



CO-OP Conversions At Scale

A Market Assessment for Expanding Worker Co-op Conversions in Key Regions & Sectors

This report was made possible with the support of Citi Community Development. It was produced as part of Citi and Capital Impact Partners' efforts to **help more small business owners access shared ownership, so that they can expand wealth for themselves, their employees and their neighborhoods.**

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Forward



Across the country, Baby Boomer-owned businesses - most of them healthy and viable - are closing rather than being sold, leaving an economic gap in vulnerable urban areas and rural towns. These established businesses contribute to the economic activity and “lifeblood” of cities and regions.

A strategy that can help preserve these at-risk businesses is to convert ownership of the business to employees. It benefits everyone: it builds assets for employees, retains quality jobs - particularly among low-income workers and people of color - and positively transforms historically low-wage service sector occupations. Conversions are also a sound way to anchor successful businesses in communities, which drive local prosperity and ensure vibrant local economies.

With momentum in favor of employee ownership and the growth of that ecosystem, there is an opportunity to prove viability of these models at scale nationally. Capital Impact Partners and Citi Community Development collaborated to conduct research to assess the growth potential of employee ownership conversions in several markets. Findings from this “opportunity mapping” will enable readers to better understand and explore lending approaches suitable for larger business conversion deals, targeting low-wage sectors that employ a high percentage of people of color and women workers. Employee ownership of businesses is viable. The findings of this report represent a significant step in making that case. Capital Impact Partners thanks its steering committee partners, namely ICA Group for their research leadership and authorship of this report and the Democracy at Work Institute (DAWI) for its collaboration to share these findings with a broader audience. We look forward to continued field discourse and new collaborations among lenders to create communities of opportunity.



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Introduction

In recent years, interest has risen in the power of converting small businesses to employee ownership as a community economic development strategy. Practitioners have looked to replicate the transformative effects of worker ownership at companies like Cooperative Home Care Associates (CHCA) in the Bronx, the Alvarado Street Bakery in the Bay Area and Childspace in Philadelphia. All three of these worker cooperatives operate in traditionally low-wage industries, but they have improved wages, increased hours, survived and thrived over the long term.

In an effort to scale these positive impacts and shorten the timeline related to their operational success, many community-based organizations have begun focusing on worker cooperative conversions. In a conversion, owners of closely held firms sell their businesses to their employees. This conversion strategy is inspired by stories such as those of South Mountain Company, chronicled in the book *Companies We Keep*, and follows the successful path that employee stock ownership plans (ESOP) have had in scaling employee ownership among larger firms.¹

However, for a conversion strategy to have a positive social impact in economically vulnerable communities and have the broadest impact on low-wage people, a coordinated approach is required:

- ▶ The focus must be on firms with 20 to 100 employees. These firms employ 17 percent of all workers in the United States. While they are more likely to have the leadership in place to facilitate a successful conversion, they are often ignored because the ESOP model does not easily apply.
- ▶ The approach must target sectors that employ low-wage, historically disadvantaged workers.
- ▶ The converted firms must have the necessary support systems to ensure the transformative impacts of CHCA, Alvarado, and Childspace are realized.

The approach must also operate at scale. Meaningful impact requires dozens of completed conversions each year. For scale to be successful, however, significant capital to finance these transactions is necessary. This report is a first attempt to assess the market potential of conversions among smaller firms and is meant to highlight a path for funders interested in pursuing this strategy.



¹ There are a number of different models of employee ownership. For larger firms, the most common (and tax advantaged) approach is an Employee Stock Ownership Plan (ESOP), a specialized retirement plan that invests primarily in an employee's company. For firms with fewer than 100 employees, a less regulated and simpler model is the worker owned cooperative, where employees directly own shares in the firm.

The Challenge

The challenges facing economically vulnerable communities and communities of color are enormous. On top of deep-seated income inequality, the United States has a wealth gap that is greater than any other industrialized nation. According to the latest data from the U.S. Census, the poorest 20 percent of U.S. households have a negative net worth. Between 2005 and 2011, the net worth of these families dropped precipitously, from negative \$915 to negative \$6,029. This wealth gap also has a significant racial component. While the median net worth of all black families is just \$1,700, among white households, the median net worth is \$116,800—almost 69 times greater.

Layered on top of this long-standing problem is a major demographic shift that is set to shake the small business landscape that makes up the economic heart of communities across the country. Each day, more than 10,000 Baby Boomers turn 65, a trend that is expected to continue through 2030. Baby Boomers own the majority of U.S. small businesses, and only 17 percent of them have a formal exit plan. Far

too often, this results in businesses closing when owners retire. This eliminates jobs while simultaneously removing businesses that provide core services and contribute to the local economy. Since 2000, in the sectors and regions examined as part of this report, more than 1,200 of these older businesses, employing more than 52,000 people, closed.

The majority of these businesses did not close due to underperformance. Older firms tend to have higher revenues and growth rates than their younger counterparts—in more than 50 percent of cases, older firms simply close up shop because the owner retires.

This impact is well underway. Among small businesses that closed across five industry sectors, the proportion that had been in operation for more than 25 years has been steadily increasing. In 2011, the “Silver Tsunami,” or the demographic shift of Baby Boomer retirement, began. Two years later, 33 percent of business closures were among older firms likely owned by Baby Boomers.

Sales and Closures of Older Firms

(Estimated Value > \$800,000)



Addressing the Challenge: Employee Ownership

There is an approach to address both these issues. Broad-based employee ownership is a powerful business retention strategy. It anchors businesses in communities, builds assets for employees, retains jobs, and has been used to positively transform historically low-wage service sector occupations.

In higher-margin industries such as food manufacturing, employee ownership increases wages and facilitates the accumulation of financial assets for employees. In lower-margin, lower-wage industries such as home care, employee ownership offers a path to job stabilization. Through a focus on training and engagement, turnover is reduced and hours are increased.

