and Zoom

Questions for the record from Chairwoman Velázquez for Corey Rosen:

- Mr. Rosen, the Main Street Employee Ownership Act envisioned ESOP loans to be processed under the Preferred Lender's Program instead of going through SBA's Loan Guaranty Processing Center for approval. Can you explain the risk to borrowers in waiting for loans that have to be processed by the SBA's Loan Guaranty Processing Center?

The difficulty here is that to being able to go through the preferred lenders program creates delays in getting a loan approved and adds additional bureaucratic requirements. Many banks in the preferred lender program are familiar with ESOPs and have made loans to ESOPs before and would make more with the guarantee; the SBA has little experience with these loans and its history on ESOPs has suggested it is not very favorable towards the idea. The MSEOA was mean to make it easier to get these loans, not harder.

- The SBA's 7(a) loan guarantee program is an important tool to support increased private lending to small and underserved businesses. Mr. Rosen, can you detail how the 7(a) program can provide the assurances to sellers to increase ESOP transfer of ownership transactions?

When an owner of a closely held company wants to sell to an ESOP, senior debt from banks is the most favorable debt that can be obtained. But these lenders will limit what they will lend to available collateral plus, in some cases, some additional credit for expected future income. For an owner who wants to sell just part of the company, this usually is enough. But if the owner wants to sell most or all of the company, as is more commonly the case, the gap in financing has to be filled either with seller notes paid off over several years and/or much more expensive mezzanine debt. The former means the seller will have to wait several years to be paid and adds uncertainty to the deal; the latter makes the deal much more costly. In light of this, some owners choose to sell instead to another buyer, such as private equity or a competitor, rather than an ESOP. The idea of the MSEOA was to provide loan guarantees that increase the availablility of senior debt that gets the company the needed funds up front at a reasonable cost. This could make an important difference for many owners and convince them an ESOP is the right path.

- Mr. Rosen, if the SBA were to fully implement the changes proposed in the Main Street Employee Ownership 2.0 Act of 2022, how many companies do you think might seek SBA financing?

It is impossible to know just how many more deals would be done. But in talking to advisors who set up these deals, it seems reasonable to expect another 25-50 deals per year as a result of making the financing more available.

- Mr. Rosen, you have argued the outreach piece of the Main Street Employee Ownership Act of 2018 is the most important element of the bill. Can you elaborate on how that might work? Maybe give an example?

Many more deals would get done even without SBA financing (they may be too large or the sellers opt for other financing) if owners of companies that make good ESOP candidates simply knew that an ESOP is a good option. Very few business owners do. That is why one of the main goals of the MSEOA was to create an SBA outreach program. This should be a simple task. There are many non-profit organizations that can provide materials, arrange speakers for meetings, and answer questions from potential ESOP companies. The SBA education network has great contacts, and regularly provides education on a variety of issues. By including ESOPs and worker cooperatives into the mix of information that is provided, I am convinced many companies would become employee owned without any further involvement form the government.

Let's say a business owner wants to sell her company and goes to her accountant to get ideas. Most accountants are not familiar with ESOPs and won't suggest the idea. But if she asks about it, if the accountant is not familiar with the idea, the accountant may steer her away. There is a natural tendency to think that ideas you do not know much about are probably not good ideas. And some accountants may think that because they do not know much about ESOPs, sellers will seek another advisor if they go down the ESOP path. If sellers go to a business broker or M&A firm, they actually have a disincentive to tell her about ESOPs because they make their money from a commission (called a success fee in many deals) they earn by finding a buyer. If sellers approache them with the idea of an ESOP, it is hard for them to then charge a 2% to 5% of the deal fee for "finding a buyer."

Questions for the record from Congresswoman Houlahan for Corey Rosen:

Recently the SBA proposed a rule to remove the restriction for individuals to utilize the 7(a) program to acquire partial ownership of a business. The preamble to the rule seems to indicate that the costs of ESOP formation and remaining in compliance with federal regulations creates a barrier for small business participation, and that is why SBA's 7(a) loan numbers in this space are so low.

- Do you agree with SBA's assessment of the problem causing their woeful lending record to ESOPs?

Unfortunately, The SBA's take on employee ownership in this proposed rule suggests they the agency has a poor understanding of both ESOPs and employee ownership in general. The proposal suggests that it would be cheaper and simpler for a few employees to simply buy the company themselves, perhaps with SBA support.

Let's consider a hypothetical example. Bill wants to sell his 40-employee company. Sally, Alan, and Eric, three managers, would like to buy it. None of them has substantial savings, but they are will to take on debt for most of the deal. They approach banks but banks want collateral—much more than most people in their position would have.

The business has been appraised at $3 million. Bill offers to take a note for the sale for $1 million each from each buyer. Bill will pay capital gains taxes on the sale. Because the money to repay the principal on the note is not tax-deductible, the three managers will have to come up with roughly $4-4.5 million, depending on their tax brackets, to have $3 million left over after taxes. In addition, there will be transaction costs for legal documents, the appraisal, and accounting. They will be substantially less than an ESOP, but will not come close to outweighing the tax savings an ESOP would provide.

Now consider an ESOP. Bill can defer taxes on the gain from the sale by reinvesting in other companies. The company will buy the shares out of future tax-deductible dollars, so the $3 million sale will cost $3 million, not $4 to $4.5 million. Transaction costs will be about $100,000 to $200,000. The transaction costs may be many tens of thousands of dollars higher, and the time to do the deal longer, but the net financial effect will be vastly better with an ESOP.

The SBA's argument does make sense for very small transactions, typically under 20 employees, where an ESOP usually does not pencil out, although a worker cooperative cold be an alternative. But for deals larger than that, an ESOP makes much more financial sense.

- Follow-up: Can you expound on whether this proposed rule will actually expand employee ownership, or is it just another way to deflect addressing the real issues with the ESOPs and the 7(a) program?

This rule does not help broad-based employee ownership at all. It may encourage a small number companies to be sold to individual employees, but even with SBA support, buying a company with your own money is a risk much larger than all but a very small number of people will be willing to undertake.

Committee on Small Business
Subcommittee on Oversight, Investigations, and Regulations
"Building Sustainable Businesses through Employee Ownership at SBA"
Tuesday, December 6, 2022 10:00 A.M.
2360 RHOB and Zoom

Questions for the record from Chairwoman Velázquez for Keith Butcher:

- Mr. Butcher, currently SBIC's are involved in ESOP deals that are in the $50 to $70 million dollar range. How can SBA tailor its programs to try to get more interest by investors, especially from impact investors, to invest in ESOP deals for small and underserved businesses?

  First, I would propose a special SBIC license that focuses on fund managers who are committed to smaller businesses. This would target funds that have maximum $25 million in private LP capital and get 2x leverage from SBIC. So, total fund size $75mm. Additionally, there would need to be requirements for LMI and BIPOC focused investing (with required impact reporting). The smaller fund size would be ideal for a large portion of the impact investing community because they tend to commit smaller total investments ($1-3 million). If there was a SBIC model designed for their investment, I believe they would embrace those investors.
  Second, we need 7(a) to work for ESOPs, because the smaller transactions need a better senior debt funding source. The 7(a) program is exactly the right partner for the new SBIC program initiative I outline above. Also, it would be helpful if 7(a) for ESOP purposes would go up to $10mm instead of the existing $5mm. If you consider a smaller transaction ($20 million)), it would be ideal to fund that with $10 million 7(a) Senior, $5-8 million SBIC and the remainder in some seller rollover participation.
  Third, some type of incentive to hit impact goals would help to align/incent fund managers. Perhaps a break in debenture interest based on certain impact goals?

