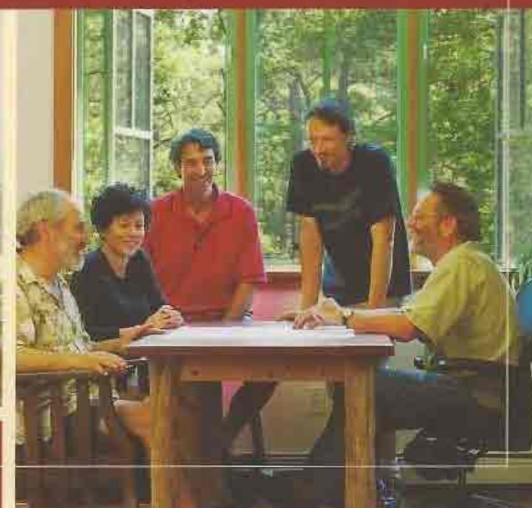
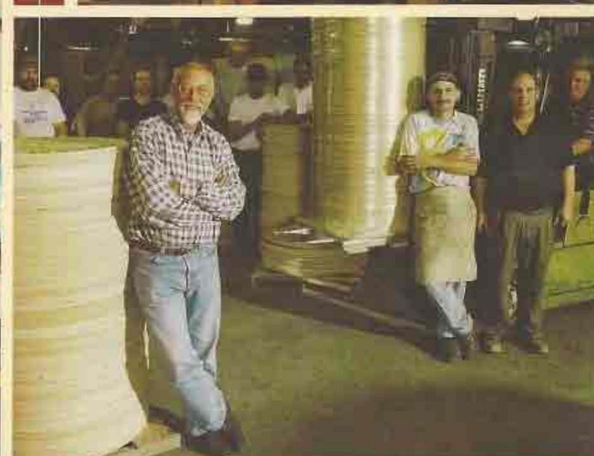
COMPANIES WE KEEP

EMPLOYEE OWNERSHIP AND THE BUSINESS OF COMMUNITY AND PLACE





JOHN ABRAMS

Foreword by William Greider

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RANDI BAIRD

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Sharing Ownership

When we all do better, we all do better.
—Paul Wellstone

Don't be afraid to take a big step when one is indicated.
You can't cross a chasm in two small steps.
—David Lloyd George

Through the 1970s South Mountain was truly an extended family business. My wife, Chris, and Clarissa—the wife of my partner, Mitchell—were integral parts. They plastered, painted, set tile, and stacked lumber. Chris prepared the bills and trucked materials from off-island, and we all lived together at the run-down farm Clarissa had inherited. Our few employees became close friends and hung around the farm as well. As we hired more employees and Chris and Clarissa began teaching careers, their role in the company diminished. The business expanded, and we built a new office next to the old shop.

By the early 1980s Mitchell had developed a strong appetite for farming; he gradually distanced himself from the business and we formally disbanded our partnership. Chris and I built a house on an adjacent piece of land that Clarissa generously carved off for us, but the business remained in its old quarters at the farm.

One night in 1984 a devastating fire burned the shop to the ground.

We regrouped soon after. Chris and I mortgaged our house, and the people in the company began building a new facility on our property. Some months later South Mountain moved into a well-equipped shop with spacious offices above. The newness was strange, but the space felt good. We were back on track. The dissolution of the partnership with Mitchell was complete. I was left as the sole proprietor of our common creation, which was now ten years old.

I felt uncertain in this new place, but curious and engaged.

The Apples in a Seed

Long before this, we had become committed to both designing and building the projects we took on. Our cues came from accounts of the old master builders of the Middle Ages, the pioneers of early America, the Arts and Crafts movement, and the Shakers. Our abilities were rudimentary and our aspirations high. We were devoted to fine woodwork and alternatives to conventional construction practices. We combined timber framing, passive solar, and an eclectic, unschooled design sense to make learn-by-doing buildings. We had mixed success. With no formal training and little experience, we were unconstrained by knowing what couldn't be done (and conversely unaware of much that could) and equally unencumbered by skill. We reinvented the wheel regularly.

But we were learning at breakneck speed and for a time that was all that mattered. At the tail end of the 1970s a series of important projects began to shape our future. We built two projects that we didn't design, which confirmed our dedication to the design/build integration. (Since then we have rarely deviated from that course; although we have occasionally designed projects that we didn't build, and although we now do some consulting work, for nearly thirty years we have not built anything designed by others.) Finally, in association with the nonprofit Energy Resource Group (which we, with others, had helped to form in order to

promote renewable energy), we orchestrated the research, design, and construction of a solar greenhouse attached to the Edgartown School. Teachers, students, and members of the public participated in the barn-raising-style event. It was our first significant venture into community demonstration work—a harbinger of things to come.

We had ten employees, including two who had been there from the beginning. I loved the work and I loved the people. We began to think about the company as an entity and to consider our role in the community. We accumulated expertise in ecological land-use and building techniques. We developed small affordable housing projects as contrast with our high-end work. I had a vague sense that we were developing something of value, but I couldn't yet articulate what our successes might suggest. Author Ken Kesey once said, "You can count the seeds in an apple, but you can't count the apples in a seed." That's how it felt to us; the seeds were germinating.

But while the philosophical underpinnings were evolving, we were also experiencing unexpected growth, which seemed to diminish the sense of intimacy within the company. We were flat-out busy—a perpetual motion machine—but our core became uncertain. Our identity as a family business working out of Allen Farm was gone. So who were we now? I had no idea.

A Democratic Workplace

Our growth, although hardly explosive, had nevertheless brought us to an unsettling perch, as if we were leaning against a wobbly railing on a second-floor balcony. No longer could we run solely on intuition and gut; the business had become too complex. How could the familial qualities we cherished be maintained in a larger context?

Issues that had not been evident became visible and urgent. The two employees who had been with us almost from the beginning, Steve Sinnett and Pete Ives, came to me and said they wanted to stay with

South Mountain, that they wanted to make their careers here, but they needed a greater stake and more than an hourly wage. It was time to do more than reinforce the railing.

Steve had been our first employee and had become a close friend. Attracted by the waterfront scene, he migrated to the Vineyard after college. After a stint as a crew member on the schooner *Shenandoah*, he came to work with us and soon became a fixture. His personal qualities—a restless desire for all things to be better for all people, intense loyalty, unflagging team spirit, and a pitch-in-when-the-going-gets-rough approach—combined to make him indispensable.

In 1978 Pete Ives had come to work. An accomplished mason, painter, drywaller, floor sander, tile setter (and surfer), he had never done a lick of carpentry. He was hungry to learn. Once he said to me, "Just tell me what to do. I'll do anything you ask, as long as I don't have to tell anyone else what to do." He was dedicated, versatile, talented, and convinced that he had no leadership qualities. He became a superb carpenter in a very short time. He began to find confidence in his work. He learned to be a foreman, first reluctantly, then with pride.

The three of us put our heads together and decided that their situation—the desire for a greater stake—was not likely to be unique; it would come up again and again if the company continued to succeed. How could we both remedy the current circumstance and welcome others, in the future, to a new status that offered more participation in decision making, greater responsibility, and opportunities to share profits? The journey of inquiry and experimentation that followed led to our discovery of the first cornerstone of our business: sharing the ownership and control.

