Does the Enron debacle which cost employees more than $2 billion in retirement savings justify major changes in ESOP legislation?

In the initial rush of outrage over Enron, there was a great outcry for requiring more diversification in all kinds of employee retirement plans. ESOPs could have been swept along with the rest, even though diversification requirements might destroy meaningful employee ownership in small or new ESOP companies where the employees have concentrated their pension investments in employer stock so that they can own and grow their company.

Now, the main pension reform bills before Congress specifically exclude employees in privately-held ESOPs from diversification requirements. It is important to keep this choice available for all employee-owned companies, and we salute legislative recognition that employee-owned companies are special. During acquisition and major expansion or recapitalization, employee-owners may reasonably need to concentrate their wealth within their company, and losing the possibility to do so would impose a major burden on them.

Beyond this important issue, what lessons for employee-owned companies can be drawn from the Enron scandal?

Lesson One: Board members, do your work of overseeing management. If something doesn’t seem right, and you don’t understand, ask. If you still don’t understand, ask again. Any embarrassment you

(Continued on page 2)
Enron Lessons (Continued from page 1)

might feel at “not getting it” the first time could be what saves the company and employees’ retirements. It does no harm for a presenter to repeat or expand on an explanation.

Lesson Two: A board with elected nonmanagement employees could have produced no worse outcome than Enron’s traditionally selected board. Why do corporations fear democracy? Nonmanagement employee-owners should elect representatives to the board. They have every motivation to keep management straight, since their jobs and pensions are tied to the long-term success of the company.

Lesson Three: Retirement plan trustees must protect plan participants’ interests. Enron’s management-appointed trustees allowed a lock-down period of three weeks while the plan administration was changed and the stock price plummeted. During this period, employees could not even sell Enron stock purchased with their own funds. Ultimately, there is no way to guarantee that plan trustees won’t be taken in or bought off by an unethical management, but the best way to ensure that plan trustees protect participants is to allow the plan participants to elect them. There have long been rumblings in the professional literature about the temptations and risks of plans entirely controlled by management. “Enronitis” calls for a dose of democracy.

Lesson Four: Companies should share information, train employees to understand it, and provide substantial opportunities for employee input into the management process. Information, training, and participation may bring unethical or illegal management to light, although it’s not a sure check on abuse. Enron management did a slick sell and skillfully manipulated the greed of employees.

Lesson Five: Employee-owned companies should build diversified pension plans into their futures. Sometimes concentrating all your capital in the company is a way to grow the business, and so we don’t recommend that diversification be legislated. But we do think employee owners need to be mindful that diversification is the right approach for keeping pension savings safe. Responsible companies that care about their employees set aside a portion of profits in prudent investments.

ESOPs are a great supplement to guaranteed pension plans like Social Security or defined benefit plans, and a good supplement to a well-diversified 401(k). We prefer ESOPs because they can return benefits in the here and now as well as in retirement. A democratically-run ESOP offers greater possibilities for direct influence on your working life and better chances to increase wealth through your own efforts than any other retirement plan.

New Management (Continued from page 1)

ners, so they act like partners.”

With Rich Croll, Jim Dunn co-founded Foresight in 1993. The firm is among the top 25 IBM partner firms in the U.S. and the largest within its niche in the Great Lakes region. It has revenues of $50 million and offices in Cleveland, Toledo, Cincinnati, Pittsburgh, Grand Rapids, and Nashville.

Employee as Friend

Bob Martin, founder and President of RJ Martin Electrical Contracting, Inc., came from a family of 15 children, and he applies his family’s values to managing the company. “We treat everyone as family. If someone needs help, they get help. We try to make sure that everyone knows everyone.”

In an increasingly impersonal world, Martin’s philosophy is revolutionary. Traditional management theorists say that employers cannot be friends with employees. Martin counters that in his experience, “The idea that an employer and employee cannot be friends is a lot of nonsense.”

Laid-off ironworker Bob Martin became an electrician in 1976. In November 1986, he founded RJ Martin in his garage and has managed the Bedford Heights company to its current level of 150 employees providing commercial and industrial electrical contractor services and generating $15 million annual revenue.

Five years ago, Martin made a promise to his employees that he would pay them back if the company’s success enabled him to meet his personal goals. Maybe the employees forgot about the promise, but Bob Martin did not.

After discussions with attorney Joe Corsaro, Martin decided to give employees 49% ownership of the company through an ESOP. Note that he is not selling 49% of his shares to the ESOP. He is diluting his ownership by contributing shares to the ESOP, beginning this year.

To help foster an ownership culture, Martin created an ESOP Communication Committee, currently chaired by Dan Oha, to educate the employees about the ESOP. Mike Prokop of Chilcote, an ESOP company, and Bill McIntyre of the OEOC spoke at the committee’s ESOP Kickoff Luncheon. “That Kickoff Luncheon was probably the best thing we’ve done so far,” says Martin.

Martin himself is not going anywhere. He will remain as President. An advantage of forming an ESOP is that the founder can give up some ownership of the company but stay involved. Martin concludes, “Eventually, I will give the employees the first option to use the ESOP to purchase my shares, but that is a long way in the future. I’m having too much fun.”

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Investing Pension Money with a Purpose

All too often over the years, we have seen economically viable small and medium-sized firms fall by the wayside because of the lack of available and timely equity investment. Every year, one or two otherwise viable employee buyout efforts to avert shutdown fail because of a lack of investment capital. Every year, jobs are lost due to corporate divestitures, especially when the plant is bought by competitors whose sole purpose is to close the place. Still other plants are closed because the owner retires and has no properly prepared succession plan.

Equally important, there are always instances of companies that are unable to pursue expansion because they can’t find the necessary equity investment in both capital and employees which is key to continued advancement of the business.

These problems have been magnified in high wage regions such as Ohio by the negative effects of globalization—when multinational corporations make their capital investments in lower wage facilities overseas rather than making those investments here. The result: fewer well-paying jobs and less prosperous communities.

Creating a fund for local investment

It could make a significant difference in Ohio’s economic development over the coming years if our region could develop a labor-sponsored capital investment fund to help small and medium-sized companies respond to the challenges posed by economic globalization and ensure that workers’ pension savings capital is invested in the communities where workers live and work.

Imagine a local investment fund that supported the growth of “high road” companies that pay good wages and benefits. Imagine having a local investment fund that helps employees buy businesses from retiring owners so that good jobs can be maintained. Imagine having a local investment fund that helps restructure companies that have gotten into trouble, but that also care about maintaining good jobs and good wages.

Can the money be found?

The obvious question is whether there is enough money out there to make such a fund effective. Here are some of the facts about U.S. pension funds:

- U.S pension funds have assets of some $7 trillion.
- Pension funds today own nearly half of all publicly traded stocks in the United States.
- Labor representatives sit on the boards of multiemployer Taft-Hartley funds with $400 billion in assets.
- In Ohio, the five Ohio State employee retirement systems have combined assets in excess of $130 billion.
- There is plenty of money, and this is workers’ money.

Is it being invested responsibly to give a good return and support the interests of the working men and women who own it?

With these challenges and possibilities serving as catalysts, and with funding from the Gund Foundation and the Northeast Ohio Research Consortium of the Ohio Urban University Program, the Ohio Employee Ownership Center has undertaken to determine if it is feasible to develop such a fund for Ohio.

