Impact Investors as a Source of Financing for Employee Ownership Companies

Impact investing is an investment strategy that seeks to generate financial returns while also creating positive social or environmental impacts. Impact investors consider a company's broader impact on society, in addition to traditional concerns about financial gain, when considering how to invest their money. Although employee ownership is not yet widely embraced by impact investors, it is beginning to gain popularity as these investors begin to focus more concretely on worker well-being. Some, if not all Employee Ownership transitions require external funding, or sources of outside financing. It is beneficial for Employee Owned-businesses to find funders that are aligned with their interests, which are advantageous as compared to generic sources of external financing. Business owners who have identified a viable employee ownership model for their company should look to these socially conscious investors as a potential source of financing.

Many different types of financing organizations now have employee ownership focused impact investing charters. Some of these types of organizations are the Community Development Financial Institution (CDFI), Private Equity Firms, and Banks. CDFI is a privately-owned bank that promotes locally-oriented financial inclusion and economic development. CDFIs often emphasize on social responsibility and inclusion, rather than a pure profit motive, and may receive support from the federal government's CDFI Fund. Private Equity Firms provide financial backing and make investments in privately owned companies based on a pre-planned investment strategy. Banks are traditional financing organizations that can make loans to companies.

Out of roughly 800 CDFIs in the US, a report[1] identified six that focus specifically on promoting worker cooperatives as a form of Employee Ownership. These are Capital Impact Partners in Washington, DC; the Commonwealth Revolving Fund run by the Ohio Employee Ownership Center in Kent, OH; Cooperative Fund of New England, which lends to cooperatives of all kinds throughout New England states; Local Enterprise Assistance Fund (LEAF) in Brookline, MA; Shared Capital Cooperative (formerly North- country Cooperative Development Fund) in Minneapolis; and The Working World in New York City.

Worker cooperatives comprise a small portion of all employee-owned Employee Stock Ownership Plan (ESOPs). There are private equity firms and Banks that take part in ESOP transactions more generally, and do not just focus on co-ops the way CDFIs do. A report identified two private equity funds focused on a variety of mid-market employee stock ownership plan transactions— Mosaic Capital Partners in Charlotte, NC; and Long Point Capital, with offices in Royal Oak, MI, and New York City. Many of the nation's largest banks have set up dedicated teams within their commercial banking divisions to actively seek out ESOP loans. However many bankers are not aware of the opportunities for employee stock ownership plan (ESOP) lending. Business owners that are seeking out ESOP funding from banks may need to educate bankers of this very lucrative opportunity characterized by the following as noted by Scott Leach a former banker and ESOP advisory: 1) large loan amounts; 2) debt that is statistically less

---

[1] Mary Ann Beyster. May 2019. "Impact Investing and Employee Ownership: Making employee-owned enterprises part of the income inequality solution." Fifty by Fifty.

likely to default;3 3) allowance for personal guarantees and requirements for collateral coverage; 4) market rates; and 5) loans that serve the greater purpose of reinvestment in community well-being.

Some of the research on companies with an ESOP shows that investing in ESOPs can be more rewarding and less risky. Some of the key points of this research are: The default rate on bank loans to ESOP companies during the period 2009-2013 was 0.2 percent annually, and by contrast, mid-market companies in the U.S. typically default on comparable loans at an annual rate of 2 to 3.75 percent; they are 25% more likely to stay in business longer than a typical company; sales increase by about 2.3-2.3% per year; they see average yearly post-transition improvement in assets returns of over 2.7% and; they have comparatively high employee retention rates as shown by 2014 data in which only 1.3% of employees in an ESOP were laid off compared to 9.5% in a non-ESOP company.[2]

Final Thoughts

Business owners should look to impact investors as potential sources of financing because of their utility and potential of financial benefits to the company. CDFI's, PE firms and some banks have already begun practices with employee-owned businesses, but they have yet to be widely accepted. Therefore, business owners will likely need to have enough information about this process and its benefits in order to better make the case to investors about why this is a good course of action for them.

[2] Scott Leach. 2021. "ESOP Lending: A Former Banker's Insight on the Huge Opportunity Bankers are Missing." UC San Diego Rady School of Management.