  In summary, I believe there is a devoted group of investment professionals who would love to support smaller transactions. However, they need access to capital. A solution is a combination of SBIC funds and SBA 7(a) working together to fund those deals. If that capital/structure were available, the impact investing community would certainly embrace it.

- The Main Street 2.0 Act proposes to prohibit SBA from requiring ESOPs and co-ops to submit a determination letter from the IRS or Department of Treasury, or to submit a second valuation if they already have one in order to qualify for a 7(a) loan. Mr. Butcher can you explain why these current requirements are not needed, and how this chance could help streamline transfer of ownership transactions

  First, although it might seem counter-intuitive, a determination from the IRS is never received prior to closing. In reality, a transaction is closed, the ESOP is put in place and then the sponsor (company) submits the ESOP plan documents to the IRS for a determination letter. The letter typically is received 9-12 months after closing. So, for practical purposes you cannot impose this requirement as no transaction would ever close because the parties would never wait 9-12 months to close their transaction.

Second, there is no need for a "SBA valuation" because the ESOP trust has a requirement to never pay more than adequate consideration (basically, fair market value). As such, every trustee hires a valuation advisor to complete a valuation of the company and to provide a fairness opinion at closing. This valuation report is significantly more comprehensive than anything SBA would require. Because of this, an additional SBA related valuation is completely unnecessary and adds expense.

Questions for the record from Congresswoman Houlahan for Keith Butcher:

As an entrepreneur by background, I understand the vast benefits of employee ownership and its unique impact on workers and communities. I was again reminded of the importance of employee ownership during a recent roundtable with the Stakeholder Capitalism Caucus, which I co-chair with Subcommittee Chairman Phillips. During this discussion, we were joined by The Standard Group, a print management and marketing logistics company located in my district in Reading, Pennsylvania. The company transitioned to being employee-owned in 2017, over a century after its founding. This transition allowed its workers to continue its legacy under its new ESOP structure and begin to experience the many varied benefits of this business model.

The Standard Group's successful transition underscores the importance of ensuring all businesses have the tools, knowledge, and access they need to transition to employee-owned models, especially amid the silver tsunami.

- Mr. Butcher, Unfortunately, we have seen how many businesses struggle with pursuing SBA 7(a) loans to finance the transition to employee ownership. Can you share more about your personal experience and difficulties in trying to complete an ESOP deal using the 7(a) program? What are the factors that led you to look towards other sources of funding?

  We have never seriously pursued using 7(a) as a funding source for ESOP transactions. In 2012, we had an existing client who was a government contractor and wanted to use the program. We helped them manage thru the process. To say it was difficult, time consuming, and impractical does not remotely do it justice. It was ridiculous. In this circumstance, the company had a set of underlying facts which enabled it to qualify for the program as it existed at that time (pre-Main Street legislation). Additionally, the company was a government contractor by trade. As a result, they were patient with the process and just wanted to see it thru. In 25 years of practice, I have never met another client who had the intellectual curiosity to see a government process in action and doubt I will meet another. But, we got it done. That is our sole experience with the program.

  After this experience, we decided that the program was not practical and focused on the traditional market. In addition, we have avoided smaller companies because the banking market for them is not feasible (without 7a).

  Finally, we had some hope after the Main Street legislation passed as it addressed many of the practical concerns we had with the program (in fact we provided input into the drafting). Unfortunately, the program has not changed. So, we remain an interested party, but we cannot commit resources to growing small business ESOPs until we see proof that 7(a) truly works.

Bipartisan Policy Center

December 2, 2022

The Honorable Dean Phillips
Chairman
Committee on Small Business
Subcommittee on Oversight,
Investigations, and Regulations
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Beth Van Duyne
Ranking Member
Committee on Small Business
Subcommittee on Oversight,
Investigations, and Regulations
U.S. House of Representatives
2069 Rayburn House Office Building
Washington, DC 20515

Letter for the Record: House Committee on Small Business, Subcommittee on Oversight, Investigations, and Regulations Hearing, "Building Sustainable Businesses through Employee Ownership at SBA"

Dear Chairman Phillips and Ranking Member Van Duyne,

Employee-owned businesses comprise a vibrant and important share of all employer businesses in the United States. Research has found, for example, that workers at these businesses often have greater retirement security, household wealth, and wages than other workers. Approximately 6,500 businesses owned through an employee stock option plan (ESOP) structure—the most common type of employee ownership—employ 14 million or so Americans. Yet the landscape of employee ownership is as varied and diverse as the world of small business. Congressional attention on this important part of the small business economy is warranted, as are potential actions to support its growth.

The Committee's hearing on December 6, 2022, provides members a needed opportunity to learn more about the challenges employee-owned businesses face in accessing capital from the Small Business Administration (SBA) that remain unresolved since passage of the bipartisan Main Street Ownership Act in 2018. Some of these challenges were highlighted recently in a proposed rule issued by SBA, in which the agency stated that only 17 of 31,940 7(a) loan guarantees used to affect a change of business ownership involved ESOPs.

As American business owners age, it becomes more important than ever that there are clear and simple ways for retiring business owners to transfer ownership of their business to their employees, if they wish. Half of all owners of employer businesses are near or at retirement age, with one in five owners of employer firms being 65 years old or older. In rural communities, the issue of business succession is often even more salient.

With bipartisan support, Congress intended to facilitate business ownership to employees through the Main Street Employee Ownership Act. Efforts to see that intent realized should also receive bipartisan backing and see congressional action soon.

IDEAS. ACTION. RESULTS.

Owning one's own business is something many Americans aspire to. We applaud the Committee's work to give more workers a share in the businesses they help make successful by creating pathways for greater employee ownership.

Sincerely,

Dane Stangler
Director of Strategic Initiatives
Bipartisan Policy Center

California Center for Cooperation Development
979 F St, Suite A-1, Davis, CA 95616
T: (530) 297-1032 F: (530) 297-1033
Email: coops@cccd.coop Web: www.cccd.coop

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of the California Center for Cooperative Development, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

In California, worker ownership has been a crucial strategy to create job security and increased compensation in jobs that do not usually have those characteristics. Worker cooperatives organized in the cleaning industry, offering in-home support services, and farms organized as worker cooperatives provided empowering, good jobs for people of color and others who often lack such opportunities. The model has also saved local jobs by enabling the opportunity for business to continue by selling to their employees.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

In Cooperation,

E. Kim Coontz

E. Kim Coontz
Executive Director

CooperationWorks!
THE COOPERATIVE DEVELOPMENT NETWORK

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of CooperationWorks (CW), we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

As the national network of cooperative developers, CW supports the development and growth of cooperatives across the United States. Worker ownership protects jobs, grows local wealth, and builds stronger communities. Our members work with new and converting worker cooperatives in many industries to support the growth of small businesses.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

In Cooperation,

Alexandra L Stone

Alexandra Stone
Executive Director
CooperationWorks!

CDS | Cooperative Development Services
Where cooperation is at work, communities prosper.