First Steps

An analysis of the economic feasibility of establishing a targeted Ohio venture capital fund has shown that it is clearly practical. Establishing the economic feasibility of an Ohio fund does not, however, mean that political feasibility follows. In our efforts to determine political feasibility, the OEOC has:

- Held discussions with labor union leaders in Ohio
- Led a four-day study trip with representatives from the Ohio AFL-CIO, the United Steelworkers, an elected trus-

An analysis of the economic feasibility of establishing a targeted Ohio venture capital fund has shown that it is clearly practical.

tee from the Ohio Public Employees Retirement System, and a researcher from Policy Matters Ohio, a labor-sponsored think tank, to visit the Crocus Fund in Winnipeg, Manitoba

- Made a presentation to the Ohio AFL-CIO Executive Board
- Held a four-session spring seminar series on labor-sponsored investment funds in conjunction with the Cleveland AFL-CIO and the United Labor Agency. Presenters included Joel Solomon, Assistant Director, AFL-CIO Center for Working Capital; Tom Croft, Executive Director of the Steel Valley Authority; Sherman Kreiner, President and CEO of the Crocus Fund; and participants in the study trip to Manitoba. The series kicked off March 28 with Joel Solomon and concluded May 16 with an exploratory meeting to discuss next steps.

The next few pages present edited presentations of Solo-

Our Pension Money and Our Jobs
Promoting Labor-Friendly Investments

Joel Solomon

The concern over investing pension fund monies is not just an issue in Ohio. It is a national issue. Investing the pension savings of working people can preserve the communities where they live by keeping jobs at home and holding management responsible for efficient performance, but it requires a heightened level of knowledge and vigilance by pension boards and trustees.

In exploring the potential for workers’ capital to achieve the twin goals of providing a secure income for retirees and better jobs and other collateral benefits for active workers, it is important to step back from the immediate goal of stimulating worker-friendly investments, and to consider the pension fund environment in which achieving that goal will be possible. Before trustees can have a constructive conversation about worker-friendly investments, considerable prior trustee education must take place. Broadening investment decision-making to include worker-friendly investments can be a major hurdle, particularly for trustees not used to taking an active role in overseeing their funds. Trustees must also overcome skeptics who wrongly assert that worker-friendly investments can only be achieved by sacrificing returns and breaching fiduciary duty. Finally, trustees must overcome the attitude that they are there to hire service providers and then passively review investment returns, rather than actively oversee the fund by developing policies to meet the needs of plan participants and beneficiaries.

To establish an environment conducive to worker-friendly investments, moving forward on three fronts makes sense. First, trustees should develop an understanding of capital stewardship, including the promotion of good corporate governance and citizenship, and developing and implementing proxy voting guidelines. Trustees should also understand how worker-friendly investments fit within the goals of fulfilling fiduciary duty and ensuring long-term value for plan assets. Finally, trustees should take advantage of educational opportunities and talk with other trustees about capital stewardship concerns.

Capital stewardship empowers trustees to oversee their pension funds consistent with fiduciary duty, enhancing the long-term value of their investments by engaging with the companies they own to promote better management accountability, corporate governance and corporate citizenship. When appropriate, they seek investments that provide solid rates of return as well as collateral benefits such as union jobs, affordable housing, and filling capital gaps faced by small and medium-sized companies.

Active Ownership

The idea that pension funds can actively engage with companies they invest in falls well within the bounds of pension law. The U.S. Department of Labor, which provides authoritative interpretations of the Employee Retirement Income Security Act (ERISA), has named as legitimate subjects of active ownership: “the independence and expertise of candidates for the corporation’s board of directors,” “the appropriateness of executive compensation,” “the nature of long-term business plans,” and the company’s “investment in training to develop its work force.”

Corporate Governance

Good corporate governance plays an important role in promoting the long-term value of fund assets. Eighty-four percent of U.S. investors will pay a premium for companies with better board governance, according to a 2000 survey by McKinsey and Company. In the post-Enron world, that figure is likely to be higher.

Some funds already incorporate good corporate governance into their investment decision-making. The California Public Employees’ Retirement System (CALPERS), for instance, dedicates billions of dollars to investments in companies in which better value can be obtained through improved corporate governance.

Proxy Voting

Public companies are required to have shareholders vote on certain issues, including election of the board of directors, corporate mergers and voluntary dissolution of the company. At annual shareholder meetings, both company and shareholder resolutions can come to a vote. Resolutions sponsored by capital stewardship-focused pension funds and other investors have focused on addressing excessive executive compensation, promoting good corporate governance, enhancing management accountability, human capital development and respect for international labor standards and the environment.

Proxy voting is a mechanical process, often done by investment managers or companies hired for that purpose. Yet if those who cast the votes receive no guidance from the pension
funds, those votes may support management positions against the capital stewardship concerns of the pension funds. As a result, some funds adopt proxy voting guidelines that give explicit instructions to those responsible for casting votes. The AFL-CIO has developed model guidelines.

Proxy voting guidelines can achieve several other goals — establish routines for fulfilling fiduciary duty, build consciousness among trustees of important issues covered in the guidelines, encourage trustees to develop a philosophy of how the interests of plan participants and beneficiaries are best served, and permit a mechanism for pension funds to engage companies around capital stewardship issues.

But voting proxies is more than an optional activity for trustees. Voting proxies is a fiduciary duty. The Department of Labor has said, “The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the value of the plan’s investment.” The Securities and Exchange Commission has also asserted that pension funds should vote their proxies.

Economically Targeted Investments

Like proxy voting, the pursuit of economically targeted investments is both legal and practiced by pension funds. In 1994, the Department of Labor issued a bulletin noting that making an economically targeted investment (ETI) will not violate ERISA. In fact, Robert Reich, Secretary of Labor at the time, encouraged “funds to reach for such collateral benefits, because — far from conflicting with their fiduciary duties — doing so complements their responsibilities to plan participants.”

However, the DOL made quite clear in its interpretive bulletin that ETIs are legitimate only if pension funds do not sacrifice return for collateral benefits. If the expected rate of return is the same on several possible real estate investments, but one of the investments also offers the collateral benefit of including only union-built properties, the fund would be acting legitimately in opting for the union-built properties. But if the union-built option is expected to perform worse than the other comparable real estate investments under consideration, the fund would be acting improperly to invest in it.

In the private equity field, investment approaches can include placements in companies that seek to create good jobs, adopt responsible contractor policies, have labor neutrality agreements, or contribute to workforce training and development. This approach can also include targeting specific regions.

Pursuing Appropriate Investment Vehicles

To the extent that pension funds pursue economically targeted investments, they must pay attention to the bottom line and diversify. From a practical standpoint, the value of plan assets must be paramount for trustees. After all, those assets exist to provide security for workers when they retire. No other use of funds could be justifiable if it detracts from that goal.

Trustees are also legally bound by the “duty of loyalty,” which under ERISA requires that trustees act “solely in the interest of plan participants and beneficiaries” and for the “exclusive purpose” of providing plan benefits and defraying administrative costs. However, as long as investments in ETIs do not detract from that goal, they are legitimate.

In the wake of the Enron collapse, the importance of diversification may be far more obvious than before: thousands of Enron employees lost billions because they were poorly diversified — too heavily invested in the stock of their employer. Yet, like the duty of loyalty, diversification is also a legal requirement. ERISA requires that trustees “diversify the investments of the plan so as to minimize the risk of large losses.”

There is a link between diversification, the bottom line and ETIs: trustees are not required to invest in assets that provide the highest rate of return overall. Rather, they are required to seek the best return compared to other possible investments in a particular asset class. Private equity investments are compared with similar private equity investments, real estate with similar real estate investments and stocks with similar stock investments.

