EMPLOYEE-LED BUYOUTS:
KEY STEPS AND QUESTIONS TO ASK

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KEY STEPS IN AN EMPLOYEE-LED BUYOUT

EDUCATE THE SUPPORTERS OF THE BUYOUT
Supporters may include all the hourly and salaried employees as well as local management. Frequently, in situations involving an organized workforce, those employees protected by a union contract are the initial proponents. Local management and salaried employees should be brought into the group as soon as they are able to do so without their jobs being put in jeopardy.

MEETING 1
The initial education usually takes place in two meetings. The first is with the original buyout leadership and includes:

- An explanation of the steps involved in doing a buyout and how Employee Stock Ownership Plans work and are used to finance a buyout.
- A detailed discussion of the key factors which should be considered before employees attempt a buyout as these factors pertain to specific circumstances of the plant in questions.
- A decision as to whether there are any obvious reasons not to pursue the buyout any further.
- A plan for the next steps and a meeting with the rest of the employees.

MEETING 2
The second meeting is a presentation to all the employees who are willing to attend. This meeting includes:

- An explanation of steps to a buyout and ESOPs.
- A presentation of the key factors which are important for a successful buyout and the leadership’s preliminary assessment of these key factors.
- A commitment on the part of a significant majority of those present to encourage the buyout leadership to continue exploring the buyout.
- If the employees are not interested in a buyout, then it is unwise to proceed any further.

ESTABLISH A BUYOUT ASSOCIATION
Membership in the buyout association is usually open to all the potential future employee owners. A leadership is usually selected to put the buyout together on behalf of the buyout association. Through its leadership, the buyout association:

- Raises funds from members and solicits matching funds from government and other potential contributors.
- Contracts with and oversees the work of legal and financial consultants.
- Develops a management team.
DO A PRE-FEASIBILITY ASSESSMENT
This assessment is a quick study by the legal and financial consultants of the key factors needed for the buyout to succeed. It should include:

- Clarification of the issue of the owner’s willingness to sell. An evaluation of the company’s historical financial performance. Identification of potential lenders and investors. Identification of the management team. A judgment about the industry and the company’s future market.
- Identification of any obstacles which are likely to cause the buyout to fall. If such obstacles exist, and the professional opinion is that they cannot be overcome, then the buyout association should not continue to invest money, time and hope any further.

CONDUCT A FEASIBILITY STUDY
A professionally done feasibility study provides an in-depth analysis of the economic viability of the plant as an employee-owned company. This generally requires five years of company financial data on the performance of the plant in question, ascertaining the approximate value of plant and equipment, estimating the size of liabilities that come with the plant, and market research.

Feasibility studies can be done by local management (especially in small projects), business analysts, investment bankers, and other outside consultants. Such studies typically cost between $15,000 and $50,000, depending on the size of the project.

If the feasibility study shows that there is no feasible way for an employee-owned succeed, then the buyout association should cease pursuing the buyout.

If there are any feasible ways for an employee-owned company to succeed, they should be identified in the feasibility study. The buyout association should select the most acceptable alternative. At this point the buyout association has most of the information it needs to complete the following steps.

DEVELOP A BUSINESS PLAN
If the buyout association proceeds beyond the feasibility study, it is because the study has explained how an employee-owned company can succeed. This explanation with a little packaging thrown in is the business plan which the buyout association will take to potential lenders and investors. The business plan explains how the new company will generate the money to repay the bank and reward the investors.

Negotiate the purchase and create the structure for the new employee-owned company.

The feasibility study should provide the buyout association with a reasonable estimate of the company’s value as well as how much debt the new company will be able to support. Negotiating the purchase may be very time consuming and expensive. Typical legal costs vary dramatically depending on the complexity of the deal.
If the buyout is a sale of stock, then the company creates an ESOP (or possibly a worker-owned cooperative) to purchase the stock. If the buyout is a sale of assets, then a new company must be incorporated with an ESOP, or as a worker cooperative. The ESOP purchases stock in the new company and the company uses the proceeds to purchase the assets from the original company, while for a worker cooperative the existing company can change its corporate entity to a cooperative.

The buyout association develops a governance structure for the employee-owned company which will encourage all of the employee owners to contribute constructively and cooperatively to their company’s future success.

The buyout association helps design the Employee Stock Ownership Plan, or the by-laws and other corporate documents of the worker cooperative. A lawyer must be hired to write the ESOP or worker cooperative documents, but the cost will be less if the buyout association already knows what it wants in the respective documents.

**ARRANGE FINANCING**

A feasibility study should identify the capital expenditures and working capital needs of the company and these should be taken into account when arranging financing in addition to the agreed upon purchase price. The financing may include equity or subordinate debt, senior debt, and working capital financing. Generally, this requires professional assistance by your lawyer, business analyst or outside financial consultant. This can often be done on a contingency basis.