While employee ownership holds significant promise as a remedy to these problems, making a real dent in the challenges facing underinvested communities across the country requires a scaled approach. Most of the conversions to employee ownership in the United States have been in private companies that employ 100 or more employees using an employee stock ownership plan (ESOP). There are currently more than 6,000 private company ESOPs covering more than 2.1 million participants, with an average of 343 employees per firm. Because of the costs and administrative burden associated with setting up and managing an ESOP, they are not viable for smaller businesses, except those that are very profitable. On the other end of the spectrum, there have been sporadic, often 'do it yourself,' conversions of firms with fewer than 20 employees into employee-owned cooperatives.

Addressing the Current Market Failure

For firms with 20 to 100 employees, a higher level of professional technical assistance is often necessary for worker conversions. In addition to feasibility assessments, independent valuation and guidance, many of these firms require assistance in preparing their books and systems for a conversion, as well as significant

support in preparing for leadership succession. Additionally, these types of conversions often require outside financing as well as support to train Boards of Directors and new employee owners on their rights and responsibilities. For ESOP practitioners, it is often not worth the time to engage with these smaller firms – the market has failed these firms.

As a result, for longstanding businesses with fewer than 50-100 employees, employee ownership is rarely a succession planning option. In this market segment, business closures outnumber business sales nine to one. Many of the businesses that close provide services that are vital to a thriving local economy, such as childcare, elder care, food access, and quality manufacturing jobs.

9 to 1

Ratio of business closures to business sales among independent firms operating for more than 25 years with 20 to 100 employees.

To fill this market gap, there has been significant effort to make broad-based employee ownership available to smaller companies. In 2016, the Democracy at Work Institute convened Workers to Owners, a collaborative effort to bring together practitioners that focus on employee ownership conversions of smaller businesses. Because of this and other initiatives, the pipeline for small employee ownership conversions – while still modest – has grown exponentially, sparking interest in the viability of this approach at scale.

To date, there has been very little quantitative analysis examining the market opportunity. This report examines the market potential for bringing employee ownership for conversions of smaller firms to scale by looking at the actual transfers and closings of businesses that are high potential targets for a successful conversion.

Using a proprietary longitudinal database, the ICA Group examined the market potential for conversions of firms with 20 to 100 employees in five industry sectors across

five geographical regions. The results demonstrate that there is a strong market for conversion of small firms to employee ownership across the five regions.

Identifying Good Targets for Conversion

Employee ownership conversions are most likely to occur in smaller, closely held firms with a meaningful connection to both the community in which they operate and existing employees. Given these factors 'target' businesses were identified as independent firms with 20 to 100 employees. Any firm with 10 or fewer locations was deemed independently owned.

Industries: Five industry sectors were researched based on multiple criteria, including workforce demographics and the potential for employee ownership to positively transform jobs: grocery stores, food manufacturing, home care agencies, residential care facilities, and child care centers.

Regions: The five regions examined are home to a number of technical assistance (TA) providers or are being targeted by a national TA provider with a specific philanthropic-funded initiative. The regions are: New England, New York Metropolitan Area, Mid-Atlantic Cities (Philadelphia, Baltimore, Washington, D.C.), Chicago Metropolitan Area, and Los Angeles and San Francisco Bay Area of California. Miami-Dade County was also examined, although given the nascent conversion support ecosystem in Miami, the data was not included in the combined regional presentation of data.



A Path to Job Transformation

The social impact of broadening employee ownership across the industries examined in this report is enormous. As the chart to the right demonstrates, these conversions comprise low-wage industries employing large numbers of service sector employees, particularly women and people of color. By converting businesses in these sectors to employee ownership, these low-wage workers will become owners.

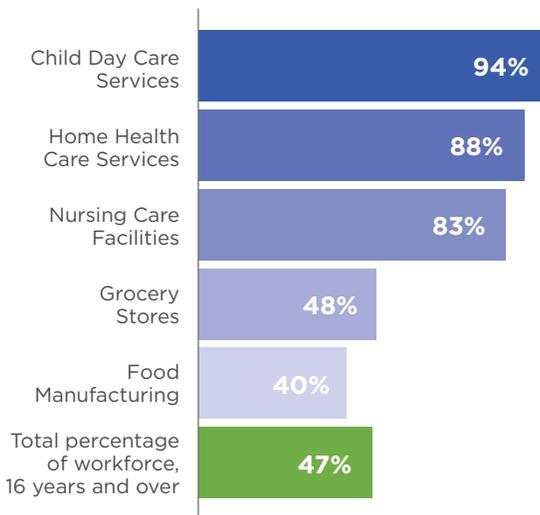
The selected industries employ disproportionately higher percentages of women than the overall workforce. While women make up slightly less than half of the total workforce, in childcare, women make up 94 percent of workers, while in home care, 88 percent are women.

These sectors also employ a disproportionately high number of African-American workers. Overall, African Americans make up only 12 percent of the overall workforce, yet make up 30 percent of home care workers, 29 percent of nursing care facility workers, and 16 percent of food manufacturing workers. As the chart below demonstrates, in none of the sectors examined is the proportion of women or African-American workers lower than the national figure.

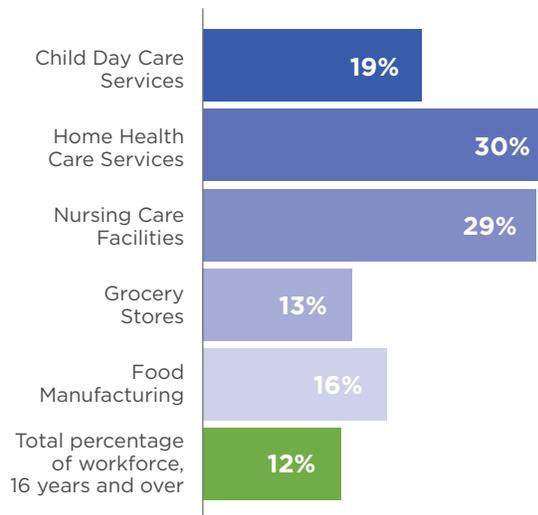
Median Wage for Major Occupations by Industry

OCCUPATION	MEDIAN WAGE
Preschool Teachers	\$13.78
Childcare Workers	\$10.18
Home Health Aide	\$10.87
Personal Care Aide	\$10.54
Nursing Assistant	\$12.78
Cashier	\$10.72
Food Processing Workers	\$11.61