State-Specific Investments

Some pension funds also target part of their portfolio to their own state, in an effort to promote community development, encourage local home building or mortgages, or fill capital gaps. CALPERS invests almost 15 percent of its assets within California, and claims to have built 21,000 homes for Californians, helped more than 470 companies through private equity placements, and provided mortgages to more than 54,000 members. Funds in other states conduct similar targeted investing programs. The Wisconsin Investment Board has some $8.6 billion invested in companies in Wisconsin.

For its part, the Ohio Teachers’ Retirement System adopted a policy in 2001 that gives “consideration to investments that enhance the general welfare of the state and its citizens, provided the funds are invested solely in the interest of participants and beneficiaries.” As of June 2001, the fund held slightly more than $1.7 billion in investments in Ohio companies.

Supporting Capital Stewardship

In 2000, the Center for Working Capital and the National Labor College convened a working group of labor educators and union staff to design a curriculum for trustees. The result was the Capital Stewardship Certificate Program, a four-course initiative to empower trustees.

Participants who complete all four courses earn the Capital
Stewardship Certificate, and they can earn college credit by completing additional assignments. The first course is an introduction to capital stewardship that examines basics of pension plan governance, fiduciary duty, investment strategies and corporate governance. The Center also tailors programs to the needs of different funds and unions.

In addition to its education courses, the Center convenes regional forums, bringing together trustees who share concerns about promoting community development and other issues on a local and regional level. Forums now meet in New York and California. The forums provide an opportunity to learn about local and regional issues of importance and develop investment-related responses. The Center is currently working to develop a regional trustee education initiative in Ohio, Pennsylvania and West Virginia.

Joel Solomon is Assistant Director of the AFL-CIO’s Center for Working Capital.

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**Capital and the Current Economic Crisis**

*Tom Croft*

The Heartland Labor Capital Network is a project started in 1995 by the Steel Valley Authority and the United Steelworkers of America. SVA is an economic development authority in a twenty county area of Western Pennsylvania, including Pittsburgh and 11 nearby distressed mill towns that suffered from the shutdowns in the steel and electrical industries in the 1980’s and 1990’s. The SVA has helped to save 9,000 jobs through high-road workplace strategies.

The world has been suffering a global recession with its roots in speculative over-investment. The recovery for the U.S. could be slow. We warned in our book, *Working Capital: The Power of Labor’s Pensions*, about the “collateral damage” to workers and communities from short-sighted speculative investments. Now, our economy is paying the price. The “collateral damage” investing that we argued against led to a downsizing and plant closing epidemic for U.S. and Canadian workers, and was a major factor in the accumulated $10 trillion in investment losses in the world economy prior to 9/11.

The most visible example is the white-collar destruction of the Enron Corporation. I call it the End-Run Corporation, a story of demented de-regulation, politicians on retainer, concocted offshore shell corporations, duped investors, exploiting an energy crisis and taking obscene short-term profits, CEOs bailing out with all the loot, cooking the books, and screwing workers.

Investigations have begun to find innumerable end-runs around acceptable corporate governance, fiduciary responsibility and corporate accountability.

Behind the downturn has been corporate and capital markets restructuring that has ushered in a short-term investment mentality, a boom in mergers and downsizing, overseas capital flight to sweatshops, trade deficits, capital gaps for small businesses, and the destruction of union workplaces. In the U.S., gigantic Wall Street pension management firms are paid $200+ billion per year to pave this “low road.” These trends have contributed greatly to a decades-long plague of low and stagnant wages and family incomes, rising inequality and growing poverty.

In this new century, as capital markets have tightened their dominance of public policy and millions of workers have been devastated by global recession, “labor’s capital” has a potential role in bringing more democracy to both the public and private sector, helping re-build our economy, and becoming a powerful force for worker- and community-friendly re-investment in older industrial communities and core metro cities.

Workers are fighting to retake control of their capital. Workers in the U.S. and Canada are moving toward a “high road,” worker-centered economy. Pension funds can prudently make substantial investments in high-quality, job-creating companies in economically-targeted regions. Advocates have been waging and winning shareholder campaigns to force corporations to become more worker-friendly, to stop the destruction of the environment, and to respect human rights, and they are doing it with community allies.

Taft-Hartley multi-employer pension plans, with $400 billion in assets, and public pension plans, whose total assets reach $2 trillion, all have labor or elected leaders on the trust boards. In the U.S., ERISA permits economically-targeted investments, or ETIs, which let pension trusts target “collateral benefit” investments, as long as the returns are comparable in similar investment classes. For instance, a construction union trust fund can invest in a housing project, and require that the workforce be unionized.

**The Heartland Network**

In 1995, we were working with the Steelworkers to raise money from the state’s pension funds to invest in a steel facility that we felt would be viable. We argued that “workers’ capital” should be invested in local businesses that pay living wages and treat workers and the community fairly, not short-term investments that hurt them.
We organized a Working Group, our goal to increase the control of working people over their pension funds. We looked to our friends in Canada who had Labor-Sponsored Investment Funds (LSIF’s) as a relevant model for our efforts. From this Heartland Labor Capital Network, we organized committees to research labor capital issues and hosted two national conferences. We pulled together a regional network of groups that had been fighting to save jobs, create worker ownership, and revitalize communities, and linked them to the Canadian LSIFs.

Our union partners, including the Steelworkers Pension Trust, and other Taft-Hartley and public pension funds, are seed-financing three or four new “Heartland” funds. These funds, with $800 million in assets now, and another $2-3 billion coming online, will invest in worker-friendly industries. Some will focus on growth, others on corporate restructuring. Regional funds are also under development.

Heartland has been involved in mobilizing Taft-Hartley pension funds to invest in small, private businesses for the first time, hopefully someday to replicate the Canadian LSIF model. And the California Public Employees Retirement Fund (CALPERS) passed in 2000 new “emerging markets” rules requiring labor standards for foreign investments, a policy also adopted by New York and other public funds.

**New directions for the Labor Capital movement**

The mission of the labor capital movement is to promote an alternative vision of the economy, one that is more humane and sustainable. The movement in North America focuses on the democratization of capital, capital accountability, responsible investment and regional community investment. We hope to launch a permanent bi-national network to explore the next steps in the development of workers’ capital.

These include development of regional trustee forums, a measure pushed by the AFL-CIO’s Center for Working Capital as well as a new trustee education program developed by the Center and the National Labor College. It will focus on shareholder initiatives and responsible investment.

Trustee forums have met in California, New York and Boston to begin organizing capital strategies around the needs of working people and their communities. In New York this led to initiatives to create affordable housing for working people utilizing labor’s housing investment trusts, and to take the lead in developing a long-term economic recovery plan.

Progress is being made:
- In Pittsburgh, we are developing a trustee education program co-sponsored by the Steelworkers, the Center for Working Capital, the National Labor College, and labor federations in the surrounding states, in cooperation with other labor-management groups and public sector pension trustees.
- In Pittsburgh, we have raised money for our local Pittsburgh Heartland Fund, that will make loans to small worker-friendly manufacturers. Structured as a for-profit corporation, the fund board includes representation from the Steelworkers and Mineworkers. Investors include Ameriserv Bank, a union-affiliated bank.
- In Ohio, the OEOC is bringing together interested activists to promote the development of a regional labor capital fund that will partly focus on employee ownership.
- In Hawaii, there is a campaign to create a socially-responsible mandate for the state’s pension funds and native trusts.
- CALPERS has pledged to invest 2% of its assets in poor and under-served areas in California. CALPERS is also starting a national worker-friendly merchant bank that might eventually have some $2 billion.