Adjusting the Model

Our national wealth has come at considerable social and environmental cost. Unless we provide a greater stake in economic decision making

for more people, these costs are likely to continue to increase. Author William Greider is convinced that most Americans think something is wrong "in the contours of their supposed prosperity."

In *The Soul of Capitalism*, he writes:

> I do not find these complaints restricted to the poor or struggling working-class, though their struggles are obviously more stark and often desperate. . . . I have heard people from nearly every income level express an oddly similar sense of confinement, as if their lives were trapped by the "good times" rather than liberated. . . . Think of the paradox as enormous and without precedent in history: a fabulously wealthy nation in which plentiful abundance may also impoverish our lives.[1]

There are significant opportunities to make our economic system more democratic. In *The Divine Right of Capital*, Marjorie Kelly says this may seem daunting when we consider the power of the financial elite, but

> we should remember that the power of kings was once as great. The very idea of monarchy once seemed eternal and divine, until a tiny band of revolutionaries in America dared to stand up and speak of equality. They created an unlikely and visionary new form of government, which today has spread around the world. And the power of kings can now be measured in a thimble.[2]

She makes the point that democracy has been an unstoppable historical force, and that if it "hasn't stopped at the doors of kings, it is not likely to stop at the door of financial aristocracy."[3]

I was thinking along these lines—crudely, however, without the rich historical sense of Greider and Kelly—as I considered my business options in 1986. I wanted the people in our company to feel prosperous and fulfilled in their work, and to share the bounty. We decided to investigate structures that would distribute both ownership and control.

This was surely a hinge point for South Mountain. For a while I was unhinged—alternately frightened and excited by our deliberations. I had the power, and the greatest financial and emotional investment; therefore, I had the most to lose. Under my ownership the company had become a viable, profitable entity with a strong reputation and a backlog of work. Sometimes, during those sessions, it felt like control was slipping away, like I was tugging on the reins of a runaway horse. Then it occurred to me that perhaps I had the most to gain: aside from the lure of clearing this new path and seeing where it led, the possibility of shared responsibility and ownership promised new freedom for me and new potential for the company. It seemed like a potent mix.

We were beginning to tamper with fundamental elements of our work lives. Greider, again, in the foreword to John Logue and Jacquelyn Yates's book *The Real World of Employee Ownership*, says

> Most people go to work for someone else and, unless they happen to be highly skilled professionals or independently wealthy, they consign a major portion of their lifetimes to the direction of others, forfeiting basic rights and autonomy in the process of making a living. With few exceptions, the system works like this: capital hires labor and capital claims ownership of the final product. Can one imagine an economy in which labor hires capital? Where workers have a legal right to the profits and legal responsibility for the liabilities because they are the owners, where workers jointly manage the firm and themselves in a democratic fashion?[4]

We were trying to imagine such an anomaly in our own quiet little corner of the economy.

Our inquiries led us to the concept of a worker-owned cooperative corporation. It seemed radical and uncommon, to be sure, but also practical, especially if we could make the shift to employee ownership and control in a gradual, carefully measured way that would not shake the foundations all at once. Expressions from the participants—excerpted from the notes of those early meetings—evoke the tone of the discourse:

> Our structure should guarantee that anyone who makes a career here be extended the privileges, responsibilities, rewards, and headaches of ownership.
>
> The underlying premise for any change we make must be mutual respect and trust. To lose what we've created in that regard would be tragic.
>
> Very little about our governance and performance systems is defined except by habit, experience, and our various quirky personalities.
>
> Pete and Steve have put a lot into the company; the restructuring should reward them (and others over time) without taking from John, who has led us this far.[5]

With some trepidation on my part, we hired Peter Pitegoff, an attorney at the Industrial Cooperatives Association, now known as the ICA Group, to advise us. I worried that hiring ICA would mean no turning back. The safety and insularity of sole proprietorship, which I had only recently earned, was about to be cast off. Engaging Peter was a semipublic announcement of intention. As a lifelong skier, I compare the feeling to summoning the nerve to drop into a steep couloir when you can't see below the crest and you know your skiing buddies are down below, waiting for you to come. With tips pointed down, I pushed off gingerly.

At a meeting in May 1986 I expressed the view that Chris and I—who owned and lived on the land on which the South Mountain Company premises were located at that time—needed to retain control of the property. I was also concerned that my customary freedom to act solo might become so constrained by shared ownership that I would no longer be comfortable in the business. It was the first ringing of the bell that all who make the shift from sole proprietors to employee-owners must hear. To say it another way, what if the thing we've built with painstaking care and love evolves into something we no longer like? It's a serious risk.

Meanwhile, it was suggested at the same meeting that "at the beginning John could have veto power over new owners, jobs we take, hiring and firing, and wages." By that arrangement I would essentially have been keeping most of the control. The idea was to spread that control widely, so the voices of all the owners had meaning. You can't steal second without taking your foot off first, and we came to agree that the only protection needed was veto power over issues directly related to the property, and that I should have a contract to manage the business until my preferred shares (the buyout of my sole interest) were paid off in full by the company, which would take five years. The payout and contract ended sixteen years ago and I still have the same job although, as you will see, it has changed significantly.

There are infinite variations on the theme of employee ownership. We will examine some of them later in this chapter. But there is one universal requirement: First the owner(s), and then the employees, have to see the value and want to pursue it. If the desire is not present, there's (1) no point in commencing the difficult and complicated journey it will surely be, and (2) no basis for identifying and developing the unique set of principles and doctrine that is going to be right for this owner and these employees. Rule number one for employee ownership transitions: You've got to want it.

In many cases an owner will see the value before the employees, and it requires a process of education and acculturation to get everyone on the same page. Sometimes the employees are threatened by the idea

because they think it's an exit strategy for the owner, and they worry that they will lose the security of that expertise and leadership. This bridge must be crossed.

Although trepidatious, we were all on the same page. At Peter's suggestion we adopted a democratic ownership structure patterned after that of Mondragon, a remarkably successful network of worker-owned cooperatives in the Basque region of Spain. Mondragon has operated for more than fifty years on the principles of employees as owners, labor controlling the enterprise and sharing the wealth, members participating in business management and decision making, a limited ratio between top and bottom pay, and education as the key to career development and progress. We made adjustments to this model to fit our own idiosyncratic needs as an organization converting to, rather than starting with, employee ownership. Particularly important was the institution of a lengthy five-year trial period before ownership. This ensured a gradual transition, allowed time to evaluate commitment and suitability before employees became owners, and provided room for training and building understanding before they were thrust into policy decision making.

We established an ownership buy-in fee. We decided this needed to be significant but affordable. If it was too steep it would discourage participation, so we set it at the price of a good used car, an expense everyone seems to be able to manage when necessary. The fee has increased slowly; at this point it's an uncommonly good investment for new owners, and it's still equivalent to the price of a good used car.

Peter conducted a valuation analysis of the company, drafted a set of bylaws, and developed a legal agenda for reorganization that laid out the process coherently. Pitegoff's help was invaluable; we were lucky to find him. His nondoctrinaire attitude was particularly reassuring. He'd never heard of such a long waiting period, for example, but he endorsed it because he understood that we were, essentially, designing a house for ourselves that we had to be comfortable living in. We could always remodel later.

The structure has stood the test of time. The five-year waiting period has turned out to be none too long. We were fortunate, too, to have a smart and open-minded accountant, Gerry Tulis of Tulis Miller in Boston. He had never done accounting for employee-owned cooperatives, but he took it upon himself to become an expert. These days he is able to advise companies that are seeking to make the transition.