**CLOSE THE DEAL WITH THE SELLER**

This will require a lawyer for the paperwork.
KEY QUESTIONS TO ASK IN AN EMPLOYEE LED BUYOUT

Employee buyouts require a large amount of energy, time and money. Therefore, it is important to identify obvious issues which indicate that a successful buyout is unlikely. This can prevent an unwise investment of money, time and hope. It can also help to identify, for the seller and the buyer in viable situations, the key issues on which they need to focus. The following list focuses on the key questions that need to be addressed in employee buyouts which involve substantial change of ownership.

Is the current owner willing to sell to the employees?

Many sellers are initially unwilling to sell to their employees but change their minds once they have received more information. If for any reason the owner does not want to sell to the employees, there is no easy way to force a sale. The only time an owner does not have complete control is in the case of bankruptcy or in the extremely rare case when an overarching community interest provides the use of eminent domain. Willing sellers:

- Provide the buyout committee or its financial analyst with access to all of the necessary information and key management personnel.
- Allow all employees (including those unprotected by a union contract) to express their active support for an employee buyout.
- Do not insist on an inflated price.
- Sometimes pay some of the buyout expenses and finance a part of the purchase price.

Do the employees want to buy?

Just like owners, employees may not support a buyout until they have received more information. A couple of enthusiastic employees or local development people cannot make a buyout happen if they do not have the active support of a significant number of employees who would eventually be owners. If the lack of interest does not kill the buyout itself, it will likely shorten the life expectancy of the new employee-owned company. Interested buyers:

- Attend educational presentations and vote to support the exploration of a buyout attempt.
- Contribute to a fund to pay for putting the buyout together.
- Make economic sacrifices or direct investments when necessary.

Will the new employee-owned company have competent management?

Most businesses need an individual or a combination of individuals who can sell, direct production, and manage cash flow efficiently. In addition, it is helpful to have a manager who has run a stand-alone operation before. Lenders will not finance a buyout without knowing who will be doing these function. When judging the performance of current management, it is important to determine whether past errors are attribution to their own level of competence or rather to the possibility that their hands were tired by an
owner or parent corporation with interests in conflict with those of the employees. Managers may find themselves in a difficult position during a buyout since they are employed by the seller. Nevertheless, when a manager takes an active role in driving a buyout, that is a good sign since managers should have a good sense of a company’s potential. When current management is unwilling to join the buyout effort or is judged to be incompetent, the buyout committee should consider former managers, previous owners, and people who other groups (like a union or a community group) might be able to identify.

Is there enough time to complete a successful buyout?

Employee buyouts take a long time. It is unlikely that one can be concluded in less than 6 months and more likely that it will drag on for about a year or maybe more. If a business is losing money, the current owners may be unwilling to keep it operating. They may decide that a quick sale or liquidation will make more economic sense.

If the current owners are not maintaining equipment, holding on to customers, and lining up future business, what looks like a viable business today may be greatly diminished by the time the employees complete their purchase. Financing the purchase of a business threatened by a shutdown frequently depends on the participation of a government loan program.

The application and review process involved will usually add an extra two to four months to the effort. While deadlines must be taken seriously, they are not written in stone. “Something should always be turned in on time but extensions to fill in more details are not uncommon. Sellers often want a bid before the buyout committee has had sufficient time to evaluate what they are buying; an attractive and timely bid can be made as long as disclaimers are thrown in.

Is the company or facility competitive?

Especially when employees are buying a sub-component of a larger company, it is important to determine how the plant will do as an independent business. A key to answering this is asking why the facility is being closed or sold. The company will need all of the normal preconditions that any business needs for success.

- Access to a sufficient supply of raw materials, at competitive prices, from suppliers willing to extend the normal credit terms for the industry.
- A level of production, both quantity and quality, which is comparable to that of the competition.
- A plant and equipment which is in good enough condition that maintenance and replacement costs will not drain the company’s cash flow.
- An established market which will assure the new company a level of sales sufficient to cover costs, meet the debt service and give the company some breathing room.
- The new company will also need to account for any hidden liabilities such as environmental issues, obligations to retired employees, and potential lawsuits.
**Will labor-management relations permit this company to succeed under employee ownership?**

Employee ownership is not an overnight solution to a poor labor-management environment. If union representatives are unwilling to shift from problem identifiers to problem solvers, or management is unwilling to share the role of the problem solver, adversarial relations are likely to be exacerbated rather than helped by employee ownership. Community development professionals can help employees and the proposed management assess whether this will be a problem by paying attention to the following issues:

- Past history as described by labor.
- Past history as described by management.
- Key issues in any recent strikes or contract negotiations.
- The willingness of different parties to reassess their roles.