And where might the future of collective labor capital strategies lead?

- We should promote sustainable, economically-targeted investment strategies. We should develop education strategies for workers, trustees and economic democracy activists, including “high road” investment, regional economic development, “social audits” for labor capital funds to screen investments, and participatory governance models for investee firms.
- We should support coalitions to make capital more accountable, through promoting progressive trusteeship of pension funds, monitoring pension funds for negative “collateral damage” investments, and pushing for emerging market investment policies with labor standards.
- We should build a regional workers’ capital network, linking developing labor capital funds in the U.S. to the LSIFs in Canada. Through expansion of labor’s capital regional investment capacity, we should direct and anchor investments in worker-friendly, sustainable industries, supporting development of democratic, high-road workplaces.

Besides nearly $3 billion in worker-friendly pension-financed investment funds in the U.S. and $5 billion (Canadian) in Canada, there are tremendous religious and social assets that could also be mobilized. These new strategies—built around the sources of workers’ capital and connected to progressive labor and community regional alliances—can have a long-lasting positive impact on society, benefiting pensioners, and contributing to the betterment of working families and communities.

For more information, see the Heartland Network web site at [www.heartlandnetwork.org](http://www.heartlandnetwork.org).

*Tom Croft is Director of the Steel Valley Authority and Heartland Labor Capital Network.*

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**Our Pension Money and Our Jobs**
Heartland’s Landmark Fund Up and Ready

The Heartland Labor Capital Network has the first of its national funds up and open for business. The Landmark Growth Capital Partners Fund reached its funding goal in June with $75 million in capital, financed by Taft-Hartley and public pension funds. The new fund will provide capital to privately owned small and mid-sized high performance companies. The fund will invest in manufacturing, transportation and other core industries and will finance plant and equipment expansion, new product introduction, strategic acquisitions, and generational and succession opportunities.

Update on the Crocus Fund

Sherman Kreiner


The Crocus Fund, like other Canadian labor-sponsored funds, operates as a mutual fund and essentially sells shares in the Fund to individuals. The funds enjoy the advantage of being able to offer federal and provincial tax credits totaling 30 percent on purchases of up to $5,000 per year. The “catch” is that the Crocus shares must be held for a minimum of eight years. That has not been a disadvantage. Since the Fund started in 1993, every shareholder who completed the mandatory hold period has more than doubled the original investment when the tax credits are included. (Ed.: This is a return of better than 8% per year.) The federal and provincial governments have not suffered either. Studies have shown that government’s investment through the tax credits is paid back in the form of tax on new corporate sales and payroll in less than two years. Using this approach, the Crocus Fund has grown to $175 million in assets, owned by more than 31,000 Manitoba citizen shareholders over the past ten years.

It is the Fund’s mission to be the pre-eminent economic development organization in Manitoba. This mission is fueled by a commitment to reaching certain social objectives. For example, before it invests, Crocus does a two-tiered analysis of the potential investee company. It does conventional due diligence, examining a company’s profit history, the condition of its balance sheet, its growth potential and whether it has a strong management team. Then Crocus supplements this with a “social audit,” which looks at a company’s record on things like health and safety, the environment and labor relations. Such extensive due diligence can take six months. In addition, there are other requirements each company must meet: the business must have a majority of its employees in Manitoba and total net assets of less than $50 million. Utilizing this process, Crocus has invested in more than 60 top small and mid-size private businesses and created, maintained or saved more than 11,000 jobs. More than 3500 of those jobs belong to employee owners. Employee ownership is the preferred exit strategy for the Crocus Fund.

In its role as the pre-eminent economic development engine in Manitoba, the Crocus Fund has supplemented its core program activities through the development of a number of smaller sectoral funds, an enterprise development corporation designed to create participative, worker-owned businesses for residents of low-income communities, and a partnership with the University of Manitoba to make participative management a common practice in Manitoba businesses. In addition, Crocus has made a direct commitment to the revitalization of downtown Winnipeg, including moving its offices to a renovated historic building downtown.

For the future, Crocus has a goal to double its assets over the next five years through appreciation and the sale of new shares.

Sherman Kreiner is President and CEO of the Crocus Fund.

Our Pension Money and Our Jobs

New Employee Ownership Funds Take Shape

Over the years, Owners at Work has covered the establishment and experience of a number of venture funds which specialize in companies that are partly or wholly employee owned. This has not been a difficult task, because they have been few in number. But the pace is picking up. So far 2002 has seen two new, and very different, ESOP funds established.

Availability of financing is key to the growth of employee ownership. Not only is it key to establishing and growing ESOPs—a recent Ohio study found that 58 percent of Ohio ESOPs are leveraged—it is also key to company growth.

In the last few months there have been two innovations in employee ownership financing. The first is a new mutual fund which invests in the stock of publicly traded companies with significant employee ownership, launched by Capstone Asset Management with the technical support of Benefit Capital. The second is a “mezzanine finance” or subordinate debt fund that exclusively targets employee-owned companies, launched by Cleveland-based Candlewood Partners.

Both have chosen to target ESOPs because they believe that there is a genuine performance advantage in ESOP companies.

First ESOP mutual fund

Among the more than 14,000 American mutual funds, not one focused on employee-owned companies until Capstone Asset Management, a Houston-based boutique mutual fund firm, launched the Capstone Employee Stock Ownership Fund (ESOF) in January. Support services are provided to Capstone by Benefit Capital, the well known ESOP consulting firm.

“Ken Winslow, Jim Leary and I were shooting the breeze about ESOPs and productivity,” related Benefit Capital’s Dick Backus. “If ESOPs do yield improved employee productivity, then a mutual fund that invested in them ought to have an edge.” Two and a half years later, the Capstone Employee Stock Ownership Fund was a reality. Its slogan: “Investing in the American Dream.”

The Capstone Fund invests in significantly employee-owned publicly traded companies. “Significantly employee-owned” means that at least 50% of employees can share ownership of at least 10% of the company through ESOPs, stock bonus plans, broad-based stock option plans, and other employee ownership plans. The universe of such companies amounts to about 600 of the roughly 8,000 publicly traded American firms. The Capstone ESOF invests in 60 to 80 of these companies.

“Employees who participate in ownership plans no longer see themselves as just workers,” explains Capstone’s Dan Watson. “They see themselves as owners with a long-term interest in the future success of their firm. Consequently, productivity takes on a new meaning, increasing both production and job satisfaction. This can create appealing opportunities for outside investors.”

Capstone is seeking investment from the employee ownership community, including ESOP participants who want to diversify, 401(k) plans in employee-owned companies, and ESOP companies prefunding repurchase obligation.

The fund is moving along nicely,” says Backus. “We just passed the $1 million mark, a good first step. What’s better: from the inception of the fund on 1/28 to 5/31, the fund has beaten the S&P 500 by 3.7% in a down market.”

More information can be obtained by contacting Capstone at 800-262-6631 or at www.capcofunds.com/eso.

New ESOP subordinate debt fund

Ohio’s Candlewood Partners is finalizing a Small Business Investment Corporation (SBIC) to invest exclusively in subordinate debt and mezzanine financing for ESOP companies.

The SBIC is a mechanism which leverages each privately raised dollar with two dollars from the Federal Small Business Administration. The consequence is that Candlewood will be able to invest about $60 million when it completes its placement of $20 million among its limited partners.

“ESOP growth in smaller and middle-sized closely held companies has been restricted in the last few years as banks have reduced their lending,” says Candlewood managing partner Ray Lancaster, who previous served as managing partner at Key Bank’s equity fund and Kirtland Capital Partners. “The lack of readily available subordinate debt has been the major constraint.”