Restructuring South Mountain Company

On January 1, 1987, I transferred the ownership of South Mountain Company to a new worker-owned cooperative corporation. Steve, Pete, and I were the original three owners. My compensation was the preferred shares, which were converted to cash over a period of five years from the company profits, and a full ownership share (a more detailed explanation of the mechanics of our structure can be found in appendix 1). The first meeting of the board of directors of the newly reorganized company convened on January 9, 1987. Attending were Steve, Pete, Peter Rodegast (soon to be the fourth owner), and myself. There were seven other employees at the time of the restructuring; they were all on a track toward ownership. This was a critical transformation in the life of the company, the setting of that first cornerstone of our developing business model. The full implications of what we were doing were not yet clear to us.

That was more than twenty years ago. It was a giant step in our journey toward democracy. I'll describe, in the chapters to come, what happened. But I want to detour for a moment to put the idea of employee ownership into context. First, some basics and background about employee ownership; then some brief case studies of employee-owned companies of different scales and structure; and finally, some analysis and discussion of the implications. In the next chapter I will continue the story of South Mountain's march to workplace democracy—how it has developed, and how it works.

Employee Ownership Basics

Peter Pitegoff, in a recent article titled "Worker Ownership in Enron's Wake—Revisiting a Community Development Tactic,"[6] suggests that the concept of employee ownership was tarnished when Enron failed and thousands of employees lost the $1.3 billion that they had, together, invested in company stock. Worker ownership at Enron, which gave only a very few employees any meaningful say in corporate affairs, was characterized by overstated earnings and the ability of top executives to sell their stock while others couldn't. This high-profile tragedy contributed to public perception about abuse of employee stock ownership.

But the Enron debacle and others like it are only the terrible perversion of a good thing, like rape is to sex. They have nothing in common with the kind of employee ownership we will be discussing here, which involves broad distribution of assets to employees combined with some degree of worker control.

Although author Wendell Berry says that we have gone from being a country owned by many to a country owned by a few, this is still a nation of entrepreneurs. Small business remains the backbone of the economy. But what happens to the businesses that result from decades of entrepreneurial sweat and love? They used to get handed down to children. Some still do. But many owners don't know what to do with their business. If there are no family members who want to take it on, and they don't want to close the doors (thereby ending a legacy, leaving people jobless, and losing the embedded value), the only other apparent option is to sell to outsiders. There are, however, other, less obvious options.

For many reasons business owners, or those starting a business, may consider an employee ownership structure. For some it is a succession strategy: a way to retire, receive compensation for some or all of their accumulated equity, and leave the business in the hands of those who have helped to create it. The desire to see the business we have

lovingly built sustain itself beyond our tenure can be strong. For some it derives from the belief that the people who create the wealth should share the wealth. Some take this farther and become advocates of a democratic workplace. Some are attracted to the possibility of greater commitment and productivity that employees who share ownership may bring. Some are driven by the objective of keeping key employees from moving on and starting their own businesses. Some are excited by the thrill of shared responsibility within the enterprise. For some, like myself, it's all of those reasons; for many it's one or more. But for others it is simply a practical financial mechanism, an exit strategy with specific tax advantages, and in those cases it may have nothing at all to do with the employees.

Sharing ownership has become widespread in the United States; all indications are that it is likely to become more so. There are two primary forms of employee ownership: the employee stock ownership plan (ESOP) and the cooperative (co-op). The most common form by far is the ESOP, which is well known to business advisers and owners.

There are roughly eleven thousand ESOPs with close to nine million employees in the United States.[7] An ESOP is, in fact, a pension plan, but it differs from conventional pension plans in several ways that make it a useful device with which employees can purchase all or part of the company that employs them. ESOPs invest in the company itself, rather than in outside firms, and they have the ability to borrow. In a sale to an ESOP, an ESOP trust is established that borrows money to buy stock from the owner, usually a portion of the total to start. Each year a part of the company profits are used to pay down the loan; as the loan is repaid, shares in the trust are allocated to the employees, and when the loan is repaid in full, financing begins for the next portion of the stock. When employees leave or retire, the trust buys back their stock.

As qualified pension plans regulated by the IRS, ESOPs are tax-exempt and confer tax advantages to the owners when they sell to employees. Once the employees purchase part or all of the company,

they share in part or all of the profits. But they do not necessarily receive a voice in the governance and management of the company. In fact, says Corey Rosen, the director of the National Center for Employee Ownership, in his book *Equity*,

> Treating employee shareholders as true partners in enterprise, and operating the business in a way that reflects it, is [uncommon]. Companies that offer stock to their employees often fail to challenge traditional assumptions and practices. They do little to change their culture. They make no effort to help employees think and act like businesspeople.[8]

In this book, I am talking about those that do, ESOPs and co-ops alike. Rosen goes on to say,

> The research on employee ownership is unusually consistent and unusually clear: employee ownership boosts a company's performance, but only when it is combined with changes in culture and managerial style.[9]

A recent study of 165 ESOPs conducted by the Ohio Employee Ownership Center reported that

> Almost three quarters of ESOPs actually do take some steps to broaden participation in firm management. The changes made in most of these firms are quite modest, however, and a quarter of firms make no changes at all.[10]

Some ESOPs, like United Airlines, Andersen Windows, Procter & Gamble, and Publix Supermarkets, are familiar names. Most are smaller

and less visible. Some ESOPs have a commitment to workplace democracy, but these are few. Some of the more exemplary are Carris Reels in Vermont, Johnny's Selected Seeds in Maine, W. L. Gore in New Jersey, Marland Mold in Massachusetts, Antioch Publishing in Ohio, Chroma Technology in Vermont, and Cirtronics in New Hampshire.

Canada has a lively employee ownership movement, too. Wellington West, a Winnipeg-based financial services company with 550 employees at thirty-five locations across Canada, all of whom now collectively own more than 98 percent of the company, was selected number one in a 2006 survey to determine the fifty best-managed companies in the country. A Canadian book called *Employee Ownership: The New Source of Competitive Advantage*, by Carol Beatty and Harvey Schachter,[11] is a warts-and-all study of the successes and struggles of ten employee-owned companies.

In both countries a small portion of employee-owned businesses are worker cooperatives, which are democratic organizations owned and controlled by their workers. A simpler and more direct form of worker ownership than the ESOP, the worker cooperative form predates the ESOP by more than a century and explicitly embodies principles of equitable ownership and control.

Like an ESOP, a worker cooperative resembles a typical corporation, and usually uses the "'C' corporation" or "limited liability company" (LLC) legal framework. It has a corporate shield against liability, earns profits, is governed by board of directors, and in most cases is managed by one or more officers. Three characteristics, however, distinguish it.

First, a worker cooperative is a membership organization, and membership is limited to employees who complete a trial period and invest a membership fee. Second, a worker cooperative is governed democratically by its members, who elect the board of directors (at least a majority) and vote on policy matters on a one-person/one-vote basis, rather than the usual one-vote/one-share governance of an ESOP. Third, a portion of corporate earnings is allocated to members on the basis of their work investment rather than on capital invest-

ment. These "patronage allocations" are in addition to normal wages, can be in cash or in a portion retained by the company in "internal capital accounts," and are regulated by Subchapter T of the Internal Revenue Code.