Women



African Americans



The Small Business Conversion Market Assessment

To determine the market potential of a scaled conversion strategy, five regions with an existing support system for employee-owned conversion were examined. Within these regions, research assessed key industries where smaller firms dominate and employee ownership is likely to succeed. The research revealed that each year within these regions and sectors, approximately 159 'target' (See box on next page) firms transfer ownership or close due to a likely retirement. In the coming years, this number is expected to increase, as both the number of small independent firms being sold increases and the number of Baby Boomer owners who hit retirement age continues to grow. Key research findings include:

Longstanding businesses are far more likely to close than to be sold. Longstanding businesses – those that have been in operation for more than 25 years and therefore are more likely to be owned by an older owner – are far more likely to close than to be sold. Between 2000 and 2014, of the 842 target companies sold, only 133 businesses (16 percent) had been in operation for more than 25 years. In contrast, 1,195 target businesses that had been operating for 25 years or more closed – 42 percent more older businesses closed than the total number of target businesses sold. Based upon census data, ICA estimates that fully 83 percent of businesses closed due to an owner's retirement. Unless efforts are made to stop these firms from closing, the number of job losses from retiree-related closings will continue to grow.

The median estimated 'enterprise' value for a target company sold since 2000 is \$777,760. Across the five regions, the median estimated value ranges from a low of \$600,000 in the New York Metro region to a high of \$1.1 million in Chicago. Which industries are most prevalent in a region is an important factor in the median business value in that region. Food manufacturing businesses have the highest estimated value, while childcare businesses have the lowest estimated value. Firms with an estimated enterprise value of more than \$800,000 (excluding real estate) represent

THE OPPORTUNITY, AT A GLANCE

159
Target Companies
Transferred Annually

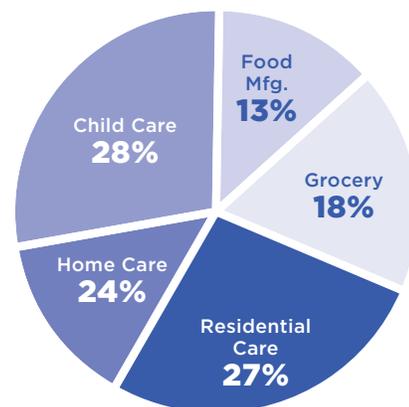
74 Target Companies
Sold Annually

85 Target Companies
Closed Due to
Retirement / Year

5,724 Jobs at Firms that Close
or Are Sold Annually

42% Target Companies
Valued Over \$800,000

Industry Profile



42 percent of all target firms and 53 percent of the target firms that were sold. A key determinant for lenders is the estimated business value of potential conversion firms. The median value was estimated using a multiple of revenue from a national valuation database – it is a rough proxy for actual value and does not include the value of any real estate.

Given these enterprise values, lenders with a target loan value of less than \$500,000 are the most likely supporters of such a strategy, although given that 42 percent of firms have an estimated value of more than \$800,000, there is also a market opportunity for lenders whose target loan amount is \$1 - \$2 million.

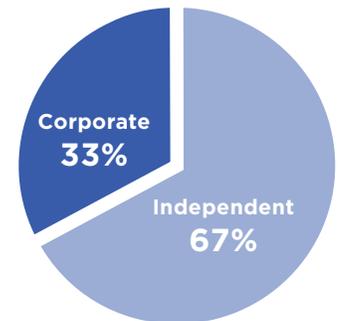
The number of small employee ownership conversions has seen a large uptick in 2016 and 2017. The number of firms that have been engaged to explore this possibility has increased significantly since 2014. According to the Democracy at Work Institute, the number of firms initiating a conversion process with a TA provider increased from 16 in 2014 to 74 in 2016 and reached 189 by year-end 2017.

Corporate firms – those that are part of a business with 10 or more affiliates – are much more likely to be sold than independent firms. Independent firms, which are most likely to seek out employee ownership, make up the vast majority of all firms with 20 to 100 employees, yet only 16 percent of the businesses that are sold each year. Given that 67 percent of business transactions occur within only 16 percent of the market, there is an enormous opportunity to increase transaction activity within this

independent market. It is plausible that the motivations of independent business owners are quite different, and that if a more socially responsible market were to develop for these business owners, the number of firms that could transition to employee ownership could increase significantly.

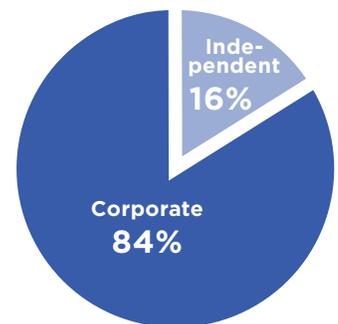
All Firms

20 to 100 Employees

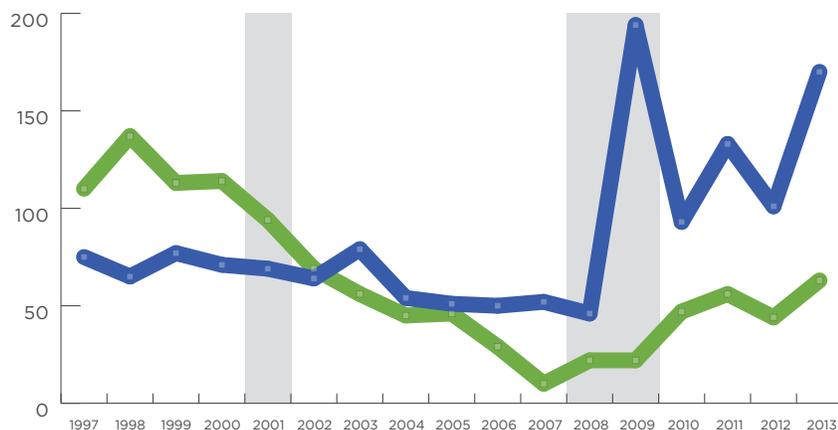
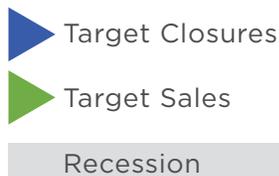