TO: The House Committee on Small Business Subcommittee on Oversight, Investigations, and Regulations

FROM: Kevin Edberg, Executive Director

DATE: December 12, 2022

RE: Comments on the Small Business Committee hearing: "Building Sustainable Businesses through Employee Ownership at SBA"

On behalf of Cooperative Development Services (CDS), a Cooperative Development Center in the Upper Midwest, we are writing to express our support of employee ownership, in particular worker cooperatives (co-ops) - a highly underserved sector of the small business community, to advocate for access to the vital benefits the Administration offers to all other small businesses.

CDS has served those seeking to start and develop cooperatives since 1985. While we primarily serve Wisconsin, Minnesota, and Iowa, we also work on a nationwide basis. In our 37 of experience, we have never seen such an increase in the interest of a sector of cooperatives as we have with worker co-ops in recent years. The volume of inquires has been overwhelming, so much so, our development center has hired a new staff person to meet this need.

Worker co-ops are the fastest growing sector of cooperatives in the country and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing eight workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee-owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations Subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and worker-ownership across the United States.

Cooperative Development Services, 997 Ticonderoga Trail, Eagan, MN 55123
www.cdsus.coop | 651-265-3678

CFNE
FUNDING THE FUTURE

COOPERATIVE FUND OF THE NORTHEAST
P.O. Box 970, Watertown, MA 02471 • 800-818-7833
www.coopfund.coop • cfne@cooperativefund.org

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"

December 2022

On behalf of the Cooperative Fund of the Northeast (CFNE), I am writing to express our support of employee ownership, a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Since 1975, CFNE has deployed over $80 million in loan capital and business development technical support to help small business co-ops across our region create and preserve thousands of jobs and hundreds of thousands of shared small business ownership opportunities. With assets over $45 million and a $32 million loan portfolio, including 140 active loans, and a 99% repayment rate, CFNE has significant and growing experience deploying and managing public and private resources to cooperative enterprises- and all without requiring personal guarantees. Our activity in 2022 has set new organizational records for loan volume deployment, reaching over $10 million year to date, and on track to deploy almost $12 million by the end of the year- 50% more than our previous high. This is just one reflection of the growing interest in cooperative business to meet varying community needs, including the small business succession crisis, the lack of decent jobs in many underserved communities, and the lack of affordable healthy food in "food deserts".

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Thank you for your consideration,

Micha Josephy

Micha Josephy
Executive Director

Current barriers of access for use of SBA lending for conversion to an ESOP.

The original MSEO Act of 2018 was an effort to make SBA lending more accessible to employee-owned entities. There were several changes that should have been impactful and more inclusive, however, as shown by the small number of ESOPs that have been funded since that time, it is clear that more considerations are needed to encourage more participation.

Barriers:

1. **Equity Injection requirement**

SBA rules for a change of ownership require a minimum of 10% equity of all project costs (cost of changing ownership) allowing 5% from a seller note and 5% from a different source as shown in the SOP (see below). There are no specific rules set aside for employee-owned entities. Of the four equity injection options, only one may be viable but is highly unlikely: (a)Cash that is not borrowed-ESOP has no cash, (b)Cash borrowed as a personal loan (not an option for the ESOP trust) (c) assets other than cash- all the assets are included in the valuation and unavailable for equity consideration, (d) Standby debt from a third party other than the seller-this is the only option that is reasonable but it is difficult to find a third party willing to accept the SBA standby terms.

Under the current SBA rules, there will always be an equity gap that is difficult to fill because only half of the equity can be provided by a seller note and the ESOP trust does not have its own equity to contribute. Allowing the full equity requirement to come from a seller note (with a shortened standby term) or waiving the equity requirement or even allowing the lender to determine an appropriate equity structure based on prudent lending practices, would allow more ESOP transactions to be financed with an SBA 7(a) loan.

Current SBA Equity Injection Requirements for changes of ownership:

Resulting in a new owner (complete change of ownership): At a minimum, SBA considers an equity injection of at least 10 percent of the total project costs (all costs required to complete the change of ownership, regardless of the source of funds) to be necessary for such transactions. Seller debt may not be considered as part of the equity injection unless it is on full standby for the life of the SBA loan and it does not exceed half of the required equity injection;

In the event the Lender is unable to document that both (i) and (ii) above are satisfied, the remaining owner(s) must contribute cash in the amount of at least 10% of the purchase price of the business, as reflected in the purchase and sale agreement

a) Source of Equity Injection:

   i) The following may be considered as equity injection:

      (a) Cash that is not borrowed.

      (b) Cash that is borrowed through a personal loan to the business owner with repayment demonstrated to come from a source other than the cash flow of the business (the salary paid to the owner by the business does not qualify). If the personal loan is made by the participating Lender, the Lender must submit the application through non-delegated 7(a) processing.

(c) Assets other than Cash – Lenders must carefully evaluate the value of assets other than cash that are injected by owners. An appraisal or other valuation by an independent third party is required if the valuation of the fixed assets is greater than the Net Book Value. A valuation of the fixed assets provided as part of a business valuation will not meet these requirements.

(d) Standby debt – Only debt that is on full standby (no payments of principal or interest for the term of the SBA-guaranteed loan) may be considered as equity for SBA's purposes. A copy of the note must be attached to the standby agreement.

2. IRS Determination letter

SBA rules state the funds cannot be disbursed to the ESOP trust until the IRS determination letter has been received, acknowledging that the ESOP meets IRS requirements. Waiting for this letter can cause significant delays as it can take many months for the IRS to process this letter. ESOP formation is a complicated and timely process that can be difficult to manage and become a deterrent to using an SBA financing. An opinion letter from an ESOP attorney could provide the same assurance to the SBA and lender.

SBA lenders need to have clarification that an attorney opinion is acceptable and the actual IRS Determination letter is not required prior to disbursement.

Current SBA requirement regarding IRS determinations letters for ESOP loans is:

Prior to first disbursement, the Lender must obtain documentation that the ESOP or equivalent trust meets the requirements of all applicable IRS, Treasury, and Department of Labor regulations.

KDC
Cooperative Solutions

Keystone Development Center, Inc.
201 S. Blakely Street, #233
Dunmore, Pennsylvania 18512
PH:717-792-2163

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of Keystone Development Center (KDC), we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Since 1999, KDC has continued to provide key technical assistance services to a growing network of cooperative businesses in PA, NJ, MD, and DE. From our experience, we can confidently say that employee ownership provides meaningful opportunities for workers while helping to stabilize local economies. This is especially important given the fact that Baby Boomers are soon to retire en masse, and it is crucial to begin preparing for the shift. Worker cooperatives are a means for retiring business owners to preserve their legacies by keeping their doors open and transitioning ownership to their employees. Employees, in turn, benefit from shared ownership in a business, continued employment, and democratic control in their workplace. The government can play a vital role in supporting these transitions.

Worker co-ops are the fastest growing sector of cooperatives in the country and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in vulnerable industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

Keystone Development Center, Inc.
201 S. Blakely Street, #233
Dunmore, Pennsylvania 18512
PH:717-792-2163

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee-owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs.