An owner selling to a cooperative sells 100 percent of the company in return for a note from the company that includes the redemption schedule along with terms and conditions that ensure the owner significant control until the note is fully paid off.

An ESOP is far more expensive to form and administer, which usually puts it out of range for companies with less than roughly thirty employees and $5 million in sales. It is subject to regulation by both the IRS and the Department of Labor, which require expensive annual valuations and a variety of other compliance measures.

An employee cooperative is simpler and less costly to establish and maintain, but it is challenging in many ways. The democratic control in a cooperative business is, by its nature, difficult to conduct in an orderly fashion and requires a process of cultural and business education of the employee-owners to understand roles, decision making, risks, and responsibilities. There must be strong bonds of trust between owner(s) and employees, and the owner(s) must be ready to relinquish control over time.

Pitegoff has seen increased activity in worker cooperative development since the 1970s and notes that while they have never been a significant portion of the US economy, cooperatives have had a modest impact in certain industry sectors and regions and in certain historical periods.[12] Over time there have been far more producer co-ops and consumer co-ops than worker co-ops. Producer cooperatives are owned by producers of farm commodities or crafts, who band together to process or market their products; a few well-known examples are Organic Valley and Land O' Lakes. Consumer cooperatives are owned by the people who buy the goods or use the services of the cooperative. REI (Recreational Equipment Inc.) is the largest consumer cooperative in the country.

Arie de Geus, in *The Living Company*, says:

> Co-op fever has recently intensified. Through their highly participative governance models (involving both members and employees in making decisions), the cooperative system is particularly well suited to combining entrepreneurial and social objectives. Because it encourages internal checks and balances and general transparency, cooperative structure also makes it easier to avoid the ethical and legal lapses that have brought down the management of many investor-owned companies.[13]

In 1984 tax law changes created what's known as IRS's 1042 rollover, which allows a tax benefit to business owners who sell 30 percent or more of their company to their employees through an ESOP or a cooperative. They can shelter the capital gains from the sale by putting the proceeds into qualified domestic securities within twelve months of the sale. This is often the primary reason why business owners create ESOPs, but until late 2005 this mechanism had not been used by a single known cooperative. The Ohio Employee Ownership Center (OEOC) and attorney Mark Stewart of the firm Shumaker, Loop & Kendrick in Toledo, Ohio, recently engineered the first use of this for Select Machine in Brimfield, Ohio.

Select Machine

The company was founded in 1994 by Doug Beavers and Bill Sagaser. They manufacture, sell, and distribute machined products for construction and demolition equipment. It's a small company, with nine full-time employees and two part-time. Says Beavers, "Bill and I set up this company to be the kind of company that we would like to work for if we were working for someone else." According to observers, they succeeded.

Doug began his career on the ground floor of a large company,

running machines and making parts. He gradually moved up to sales. His partner Bill took the same route, in the same firm, and wound up in purchasing. When the company was bought by a Japanese consortium, Doug wasn't thrilled with the new direction and decided to strike out on his own. He started Select Machine, and a year or so later Bill joined him and became a partner.

But after ten years, and many years before that in the industry, Beavers and Sagaser were ready to slow down. They looked for buyers, but the several potential purchasers they found wanted to take the customer list and some of the equipment and fold the company into underutilized facilities elsewhere. Beavers and Sagaser hadn't built the business to shut the doors and leave the employees out in the cold, so they began to wonder about selling the company to their workforce, and turned to the OEOC for advice.

Director John Logue and the OEOC staff went to work. It immediately became clear that this company was too small to do an ESOP (it would be too expensive), but they thought, *Why not create a cooperative and realize the same benefits for the owners that an ESOP would?* Working with Stewart, one of the nation's leading co-op attorneys, and Eric Britton, an ESOP specialist at the same firm, they invented the tools and legal framework to make it work.

The initial feasibility study was positive. A valuation was completed, and a local bank teamed with a revolving loan fund; together the two were willing to loan money for the initial purchase, which would redeem 49 percent of the owners' stock. Stewart prepared an offering statement, which detailed the proposed transaction, the risks involved, the intent of the owners to sell the rest of the stock over time, the means by which the co-op would redeem the stock, and how the company would be managed.

Once the debt to purchase the 49 percent has been repaid, from company proceeds, Beavers and Sagaser will sell the remaining 51 percent of their shares. Meanwhile, they stay on, as co-op members, and train the other members to run the company successfully.

It's now two and a half years since the co-op was formed. By the end of 2008 the first 49 percent of the buyout should be complete, fully paid off from company net income. Final management plans will be complete and in place. Sometime in 2009 the employees will purchase the other 51 percent and Doug will retire (Bill already has).

Doug Beavers is about the friendliest, most unassuming guy you'd ever want to talk to. He's impressed by the number of firms (about a dozen) who have contacted him since the formation of the co-op, but he is not by nature a crusader. As he puts it, "I'd walk a mile to help anyone, but I'm not looking for pats on the back. We do a lot of charity work, but it's by and large anonymous."

I asked him what he will do after retirement from Select Machine (after all, he's only in his midfifties). "Don't have a clue. This has been a nice ride, but I'm ready for something different. Maybe I'll become a professional poker player (as long as my wife agrees to support me on the down days), maybe I'll be a greeter at Wal-Mart, but I have to tell you this whole co-op thing has really intrigued me." My guess: He'll be doing something in the employee ownership biz.

Select Machine assembled the right team and the job got done. At Johnny's Selected Seeds in Maine it took a longer time, and there were more trials and tribulations on the way to conversion.

Johnny's Selected Seeds

Rob Johnston started Johnny's Seeds in 1973 at the age of twenty-two with $500 in savings and a goal of producing and selling high-quality seeds to home gardeners and specialty commercial growers. He had been working on a communal truck farm in New Hampshire; the produce was sold in Boston and New York. A Japanese distributor in New York City wanted special Oriental varieties. In order to grow these, Johnston first had to find the seeds. "We had to go to Japan to get the seed because no one was offering them," he says on the company's Web site. He became engrossed in his own private seed research project. Other regional growers heard about Johnston,

began to contact him for hard-to-find varieties, and he started the seed company.

Several years later he moved the company to Albion, a small town in central Maine. It's still there today, thriving and growing. It was always a mission-driven company; Rob was and remains passionate about high-quality products and customer service. It was organic from the start. Although his business depended on selling seeds, he wrote a book called *Growing Garden Seeds* to educate gardeners about how to save their own.

Today Johnny's has about one hundred full-time employees (and more in the summer) and $20 million in annual sales, and Rob has established an ESOP to sell the company to his employees. They now own 30 percent; a plan is in place to increase their share to 100 percent over time. The ESOP structure is the result of an elaborate and introspective process that goes way back. During the '80s, Rob realized he wouldn't have this company "into eternity"; that he wanted it to keep going and keep growing (it has grown steadily, from 6 to 13 percent per year, for the past twenty-five years); and that he'd better start thinking about what to do with it. He came up with three possibilities: sell it someone else, go public, or sell it to his employees. He also started thinking about what parts of the business he did and did not want to devote himself to. He decided that his strength and his interest was in the products and the customers, not in managing people and numbers, so he hired a general manager, who turned out to be the wrong guy. It took six or seven years to figure that out and get it settled, and they parted company in 1999.