Firm Sales

20 to 100 Employees



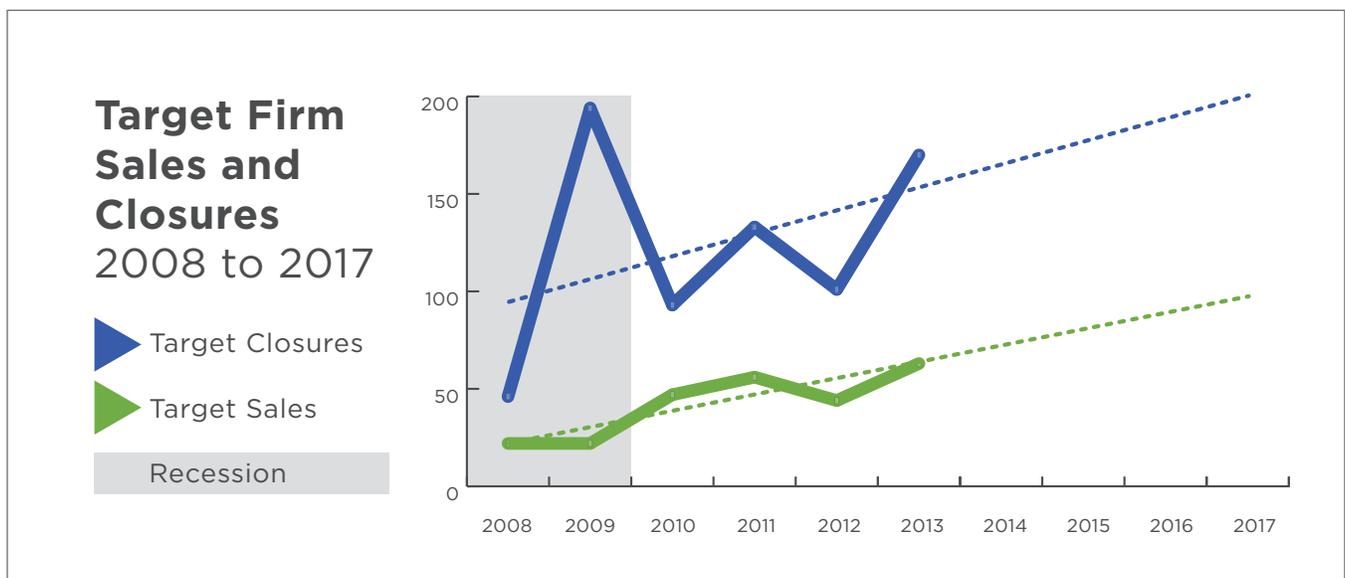
Target Firm Sales and Closures 1997 to 2013



Furthermore, if investors with a focus on employee ownership were to enter the 'corporate' market, the potential market size would increase dramatically. While the median value of 'independent' firms is significantly lower than corporate firms (\$537,600 versus \$922,000), in sheer numbers, higher-value independent firms outnumber higher-value corporate firms. Only 42 percent of independent firms are valued at more than \$800,000, compared to 61 percent of corporate firms; there are almost 7,000 independent firms with this higher value compared to 5,600 corporate firms.

For the industries and regions examined, there is an estimated market of 159 conversions per year and the market will grow in coming years. Across the industries and regions examined, 74 target companies are sold each year and 85 companies that have been in business for more than 25 years close each year. Since 2000, there has been a steady increase in the proportion of firms that close that have been in operation for at least 25 years. Between 2000 and 2010, the proportion of firms that closed that were likely the result of a retirement hovered between 15 percent and 25 percent, between 2011 and 2013, the percentage was between 29 percent and 33 percent. The demographic shift of Baby Boomer retirement referred to as the 'Silver Tsunami' indicates that the number of businesses closing due to owners retiring is likely to grow and potentially increase.

In the second year of the Great Recession, a record number (190) of these older firms closed, and in the years since, an average of 120 of these older firms close each year. This is a striking change and correlates closely with the shift of Baby Boomers starting to turn 65 in 2011. Based upon trend data from the last five years, we should expect that by 2017, an average of 200 older businesses will be closing per year.



Based on this analysis, it is clear that there is an existing market for conversions of smaller firms, and in the coming years, it is poised to grow. To capitalize on this opportunity, employee conversions must be considered as a tool within a larger strategic framework. Building upon the existing efforts of the Workers to Owners Collaborative, we recommend that the following efforts should be pursued.

The Power of Financing Membership Fees

Most employees don't have the resources to buy their company. Employee ownership transitions offer up this opportunity, but many lenders want employees to have "skin in the game." A pool to finance membership fees, a strategy that has been successfully employed in France, would go a long way toward addressing this equity gap.

1. Education and outreach to business owners:

Continued emphasis on outreach to small, independent businesses: Very few small business owners are aware that employee ownership is an option. Efforts such as the Democracy at Work Institute's Legacy Business Initiative funded by Citi Community Development have been successful at increasing market awareness. Deliberate outreach and education efforts targeting older business owners should be continued and expanded.

Parallel emphasis on a strategy to capture "corporate firms:" The bulk of small business transactions involve non-independent or corporate firms.² Capturing a larger percentage of this market involves a different set of strategies than approaching independent business owners and should be explored and launched parallel to those efforts.

2. Improved access to financing capital:

Increase capital for standalone co-op conversions: At a median estimated value of \$777,000 per firm, facilitating the transfer of 30 firms per year will require \$23 million in capital. Currently, the Community Development Financial Institutions (CDFIs) focused on cooperatives (excluding Capital Impact Partners) have combined assets of \$50 million dedicated to all forms of cooperative lending. While capital sources will follow effective TA systems, bringing employee ownership conversions to scale requires a significant expansion of debt capital. Financing these deals will also require an expanded patient first-loss risk capital pool.