“ESOPs are an underserved niche,” comments Candlewood’s Jeff Dombcik. “For the average venture fund, there are plenty of opportunities without having to deal with the additional complexity of ESOPs.

“We understand ESOPs. We think we can get superior risk-adjusted returns, given the inherent benefits of employee-owned companies. First, there’s the cash flow benefit that comes from the ESOP. Second, studies demonstrate that ESOP companies with participative management are more productive. We are actively looking to invest in companies with participative management.”

The Candlewood ESOP fund targets investments of $2+ million in junior debt and preferred stock in manufacturing, distribution, and business service firms with revenues of $20-100 million. It will invest in companies with ESOPs in place or planned primarily in the Midwest and northeast. It expects to make placements in 10 to 12 companies over the next three to four years.

Candlewood, which has entered into a joint marketing rela-
A - 52% employee and managers in ESOPs encourage teamwork? 

Are ESOPs a better investment risk?

So far Capstone’s Employee Stock Ownership Fund has beaten its S & P 500 benchmark, but it has only a four month history. American Capital’s Employee Ownership Index of 350 publicly traded companies that were more than 10% employee owned matched the performance of the S&P 500 and Dow Jones Industrial Index for the 1992-1999 period, although there were periods in which it did substantially better than these benchmarks. While banks’ experience with ESOP loans has not been studied, Mary Josephs of LaSalle Bank—the country’s leading ESOP lending institution last year—notes that LaSalle’s ESOP portfolio (approaching $1 billion in commitments) has a very strong performance record. “In fact, we’ve been able to determine that the average risk weighing on the mature ESOP portfolio is no less than what we book new loans at.” This—anecdotally speaking—is completely consistent with research already done on privately-held ESOP companies that outperform their non-ESOP peers.

Will investing in ESOPs prove a profitable investment strategy? Time will tell. It’s a story that we will revisit in the future. OAW

New Employee Ownership Center

After years of news about state employee ownership centers being closed and defunded, a new center is being born in Vermont. Board chair Cindy Turcot of Gardener’s Supply Company reports that the Vermont Employee Ownership Center has already participated in three efforts to save jobs and has succeeded in amending state law to allow professional corporations to be ESOPs with part ownership by nonprofessional employees. Startup funding comes from Ohio’s Nationwide Insurance Foundation and a $100,000 matching grant from the U.S. Department of Housing and Urban Development. OAW

Leading & Managing Owners: Teamwork

A sk someone to describe their ideal vision of what employee ownership is and they are likely to describe it in terms of teamwork—sharing common goals, being listened to, mutual respect, and working together.

Teams are important building blocks of an ownership culture, but in reality teamwork can be difficult. How do leaders and managers in ESOPs encourage teamwork?

A 'one team culture' drives PT Tech

“We consider ourselves one team,” says Keith Nichols, President of Power Transmission Technology, a 32-person, 52% employee-owned firm in Sharon Center. “Our work essentially involves cross-functional projects and so each employee realizes it is in his/her best interest to help the others solve their problems. Our entire company has a team culture so the ESOP is enmeshed in our business.”

PT Tech designs and manufactures industrial clutches and brakes for heavy industry and is a technical leader in the power transmission market. “We really sell a service that offers our customers innovative solutions to their problems with their equipment,” says Keith Nichols. Their products now set the standard in the mining industry.

PT Tech was founded in 1978 by Dave Heidenreich, the firm's chief design engineer, who left a larger firm in order to develop his own ideas backed by four other investors. The ESOP was established in 1990 as a replacement for an existing profit sharing retirement plan for the firm’s 12 employees. The main reason for the ESOP is to create a long term transition method for the company stock. It helps reduce the likelihood of the original owners selling off the company and losing the unique culture through acquisition. The ESOP has been leveraged twice in the years since to buy shares from the original investors.

PT Tech's team culture is reflected in their corporate goal to promote cooperation and continuous improvement with customers and suppliers through the development of partnerships. Employee-owners work in partnership too, through a cross-functional structure of company meetings. First, strategic teams develop long term projects. Then, the Operations Group meets monthly to develop an action plan. Next, Engineering meets every two weeks for project oversight; their meetings are attended by representatives from the two other operational departments, sales and production, for a look ahead on projects.

“The ESOP is an HR challenge,” says Nichols, who encourages informal interactions to help build the firm’s team culture. Everybody eats lunch together twice each month with members of the company’s three departments taking turns to organize a presentation to the group; the company buys the lunch. Nichols keeps a jar of snacks on his desk and invites everyone to stop in and help themselves, which encourages relaxed communication. “We laugh at ourselves here too,” he adds, by giving rewards for humorous “mock” mistakes each year at the Annual Meeting.

Nichols believes that the open sharing of financial results promotes a ”this is my company” attitude, so the company tracks sales per employee, educates employees on the company’s finances, and helps each employee link his/her own job to business goals through participation in the Excellence by Objectives program. With the EBO, each employee sits down four times a year with his/her manager to discuss ideas for how to improve his/her own job and better the company as a whole.

Two short term bonus plans reward teamwork as employee-owners: a yearly team bonus based on retained earnings and stock dividends. The company also contributes 8% to 15% of earnings into the ESOP on an annual basis.

PT Tech has a near zero rate of turnover, though Nichols
states that the ESOP is not for everybody. “We had 3 or 4 employees who didn't fit the ESOP culture and left after we got the ESOP started.”

“An ESOP is nothing more than culture,” Nichols believes, “and the culture drives our business. Because every detail is aimed at our customers, employee owners’ voices get heard here. Everybody's paying attention.”

**Team Successes at Republic Storage**

“We are starting to think like an ESOP now,” says Mark Waidman, the Team Facilitator at Republic Storage Systems Company in Canton. “This is the way we run our business. We have a very knowledgeable workforce and people are willing to give information and volunteer to help the company as a whole. Teams go through the process that management used to go through.” Republic Storage Systems Co. is Ohio’s largest 100% employee-owned firm with 550 employees. It is a manufacturer of lockers, shelving, and storage systems.

When they first started their joint participation committee or JPC process, there were lots of critics and no one had the time to help, but as Waidman explains, “Now because our CEO is 100% behind it, we have lots of supporters. We have managers, superintendents, supervisors, and shop employees who we can depend on to champion teams and lead them.”

Republic Storage Systems Co. began its ESOP in 1986. “We were part of Republic Steel which merged with LTV in 1984, and we put in the winning bid to purchase our company from LTV so our competitors wouldn’t buy us and close us down,” explains Roger Elder, Republic’s Human Resources Director and the former president of USWA Local 2345. “We took 15% wage concessions and in return we got our jobs, job security, ownership, and one of the best health plans in the United States.”

“In terms of attitudes, we are worse off than smaller companies,” says Waidman. “Our company is over 100 years old and ill feelings from a traditional management-steelworkers relationship are ingrained in us. All the suggestion systems we’ve tried have failed and all the reward systems too. Currently, we are on our third joint participation program. Though we have tried to go by the book, we have learned that we have to do what works at our shop.”

Waidman knows what makes teams work in the shop, and cited 100 team projects completed and another 34 in process:

- “We have no boundaries, nothing is untouchable. We bring a top union official into the room when we discuss why we want to make a change.
- We tackle projects that make a positive impact because they either improve our morale or they improve our work-flow, quality, or efficiency. When we put in bar coding to replace the system we had in place for the past 100 years, we got together as a team who would be affected and asked them to figure out how their jobs would change.
- We think like an ESOP and our teams are not wasting money. One team analyzed the pallets we were using and came up with changes which capture an annual savings of over $40,000.
- We take on smaller projects and get them done. One team looks at ways to increase our warehouse capacity and has found 1400 new storage areas for small loads.
- Top management knows we will do the right thing. If we think it will work, then they tell us to go for it. We are building trust.”