Rob wasn't sure what to do. He met with all the employees and told them that he wanted to find an inspired general manager, but he didn't know how, and he was willing to sell the company if that was the only way. He hired an investment bank and a search firm at the same time. The investment bank came back with three viable offers, but Rob and his wife, Janika Eckert, weren't thrilled with any of them. The search firm recommended Mike Comer, a seasoned manager with an MBA. It

was a good match, and Mike was hired to run the company. Rob and Mike have managed the company together since then, with emphasis gradually shifting from Rob to Mike.

In 2004, at Janika's urging ("We're in our midfifties—we've only got so many years to ride our bikes and do other things. Right?"), Rob decided it was time to start exploring the sale of the company to the employees. He and Mike went to an ESOP conference in Boston—the kind of place where, as Rob puts it, "All the third-party types are trying to sell their wares." They were unimpressed. But coincidentally Janika, who had come along to Boston to do some research for a Philadelphia bicycle maker and friend, was impressed by someone she met. She visited Independent Fabrication, the employee-owned custom bike manufacturer in nearby Somerville, Massachusetts. She talked to them about Johnny's, and the quest for information about selling to the employees. They suggested a consultation with the ICA Group in Boston. Ultimately Johnny's hired Jim Megson at ICA to help restructure the company.

The restructuring took several years. Rob wanted senior management to invest money upfront, but they felt it was too risky; Rob finally decided he had to accept that if he wanted to get it done. Now, in 2008, Johnny's Selected Seeds is in the throes of transitioning to an employee-owned company. The stock will be sold to an ESOP in three stages. Funding for the first third was partly money from Johnny's and partly a bank loan. In 2009 the first 30 percent will be paid off, and another chunk will be sold to the employees. This will continue until all is transferred, and Rob will remain as chairman of the board until that time, when he will become a former employee—unless, as he says, "they try to hire me back." And he accepts.

Mike is excited and energized by the process, but staggered by the complexity of it. He expected a shift, but he now sees that this is a long-term evolution. "It's a very complex process," he says. "We have to figure out what democratization means, and to what degree we pursue it." He's sixty-one, and he sees this endeavor—to make the

new structure work as it's intended to—as his last big challenge. He says he's learning every day, and the opportunities are greater than he previously thought.

Already he has noticed that there are people within the company—some people—who, he says, always thought of themselves as plain old wage slaves, but are thinking differently now, about themselves and the company. They're stepping back, taking a look, and imagining a career path. He says, "This hasn't been articulated—it's just something you see in their eyes. They're looking up. They get it." At the same time, he's frustrated by others, some in positions of influence, who don't.

As for Rob, he has his own frustrations—primarily that so much of his time these days is occupied with the complexities of the employee ownership transition, all of which is time away from seeds and customers. He wishes it were simpler. But, as Megson points out,

> The complexity is due primarily to the fact that they "want to do it right"—and to do so they must work hard to involve people and prepare them to run the company. They used to have a single shareholder who made all management and policy decisions. Sure, that's simpler. Now they have a real board of directors; that requires a whole new set of policies and procedures.[14]

Rob has concerns, too. He worries that conservatism might come with employee ownership. He describes himself as "hopelessly ambitious"—always looking for new products and new avenues for the business. He's not motivated by financial potential; he's interested in growth and innovation, and he wonders whether the employee owners might become too risk-averse by worrying excessively about protection of their investment.

But mostly he has dreams. He wants to continue to "blur the boundaries between the company and its clientele." He believes that Johnny's does important work, every day, by helping small commercial growers

make a living and succeed. When a grower says to him, "You know that new carrot variety you supplied us with? We did very well with it—it was financially successful and our customers really liked it. What else do you have coming up?" it's part of a rich exchange. They are each making the other's business better, and they are each contributing to the health of the small farming industry. Rob hopes to be able to look back, as a wise old "former employee" of Johnny's, and see the seed company as inseparable from American specialty farming.

Sounds like a seed grower who's walking down the same path that he did more than thirty years ago when he wrote a book to help gardeners and farmers save their own seeds.

Carris Reels

Carris Reels, headquartered in Rutland, Vermont, has an even longer history than Johnny's. It was founded by Henry Carris in 1951 to manufacture hardwood and plywood reels (spools) for the wire and cable industry. That's what they do today, almost 60 years later. The only difference is that now some are wood and some are plastic.

Bill Carris, Henry's son, grew up with the company, left Rutland for college and military service, and came back. He took over as CEO from his father in 1980. The company grew and prospered and became a fixture in the Rutland area. Today they have six locations in the United States, one in Mexico, 550 employees, and close to $100 million in annual sales.

Bill is at once a soulful person and a good businessman. He brought management and leadership skills to the company, but he also brought a desire for the Carris employees to become owners and essential participants in the planning of their own future. In 1994, after many years of studying, working with consultants, and assembling his thoughts, Bill completed the Carris Long Term Plan (LTP) and shared it with his employees. It's a remarkable document. I wish I could reprint it here in its entirety, but its thirty-four pages wouldn't fit. Reading it, I experienced profound joy and the desire to stand up and pump my fist at the

same time. Written in plain English—conversational, almost—parts of it are heartrending, poignant, and philosophical, but it presents a detailed, pragmatic plan to make Carris Reels a successful, 100 percent employee-owned and -governed company.

The capitalist system suffers from inherent unfairness, according to Carris, while the communist and socialist systems are fundamentally ineffective; he concludes that we need to combine the productivity of the free-market system with better distribution of its wealth, goods, and services. Understanding that to work effectively there must be hierarchy, he nevertheless is absolutely clear about its place: "Equality must be primary, and hierarchy secondary."

> Our goal is to upgrade employees' health, wealth, and happiness as a result of changing from a traditional, privately-held company to an employee-owned and governed organization. Employees are the soul of our corporate community; they deserve to become legal owners. Every attempt will be made to provide opportunities for those who have had the least chance. Personal and spiritual growth will be valued and encouraged for all individuals. There is no organizational success without its individuals succeeding and growing.[15]

The second section of the plan, which is called "Beliefs, Principles, and Values," is broken into three parts: "The Spiritual Company," "The Emotional Company," and "The Physical Company."

And yet, throughout, he recites the mantra of profit, and never loses sight of the fact that "profits = existence." He emphasizes that "although it may seem inconsistent to focus heavily on profit when my mission is to improve one's quality of life, [it] goes hand and hand. Profit is the critical means to achieve our mission."[16] His aspiration is for Carris Reels to be a great provider of all things that a company can provide: employee fulfillment, customer satisfaction, high quality, fair

prices, community service, and profit. He doesn't include "changing the world," but that's what they're doing.

Carris knew that he wished to sell the company at a deeply discounted rate to his employees, not to outsiders. He expected to teach the employees to run the business and establish governance based on two basic ideas: One person, one vote; and transparent, accountable decision making using consensus with a one-person, one-vote backup. He didn't expect this to happen overnight, and it hasn't.

The ESOP approach emerged as the most appropriate structure because of the tax advantages, but the system that developed has all the characteristics of a cooperative. Cecile Betit, an independent researcher who has spent more than a decade documenting the Carris journey, says about Bill Carris, "Over the years, material goals had lost importance for him, and he gained satisfaction from being a positive influence in other people's lives." He felt that "liberty and the pursuit of happiness also meant a right to share wealth, to manage our daily work and ultimately to be in control of our lives."[17] Further, he believed that the corporate success stories of the coming decades would be those companies that involved more people in information processing and decision making.