Build a pool of capital to finance membership fees: The vast majority of employees at the target firms are low-income and do not have the means to contribute equity. Yet many lenders wish to see employee owners have "skin in the game" and expect employee-owner equity to equal up to 10 percent of the total transaction. While slow contributions over time can address this, a pool of capital to finance membership fees would increase the equity investment at the time of the initial transaction.

Build a pool of capital and technical assistance capacity for acquisition-style conversions: Many of the companies that are strong candidates for conversion are not interested in providing seller financing and would prefer a more traditionally structured

² See Profile of Target Company section for more detail and definitions surrounding how independent and corporate firms were defined.

transaction from an interested buyer. To capture this market, it is necessary to have a pool of capital to purchase companies outright paired with technical assistance that would strengthen the business and set it up for a successful transition to employee ownership.

3. Increasing capital access:

Develop sustainable funding sources for technical assistance: Employee ownership cooperative conversions provide a powerful benefit to communities at a low cost per job created or retained. Scaling the number of employee-owned conversions will require leveraging this community benefit by identifying and securing sustainable funding sources. These include economic development or workforce development dollars that can offset the transactional and ongoing ownership culture costs of the transition.



Support industry- and/or geography-specific initiatives: Employee ownership cooperative conversions are more effective when concentrated in an industry and/or geography. Specific strategies with a regional and industrial focus, such as that being funded by Citi Community Development in the childcare space, should be encouraged and expanded. In the first eight months of this effort, more than 50 businesses—100 percent of which are owned by women and 88 percent of which are owned by people of color—have received support. Two of these firms have already begun the process of conversion to employee ownership.

Develop support institutions for converted companies: Like many small businesses, converted employee-owned companies face challenges related to high purchasing costs, recruitment, training, marketing and more. Producer cooperatives, organizations that work together to increase marketing possibilities and production efficiency, are part of a proven strategy that supports the success of independent businesses. They can be leveraged to tout the long-term success of converted businesses in an industry. Also, they can be used to educate cooperative members that do not yet support employee ownership as a succession planning strategy.

Conclusion

Employee ownership holds great promise to transform the lives of economically disadvantaged communities, especially communities of color in urban areas. It also offers a positive response to the coming wave of business closures that are the result of Baby Boomer business owners facing retirement. Accomplishing these goals, however, requires an approach that takes into account the realities of the market and has the necessary support systems to ensure long-term success. The following appendices are a brief introduction to the conversion opportunity across six regional markets and five industry sectors. For copies of the full market study that examines each of these areas in more detail, contact the ICA Group at (617) 232-8765 or ica@ica-group.org.

Regional Analysis: At a Glance



New England

Market for Conversions: Each year, across the five sectors, 23 businesses that have been in operation for more than 25 years close and 19 are sold, for a total conversion potential per year of 42 firms employing 1,528 people.

Technical Assistance: New England has a very strong technical assistance capacity, including both national and regional organizations with dedicated programs for small employee ownership conversions. In addition, there are two CDFIs that focus on cooperatives.



Target Companies	Median Value by Sector	Regional Boundaries
Companies 2,271	Food Mfg.....\$2,604,000	All six New England states, minus Fairfield County, CT, which is included in the New York Metro area
Jobs100,138	Grocery\$720,000	
POC-owned 2%	Residential Care..\$820,787	
Woman-owned11%	Home Care \$575,000	
Older Firms.....48%	Childcare\$328,000	

New York Metro Area

Market for Conversions: Each year, 20 businesses that have been in operation for more than 25 years close and 18 are sold, for a total conversion potential per year of 38 firms employing 1,242 people.

Technical Assistance: New York has a strong technical assistance capacity, including both national and local organizations with dedicated programs for small employee ownership conversions, many of which receive funding from the New York City Council.



Target Companies	Median Value by Sector	Regional Boundaries
Companies2,743	Food Mfg..... \$1,392,000	Counties within the NYC-Newark-Jersey City Based Statistical Area, including the county in which Trenton, NJ is located
Jobs 111,661	Grocery\$992,336	
POC-owned 5%	Residential Care..\$822,802	
Woman-owned 10%	Home Care \$667,000	
Older Firms..... 44%	Childcare \$314,880	

Mid-Atlantic Region

Market for Conversions: Each year, 12 businesses that have been in operation for more than 25 years close and 13 are sold, for a total conversion potential per year of 25 firms employing 855 people.

Technical Assistance: The Mid-Atlantic region has a growing technical assistance system centered in Philadelphia, with efforts developing in Washington, D.C. and Baltimore as well.



Target Companies	Median Value by Sector	Regional Boundaries
Companies 1,587	Food Mfg..... \$2,174,472	Counties in and around Baltimore and Philadelphia, and Washington, D.C. County Based Statistical Area, and counties within the Interstate 95 corridor between these metro areas
Jobs65,492	Grocery \$735,688	
POC-owned 5%	Residential Care....\$677,159	
Woman-owned13%	Home Care..... \$951,260	
Older Firms.....39%	Childcare\$350,000	

Chicago Metro Area

Market for Conversions: Each year, eight businesses that have been in operation for more than 25 years close and 10 are sold, for a total conversion potential per year of 18 firms employing 708 people.

Technical Assistance: Although Chicago does not have a developed local technical assistance landscape, national organizations are active in the region.



Target Companies	Median Value by Sector	Regional Boundaries
Companies 1,162	Food Mfg..... \$3,730,632	Counties found in the Chicago Metro area as defined by the U.S. Census' County Based Statistical Areas
Jobs52,061	Grocery\$1,200,000	
POC-owned 5%	Residential Care....\$744,000	
Woman-owned11%	Home Care.....\$548,800	
Older Firms.....41%	Childcare \$357,560	

Los Angeles & San Francisco Bay Area

Market for Conversions: Each year, 17 businesses that have been in operation for more than 25 years close and 20 are sold, for a total conversion potential per year of 37 firms employing 1,392 people.

Technical Assistance: The San Francisco region has a very robust employee-owned cooperative ecosystem. The landscape in Los Angeles is less fully developed, although there is an emergent cooperative development community and national organizations are active in the region.