On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Sincerely,

Mary Ann Iezzi

Mary Ann Iezzi,
Executive Director
Email: maryann@kdc.coop / ed@kdc.coop

NCBA CLUSA
The National Cooperative Business Association • CLUSA International

Testimony of Doug O'Brien
President and CEO, National Cooperative Business Association CLUSA
House Committee on Small Business
Subcommittee on Oversight, Investigations, and Regulation
Hearing on "Building Sustainable Businesses through Employee Ownership at SBA"

Chairman Phillips, Ranking Member Van Duyne, and Members of the Subcommittee, thank you for the opportunity to provide written testimony for the hearing, "Building Sustainable Businesses through Employee Ownership at SBA."

The National Cooperative Business Association CLUSA International (NCBA CLUSA) is the apex trade association for cooperatives across all sectors of the U.S. economy, including worker cooperatives, consumer food cooperatives, and credit unions, all of which have an important role in the conversation of access to capital for cooperatives.

The issue of employee ownership is timely and critical to the future health of our economy and local communities. More and more people are looking to the cooperative business model as a key strategy to establish and maintain small businesses in their communities - including Baby Boomers looking for options to sell their businesses and workers interested in having a stake in their business and the local economy. We also see more people coming together to form new businesses of nearly every type by utilizing the cooperative business model so workers can own, control, and benefit from the businesses they work for. One of the biggest hurdles these small business owners and workers face is an unfriendly policy environment, including the lack of access to SBA loan programs.

First, NCBA CLUSA would like to express our appreciation for the work of the House Small Business Committee—and especially that of Chairwoman Velázquez and her staff— for ensuring that cooperative businesses were eligible for primary small business disaster relief programs in response to the COVID-19 pandemic through the CARES Act. Expressly including cooperatives in both the Economic Injury Disaster Loan and Grant program and the Paycheck Protection Program brought certainty to thousands of cooperative small businesses. Over 3,000 cooperatives accessed these programs, providing over $1.2 billion in direct assistance to maintain operations and make necessary adaptations to keep more than 1.2 million people employed.

These programs also revealed the inconsistencies and lack of institutional knowledge of cooperatives held by the U.S. Small Business Administration. While ultimately resolved, scores of cooperative businesses faced delays or undue denials in their applications due to a lack of awareness as well as incompatible SBA processes and forms for. Excluding these disaster programs, NCBA CLUSA is aware of just one loan guarantee that SBA has administered to a cooperative business, which occurred in 2020. The Main Street Employee Ownership of 2022 and Improving SBA Engagement on Employee Ownership Acts, introduced by Chairwoman Velasquez and Subcommittee Chairman Phillips, would address the longstanding issues that the cooperative community has faced within SBA lending programs and improve efforts to engage with the Agency.

One in three Americans is a member-owner of at least one cooperative business, but membership is unevenly distributed across types of cooperatives and sectors of the economy. This is in large part due to policy scaffolding around each sector. For example, 125 million member-owners access safe, affordable financial services through their local credit union. Products produced by farmer cooperatives are household names like Organic Valley, Cabot Creamery, Ocean Spray, and Sunkist. And more than 20 million households, businesses, and schools receive electricity as member-owners of their electric cooperative. Despite the presence and success of cooperatives for more than 100 years in the United States, the U.S. Small Business Administration has failed to incorporate its products and services to include this business model.

The testimony from the U.S. Federation of Worker Cooperatives (USFWC) detailed the issues that worker cooperatives face in gaining start-up funds through federal programs intended to support small businesses. Worker Co-ops across the country are not able to access capital at SBA because no single member-owner owns at least 20 percent of the business. As USFWC and other co-ops have indicated, it would be immensely helpful to access traditional, affordable, and safe forms of capital like the programs offered by SBA. The cooperative structure should not prevent businesses from attaining that goal. This lack of access at SBA demonstrates why, unlike other sectors, there are only 612 worker cooperatives in the United States[1] compared to cooperatives in other sectors that have gone to scale.

Worker cooperatives are the exact type of business that SBA should be reaching. Worker cooperative ownership creates paths to economic mobility that may otherwise be unattainable by a single aspiring entrepreneur. Cooperatives form primarily for one of three reasons:

- To address market failures where neither the private sector nor government provides a needed service
- To help small players gain parity with large investor-owned competitors
- To give consumers a deliberate choice of business to better meet their common needs and aspirations

Member-owners of cooperatives have 'skin in the game' both through personal financial investment in the business and a desire to ensure a long-term solution to the aforementioned challenges to improve quality of life. As a result, worker cooperatives enjoy five percent higher productivity levels than traditional businesses, are two-thirds more likely to succeed than the average business, offer higher pay, and have more satisfied employees.

Cooperatives also enjoy lower worker turnover than average businesses by a margin of at least 35 percent. Many co-ops institute workforce development programs that help employees build new skill sets and continue to grow and innovate within the cooperative. As member-owners, people also work with the co-op's finances and have a voice in governing the co-op's path forward.

The United States is in a unique moment where workers across the country are seeking to form cooperatives at rapidly increasing rates. It is critical that SBA provides a level playing field to cooperative start-ups. In addition to supporting start-up cooperatives, access to capital at SBA

[1] Democracy at Work Institute, State of the Sector Report 2021.

could also help to prevent thousands of small business closures as America's largest generation approaches retirement. According to the U.S. Census, 74.9 million people, or 40 percent of the U.S. population, are Baby Boomers, and over the next decade, 10,000 individuals will turn 65 every day. Over half of all small businesses across the county are owned by these individuals who are fast approaching retirement. While some owners may choose to simply close their business, a better option – for the owner, the workers, and the community the business has served – is to convert the ownership of the business to a cooperative. Converting to cooperative ownership ensures that not only the owner earns the profits of their hard work but ensures that the goods and services provided by this business are still available to the community. In many cases, the employees or the business's consumers who have helped build the success of the business over its lifetime are best positioned to become the next generation of owners.

In 2018, House Small Business Committee led the effort to pass the bipartisan Main Street Employee Ownership Act that asked SBA to identify and recommend practical alternatives to the agency's underwriting criteria so that cooperatives could participate—notably, this centered on SBA's use of personal and entity guarantees. Unfortunately, SBA published a disappointing report to Congress that failed to recommend any alternatives to allow cooperatives to participate in SBA programs.

For this reason, the Main Street 2.0 and Improving SBA Engagement Act are welcomed by the cooperative community. These two pieces of legislation would require SBA to take the actions intended by the Main Street Employee Ownership Act by removing barriers such as a personal or entity loan guarantee, making cooperatives eligible for disaster relief programs, and requiring SBA to engage with the cooperative community and create shared solutions to strengthen local economies across the country.

Small business owners and workers face an amazing opportunity with the potential growth of worker cooperatives. To help people capture this opportunity, we strongly believe the most important thing Congress can do is ensure that cooperatives have access to SBA lending programs. NCBA CLUSA urges Congress, in the strongest terms, to level the playing for cooperative businesses at SBA so that these businesses owned by people in the community have an opportunity to thrive.

