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BEFORE THE SENATE COMMITTEE ON SMALL BUSINESS AND ENTRPRENEURSHIP

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Good afternoon Chairman Shaheen, Ranking Member Ernst, and members of the Committee. My name is Tabitha Croscut and I am a Shareholder at the New Hampshire law firm of Devine, Millimet & Branch, P.A. For over twenty years I have helped my clients, who are owners of both small and large privately held businesses, to assess, consider, and navigate the feasibility and implementation of Employee Stock Ownership Plans (ESOP) as an ownership succession and employee incentive strategy. I would like to thank you for the opportunity to appear before you to discuss the importance of succession planning and for allowing me to share with you how and why ESOPs can be a better option for many business owners looking for a sustainable and impactful succession strategy.

ESOP Statistics

Before I share with you a couple ESOP success stories from the State of New Hampshire, I would like to outline some important statistics for background.

One recent survey has estimated that "[e]ighty-seven percent of American businesses are family-owned or controlled."[1] In New Hampshire, the Center for Family Enterprise out of the University of New Hampshire reported that around eighty-five percent of businesses in the state are family owned.[2] Across the U.S., these family owned businesses represent "54% of U.S. GDP and 59% of employment, meaning family-owned businesses directly affect more than half of U.S. workers."[3] However, according to an often cited 2021 survey done by PwC, "only 34%

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[1] Arturo Holmes, "Most family businesses don't look like 'Succession.' Here's what America's enterprising families bring to the table", Fortune (May 29, 2023), *available at* https://fortune.com/2023/05/29/most-family-businesses-dont-look-like-succession-heres-what-americas-enterprising-families-bring-to-the-table/.

[2] Paul Briand, "An enterprising endeavor: Center for Family Enterprise expands to encompass all NH businesses", Foster's Daily Democrat (Jul. 3, 2019), available at https://www.fosters.com/story/business/2019/07/07/center-for-family-enterprise-expands-to-encompass-all-nh-businesses/4749136007/.

[3] Holmes, *supra* note 1.

[of respondents] said they had a robust, document and communicated succession plan in place."[4] Those are just the family-owned businesses in our communities. Others also report that "baby boomers who are at or near retirement age own nearly half of the nation's privately-held businesses," and" more than half of small business owners expect to retire in the next 10 years, [with] fewer than fifteen percent hav[ing] a formal exit plan in place."[5] As a result of such lack of planning, many companies are bought up by third parties, such as private equity firms, and some even close their doors when they are unable to find a buyer. For other business owners the lack of planning results in lower value paid for an investment they have spent their lives and livelihood to build. This is a challenge for not only the business owners, but also for the many families and communities that rely on their companies.

It is not my position that private equity is "bad" per se, or even that selling to a third party is bad, but rather that for many successful, small businesses—family owned and community centric—an ESOP could be a better alternative. Unfortunately, the ESOP alternative has far less public awareness than third party sales, but offers small businesses in many cases a more favorable and higher impact alternative.

The National Center for Employee Ownership (NCEO) estimates that, as of 2023, there are roughly 6,500 ESOPs in the United States covering almost 14 million participants.[6] The vast majority of these ESOPs own stock in privately held companies.[7] More than half of these privately held companies have what are referred to as "small plans", meaning they include under 100 participants.[8] According to the NCEO, more than half of the nation's ESOPs are professional science or technical services, manufacturing and construction companies.[9]

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[4] "PwC's 2023 US Family Business Survey" (May 16, 2023), *available at* https://www.pwc.com/us/en/services/trust-solutions/private-company-services/library/family-business-survey.html.

[5] Rutgers School of Management and Labor Relations, "Main Street Employee Ownership Act Summary", *available at* https://smlr.rutgers.edu/sites/smlr/files/Documents/Faculty-Staff-Docs/3-21-18_main_street_employee_ownership_act_summary_5_copy.pdf.