Target Companies	Median Value by Sector	Regional Boundaries
Companies2,174	Food Mfg. \$3,738,480	Los Angeles and Orange County and the San Francisco-Oakland-Hayward County Based Statistical Area and Santa Clara County
Jobs 96,505	Grocery \$960,000	
POC-owned 8%	Residential Care. \$845,603	
Woman-owned12%	Home Care\$862,520	
Older Firms.....41%	Childcare \$304,780	

Miami Metro Area

Market for Conversions: Each year, five businesses that have been in operation for more than 25 years close and two are sold, for a total conversion potential per year of seven firms employing 246 people.

Technical Assistance: Although Miami does not have a developed local technical assistance landscape, there is interest by a number of different groups in the area.



Target Companies	Median Value by Sector	Regional Boundaries
Companies 370	Food Mfg. \$2,448,000	The 34 municipalities that make up Miami-Dade County
Jobs 14,461	Grocery\$825,456	
POC-owned12%	Residential Care.... \$827,731	
Woman-owned11%	Home Care \$360,000	
Older Firms.....37%	Childcare\$240,000	



Firm Size: Firm size varies greatly by industry. Among the five sectors, food manufacturing, grocery, and residential care represent 89 percent of higher-value firms, with food manufacturing alone representing 39 percent of higher-value firms.

Real Estate: In this analysis, estimated values are based upon a multiple of revenue (see the “Methodology” section for further explanation) and do not include the value of any real estate owned by the firm. Practically speaking, this means that the financing associated with the sale of these firms might be significantly higher. Especially in the manufacturing, grocery, and residential care sectors, real estate may be owned by the firm and be a necessary part of the transaction. In certain places, especially New York, San Francisco, Washington, D.C., and Boston, real estate may present an obstacle to any transaction given that the land underneath a business may be multiples of the enterprise value of the operating firm.

Sales and Closure Trends: Between 2000 and 2013, the industries experienced different trends on sales and closures of target firms. In grocery, for example, closures peaked during 2010 and then leveled, whereas in child care, closures continued to grow.

Home Care Agencies

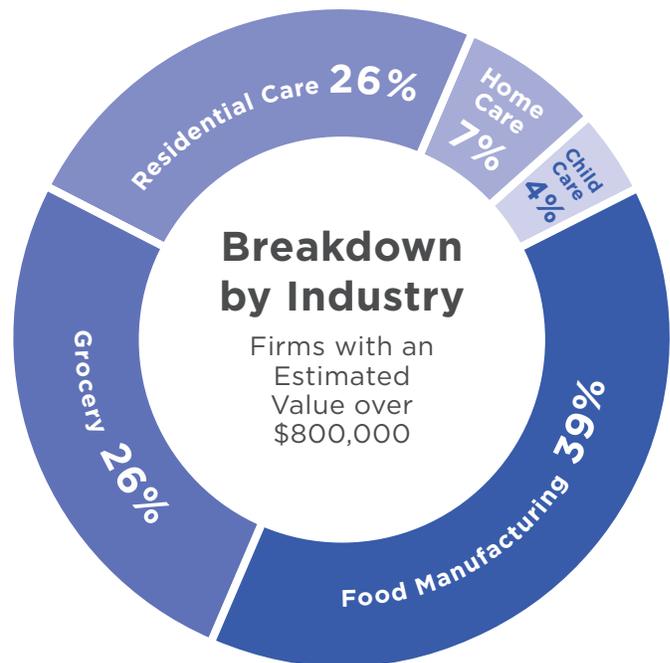
Industry Overview: The home care industry experienced significant growth from 2011 to 2016, growing at an annualized rate of 4.5 percent and is expected to experience increased growth over the next five years with an annualized growth rate of 6.7 percent. As with other health care-related businesses, cuts in Medicaid and Medicare funding, as well as reimbursement rates, have reduced profitability. Despite projected revenue growth, profit margins are not expected to grow over the next five years. These cuts have increased the number of consolidations as home care businesses seek to reduce costs. As a service industry, wages are the largest segment of the home care industry’s costs at 47.1 percent of revenue. This

has declined over the last five years as home care firms have pursued cost-cutting measures.

Transaction Activity: In the period between 1991 and 2001, it was quite common for there to be more than 10 target home care agencies sold annually. Since 2004, the total number across the five regions has not exceeded five sales per year.

Residential Care Facilities

Industry Overview: As of 2016, the residential care industry had 22,898 firms earning \$9.1 billion on \$132 billion in revenue. In the previous five years, the industry had an annual growth rate of 2.3 percent and is projected to more than double that growth rate through 2021 with an annual growth rate of 5.7 percent. The industry’s current and expected growth is driven primarily by the aging of the American population with the number of adults aged 65 and over expected to increase by 45.8 million over the next five years. This growth has been tempered by reductions in reimbursement rates for both Medicare and Medicaid.



Due to this reduction in government funding, there has been an industry shift away from residential care facilities toward at-home care. As a response, some residential care firms have pursued mergers and acquisitions of home health and home care companies. These actions broaden their services and allow them to react to structural shifts in government funding of health care services. While wages continue to be the largest cost to residential care facility operators, wages as a share of company revenue have dropped more than four percent in the last five years. This reduction is due to slow growth in industry employment because of government spending cuts.

Transaction Activity: The rate of closures and sales in the sector has seen an increase following the Great Recession. While the sales of target firms appear to have leveled off at a lower rate in 2012, data for the overall sector (not just target firms) paints a different picture. Among all firms with 20 to 100 employees, the number of sales increased dramatically in 2013 and 2014. In 2013, 75 mid-sized firms were sold, 67 of which were “corporate” affiliated firms. In 2014, the number of mid-sized firms sold was 188, 180 of which were “corporate” affiliated firms. Despite independent firms representing 82 percent of all residential-care facilities, between 1991 and 2014, they represented only 28 percent of sales.