In his role as the Team Facilitator Waidman assists teams to set up a process, offers direction, and helps teams experiencing difficulties. “I help the teams with problem solving and time frames. I am a watchdog. I don’t let projects die. I keep after teams and individuals to do their part in a timely fashion. I go to every staff meeting and production meeting so I know what’s going on and get information out to people. I report to our Labor Management Communication Group on the status of projects.”

“Selecting the right facilitator is important,” says Karen Thomas, of the OEOC. “Waidman has credibility out on the shopfloor and a track record as an effective communicator and supporter of joint team efforts.” He was selected by a panel of labor and management leaders through a joint process of evaluating the skills, knowledge, and experience among many interested candidates. He brings 28 years of service at RSSC including past experience as a Boilerhouse Operator/Plant Serviceman, former vice-president of the union local, former member of the ESOP Buyout Team, and former union-elected ESOP Administration Committee member.

“The two things that make teams work for us are support and follow-up,” adds Waidman. “I can’t see any partnership without total support from the CEO. We needed the right CEO to get everyone to bring forth this effort. Support is given also by the local union by becoming advisors to teams and by letting other employee-owners become leaders within the teams. Employee-owners are leading teams without an individual or team reward system except for the personal satisfaction and the goal to improve the company. The other item that is crucial is follow-up. The old programs died from lack of follow-up.”

“Other keys to success are simplifying projects one step at a time and starting with easily attainable projects without a lot of capital expenditure to create trust, respect, and credibility in the program.” OAW
Upwards of 325 participants attended the 16th Annual Ohio Employee Ownership Conference April 12th at the Hilton in Fairlawn, Ohio. After welcoming remarks from Daryl Revoldt, the Governor’s Economic Development Representative for Region 9 and John Logue, Director of the Ohio Employee Ownership Center, the participants were treated to a plenary panel that addressed the role of employee ownership in strengthening the concept of community in the workplace, in the company and in the society.

Sheila Henderson, HR Staffing/Training Coordinator at Yellow Springs Instrument, a producer of sensor technologies for the biosystems market and a 48% ESOP in Yellow Springs, Ohio, spoke about YSI’s philosophy that a business should be an asset within the community and that employees should be encouraged to develop themselves. Jim Anderson, President & CEO of Republic Storage Systems, a 100% employee-owned maker of lockers, shelving and storage systems, and Pete Martelli, President of Steelworkers Local 2345, looked at both sides of their commitment to rebuild labor-management relations and grow the company through improved levels of service to the customers. As Martelli put it, “Partnership takes a lot of effort, but the results are worth it.”

Gar Alperovitz, Professor of Political Economy at the University of Maryland, took the larger view of the role of employee ownership in society as a whole. Alperovitz’s work in employee ownership goes back nearly 30 years when he became involved in the 1977 Youngstown steel mill closings. Alperovitz felt that much of the subsequent political and organizational interest in worker ownership stemmed from those events.

J. Michael Keeling, President of The ESOP Association, Washington, D.C., a national association promoting employee ownership in America, was the featured speaker at lunch. Keeling and The ESOP Association have been keeping on top of activity in Congress surrounding ESOPs, and he delivered an in-depth report about the possible legislative aftereffects of the Enron situation.

The luncheon also featured the presentation of the 2002 Ohio Employee Ownership Awards to Ohio companies and individuals who have demonstrated exceptional leadership in making contributions to employee ownership. Falcon Industries was honored for Getting Their ESOP Off to a Good Start. On October 3, 2000, Falcon Industries established its Employee Stock Ownership Plan as a reward for the firm’s employees, who helped grow the company into a multi-million dollar business. Falcon, a 30 percent ESOP located in two identical plants in Medina, Ohio, and Cosmos, Minnesota, is a fabricator of screw flighting and conveyor screws and has long had a participative management style. Bob Taylor, President, noted “The two best years in the company have been the two years we have had the ESOP.”

The Ruhlin Company was presented an award on their ESOP’s 25th Anniversary. The Ruhlin Company, one of the largest and most prominent general construction contractors in Ohio, is located in Sharon Center and is 81 percent employee-owned. The decision to establish an ESOP twenty-five years ago fit the Ruhlin family’s philosophy of sharing profits with all those who make the

Highlights from the Conference (L-R, clockwise): Jeff Nasci from Republic Storage Systems; Greg Horning, and Duane Payne; (L-R) Gar Alperovitz, Tom McNutt, and Nancy FitzGerald; Bob Taylor, Mike Smith, Pat Kappele; Sheila Henderson from YSI Instrument Manufacturing Sales.
business a success. According to Jim Ruhlin, “The company has prospered and much of it is due to the interest of the people. Most people are very interested in owning a ‘piece of the pie.’”

The 2002 Lifetime Service to Employee Ownership award went to a very special individual. Nancy Cronin, a pioneer of economic development in Northeast Ohio, has been on the OEOC’s Advisory Board since it was established in 1987, and we’re happy to say, will continue to serve. “There’s a thread to what I’ve been doing,” Cronin says, “Workers are perfectly capable of owning and running companies. That’s why I’ve been proud to be on the OEOC’s Board. What’s the point of economic development if it doesn’t benefit the workers?”

Throughout the balance of the day, the Conference offered panel discussions on 16 different topics including technical presentations for selling shareholders and new employee owners, updates on Sub-S ESOPs and the new tax law, using ESOPs for investing and financing, and a look at the impact of Enron.

Following the morning plenary, Jennifer Gill King, Xtek; Joyce Swords, ComDoc; and Duane Payne, Ruhlin joined Gar Alperovitz in a discussion about the role of ESOPs In Our Communities. Also in the morning was a panel on Communicating the Business to Employee Owners that featured Ed Schmitt, Riesbeck Food Markets, along with Josh Brown and Josh Conrad, Casa Nueva Restaurant, talking about promoting employee-owners’ understanding of the financial side of the business. Rounding out the non-technical panels in the morning was one on Successful Ownership Cultures with Barry Hoskins, Antioch Company, on their “Retire at 50” program, and Jim Dunn and Michael Grone of Foresight Technology on their ‘Caritas’ philosophy.

In the afternoon, Don Fitzgerald, Mike Smith and Bob Taylor of Falcon Industries discussed using an ESOP as a succession planning strategy on the panel Selling to Your Employees. At the other end of the spectrum, a panel on Using an ESOP for an Employee-Led Buyout was made up of John Chetsko and Jeff Chine from Brainard Rivet along with Roy Campbell and Mick Brown from Harvard Industries. Also in the afternoon, Creating Meaningful Employee-Owner Committees explored how various committees build a spirit of teamwork through presentations by Jose Bezares and Kathy Kalal of Albums, Inc., George Moore and Karen Valko of the Mosser Group, and Josh Brown of Casa Nueva.

Building an Effective Board of Directors was the topic for three Board members, Jeff Evans, Will-Burt Company; Mary Landry, Maryland Brush; and David Scott, Dimco-Gray. Employee-owned companies, like all companies, have their problems, an issue that was examined in the panel on Pitfalls of ESOPs and How to Avoid Them by Diane Bartlett and Alane Updegraff of ACRT.