[6] National Center for Employee Ownership, "Employee Stock Ownership Plan (ESOP) Facts", *available at* https://www.esop.org/#:~:text=Employee%20Stock%20Ownership%20Plan%20(ESOP,covering%20almost%2014%20million%20participants.

[7] National Center for Employee Ownership, "Employee Ownership by the Numbers", *available at* https://www.nceo.org/articles/employee-ownership-by-the-numbers.

[8] National Center for Employee Ownership, *supra* note 7.

[9] National Center for Employee Ownership, "A Statistical Snapshot of ESOPs: Company and Participant Numbers, and Industry Distribution", *available at* https://www.esop.org/infographics/statistical-snapshot-esops.php.

According to information collected annually by the U.S. Department of Labor, in the Granite State there are approximately 30 ESOPs in privately held companies.[10] Of these ESOPs, approximately 27 are headquartered in New Hampshire (and that's important) –small towns in the Monadnock Region or White Mountains, cities like Manchester or Salem.[11] These are companies that are staying in New Hampshire and are heavily invested in the success of their communities. Those 30 New Hampshire ESOP owned companies cover over 4,600 participants, of which approximately 3,300 of those are identified as current employees.[12]

In New Hampshire, most of the ESOP owned companies are smaller businesses; in fact, more than two-thirds have under 100 employees.[13] Taken as a whole, however, these small businesses have ESOP plans that have accumulated significant wealth for their employee-participants. Together, New Hampshire ESOPs hold more than $800 million of retirement asset value for the employee-participants of those plans.[14] New Hampshire ESOPs also come from a wide variety of industries: approximately 33% are manufacturing companies, 30% professional services, 17% construction, 10% retail, and healthcare, finance and insurance, and miscellaneous services each make up 3%, respectively.[15]

Given the positive impact of ESOP owned companies, you might be wondering, why are there only 30 ESOP owned companies in New Hampshire? I believe there are two primary obstacles to the utilization of ESOPs as a positive succession strategy, not only in New Hampshire, but across the United States. First, there is low public and professional awareness about ESOPs. Second, there is a shortage and/or absence of lending capital for ESOP formations and their related stock acquisitions from business owners, which puts ESOPs at a disadvantage.

Before proposing how we can address those obstacles, I would like to take a few minutes to share with you a couple ESOP success stories from New Hampshire. I think these stories demonstrate well why ESOPs should be an option for any successful small business owner looking to make an impactful ownership succession planning choice.

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[10] National Center for Employee Ownership, "NCEO analysis of Dept. of Labor Form 5500 data" (last accessed Jan. 17, 2024).
[11] *Id.*
[12] *Id.*
[13] *Id.*
[14] *Id.*
[15] *Id.*

Yankee Publishing

Since 1792, across the U.S. consumers have thumbed through The Old Farmer's Almanac to predict the weather, learn a couple of jokes, or obtain new gardening tips. The Almanac is the oldest continuously published periodical in North America, and, for many years, Yankee Publishing has owned the exclusive rights to it.

Based in rural Dublin, New Hampshire, Yankee Publishing is an 88-year old family business that publishes (in addition to The Old Farmer's Almanac), Yankee Magazine, New Hampshire Magazine, and the NH Business Review, to name a few. It employs approximately 75 people in a region of New Hampshire where the town populations typically consist of 2,000 people or less.

When it came time to start seriously considering an ownership succession plan, Yankee Publishing had almost a dozen third generation shareholders, two of which worked in management, and a number of other family member shareholders. The combined ownership was looking ahead to around twenty-two children, and none of them were particularly interested in running the company. The need for a viable ownership transition strategy became pressing.