Childcare Services

Industry Overview: In 2017, the childcare industry had 755,457 businesses in the United States, earning an annual total of \$4.7 billion in profits on \$47.8 billion in sales revenue. From 2012-2017, the industry experienced a growth rate of 1.3 percent and is projected to grow at 2.1 percent over the next five years. Following the 2008 recession, the industry experienced little growth due to reduced government funding for childcare services and declining disposable income. The industry has rebounded and is expected to experience higher growth rates due to increases in disposable income. This growth, though, will be limited by expected increases in the cost of childcare services. Other factors that affect the growth of the childcare industry include government funding for programs such as Head Start, the female labor force participation rate, and the number of children aged nine and younger. Wages have increased as a share of

industry revenue from 49.1 percent in 2012 to 53.3 percent in 2017, as childcare providers are increasingly competing based on having a high staff-to-child ratio.

Transaction Activity: Among target firms, the transaction activity between 2001 and 2011 remained quite low, although in the years following the Great Recession, sales activity has seen an uptick. More striking is the change in the number of target firms that had been in operation for more than 25 years that closed. Between 2000 and 2008, the number of older firm closures remained steady at between 10 and 20 per year. Between 2009 and 2013, however, 211 older target firms closed—an average of 42 per year.

Grocery Industry

Industry Overview: The grocery and supermarket industry has 41,076 businesses in the United States and earned \$611.9 billion in revenue and \$12.2 billion in profits in 2016. Over the last five years, the industry has grown 1 percent per year and is projected to grow at 0.8 percent per year over the next 5 years. The future growth in the industry is predicated on increasing disposable income and consumer preferences shifting towards more specialty products such as organic produce. The industry has also experienced increased competition from alternative format stores, such as Costco and Trader Joe’s. The industry is experiencing a shift toward a larger percentage of the workforce earning higher wages as new technologies, such as self-service checkout, have decreased the need for low-wage jobs.

Transaction Activity: Closings of older grocery stores saw a peak during the Great Recession, and the number has remained above its historic average since then. Similarly, the short-term trend among sales of target grocery stores has seen an increase in the latest recovery, although the levels are not at their early- to mid-1990s’ levels.

Food Manufacturing

Industry Overview: In 2017, the food manufacturing industry earned \$37.4 billion in profit on \$797.3 billion of revenue. Over the previous five years, the industry experienced a growth rate of 0.4 percent but is expected to grow just under two percent for the

upcoming five-year period. This industry includes many sub-industries with their own unique attributes. For all of the sub-industries, the price of raw materials is a key driver of industry profitability with the price of feed also becoming an important variable for animal products. Additionally, consumer tastes and disposable income are important variables in determining the industry's growth projections. Finally, international prices for food commodities along with the relative value of the U.S. dollar are important for determining the export market's size for food manufacturing.

Transaction Activity: Sales and closures of food manufacturing firms that have been operating for more than 25 years have been relatively stable since the late 1990s. While there was a surge of closings during the Great Recession and the number of sales decreased in the lead up to the Great Recession, the transaction activity since 2010 follows a similar pattern to that of the period between 1997 and 2003 with 10 to 25 sales across the five regions annually. Like other sectors, independent firms make up a larger portion of all firms, but a smaller percentage of sales. In food manufacturing overall, independent firms make up 80 percent of all firms, but only 34 percent of the total sales that occurred between 1991 and 2013.

Other Promising Sectors

In addition to those identified above, there are a number of sectors that warrant further exploration for rapid conversion potential.

Solar Installation and Design Build

A subset of the construction sector, a number of solar-installation and design-build businesses have already converted to employee ownership. South Mountain Company in New England and Big Timberworks in Montana are both design-build firms that converted to employee ownership a number of years ago. In recent years, companies - such as Namaste Solar (Colorado), Metis Construction (Washington) and Sun Light and Power (California) - have converted to employee ownership. As of June 2017, there were at least four firms within the five regions that were actively exploring employee ownership as an option.

Engineering & Architecture

Quite a few larger scale employee-owned engineering firms have an ESOP, such as KCI Technologies in Baltimore and Urban Engineers of Philadelphia. While the number of employee-owned cooperatives in this area is relatively small, examples exist, such as Warren

Street Architects in New Hampshire and Ewing Controls in Massachusetts. The promotion of sustainable building practices and the need, especially among smaller firms, for strong collaboration make this a sector worth exploring.

Landscaping

There are a number of small employee-owned firms in the landscaping sector that are a result of cooperative conversion, including A Yard and a Half in Massachusetts and Lodi Farms in Michigan. Additionally, a number of startup employee-owned landscaping businesses are in operation, including Team Works in California. Given the important role that front-line employees play in this sector, ownership is a good fit.

Light Manufacturing

While manufacturing is a large multi-faceted sector, there are numerous examples of employee ownership in larger manufacturing firms through ESOPs, and the sector shows great promise for worker cooperatives. ICA examined the machine shop sector in Massachusetts and found that 95 percent of these businesses were likely owned by someone looking at retirement. Also, a large number of these older, smaller firms were closing despite overall growth in the sector.



Key Terms Defined

Independent: Firms were ruled “independent” if the headquarter’s DUNS Number for a location was shared by 10 or fewer others, meaning that fewer than 10 other locations were part of the same parent company.

Corporate: Firms are defined as “corporate” when they have 10 or more related enterprises that share the same headquarter’s DUNS Number.

Target Company: Target companies are those that are most likely to transition to employee ownership successfully, have between 20 and 100 employees and are “independent.”

ESOP: An employee stock ownership plan (ESOP) is a specialized stock bonus plan that is allowed to invest primarily in employer stock. ESOPs are governed by both the Internal Revenue Service and the Employment Retirement Income Security Act (ERISA). In an ESOP, employees do not own the stock of the company directly, but rather through a trust.

Worker Cooperative: A worker cooperative is a firm where the employees own all or at least a majority of the company. Employees are entitled to own only one voting share. When owners vote on issues, they do so on a one-person, one-vote basis. Membership in a worker co-op also entitles one to a share of the profits in proportion to the labor contribution each member made.

The key distinction between co-ops and ESOPs is how the ownership is held. In a co-op, workers control the shares directly, while in an ESOP, the shares are held in trust for the employees. The practical distinction between the two is the regulatory burden each carries and the requirement that workers have a role in the governance of a co-op. ESOPs are ‘qualified’ retirement plans that require engaging a trustee, and annually completing an audit, an independent valuation, and other filings with the Department of Labor.