NCBA CLUSA appreciates the Committee's continued attention to this important issue. Cooperatives are a tested model for building a more resilient, inclusive, and sustainable economy and will be an integral component of our nation's recovery in the face of economic strife. We look forward to continuing to work closely with the Committee and SBA to help make dreams of entrepreneurship possible for more people through cooperatives.

ownership
AMERICA

The Honorable Dean Phillips
Chairman
Committee on Small Business
Subcommittee on Oversight,
Investigations, and Regulations
U.S. House of Representatives
2361 Rayburn House Office Building
Washington, DC 20515

The Honorable Beth Van Duyne
Ranking Member
Committee on Small Business
Subcommittee on Oversight,
Investigations, and Regulations
U.S. House of Representatives
2069 Rayburn House Office Building
Washington, DC 20515

Letter for the Record: House Committee on Small Business, Subcommittee on Oversight, Investigations, and Regulations Hearing, "Building Sustainable Businesses through Employee Ownership at SBA"

INTRODUCTION

Ownership America Education Fund is a 501(c)(3) organization committed to accelerating the growth of employee ownership.The bipartisan roots and policy rationales for employee ownership first entered federal law in 1973 through the Employee Retirement Income Security Act (ERISA) championed by Senator Russell Long (D-LA). Employee ownership has a decades-long track record of creating significant social and economic value for workers, local communities including rural areas, and the financial bottom line. These economic benefits are exceptionally significant for low and moderate-income workers including workers of color. Employee-owned businesses have been demonstrated to generate 2.5 times more retirement wealth for workers compared to conventional companies, and have also been shown to grow faster, innovate more frequently, enjoy higher productivity, lay off fewer workers during economic downturns including COVID-19, and provide superior pay and benefits including an ownership stake that significantly supplements other retirement income.

Employee ownership is also a particularly effective tool in strengthening and retaining the domestic manufacturing base (the manufacturing sector has produced more ESOP companies than any other industry) and ensuring that American industry remains globally competitive. Finally, employee ownership is also an effective policy prescription at the regional level; employee-owned companies increase the retention rate of local business ownership while simultaneously building wealth for workers in economically distressed areas that frequently struggle to attract sufficient levels of private investment to keep their economies thriving.

While tax incentives for selling owners have helped to produce modest levels of employee ownership in the U.S. economy, employee ownership remains a peripheral phenomenon. Only about 3 million workers across roughly 6,000 privately held companies currently have access to significant broad-based ownership stakes—a figure that excludes public companies that are typically 1 to 5 percent ESOP-owned. A key barrier preventing further adoption and scale of the employee ownership model is capital to facilitate the voluntary sale of businesses from selling owners to their employees.

THE MAIN STREET EMPLOYEE OWNERSHIP ACT OF 2018
BARRIERS TO SUCCESS:

The Main Street Employee Ownership Act of 2018 secured a key bipartisan precedent in directing the SBA to engage in financing support of ESOPs and worker cooperatives through the 7(a) program and public outreach related to employee ownership. By enabling conversion transactions for both structures through the 7(a) program, Congress intended to provide critical financing support for the smallest businesses that otherwise would struggle to attract bank financing to facilitate a sale of a privately held business to employees via an ESOP or worker cooperative.

However, the implementation of the law has fallen short of Congressional objectives. Since the enactment of the legislation, SBA has reported that only seventeen ESOP transactions have been supported through the 7(a) program; the number of worker cooperative transactions is even lower. The barriers preventing the realization of congressional aims are well-known by the employee ownership field, especially the four key barriers outlined by Mr. Corey Rosen of the National Center for Employee Ownership in his testimony before the Committee. These barriers include:

1. The inability to approve ESOP loans through the Preferred Lender's Program, despite many national commercial banks possessing in-house expertise through dedicated ESOP lending divisions;

2. The requirement that a change of control transaction include an unrealistic equity position outside of the ESOP by virtue of the 10% percent equity injection requirement;

3. SBA policy that an ESOP loan cannot be disbursed until the IRS determination letter has been issued and received from the IRS indicating that the ESOP qualifies under the Internal Revenue Code, which adds prohibitive delays; and

4. The duplicative requirement by SBA to require its own valuation for every ESOP transaction despite an annual valuation requirement under the Employee Income Retirement Security Act (ERISA) of 1974.

In addition to these implementation barriers above, the SBA requirement that worker cooperative transactions must include a personal guaranty is incompatible with the nature of the structure and bypasses alternative proven underwriting methods. Since nearly all worker cooperative transactions rely upon substantial seller financing, these sellers already have "skin in the game" since these seller notes are subordinate to the 7(a) guaranteed bank loan. Collectively, these implementation decisions have stymied the congressional intent of the Main Street Employee Ownership Act of 2018. Until each are addressed, this law will remain a disappointing missed opportunity with respect to supporting employee ownership conversions among the smallest segment of the small business spectrum.

EMPLOYEE OWNERSHIP AT SBA: A TWO-PRONGED APPROACH

While addressing the above implementation barriers with the Main Street Employee Ownership Act of 2018 is necessary, it is not sufficient in meeting the financing needs of small businesses contemplating a sale to an ESOP or worker cooperative. Given that prospective employee owners generally have limited equity capital to initiate their purchase of the selling business owner's interests, transactions that would create meaningful employee ownership are often dependent upon a combination of 1) bank leverage using company assets as collateral and 2) sellers taking back substantial subordinated, long-term notes. The seller in these transactions must often wait for five to ten years to fully realize the cash proceeds of the sale of their business to employees, which is often viewed by the seller as unacceptable–as a result, the overwhelming majority of both ESOP and worker cooperative transactions rely upon relatively narrow segment of selling owners that are willing to self-finance a significant part of the transaction. The Main Street Act would mitigate the over-reliance on seller financing for the smallest segment of the small business size spectrum, but the 7(a) loan guarantee program has a maximum of $5 million per transaction. Additional credit enhancement tools are needed order for employee ownership to be a viable succession option for larger businesses:

Specifically, the larger end of the small business spectrum requires subordinated or "mezzanine" debt in addition to conventional bank financing in order to provide the seller with liquidity in a sale. This type of subordinated debt investing is exactly what the Small Business Investment Company (SBIC) program already supports. Unlike the 7(a) program, the SBA loan guarantee for SBIC effectively operates at the fund level through the provision of low-cost SBA-backed debentures. These funds can raise tens (and sometimes hundreds) of millions of dollars in private capital which is then multiplied by SBA-backed debt. **This kind of scaled capital is exactly the kind of financing needed to provide selling owners full liquidity for an ESOP or worker co-op.** Such a fit is also evidenced by the participation of Mosaic Capital Partners in the SBIC program; however, it is the only ESOP fund of its kind with an SBIC license.

EMPLOYEE OWNERSHIP SIZE CONSIDERATIONS

Enterprise Value	Employment Count Range	Appropriate SBA Tool
$2M to $15M	10 to 30	7(a) / Main Street Act
$30 to $80M	100 to 200	SBIC
> $80M	200+	No existing tools

7(a) loans are fundamentally not designed to fill the kind of subordinated debt/mezzanine capital gap that is currently inhibiting the adoption of employee ownership for small businesses beyond the $15M in enterprise value. The larger and more valuable the business, 1) the more capital is needed to finance its sale to employees, 2) the more federal credit enhancement is required to make such a transaction viable, and 3) the more essential it becomes to be able to provide the seller liquidity at closing (in part through the credit enhancement) because that seller will have other exit alternatives that are not a sale to employees.