Fifty percent of the stock would be a gift to the employees—Carris felt that this was an essential recognition of their contributions—and the rest would be sold at the predetermined price. Among the thousands of ESOPs in the United States, Carris was unable to find a single ESOP company, to use as a model, that had created 100 percent employee ownership and 100 percent employee governance. He started distributing the stock in 1995; by the end of the year 2000 the employees owned 43.2 percent of the stock. But then, for a while, everything ground to a halt.

The years 2001 through 2003 were the most difficult in the company's history; the dot-com collapse and the telecommunications crisis significantly reduced demand for wire and cable. They had to close a subsidiary company, sell another, resize, and take measures that, for

them, felt nearly draconian. Says Betit, "They could easily have put the brakes on their march to employee ownership and control, but they didn't. They just delayed."[18] The management team of Carris, CEO Mike Curran, and CFO Dave Fitzgerald struggled valiantly in the trenches and emerged with their values, and the business, intact. Karin McGrath, the human resources director, has been with the company for thirty years. She told me, "The fact that we survived and we are as strong as we are today was reassuring for all. Everybody was looking for ways to tighten our purse strings. We were open and honest with information. During this time Bill and Barbara Carris went around to all our locations, sat in front of small groups of employees on different shifts, and answered the questions they asked. It meant a lot to the employees—especially those that were not in Rutland."[19]

In 2005 the remaining 6.8 percent of the first 50 percent gift was transferred to the employees, and the first 15 percent (of the second 50 percent) was sold. This was truly the big moment for the company, especially because it came on the heels of such a traumatic time. Says Karin, "Becoming majority owners at 65 percent was huge. It felt like—we are going to make it! There was a lot of excitement."[20]

Betit has devoted a large piece of her life to studying and chronicling the Carris Reels story. In fact, she has been a part of it. Says Karin, "Sometimes we go to Cecile after a meeting and ask for her notes so we can find out what really happened, and who really said what."[21] Cecile says that although Carris's great love for his people and depth of commitment are large factors in the success, it's also come thanks to Curran, Dave Fitzgerald, McGrath, VP of Sales and Marketing David Ferraro, and a host of others. Carris clearly brought the right people on board, and Betit is constantly impressed by how hard they work to stay aligned with their principles. She describes the partnership between Carris (now chairman of the board) and Curran (the CEO) this way: "Bill is the one who relentlessly carries the big vision and Mike is the one that knows how to make things work, the one that always knows just how much heat it will take to raise the temperature."[22]

On January 1, 2008, Carris Reels became 100 percent employee owned and governed. Says Karin about this moment, "Bill's dream was realized. It has been an incredible journey and an incredible gift from Bill and Barb. Employees are proud to work at [and own, and run] Carris Reels."[23]

And how does it feel to Bill? "I would have to say it feels good, but not an end. We still have a lot of work to do . . . to plan for the future success of the business. We have always felt that the success of the business has to trump everything or all the rest of our work will have been for nothing."[24] He adds, "I don't think of it as a transformation but a process of growth that I hope continues. To some extent this is an experiment in change."[25]

Carris Reels has a bright future. How many other bright futures may derive from the extraordinary model they have created, and how much will we be able to learn as this ongoing experiment in change continues? If it's anywhere near as much as we have learned from the storied collection of cooperatives in the Basque region of Spain known as Mondragon, it will not be inconsequential.

Mondragon

In 1941 a young Jesuit priest named Don José Maria Arizmendiarrieta was assigned by the Catholic Church to the town of Mondragon. When he arrived, the area was locked in poverty and still recovering from the devastation of the Spanish Civil War. Don José Maria had narrowly escaped being put to death for his own participation on the Republican side. Convinced that part of his service was to raise the economic fortunes of the people of Mondragon, he founded a technical school. In 1955 five of the graduates, with his assistance, founded a small worker-owned company to manufacture kerosene stoves. More cooperative businesses formed during the remainder of the 1950s, and Arizmendi encouraged the creation of a bank that, when it opened in 1959, became a cooperative credit union dedicated to the establishment of more cooperatives. The association of cooperatives contin-

ued to grow; in the 1970s a research institute opened to help with technology development, and in the 1990s Mondragon University, a private university dedicated primarily to the study of business and commerce, was established. Don José died in 1976, but the Mondragon Corporacion Cooperativa (MCC), which binds together all the coöperative enterprises, continues to thrive.

In January 2001, sixty years after Don José's arrival, I visited Mondragon with a small group of Americans for a four-day examination of the culture of both the town and the MCC. Having used a version of the Mondragon principles as the basis for the restructuring of South Mountain Company fourteen years earlier, it was thrilling to get a firsthand look at this system of worker-owned cooperatives that appears to be unparalleled in its dynamism and its impact on a region.

MCC now consists of more than 150 cooperative businesses (and other businesses), in addition to the bank, the research institute, and the university. There are over eighty thousand employees. Roughly half of these are owners. MCC's gross revenues in 2006 were more than $13 billion, making it the largest corporation in the Basque region and the seventh largest in Spain. The co-ops include Spain's largest producer of refrigerators, leading tool-and-die makers, and many other industrial companies. They make forklifts, windmills, bicycles, appliances, nails, wire, boilers, health and exercise equipment, automobile parts, furniture, woodworking and machine tools, specialized electronic products, manufacturing machinery and robots, and dozens of other industrial products. MCC's Eroski is the largest supermarket chain in Spain, and it does catering, dairy farming, greenhouse horticulture, and rabbit breeding as well. Other co-ops provide engineering, market research, and consulting services. Some develop housing in the area. Mondragon has created a total system wherein people can learn, work, shop, and live within a cooperative environment. The town, in its isolated valley, has a vital, prosperous feel—a small bustling city with a comfortable mix of young people from the university, new middle-class families, and those who have been in the valley for generations. The surrounding hills are

verdant and productive, dotted with villages and farms. The MCC's influence reaches into every aspect of community life.

We visited Fagor Electronica, a large producer of residential appliances. The sprawling factory looked like any other from the outside. Inside it was clean and bright. The atmosphere was relaxed and not too noisy. People worked in small teams on assembly lines, and they traded places with one another from time to time to relieve tedium, and for each to learn the several jobs on the line. A mezzanine level housed offices, meeting rooms, and a coffee bar. The rooms had glass walls and were highly visible from below. Floor workers freely walked up to conduct business upstairs; managers were comfortable on the floor. There was a sense of camaraderie, teamwork, and integration. We were told that this workplace was highly productive. It felt that way.

Success is an institution at Mondragon. There are several new start-ups each year, and only two have ever failed. In the United States more than 90 percent of business start-ups fail within the first five years. Peter Pitegoff says, "Mondragon stands out as the most successful coordinated complex of worker cooperative enterprises in the world, with demonstrated capacity for economic growth and long-term survival."[26]

The visit, however, produced questions. What drives their recent interest in export and locating new plants overseas? Can they continue dancing on the tightrope between ongoing success in a global business climate and holding true to their core values? Why doesn't their environmental consciousness (which seems higher than normal but not extraordinary) match their concern about social equity and economic democracy?

In response to our questions, our hosts were pragmatic: Their primary purpose is the creation of safe, secure lifelong jobs and prosperity for their employee-owners. Sometimes they must compromise to achieve this. But they continue to attempt to balance their democratic social goals with survival in competitive markets. They are passionately committed to their cooperative principles and always trying to extend democratic values to traditional enterprises they have acquired.