About The ICA Group

This report was authored by the ICA Group, a nonprofit consultancy whose mission is to expand economic opportunity and self-determination for low-income people by supporting initiatives that empower workers, build community assets, and root capital locally through employee ownership.

Since 1977, the ICA Group has applied expert analyses, results-based planning and a collaborative management approach to helping start and grow worker cooperatives, democratic ESOPs, and other social purpose ventures. We believe that all people should enjoy economic self-determination as a means to foster an environment where workers’ livelihoods and the communities where they live are stable and secure.



Methodology

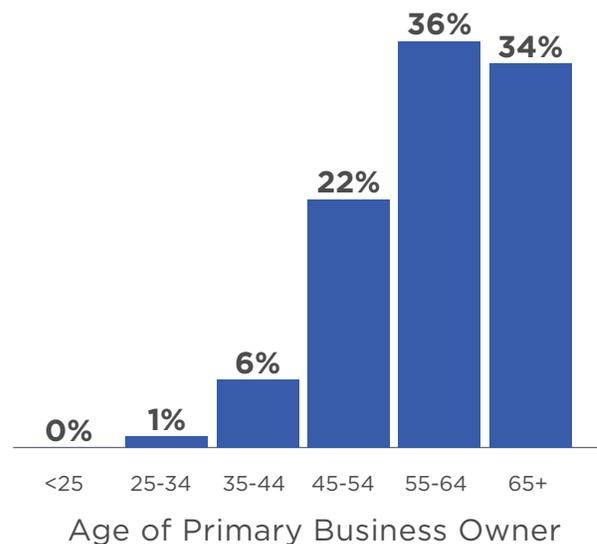
In determining the potential for small employee ownership conversions in the five geographic regions, the ICA Group utilized the National Establishment Time Series (NETS) database. NETS is a proprietary database developed by Walls & Associates that converts Dun and Bradstreet (D&B) archival establishment data into a time-series database of establishment information. The NETS Database provides longitudinal data on various dynamics of the U.S. economy that include establishment job creation and destruction, sales growth performance, corporate affiliations and historical D&B credit and payment ratings.

Target companies were identified as being mid-sized and independent. Mid-sized businesses were defined as firms that had between 20 and 100 employees during their last year of operation. Independent businesses were defined as firms that had less than 10 related entities. We identified independent, mid-sized businesses that sold in the five geographic regions and five industries as businesses that held potential to be converted to employee ownership.

Using the above selection of businesses with 20 to 100 employees and less than 10 related entities, we determined that firms that have been in operation for more than 25 years were much more likely to have owners approaching retirement age. Therefore, they are another pool of businesses with conversion potential. Using the U.S. Census' Public Use Microdata Survey of Small Business Owners, we found that there is a statistically significant relationship between the age of the primary owner and the year in which the company was established. In other words: the older the business, the older the owner. Using data gathered in 2007, we found that, of businesses established before 1980, 34.3 percent had owners that were 65 years old or older, and 70.1 percent of owners were 55 years old or older. This analysis determined that the subset of businesses with 20 to 100 employees and less than 10 related entities that have been in operation for more than 25 years have the highest conversion potential. This group, along with the group of businesses sold, will be identified as "Conversion Potential" for the remainder of this analysis.

Using the Conversion Potential businesses in the NETS data set, we analyzed both business sales and closings to identify conversion opportunities by both geographic region and industry. While portions of the analysis will only look at sales and closings since the year 2000, the data set is for the years 1991 to 2014, and summary data will cover that period.

25+ Year-Old Firms



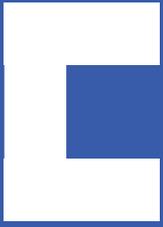
Since the NETS dataset had sales data but not net revenue data, we determined business valuations by using a multiple of sales revenue. This multiple was drawn from the Pratt's Stats database, which houses data on businesses sold by industry. Using the average multiple across the industry, we estimated each business in the NETS database's value by multiplying its final year's sales revenue by the multiple from Pratt's Stats. While this valuation methodology only provides a very rough estimate of firm value, when applied across a wide array of firms and used to identify measures of central tendency, we believe that it provides the most accurate measure given the data available.

The table below shows the valuation multiple used for each industry.

SIC3	Industry	Valuation Multiple
201	Food Manufacturing	0.48
202	Food Manufacturing	0.48
203	Food Manufacturing	0.48
204	Food Manufacturing	0.48
205	Food Manufacturing	0.48
206	Food Manufacturing	0.48
207	Food Manufacturing	0.48
208	Food Manufacturing	0.48
209	Food Manufacturing	0.48
514	Grocery	0.16
541	Grocery	0.16
805	Nursing Care	0.31
808	Home Care Agencies	0.40

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BUILDING COMMUNITIES OF OPPORTUNITY THAT BREAK BARRIERS TO SUCCESS



Cooperative Development Supports Our Larger Vision

Capital Impact Partners champions social and economic justice for underserved communities, transforming them into communities of opportunity that foster good health, economic opportunity, and interconnectedness. Through mission-driven lending, incubating social impact programs, impact investing, and policy reform, we partner with local communities to help create equitable access to health care and education, healthy foods, affordable housing, and dignified aging for those most in need.



2.5 MILLION

PATIENTS
receiving health care at
533 community health centers



253,000

STUDENTS
in 248 high-quality
charter schools



1.1 MILLION

PEOPLE
with access to healthy
food from 88 local retailers



37,000

ELDERS
aging in their community
through 190 communities



38,000

AFFORDABLE HOUSING
units in 246
communities



870,000

COOPERATIVE CUSTOMERS
served by 291
co-op businesses

WE HAVE DEPLOYED OVER **\$2.5 BILLION** TO SERVE NEARLY
5 MILLION PEOPLE AND CREATE MORE THAN **32,500 JOBS**
NATIONWIDE IN SECTORS CRITICAL TO VIBRANT COMMUNITIES.



CAPITAL IMPACT
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