CONCLUSION

In summary, there are two key dynamics with credit enhancement in an employee ownership context that make it distinct from traditional small business credit enhancement:

1. **The larger the company, the *more* federal intervention is required to make employee ownership possible because larger companies will have more M&A alternatives.**

2. **While the 7(a) and SBIC program channel federal loan guarantees through commercial banks and licensed private investment funds, respectively, *it is the individual employees that are the functional end-recipients of the credit enhancement.* Workers have the capital to buy companies whether those companies are small or large.**

These dynamics necessitate a rethinking of business size considerations in the context of employee ownership. Loan guarantees are functionally enhancing the household balance sheets of individual workers in order for those workers to benefit from asset ownership through a stake in business where they work that otherwise would not be available to them. By leveraging a number of tools at SBA including the 7(a) program and SBIC programs and perhaps new additional capabilities in the future, SBA can play a catalyzing role in enabling a more broadly prosperous, dynamic, and inclusive American small business sector.

Respectfully,

Jack Moriarty
Founder and Executive Director
Ownership America Education Fund, Inc.

Submitted Comments of R.L. Condra

Senior Vice President of Government Relations

National Cooperative Bank

The Small Business Subcommittee on Oversight, Investigations, and Regulations

Hearing titled: "Building Sustainable Businesses through Employee Ownership at SBA."

December 12, 2022

Submitted Comments of R.L. Condra
Senior Vice President of Government Relations
National Cooperative Bank

Chairwoman Velázquez, Ranking Member Luetkemeyer and members of the Committee.

I had the honor of testifying twice on this issue in 2019 and 2021 and would like to thank the Committee's continuing interest regarding the Small Business Administration's (SBA) inability to provide cooperative businesses access to its lending programs.

Is there anything more gratifying than becoming a small business owner? During the Covid 19 pandemic, haven't we learned how essential grocery stores and small businesses are to our communities?

Unfortunately, the SBA, the federal agency that oversees small business assistance and growth continues to block cooperative businesses and their tens of thousands of jobs from being created. To be clear: cooperative businesses should have the same opportunities, service and financial products as other SBA borrowers.

There are over 65,000 cooperatives in the US and the top 100 generated $226 billion in annual revenue in 2020. Some notable cooperatives include REI, ACE Hardware, Ocean Spray, Land O'Lakes, and Congressional Federal Credit Union. It's not a new concept, Benjamin Franklin founded the first insurance cooperative in America which continues to operate today.

In the last decade, the number of worker cooperatives have doubled, and have become a preferred business option for young people, women and minorities. According to the 2019 Worker Cooperative Economic Census, 50% of owners of worker co-ops are Latino and African American, and women make-up 60% of the workforce.

Additionally, over 160 food cooperatives have opened during this time, creating over 4,200 jobs. In the last few years, start-up food cooperatives have opened in Colorado, Nebraska, Virginia, Ohio, Pennsylvania, and New York. All this progress has occurred without the SBA's assistance.

The SBA has amended its outdated eligibility regulations to include cooperatives but continues to block these businesses from accessing its programs with its own federal version of a Catch-22.

Now technically eligible, co-op businesses must meet the agency's personal guarantee requirement which states that any owner of 20 percent of the business must sign a personal guarantee for a loan. Due to its unique business structure, a co-op is just not able to meet the "check the box" personal guarantee requirement the SBA requires.

For example, if a custodial worker cooperative in New York City is owned equally by 10 women, which owner of 1/10th of the business signs the personal guarantee? If a food cooperative has 5,000 member-owners, which customer signs over their house to cover the other 4,999 customers?

A cooperative borrower does have "skin in the game." They raise money through member shares and member loans that should secure financial and equity obligations that lenders require.

In 2018, Congress attempted to level the playing field for cooperatives by passing the "Main Street Employee Ownership Act" championed by Chairwoman Velázquez and Senator Gillibrand.

We were greatly disappointed to learn the SBA did not provide practical alternatives for loans as required by law. Instead, the agency relied on its existing requirements that continue to keep cooperative businesses from much needed access to capital. Essentially, the SBA ignored Congressional direction and the needs of business owners and consumers.

My employer, the National Cooperative Bank, has provided loans of more than $2.5 billion to cooperatives and independent retailers including over $85 million to food cooperatives. Per our loan policies, we do not require a personal guarantee for consumer and worker cooperative loans.

Along with the private sector, there is federal precedent for not requiring personal guarantees to cooperatives. The Department of Agriculture does not require a personal guarantee for loans to cooperatives, but most start-ups are in urban areas. Ironically, even SBA does not require personal guarantees for loans to Employee Stock Ownership Plans, known as ESOPs, that have a similar structure as worker cooperatives.

The cooperative business sector caught a break when Congress removed the personal guarantee requirement in the CARES Act for all EIDL and PPP business loans, thus giving cooperatives access to federal funding during the pandemic. Although, this Committee had to include specific bill language for cooperative businesses to become eligible for the Covid relief programs.

Using the SBA reported numbers, the National Cooperative Business Association estimates that over 2,500 cooperatives received Covid relief loans totaling $1.2 billion in funding that saved over 93,000 jobs.

Chairwoman Velázquez, let me personally thank you and the Committee for helping these businesses and workers during one of the most difficult times of our country. Please be aware that the same cooperative businesses that received covid relief funding are not able to access the SBA's existing loan programs.

Especially in Black and Brown communities, entrepreneurs are turning to the cooperative model as an opportunity to own a business or meet the grocery needs in their neighborhoods, many of which are food deserts.

In 2015, Pastor Reginald Flynn of Flint, Michigan, wanted to start a food cooperative due to the grocery chain closures in his community. Pastor Flynn was unable to obtain financial support from the SBA. Six years later, he has raised $7.6 million and now has over 900 member-owners. With the help of a $1.25 million grant from the state of Michigan, the food cooperative has finally started to break ground.

This is a success story on resilience and commitment to a community, but truth be told, access to an SBA loan would have allowed them to break ground years earlier. No small business should have to wait six years to achieve their dream.

On behalf of small business owners throughout the country, thank you for your continued support on this much needed change to this challenging policy issue.

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"

December 2022

On behalf of the Austin Cooperative Business Association, the regional trade organization for cooperative businesses of all kinds in Central Texas, we are writing to express our support of employee ownership. We are writing in particular about worker co-ops - a highly underserved sector of the small business community - to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Cooperatives are a thriving and growing part of the Central Texas economy - but more support from the SBA and other federal agencies would mean significantly more people in our region could become cooperative owners and access all of the benefits cooperatives have to offer. Dozens of cooperatives are members of the ACBA, including worker cooperatives as well as housing cooperatives, consumer cooperatives (including Texas' only consumer-owned grocery store), and producer cooperatives. In the past year we have developed a worker cooperative training program with the City of Austin and the Rural Cooperative Development Center at the University of Texas - Rio Grande Valley. This program, the Austin Cooperative Coaching and Training program, graduated its first class this year. We are also working with Go Austin! Vamos Austin! on developing a cooperative grocery store, potentially worker-owned, in an disinvested community in East Austin. ACBA's member organizations, certificate program graduates, and future cooperatives in our region would all benefit immensely from full access to the SBA's tools, especially loans with more flexible guarantee requirements.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Sincerely,

Carol Fraser

Carol Fraser
ACBA Board President

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of my worker cooperative clients and for new groups who want to form cooperatives, I am writing to express my support of employee ownership, in particular worker cooperatives - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Small Business Administration offers to all other small businesses.