Ownership considered all of the standard succession options, including a shareholder buyout and a management buyout, however, no one had the capital or interest to pursue this option further. They next turned to the idea of selling the company to a third party, but not many people lined up to buy a publishing/media company. Ownership next considered selling the assets of the business. This was not seen as a viable option primarily because it would likely result in operations being moved out of Dublin and employees losing their jobs. Ownership felt they had a duty to continue to preserve not only the family legacy, but also Yankee Publishing's commitment to the community. As such, they spent some time researching other non-mainstream ideas, including the ESOP, and decided to go forward with the sale of the Company's stock to an ESOP for the benefit of the company's employees. Leadership of Yankee Publishing decided to approach the stock sale by selling 30% to the ESOP in 2019 and the remainder in 2022, which demonstrates the flexible and accommodating nature of the ESOP. Today the Company is 100% ESOP owned and the two shareholders that worked in the business before the sale of stock to the ESOP, continue to work at Yankee Publishing today.

Yankee Publishing ultimately chose the ESOP option for their ownership transition because the shareholders were willing to be patient with receiving fair value for their shares and they believed the ESOP would allow their business to remain independent and headquartered in Dublin; that employees would be able to retain their jobs, and, most importantly, that the employees, many of whom had been employed by Yankee Publishing for a long time, would get to share in the future value of Yankee Publishing.

I can report that today the 75 employee-owners of Yankee Publishing, headquartered in rural New Hampshire, are very happy with the decision of prior family ownership to sell the business to an ESOP.

Geokon

Now let me turn to a different and important industry - manufacturing. Geokon is a manufacturer of geotechnical and structural health instrumentation. Although they are headquartered in Lebanon, New Hampshire, they have an international presence. In the 1970's, after graduating from Oxford with an engineering degree, the company founder was working in the mining industry in Canada and began to see that modifications needed to be made to the geotechnical monitoring and measuring instrumentation that he was working with. Geokon was later formed in 1979 in Lebanon, New Hampshire in order to do just that – and it has been very successful.

For over 40 years now, the company has enjoyed consistent growth – they have acquired multiple buildings in Lebanon, New Hampshire, while also adding small offices in Singapore and Chile. As the founder would tell you, a central reason for their success is a culture that revolves around the concept of giving back to the community and Geokon's employees.

While the founder was at the helm of Geokon, the industry saw (and continues to see) many acquisitions by private equity consolidating manufacturing as well as service providers. With this in mind, and because of the founder's employee-centric philosophy and commitment to the community, he started looking for alternative business succession planning options. His research took many years, but after he learned about it, he knew the ESOP was the right fit for Geokon.

Important considerations in his decision to pursue an ESOP ownership transition included the realization that an ESOP would reward the employees, that it would maintain the local, community presence, that it would protect the business from being dismantled by industry focused private equity, that management would be able to retain day to day operational control, that there would be significant tax benefits for the company, and that there would be an opportunity to leverage the ESOP to further foster an employee culture of continuous improvement and success.

Today, approximately 140 employees of Geokon are still located in Lebanon, New Hampshire and benefit from ESOP ownership in the company.

Legislative Changes

While both Yankee Publishing and Geokon are great examples of successful ownership transitions utilizing ESOPs, we continue to struggle with the challenges of access to capital and a greater awareness of the ESOP succession strategy. Chairman Shaheen has supported several policy solutions to address such issues, including The Main Street Ownership Act passed in 2019, the Worker Ownership, Readiness, and Knowledge (WORK) Act in 2023, and Employee Equity Investment Act (EEIA) bill introduced in 2023, but more is needed. The Main Street Ownership Act passed in 2019 was championed as a win for ESOPs, but it was in fact slow in providing additional access to capital for ESOP transitions through SBA's 7(a) lending program, which due to certain procedural requirements, actually had minimal ESOP loans funded by the program. Since passage of the Act in 2019, I personally assisted only four companies to utilize SBA 7(a) loans in successfully financing their ESOP ownership transitions. According to the SBA reports, between FY 2018 and FY 2021 there were only 17 SBA loans to assist ESOPs in acquiring 51% or more of the equity ownership of small businesses.[16] Why have the numbers been so low? Unfortunately, the Act fell short in fully streamlining the lending process for small companies that desire to utilize an SBA 7(a) loan to finance an ESOP's purchase of company stock from the business owner. The exclusion of ESOP loans from the Preferred Lending Program caused inconsistency and delays in the review and approval of SBA 7(a) loans. Those are delays and risks that business owners are not willing to accept. However, I do believe that recent steps taken by the SBA to remove barriers in the SBA 7(a) loan process have been