But the biggest question is this: Why is Mondragon such a secret

in the United States? It has attracted great attention worldwide, but far less here. Even the US-based socially responsible business movement pays it little mind. Is the idea that capital is a tool, rather than the residence of power, too radical to embrace? Instead of awarding profit and control to capital, Mondragon has succeeded by awarding profit and control to labor in a system of democratic capitalism. It has developed an enduring way to use capital productively and distribute income equitably at the same time.

Select Machine, Johnny's Selected Seeds, Carris Reels, and Mondragon—different scales, different structures, and different locations. They are all part of the leading edge of a movement that is, at present, only a distant blip on the broad cultural and economic horizon. It is, however, gathering steam, generating interest, and provoking questions among many business owners today.

The ESOP or the Co-op: Which Way to Go?

Among small and medium-size businesses considering employee ownership, one of the most common questions is: Which makes more sense, the ESOP or the co-op? Although most employee-owned companies are ESOPs, more companies are exploring and choosing the cooperative alternative.

Jim Megson, the employee ownership consultant with the ICA Group in Boston, has done comparisons for companies to analyze the benefits and drawbacks of each option. These will vary for each company, but here is his summary report for one specific company; I've made minor modifications:

Sale to a Worker Cooperative

Advantages

- Relatively inexpensive to set up.

- No annual maintenance fees.
- Can use IRS 1042 rollover to defer capital gains under certain conditions.
- Owner can retain oversight until note is paid off.
- Members buy a membership share, which makes ownership "real."
- The democratic structure involves all employees.
- Shares can only be held by employees.

Disadvantages

- Owner sells 100 percent immediately and therefore does not gain from future increases in company value.
- Owner must finance the transaction as cooperatives are not well understood by banks.
- Employees must find the cash to buy a membership share.

Three-Phase Sale to an ESOP

Advantages

- ESOPs are highly regulated and understood by banks.
- Selling the company in stages makes the transaction more manageable for the company.
- Can use IRS 1042 rollover to defer capital gains under certain conditions.
- The value of the stock should increase over time; therefore the price for subsequent portions of the stock would be higher.
- After the first one-third transaction, the owner still retains full control and can see how the system works before turning over control to the employees.
- If things do not work out after the first transaction, there is still the option of selling to a different buyer.

- Employees are not required to invest any of their own money.

Disadvantages

- More expensive to set up ($25,000–50,000).
- Annual maintenance costs of $10,000–20,000 (annual appraisal, plan administrator, etc.).
- Because the first sale is not a controlling interest it will be discounted for "lack of control."
- Owner may be required to provide personal guarantee for bank loan to ESOP.
- Shares can be passed on to heirs, who can vote the shares, potentially diluting the company culture.
- Employees are not required to invest any of their own money.[27]

This is, of course, all very subjective and company-specific. Under "Cooperative," one of the advantages is the democratic structure, but if you don't want a democratic structure, or don't think it will work well in your company compared with the more traditional corporate structure of an ESOP, it doesn't qualify as an advantage. The fact that employees are not required to invest any of their own money is listed as both an advantage and a disadvantage with an ESOP. It's an advantage because employees often do not want to invest; it's a disadvantage because they are therefore less invested.

Each company needs to do its own soul searching and financial analysis. There is no one-size-fits-all in the world of employee ownership. Whether or not an owner is planning to use a tax deferral under IRC Section 1042, the choice between sale to an ESOP or sale to a worker-owned cooperative will yield different tax and cost consequences for the business and a dramatically different employee experience in subsequent operation of the business.

Co-op attorney Mark Stewart and his ESOP attorney partner Eric Britton have written a position paper called "Selling Stock to

Employees Through a Qualified Worker-Owned Cooperative and Sheltering Capital Gain: The IRC § 1042 Rollover." Although the piece was intended to establish the viability of the 1042 rollover for cooperatives, it also includes some detailed comparative analyses of ESOPs and co-ops.

The pair reinforces Megson's assertion that because employee cooperatives, unlike ESOPs, are not employee retirement plans, they are not subject to the numerous restrictions imposed by the Employee Retirement Income Security Act of 1974 (ERISA). As a result, cooperatives avoid such regulatory burdens (and related expenses) as extensive legal and consultant fees to establish the ESOP, hiring a bank trustee or other independent plan fiduciary to represent the employees' interest, an annual independent appraisal, IRS and Department of Labor audits and the possibility of noncompliance findings, and the elaborate nondiscrimination rules imposed on qualified retirement plans.

On the other hand, the advantage conferred on an ESOP because it is a retirement plan is its tax-exempt status, which presents attractive tax-planning opportunities and savings for the company.

An employee cooperative is not a tax-exempt entity, but it can pass profits, losses, and other tax benefits through to its employee members without federal taxation at its corporate level. The employee-recipient is responsible for the tax, and distributions must be made in accordance with Subchapter T of the Internal Revenue Code. The result of this is that the cooperative's income is taxed only once in its journey from the cooperative's business operations to the employee-owner. This single tax treatment is similar to the pass-through of income in a subchapter S corporation or an LLC. In addition, an employee cooperative may establish a qualified retirement plan that is simpler, safer, and more cost-effective than an ESOP to which it can make tax-deductible contributions, as we do at South Mountain.

Regarding the IRS 1042 mechanism, I asked Mark Stewart why it hadn't been done before, given that the provision has been in effect since 1984. He replied,

> The professionals involved in employee ownership transitions concentrate on ESOPs; they involve larger companies and there's more money there. There are many co-op attorneys, but their concentration is on consumer co-ops and producer co-ops, like agricultural co-ops, rural electric co-ops, and food co-ops. Very few attorneys understand the potential breadth and scope of worker-owned cooperative businesses in the American economy. But once we started looking at the Select Machine idea, it became clear to us that the articles and bylaws that have been written for decades for these other kinds of cooperatives were easily adaptable.[28]

Stewart and Britton suggest that cooperatives are beginning to take their place as a real option, or "choice of entity," when organizing or reorganizing a business for employee ownership, as some of the advantages become clear. "Many business owners," they say, "would like to take advantage of Section 1042 of the Internal Revenue Code to sell stock in their company without immediate taxation of their capital gains, but are deterred by the complex and potentially onerous rules imposed on Employee Stock Ownership Plans (ESOPs)."[29] But selling to an ESOP, it has become clear, is not the only way. Selling to an eligible worker-owned cooperative can accomplish the same thing while avoiding some of the expenses and legal complications associated with an ESOP.

Is this cooperative approach only applicable to very small companies like Select Machine? The conventional wisdom among most employee ownership experts is that co-ops are best for businesses with twenty-five to thirty employees or less; beyond that, it makes sense to use the ESOP approach. But that may be changing.

Stewart feels that there is no cap on size; if a democratic organization is the goal, a co-op can work at any scale. John Logue of the Ohio Employee Ownership Center thinks the co-op approach is going to take off and become very popular. "There are many people out there,"

he said to me, "besides eccentric businesspeople like yourself and idiosyncratic academics like me, who will find this idea appealing for a variety of reasons." He described an HVAC company in Oregon he is working with. They are well above the ESOP financial threshold, yet the owner doesn't like government regulation, does like his employees, has some solid workers who will provide adequate succession, and has a company worth about $650,000 with a total basis of $2,978. There you have it—ready to become a co-op and use the 1042 rollover.