I have been working with cooperatives for over 25 years and with worker cooperatives for more than 15 years, and all of the small businesses need help with capital funding for their start-ups and for on-going operations. When a group of people want to form a business where they are both the owners and the employees, they are creating jobs for themselves, creating wealth for their families, and they are benefiting their communities with purchasing power and with tax income. These businesses deserve the right to apply for and obtain funding from the SBA.

Worker co-ops are the fastest growing sector of cooperatives in the country and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

In 2018, I was proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, I have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee-owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership – I want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, I thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. I look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States. Please let me know if there is any way I can help.

Linda D. Phillips
Senior Of Counsel
Jason Wiener, PC, a public benefit corporation
Email: linda@jrwiener.com

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of the Indiana Cooperative Development Center, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Over the past few years, we've been educating citizens of Indiana about worker co-ops and ESOPs in anticipation of the impending "silver tsunami" as well as the general interest in worker co-ops. Without access to SBA's tools, including financing tools, the ability of small business owners becomes much harder and in some cases, impossible.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Sustainable
Economies
Law Center

Legal education, research, advice, and advocacy for just and resilient economies.
1428 Franklin St. | Oakland, CA 94612 | www.theSELC.org

From: Jay Cumberland (jay@theselc.org), Worker and Housing Co-op Conversions Attorney, Sustainable Economies Law Center

To: Lauren Finks (Lauren.Finks@mail.house.gov), Clerk at U.S. House of Representatives, House Small Business Committee

Re: Comments on Affiliation and Lending Criteria for the SBA Business Loan Programs

Date: December 09, 2022

On behalf of the Sustainable Economies Law Center in Oakland, California, **I am writing to express concern about the Small Business Administration Regulation updates. Currently, worker cooperatives cannot access the Administration's 7(a) loans like all other small businesses because of the personal guarantee requirement.** I am concerned the updates do not include a solution to this access issue.

I am also writing to propose solutions that would allow worker cooperatives to access the Administration's 7(a) loans.

Worker cooperatives are the fastest growing sector of cooperatives in the country. This is, in part, because worker cooperatives are increasingly recognized as a solution to our country's economic challenges. Worker cooperatives are strong companies where workers hold all of the profit rights in the business. Many small businesses have begun converting to worker co-ops to access these strengths.

The worker-owners in worker cooperatives commit themselves to the strength and longevity of their co-owned businesses. Worker co-ops are typically small businesses. On average, they employ 8 workers and pay $19.67/hour, even in low-wage industries like retail, manufacturing, food service, home care, and childcare. Worker cooperatives last longer than other small businesses. 25.6% of worker cooperatives reach 6-10 years of operation compared to only 18.7% of other small businesses.

Worker cooperatives need access to the full range of the SBA's tools, including the 7(a) loan program. This will allow them to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Programs like the 7(a) loan program are needed to accelerate the already rapid growth of worker cooperatives in the U.S.

Unfortunately, the personal guarantee requirement of SBA 7(a) loans makes these loans virtually impossible for worker cooperatives to access. It is necessary to ensure that loans are sound. However, requiring that anyone owning more than 20% of a business guarantee a 7(a) loan does not work for worker cooperatives given their unique ownership structure. In many cases, no worker-owner owns more than 20% ownership of a worker cooperative. The average worker cooperative has 8 worker-owners. This means the average worker-owner has only a 12.5% ownership interest.

I am asking only that worker co-ops be given access to the resources available to all small businesses. Congress has already expressed its support for employee ownership through the Main Street Employee Ownership Act. I want to see the spirit of the Main Street Employee Ownership Act fulfilled. It requires the Administration not only provide education and outreach regarding employee ownership but also create a workable solution for cooperatives to access SBA programs.

As a primary workable solution, I recommend that the Administration remove the personal guarantee requirement in 7(a) loans for worker cooperatives. Private funders and states that have made loans available to co-ops without personal guarantees have reported minimal losses.

As a secondary workable solution, I recommend that the Administration limit the personal guarantee requirement in 7(a) loans for worker cooperatives. My organization helped the City of Berkeley, California implement this solution in its revolving loan fund for small businesses, which is funded by the U.S. Economic Development Administration. Instead of requiring a personal guarantee from worker-owners for the whole amount of the loan, the City of Berkeley now requires that a worker cooperative put forward a panel of worker-owners representing at least 50% ownership. Each worker-owner on the panel becomes responsible for an equal share of the personal guarantee amount. If a worker-owner on the panel leaves the business, the worker cooperative must designate another to take their place. The U.S. Economic Development Administration did not find this change to the revolving loan fund's personal guarantee requirement for worker cooperatives significant enough to require its approval.

On behalf of the worker co-op business community, I thank the Small Business Administration for its attention to this issue. I look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Sincerely,

Jay Cumberland

Jay Cumberland

Worker and Housing Co-op
Conversions Attorney

jay@theselc.org | 205-253-9151

Dear Ms. Finks,

On behalf of Project Equity and our dozens of partners around the country and the small businesses we serve nationwide, I am writing to express our support of broad-based employee ownership, including worker cooperatives, Employee Stock Ownership Plans (ESOPs) and employee ownership trusts, and to advocate for employee-owned companies (and businesses with potential to become employee-owned) to have access to the vital benefits that the Administration offers to all other small businesses.

Project Equity is a national leader in the movement to harness employee ownership to maintain thriving local business communities, honor selling owners' legacies, and address income and wealth inequality. Headquartered in the San Francisco Bay Area, Project Equity works with partners around the country to raise awareness about employee ownership as an exit strategy for business owners, and as an important approach for increasing employee engagement and wellbeing. We also provide hands-on consulting and support to companies that want to transition to employee ownership, as well as to the new employee-owners to ensure that they, and their businesses, thrive after the transition.

Over the next decade, there is an opportunity to avert massive job losses and business closures by transitioning companies to employee ownership: in the "small business closure crisis," our research shows that 2.9 million businesses are currently owned by baby boomers and are likely facing imminent closure or sale. Employee ownership is a powerful tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

Employee ownership, in the forms of worker cooperatives and Employee Stock Ownership Plans (ESOPs), is proven to benefit businesses, workers, and local economies. Worker-owned firms see stronger overall business performance and resilience during economic downturns. Employees at these firms see greater wealth-building opportunities and increased job security compared to their counterparts at traditional businesses. And employee-owned companies were four times more likely to retain employees during the darkest days of the COVID-19 pandemic, as they have been in many past recessions.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, which aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress recognized that employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, and education.

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been extremely limited, save the efforts of a small group of highly motivated Small Business Development Centers, such as California's North Coast SBDC, with which we have partnered for several years.

Outside of the SBA, private funders, including CDFIs, have made loans available to coops without personal guarantees, and have reported minimal losses. Common sense access for employee-owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives and all employee-owned businesses need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership, and we now seek to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding succession planning options, including employee ownership, and to create a workable solution for cooperatives to access SBA programs.

On behalf of the employee ownership community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Please feel free to contact me at (510) 501-3746 or hilary@project-equity.org if you have any questions. Thank you for your consideration.