All in all, the day secured our position as the best one-day ESOP conference in the country! We thank everyone who made this year’s conference the largest employee-ownership event in the region and we look forward to seeing everyone at next year’s conference to be held Friday, April 11, 2003.
Ohio's Employee-Owner of the Year

Dianna Tillman, a product data management associate at YSI Inc., is Ohio’s 2002 Employee-Owner of the Year. Tillman, with 30+ years of service in manufacturing, administrative, and material handling roles, is a take-charge person who thrives in YSI's employee-centered culture. As she recalled during a recent interview:

“I raised all three of my children while working here. YSI gave me time off when my family needed me and enabled me to send all of my children to college. In turn, I always gave back and worked extra as needed. As an owner I have an obligation to make sure that orders get out. From the day I was hired, managers have been open to what I have to say and my opinion has been asked. I encourage other employees with potential because others encouraged me. This is all part of being an owner and adds to the success of this company.”

Tillman currently serves as co-chair of the ESOP Communication Committee and a member of YSI’s Employee Owners Council of employees throughout the globe. YSI, which specializes in scientific instrumentation, is 48% ESOP-owned and headquartered in Yellow Springs. Their ESOP was established in 1983.

Concrete Technology’s ESOP Communication Committee

The ESOP Communication Committee at Concrete Technology, Inc. won the 2002 Group Excellence Award given by The ESOP Association Ohio Chapter. The committee has 11 members, who serve three year terms and meet bi-weekly to promote the ESOP among employee owners and their families. Members participate in local and national Employee Owner Retreats and ESOP conferences to develop ESOP knowledge and leadership skills. They organize a yearly luncheon for new ESOP participants and publish a monthly employee newsletter on company issues. Last year they supported an employee financial education program and promoted widespread communication of financial results. The group also organized a company-to-company visit last year.

The committee involves employees’ families in activities during ESOP Month. They hosted a blood drive last year, donated to September 11 relief, and adopted a family for Christmas. In addition, members contact lawmakers to stress the value of ESOP companies. CTI is a 100% employee-owned producer of architectural precast concrete exteriors, headquartered in Springboro.

ESOP Attorney Tim Jochim

Tim Jochim is the 2002 winner of The ESOP Association’s national Member Recruitment Award. Jochim is managing partner of Jochim Co., L.P.A. in Columbus with an expertise in business succession, ESOPs, corporate finance, and corporate governance. He is an adjunct professor of corporate finance at Capital University School of Law and has published extensively on ESOPs.

First International Policy Conference of the Capital Ownership Group (COG)

“Can Globalization Be Inclusive, Democratic, and Sustainable?”

October 9 & 10, 2002
Four Points Sheraton Hotel
Washington, D.C.

This conference highlights problems caused by increasing concentration of capital and decision-making and poses solutions. While we appreciate the production efficiencies of global trade, we question conventional assumptions about the balance between civil and property rights, and about how wealth, money and capital are created. We demonstrate how rules and institutions can be transformed to benefit democracy and strengthen communities. We explore successful examples and present new policy proposals that promote social stability, decrease poverty and increase democracy by enabling increased broad local ownership and control of productive assets. The methods and proposals presented are politically feasible because they provide broad access to creation of new wealth without resorting to redistribution of current wealth.

Funded by the Ford Foundation
Donald K. Day died in April of natural causes. He was 65 years old. Day was a member of the Ohio Employee Ownership Center’s Advisory Board from 1996 until his untimely death. We are grateful for those six years of valued service to our organization. Donald Day was Secretary-Treasurer of the Ohio AFL-CIO, a post he had held since 1987. He was the first African-American to take a leadership position in that organization. Prior to that, he served 14 years on their executive board, representing Ohio AFSCME Council 8.

He was a key figure in Ohio politics and civic affairs as an advocate of social and economic justice for working families. Day was also a Kent State graduate, having earned a degree in government administration.
Broadening Ownership Builds Stronger Communities

Gar Alperovitz

Gar Alperovitz, one of the nation’s leading political economists, was among our keynote panelists at the 16th Annual Ohio Employee Ownership Conference discussing employee ownership and community. Here are some of his provocative thoughts on the subject of how we can build community through broadening the ownership of productive assets.

Wealth and income inequality have increased dramatically over the past three decades. Since the mid-1970s, households in the top 5 percent have seen their share of national income increase by a third (from 15.9 percent to 21.5 percent); and the inflation-adjusted income gap between the average family in the top 5 percent and the average family in the bottom 20 percent has grown from $142,658 to $235,392 (in 1999 dollars). The top 1 percent’s share of household wealth nearly doubled (from 19.9 percent to 38.1 percent).

Growing inequality has negative consequences for our sense of community. It contributes to the marked decline in generalized trust, social capital, and civic engagement over the same time period. And an economy characterized by free-ranging corporations which open, close, and relocate according to narrow financial criteria makes economic dislocation virtually inevitable.

The tremendous upheavals and devastation left in the wake of the rust belt plant closures during the 1980s, as well as the ongoing abandonment of inner city areas by business and investors, are only the most obvious examples of a phenomenon which has not significantly declined even in the most recent economic boom. Indeed, corporate migration within the U.S. has accelerated sharply since 1996 from fewer than 5,200 occurrences annually from 1980 through 1994 to more than 11,400 a year in the late 1990s. More than 11 million jobs were eliminated between 1993 and 1999 alone.

Since the New Deal, we have sought to redress economic inequality through tax-and-transfer measures that redistributed income. In recent years, however, such traditional measures have been politically stymied.

In the face of these unyielding trends, a growing number of advocates have begun to advocate remedies that are asset- or wealth-based. The basic concept is that giving relatively poor and other Americans a capital stake up front may be politically feasible and in some areas more efficient than trying to compensate after the fact for inequality through redistributive policies. As Harvard’s Richard Freeman puts it: “Equality of income obtained in the first instance via greater equality of assets, rather than as an after-the-fact...state redistribution of income from rich to poor, would enable us to better square the circle of market efficiency and egalitarian aspiration.”

Most of the asset-based strategies and policies now being proposed involve giving lower-income Americans some form of individual savings or equity account. A critically important related alternative involves community-based, asset-holding economic institutions. They can take additional steps to help stabilize local economies and to foster greater participation.

Employee ownership

Employee ownership is one of several community-based ownership strategies. Worker-owned firms in the form of Employee Share Ownership Plans (ESOPs) have grown rapidly. In 1974 there were only 200 ESOPs. By 1980, there were 4,000 ESOPS and equivalent programs involving 3.1 million employee-participants and $20 billion in assets. By 1998 there were 11,500 ESOPS (and similar stock bonus plans) with 8.5 million employee-participants and $400 billion in assets.

Other forms of employee ownership have evolved alongside ESOPs. Some 3,000 broad-based stock option plans (plans that grant stock options at half the full-time employees) now involve some 7 million employee-participants. Another 4,000 stock purchase plans (which can give employees a 15 percent discount on company stock and which receive preferential tax treatment) involve 15.7 million employees. Finally, at least 2 million employees were covered by 401(k) plans invested primarily in company stock.

The total number of employee-owners in the U.S. dwarfs the number of private sector union members, a mere 9.4 million workers in 1997. According to a recent estimate (which does not include employee share purchase plans) employee-owners controlled 8.3 percent of corporate equity in the U.S.

As impressive as these ownership trends may be, most of these plans provide little worker control or participation. Yet worker participation and control are important elements in anchoring ESOP firms in their communities especially when employees (a) hold a majority of shares and (b) are able to vote their shares for or against buy-outs or relocations. In the long run, restructuring decision-making in employee stock ownership companies will be important if the community stabilizing potential of worker ownership is to be actualized, especially in publicly traded firms.