[16] National Center for Employee Ownership (Oct. 31, 2022), "SBA Says Main Street Employee Ownership Act Has Not Produced Many ESOP Loans", available at *https://www.nceo.org/employee-ownership-blog/sba-says-main-street-employee-ownership-act-has-not-produced-many-esop-loans.*

successful. Just last month I assisted a business owner in transitioning 100% of their stock in a sale to an ESOP utilizing an SBA 7(a) loan, and the process was much faster! We must continue to streamline the SBA 7(a) loan process to make it more appealing to small business owners.

Turning to the other primary obstacle, The Main Street Ownership Act also directed the SBA to promote awareness of ESOPs and employee ownership. As previously mentioned, awareness of ESOPs is a primary barrier to businesses utilizing ESOPs for their ownership transitions. If a business owner and their professional advisors are unaware of how ESOPs work or that they even exist, they will lose out on the opportunity to transition ownership to an ESOP and instead sell to a third party buyer or simply shutdown the company. While The Main Street Ownership Act directs the SBA to promote such awareness, a step in the right direction, that only helps when the SBA has adequate support, structure and resources to implement that directive. The Employee Ownership Expansion Network reports that 40% of the 957 ESOPs created from 2014 through 2017 were by businesses located in states that had centers for employee ownership – that is a formal organization in the state to provide resources and education around the benefits of ESOPs.[17] The Work Act also took a big step in the right direction, as it requires the Department of Labor to establish an employee ownership initiative to promote employee ownership, which includes funding existing state programs or creating new ones. Again, we have seen initiatives passed previously but have limited impact due to how they were actually implemented. Focus needs to be given to ensuring the Work Act funding is made available quickly to those organizations that can maximize employee ownership outreach. The numbers show that if we can support the expansion of state centers throughout the United States while also empowering the SBA's promotion of ESOPs through Small Business Development Centers (SBDCs) and Women Business Centers (WBCs), business owners will have more access and be better educated on the ESOP succession option, which will lead to stable jobs and stronger communities.

Lastly, a number of our small businesses take advantage of programs for disadvantaged groups, including programs for minorities, women and veterans, to name a few. These businesses are

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[17] Employee Ownership Expansion Network, *available at* https://www.eoxnetwork.org/state-centers (last visited Jan. 19, 2024).

then penalized when they consider an ESOP ownership transition because the various certification requirements to qualify for such preferences generally require some portion of the company's stock to be owned by eligible members of the disadvantaged group, which does not consider the ESOP. As a result, those business owners must choose between a 100% transfer to ESOP ownership with a loss of their preferential status, or keeping their preferential status while finding an alternative ownership transfer option; which is a choice that typically has negative implications on the value of the stock of such business if they choose a sale to an ESOP. Fortunately, legislation has been proposed to address these barriers. The Employee Equity Investment Act (EEIA) directs SBA to study and report on alternative solutions for ESOPs, issue rulemaking to provide a path for majority ESOPs to maintain their contracting preference, and provide a two year grace period for majority ESOPs to maintain their preferential status. The EEIA also seeks to help bridge the capital gap that small businesses experience when considering options other than a third party sale.

Conclusion

In conclusion, there is a significant challenge for all privately held businesses across the United States - ownership succession. There are limited solutions for a business owner to solve that challenge. I propose to you that ESOPs can be a greater part of that solution, which will keep good jobs intact, strengthen local communities and, at the same time, allow business owners to receive the value of their businesses. With more awareness and understanding of the ESOP option, as well as greater and easier availability of capital to small businesses, we can ensure this once in a lifetime decision for many business owners to sell their companies, is also a win, win for employees and the communities they live and work in.

I appreciate the opportunity to appear before this Committee. I look forward to answering any questions you may have.