The Essentials for Business Owners

WHY DO IT? Conversion to employee ownership can be a great deal for outgoing owners for a number of reasons:

- **Significant potential tax advantages:** IRS Section 1042 Rollover allows owners of closely held c-corps to defer capital gains taxes on earnings when they sell at least 30 percent to employees and reinvest the profits into domestically-owned establishments, securities or trusts.

- **Flexible sale process:** If you are starting to plan for retirement but are not ready to hang up the address book just yet, converting to employee ownership can provide a flexible process for gradually exiting the firm. Outgoing owners often remain company leaders after the sale is consummated, providing advice, guidance and mentorship to new employee-owners.

- **Financing alternatives:** Conversion deals have a good track record of securing financing. Most deals entail a combination of capital sources (bank loan, subordinate debt, loan from outgoing owner, loan from company itself), and repayment can be structured in a variety of ways (e.g. fixed terms, share of profits, dividends).

- **Safeguard your legacy:** If you worry that selling could put your employees and community at risk, conversion to employee ownership may be the answer. Selling to your employees can sustain the culture you have built within the firm, make it much less likely that your company will suddenly move to another location, and gives your employees greater control over their economic future.

Homegrown Legacies

Keeping businesses rooted in North Carolina

WHAT IS IT? Types of Employee-Owned Enterprises:

- **Worker-Owned Cooperative:** Business entities with binding bylaws and operating procedures that determine how management is shared among some or all employees. The worker-owned cooperative structure is still most common for smaller firms, but it has proven successful even for large companies with hundreds or thousands of employees.

- **Employee Stock Ownership Plan (ESOP):** A benefit plan that allows employees to acquire ownership stakes in their company. ESOPs can vary widely in how they are structured. Ownership can be structured in a variety of ways, including direct employee ownership of stocks and employee stake in a trust that, in turn, holds company stock. Regulatory requirements, tax advantages, and familiarity within legal and accounting professionals lead most medium and larger companies to convert through an ESOP. While not all ESOPs are democratically governed, there are a variety of ways to provide employees an active voice in managing the firm, such as electing representatives to sit on the company's board of directors.

- **ESOP/Cooperative Hybrid:** Companies are increasingly exploring hybrid structures that combine an equity stake provided through an ESOP with the democratic decision-making at the core of employee-owned cooperatives.

HOW DO YOU DO IT? While every deal is unique, conversion to employee-ownership usually include the following steps. Many of the steps listed below can be greatly streamlined by working with legal, accounting, and employee-ownership technical experts who have seen the process through with other firms. In many cases, funds to pay for technical assistance can be included in the capital raised to finance the sale of the company, meaning that the outgoing owner need not cover all costs.

1 Basic Exploration (2-4 weeks)

- Owner learns the basics of conversion to employee-ownership
- First conversations held to evaluate employees interest
- Owner and employee decide whether to continue with feasibility assessment

2 Feasibility Assessment (1-4 months)

- Form owner and employee assessment teams
- Perform company valuation
- Evaluate company financials
- Identify gaps that will need to be filled with ultimate departure of current owner
- Identify other knowledge or skill needs to be filled
- Develop draft timeline
- Owner and employees decide whether to continue with conversion

3 Prepare for Deal (2-6 months)

- Educate employees on essential business skills (accounting, human resource management, business model development, etc.)
- Educate employees on how to operate a democratically-controlled business
- Choose post-conversion business structure (e.g. cooperative, ESOP, or other structure)
- Draft by-laws
- Establish new management structure
- Identify potential financing sources
- Owner and employees decide whether to negotiate terms of final sale

4 Finalize transition (1-4 weeks)

- Negotiate final price
- Finalize new operating bylaws
- Finalize new management structures
- Secure financing
- Sign deal transferring ownership to employees

5 Support and Monitoring (1-5 years)

- Transfer outgoing owner's knowledge to new management team (e.g. supplier/customer relationships, technical expertise, etc.), often with former owner retaining a role in the firm for months or years after conversion.
- Consultants and/or internal team support implementing management and governance structures, facilitate democratic decision-making,
- Consultants and/or internal team deliver training to employees taking over new business functions (e.g. management, business development, human resources, etc.)

Have questions? For more info, contact:

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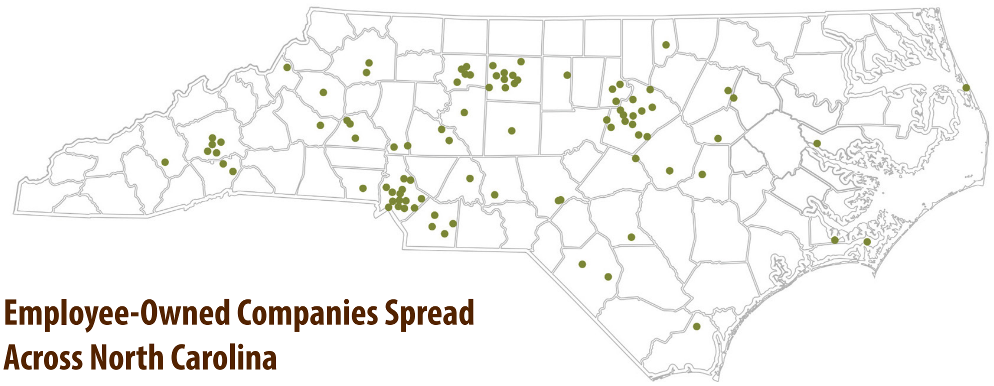
Read the report "Down Home Capital: How Converting Businesses into Employee-Owned Enterprises Can Save Jobs and Empower Communities" at **bit.ly/DownHomeNC**.



Employee-Owned Companies Spread Across North Carolina

Employee ownership already has a major footprint in North Carolina. Spread all across the state, employee-owned companies range in size from corporate behemoths to small firms with only a handful of employees. Employee ownership can be found in a wide range of industries, including manufacturing, distribution, finance, engineering, retail, and construction.