But all of this, as Megson reminds me, still must be looked at in terms of size. The "governance difference between running a relatively small democratic company and a larger one," he says, "is the difference between direct democracy and representative democracy with all its implications and complications."

There is normally some adversarial tension between the employees and management in a company. Employee cooperatives and democratic ESOPs must overcome this conflict and the natural reluctance of employees to assume responsibility. Democratic companies are most appropriate when the employees recognize their common interest in working together to sustain the business and, therefore, their jobs and careers; when they believe they will create and gain greater value—of whatever kind—from their work in a collectively owned and managed workplace; and when they are willing to engage in the process of decision making and learning the skills of business ownership. The hope is that with equity comes trust, and adversarial tensions succumb to collaborative bonds. When the employee owners share both profits and control, there's no separation. The group is vested with both the benefits and the burdens of distributed power.

The Promise of Employee Ownership

I often wonder why the socially responsible business movement in the United States has not embraced employee ownership more fully.

This movement has popularized ideas about commerce as a means of implementing people-centered human resources programs, pursuing environmental sustainability, encouraging participation in local community life, and promoting social and economic justice. As far as I can tell, though, there's only a faint murmur (albeit gradually increasing in volume) about distribution of ownership. Entrepreneurs are risk takers, but perhaps—and I am only speculating here—giving up control seems like too great a risk to these pioneers who have already risked so much to build businesses that embody their personal values.

I've come to believe, however, that giving up control is the business risk that has the greatest potential to generate positive returns. It's not unlike choosing to have a baby. There can't be anything we do in life more risky than having children, but for most people the perils are apparently outweighed by the potential pleasures and fulfillments. That's how it felt to me—a worthy gamble. Not to mention that offering ownership without control seems like selling someone a car without turning over the keys.

One of the limitations of employee ownership that may account for some of its lack of attention is the difficulty of raising capital. Investors have little interest. The Mondragon model solved this problem by requiring 50 percent of retained earnings to be reinvested in the company. In this way, Mondragon avoids having to go to capital markets. The workers commit to reinvestment in the company, and capital remains tied to the community. Our system works the same way. Equity is assigned to each owner and we gradually build a reserve fund to buy out owners' equity shares when they retire, thus keeping the shares within the company.

This system also cures another serious structural flaw that inhibited the growth of worker cooperatives for many years. Logue et al. point out in their book *Participatory Employee Ownership* that, as with all forms of business, there have been some failures. The problem, however, was with those that succeeded. Each member of the co-op owned an equal share; if the co-op was successful, all the shares appreciated. When

founding members wanted to retire, new workers couldn't afford the share price, so, the authors say, "Success was as fatal as failure: retiring members sold to outside buyers," and gradually the cooperatives became conventional corporations. This, too, was solved by the Mondragon system, where shares must be sold back to the cooperative, and further developed by the Industrial Cooperatives Association (now the ICA Group) into the internal capital account system that employee-owned cooperative businesses use today (see appendix 1 for a detailed explanation).

In the autumn 2007 issue of *Strategy + Business* magazine, an article called "A Cooperative Solution," by Ricardo Lotti, Peter Mensing, and Davide Valenti, discusses Rabobank, the cooperative Dutch financial institution that is among the twenty-five largest banks in the world, and COOP, a consortium of Italian regional retail cooperatives, whose advertising slogan "La coop sei tu" (the co-op is you) has become a national catchphrase. The authors ask, "How well can cooperatives compete with fiercely entrepreneurial companies emerging in a globalizing world?" Whereas to many observers, cooperatives appear to be burdened with features that are liabilities in conventional business models, the authors point out in several ways how cooperative leaders have learned to make them into assets. To give just one example, in terms of long-range planning and experimentation, Rabobank's CEO Bert Heemskerk says, "You can take your time. There's not such an immediate pressure of quarterly results. Obviously, we have to perform well financially and remain solvent. But we don't feel the pressure of showing a 20 percent return this year. If we have 10 or 12 percent, it's acceptable."[30] This means that they, as a private cooperative corporation, do not need to submit to the pressures and demands of Wall Street.

Employee ownership is clearly coming into its own. Corey Rosen says in his book *Equity*,

> What's interesting about employee ownership isn't only that it's widespread. It also turns up in a disproportion-

> ate number of influential and innovative companies. Nearly 80 percent of the corporations on *Fortune*'s "100 Best Companies to Work For" list had some kind of broad-based ownership plan.[31]

And he continues:

> The extent to which high-tech firms that are focused on the Internet have granted ownership to their employees has no precedent in modern American history. No other industry has ever attempted, much less achieved, the depth, breadth, and extent of wealth sharing found among these firms.[32]

It sounds like we're learning something—that companies offering ownership and control to their entire workforce have the potential to unleash an explosion of entrepreneurial activity. They are offering a share in capitalism itself.

Steve Magowan, a Vermont employee ownership attorney with Steiker, Fischer, Edwards & Greenapple—a firm with offices in four cities—said to me recently, "We feel like employee ownership is expanding for two reasons: (1) baby boomers reaching retirement age, and (2) bad experience with private equity firms." Many business owners have had the experience that Select Machine avoided: Private equity buys the firm, takes control, becomes focused solely on returning the shareholders' investment, cuts costs and personnel or takes the company lock, stock, and barrel overseas—whatever it takes to maximize return, without regard for the employees, the community, or any of the other real stakeholders.

Employee ownership and democratic governance are not for everyone, however. As the stories I've told illustrate, the conversion to employee ownership of any kind is complicated and difficult. It's hard to do. There are people who should never attempt to make their businesses employee

owned; they are the people who don't believe in it. For them it will never work.

I have come to the conclusion that the foundation, the fuel, and the inspiration for the modest successes we have had at South Mountain Company is the profound ethic of employee ownership and all that spills from it and gathers around it. The employee-owned workplace is, in my view, the spawning ground for a restorative future.

The Workstead Act of 2010

William Greider, in *The Soul of Capitalism*, calls the Homestead Act of 1862, which awarded free land, if the recipients worked it and stayed on it, to more than half a million American families, a "a public works project of grandly egalitarian intent" that "was probably the nation's greatest single stroke of economic development channeled directly through people. . . ." He goes on to say: "In present times, some advocates suggest a parallel between employee ownership and homesteading. Instead of land . . . government, it is argued, should provide access to capital to finance the broadened distribution of equity ownership. . . ."[33]

In the next State of the Union address, I hope the president will propose the Workstead Act of 2010. About four million Americans are born each year. If, at birth, $10,000 were invested for each baby, it would become approximately $40,000 at age twenty. If, in addition, we offered $40,000 to each person turning twenty each year (until those being born come of age), the total annual cost would be less than the recent Bush tax cuts for the wealthy. This sum would be available to each young citizen to invest in the business of his or her choice after becoming an employee. How good would it be for American business—for capitalism—if every new employee was an investor?

If we were to begin thinking of employee ownership the way we do homeownership—as a right to be enjoyed by all Americans—it might have a cascading problem-solving effect. I understand there are a host

of worthy competing interests for funds. But this would be a fundamental investment in the future of our children, our economy, and our country. How good would it be for business if our children were the new source of venture capital? If they were, what would they invest in? Do you think, as I do, that they would want to own businesses they believe in, businesses designed to make a better world? If many did, this would be a change of epic proportions.