CITATIONS:

1. Small Business Closure Crisis: data and infographics (Project Equity)
2. The Case for Employee Ownership, Project Equity (2020)
3. Employee-Owned Firms in the COVID-19 Pandemic, Employee Ownership Foundation and Rutgers University (2020)

Sincerely,

Hilary Abell

Hilary Abell

Hilary Abell
Co-founder, Chief Policy & Impact Officer

Greetings Ms Finks,

From my experience in a startup worker owned cooperative (Empower Energy Cooperative, incorporated in Massachusetts) and from my current work with the Coalition for Worker Ownership and Power, I am writing to express support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses. My Cooperative was able to access limited business development education through SBA in the City of Worcester, but this support was not tailored to the specific needs of worker owned cooperatives, and our business was not eligible for financial support that SBA could have offered other types of businesses.

Worker owned cooperatives are a special type of business that invests in workers and thereby communities uniquely, because of the way that governance and profits are shared in these institutions. They are like other businesses, and require appropriate TA and funding, and thus it is important for our economy and communities if SBA had more and better support to worker owned cooperatives.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Thank-you for your attention to concerns raised in my written testimony to you regarding the need for SBA support to worker owned cooperatives.

Sincerely,

Sarah S. H. Assefa

Good Morning,

On behalf of Common Good Bookkeeping Cooperative, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Common Good Bookkeeping Cooperative is a union worker-cooperative in Madison, Wis. We specialize in bookkeeping and administrative services and training for worker-cooperatives, union shops, nonprofits, micro-enterprises and B-corporations.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Cooperatively,

Andy Browne, MPA, CPA
Common Good Bookkeeping
Accountant

George Cassiere

My statement is simple.

Companies are very interested in ESOP transactions funded by SBA 7a loans. 1st, the Government entities: IRS, DOL and SBA need communication and coordination. 2nd, there needs to be education and training.

I facilitated 4 closed transactions thus far. Hoping to be up to 15 by the end of 2023.

Thank you.

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of the Alaska Cooperative Development Center, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

There are no worker cooperatives operating in Alaska yet, but we have seen increased interest in the last couple of years. In part this is due to the Mainstreet Employee Ownership Act, which has increased awareness of this type of business. It also has to do with how worker cooperatives fit into the new, challenging economic landscape.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Sincerely,

Andrew Crow
Director
Alaska Cooperative Development Center

With SBA ESOP transactions the 7a "change of ownership" rules require an equity injection of 10%. Existing ESOPs may either have the cash, or pass a 9:1 financial leverage test. New to-be-created ESOPs, however, typically have no cash to inject. SBA understandably prefers the Buyer to put up this cash equity and have it at risk, aka: skin in the game, but there are no direct owners to fund it. It stops the process from being viable.

If newly created ESOPs are to be assisted with 7a loans, a solution is needed with no cash coming from the ESOP. The SBA would in this case be adequately protected if the 10% requirement is met by a **Full Standby** Seller Note for 5%, and the other 5% can come from a **Standby** Seller Note that amortizes over the same term as the SBA loan, paying principal and interest at same speed as 7a loan, providing cash flow to Seller to cover the income tax payments due on the interest that is accruing.

Respectfully,

Ted Lauer
SVP

December 2022

On behalf of Redwood Roots Farm Cooperative, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

As a small organic. women- run farm cooperative, we feel very strongly that the need for this Administration to advocate and support worker-owner cooperatives is imperative for us all to survive and thrive.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Thanks for your time,
Jasmin Segura

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of A Slice of New York, a worker cooperative formed in 2017, I am writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

As a worker cooperative, A Slice of New York has created an ownership mentality in individuals that have been in roles that are considered replaceable or disposable. As an owner, the workers can determine what priorities the business should have, how to better care for their needs, and most importantly, to give the workers a vote and a voice in their future. Our worker- owners created our organization's first PTO plan (faster growth for members of the co-op), a Paid Family Leave policy, a 401K plan, and prioritized health and safety during COVID-19 which allowed the business to stay open and no one contracting COVID-19 at work. While we were able to apply for covid relief funding, our application for increases in access and need for more EIDL loan funding never happened because of the many delays in SBA understanding our structure. We need many changes to help businesses like ours.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare. In A Slice of New York's case, starting workers make over $25/hour and the average wage paid to our team is about $35/hour.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education. I know this is not SBA's fault since the funding for these programs never materialized, but we need to find ways to make this education and awareness happen too.

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Kind regards,

Kirk Vartan
Founder/General Manager

December 2022

On behalf of Jason Wiener P.C., we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.

In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.

Comments on Small Business Committee hearing "Building Sustainable Businesses through Employee Ownership at SBA"
December 2022

On behalf of the Worker-Owned Recovery California (WORC) Coalition, we are writing to express our support of employee ownership, in particular worker co-ops - a highly underserved sector of the small business community, to advocate for access to the vital benefits that the Administration offers to all other small businesses.

Worker co-ops are the fastest growing sector of cooperatives in the country, and are an increasingly recognized solution to economic challenges. They strengthen companies, reward workers, and prevent job loss in the case of converted businesses. Over the next decade, converting businesses could avert massive job losses in the succession crisis for the 2.34 million businesses that are currently owned by baby boomers, imminently facing closure or sale. Alongside employee stock ownership plans (ESOPs), worker co-ops are an important tool for small businesses to survive this immediate threat and to keep strong jobs rooted in our communities.

At its core, worker ownership means that more people are committed to the strength and longevity of the businesses. They are typically small and strong businesses, typically employing 8 workers, and paying an average of $19.67/hour often in insecure industries like retail, manufacturing, food service, home care and childcare.
In 2018, we were proud and energized by the passage of the Main Street Employee Ownership Act (MSEOA), which passed with overwhelming bipartisan support. This legislation, aimed to improve access to capital and technical assistance for cooperatives and other employee-owned businesses, includes:

- Financing the sale of businesses to their employees
- Working with Small Business Development Centers to provide training and education on employee ownership options
- Reporting on SBA's lending and outreach to cooperatives and other employee-owned businesses

This clear mandate from Congress that recognized employee ownership was incredibly important for businesses that have long sought reasonable access to these programs. **Unfortunately, we have not seen any meaningful support from the SBA since the passage of the MSEOA with regard to financing, outreach, nor education.**

The personal guarantee requirement of SBA 7(a) loans continues to make these loans virtually impossible for worker cooperatives to access. Asking a single member or the selling owner to take on ultimate responsibility for the loan is directly at odds with the shared ownership structure of cooperatives, which shares the financial burden across multiple deeply committed co-op members. Additionally, outreach and education about employee ownership has been virtually non-existent, save the efforts of a small group of personally motivated Small Business Development Center advisors.

Outside of the SBA, private funders, including CDFIs, have made loans available to co-ops without personal guarantees, and have reported minimal losses. Common sense access for employee owned businesses paired with outreach and education on employee ownership would be hugely impactful for both business startups and business transitions.

Worker cooperatives need access to the full range of the SBA's tools to foster and create stable, high-retention jobs that empower workers and provide workplace flexibility. Congress has already expressed its support for employee ownership - we want to see the intent of the MSEOA fulfilled, and for the Small Business Administration to follow through on its mandates: to provide education and outreach regarding employee ownership, and to create a workable solution for cooperatives to access SBA programs. On behalf of the worker co-op business community, we thank the Oversight, Investigations, and Regulations subcommittee for your attention to this issue. We look forward to working with you to ensure a prosperous future for our small businesses and workers across the United States.