Community Development Corporations

A second community-based ownership strategy which has emerged in American urban areas over the past 30 years is the community development corporation (CDC). The CDC was developed in the 1960s and adopted as an innovative tool in the War on Poverty. CDCs were widely seen by many political leaders as a new engine for economic development. The original concept was one that integrated both for-profit and non-profit functions at the level of the urban neighborhood.

CDCs have built an impressive record of housing and commercial development; they have continued to proliferate at a dramatic rate from less than 200 in the early 1980s to 3,400-3,600 in 1998. CDCs have produced an estimated 550,000 units of affordable housing, 71 million square feet of commercial/industrial space, and 247,000 private sector jobs.

While most CDCs have focused exclusively on housing, some have become major creators of jobs, especially in areas
underserved by the private sector. For example, New Communities Corporation (NCC) in Newark, New Jersey, employs more than 1,400 people, making it one of the largest private sector employers in the city. Among other projects NCC owns and operates a Pathmark supermarket and neighborhood shopping center. The supermarket is one of the most successful in the entire Pathmark chain, with yearly profits of over $1 million. As its majority (two-thirds) owner, NCC has made important decisions in connection with hiring (100 percent local); prices (lower prices on essential items for a healthy diet); and hours (open 24 hours to meet resident needs). As sole owner of other franchises in the shopping center (e.g., Dunkin Donuts, Mail Box, Pizza Hut, Taco Bell, etc.), NCC has also been able to give its hourly workers (even part-timers) full health benefits. In addition, NCC uses its share of the profits from Pathmark to help support the CDCs job training, day care, educational, and health programs.

The experience of New Communities suggests how CDCs can help impact inequality and economic stability. First and most obviously, CDC jobs can provide an alternative that not only offers more money, but also a more stable source of income. Because CDC-owned businesses are largely free of narrowly defined profit maximization pressures, they often can choose to stabilize jobs, rather than maximize top-dollar returns to the bottom line. They can keep job-providing businesses running during good economic times and bad at only modest profit rates that either would not interest a private investor or would-be entrepreneur in the first place or would encourage them to move on to greener pastures. CDCs can also use some portion of retained surpluses to fund community services that both provide service jobs and meet community needs. Finally, CDCs can choose to sacrifice some portion of profits in the interest of higher wages or more benefits for employees or lower prices for residents.

Community development finance institutions
A related development is the growth of new financial institutions dedicated to the needs of a particular local area, usually one that is underserved by traditional commercial lenders. Community Development Finance Institutions (CDFIs) include community development banks (such as South Shore Bank of Chicago) which operate at a profit by making investments in low-income communities. Also included are community development credit unions, community development loan funds, and micro-credit/microenterprise programs. CDFIs received a considerable show of support from the federal government in 1994 when Congress overwhelmingly approved a Community Development Financial Institution Fund in September of 1994. The CDFI Fund provides assistance to certified CDFIs in a variety of forms, including equity investments, deposits, loans, grants, and technical assistance. In its first two rounds, the CDFI Fund awarded $75 million to 74 CDFIs and $30 million to 93 banks, thrifts, and CDFIs for lending and investing in low-income communities under the Bank Enterprise Award Program.

Other avenues for community-based ownership development include community land trusts, which provide affordable housing; leasing of municipal property for development that is designed around community needs; and expansion of local public enterprise to include cable TV and internet service in low density areas where they are not otherwise being provided.

The role of government
The emergence of community-based institutional forms has been assisted in varying degrees by federal, state, and local policy over the last thirty years.

CDCs, as noted, were strongly supported by the federal War on Poverty. The federal government remains the CDCs’ biggest funding source. At the state level, there are model programs assisting CDCs in housing provision in Ohio and several other states. Local government support and cooperation has also played a key role in CDC success. Community Development Financial Institutions have also expanded with Federal action.

As for worker ownership, ESOPs began to take off after Congress approved a provision in 1974 tax legislation which allowed companies to deduct contributions of stock or cash to a worker trust. Over the next twelve years new ESOP tax incentives were passed in every Congress; one of the most important being a 1984 law allowing owners of closely-held private companies to be excused from the capital gains tax if they sold at least 30 percent of their company to employees. Seventeen states also have some level of legislatively mandated support for worker ownership, and five states have had active state worker ownership programs.

Policies in support of community-based economic institutions appear to be increasingly politically viable. There is considerable evidence that the idea of worker ownership, for one, is politically popular across partisan lines. Politicians and commentators who have spoken out in favor of worker-ownership include Jesse Jackson, Jesse Helms, Ronald Reagan, Bill Clinton, George Bush, Mario Cuomo, Dick Gephardt, Dick Kemp, Bill Bradley, William F. Buckley, and George Will. Rep. Dana Rohrabacher of California, a former Reagan speech writer and one of the House’s more conservative Republicans, recently introduced the Employee Ownership Act of 2001, with the goal that by the year 2010, 30 percent of all United States corporations would be owned and controlled by employees of the corporations. The bill would create a new kind of employee-owned and controlled corporation in which employees would own at least 50 percent of voting stock and would get to vote on all corporate issues on a one person, one vote basis. The bill’s co-sponsors run the political gamut, from very conservative Republicans like Rohrabacher and Ron Paul of Texas to liberal Democrats like Marcy Kaptur of Ohio.

Although community-based institutions we are examining are currently relatively modest in scale, given adequate support, a major expansion in the next century is now a realistic possibility. The developmental and policy work done over the last 30 years has established a firm foundation upon which to build in the future.

Alperovitz develops these themes further in his forthcoming book, Making a Place for Community, with Thad Williamson and David Imbroscio, which is to appear in the fall of 2002. Alperovitz is Lionel R. Bauman Professor of Political Economy at the University of Maryland.
Lockrey Manufacturing in Toledo became 51% employee-owned in January 2000. How could this change affect the business? Recently published findings from The Real World of Employee Ownership reveal that participative management, employee interest, and strong operational and economic performance are more common in majority-owned firms.

With 60 employees, Lockrey Manufacturing is an ISO 9002-certified precision machining and sheet metal fabrication supplier/partner to leading manufacturers.

Mark Makulinski, 51, the firm’s president and CEO, established the ESOP as an estate planning vehicle and as a long-term business continuation strategy. Trained as an engineer, he remains active in the business. “I was in the twilight zone about ESOPs at first,” explains Makulinski. “It took me about four years to get comfortable with the concept because an ESOP is not a narrowly defined plan like a 401(k). Instead you have a ton of latitude in how you can set up an ESOP and integrate it with other plans.” To establish the company’s ESOP, Makulinski donated 51% of his stock to a Charitable Remainder Trust, which in turn, has sold the shares to the ESOP on a 10-year note.

Lockrey Manufacturing is now in position to tap into a surge of interest from its employees. John Logue and Jacquelyn Yates report in The Real World of Employee Ownership that the operational and profit performance of majority-owned companies was equal to or better than other Ohio ESOP companies, even though they had gotten off to a rockier start.

The 48 majority-owned companies studied were more likely to add substantial communication after becoming an ESOP. About two-thirds of majority-owned firms (68%) added at least one new type of communication, and almost a quarter added 3 or more. In 119 minority owned firms, only 38% added at least one type, and only 6% added three or more. The majority-owned companies also made a greater investment in education and training of nonmanagerial employees. Nearly 70% of majority-owned firms increased training after establishing the ESOP, compared to 35% of minority ESOPs.

Half of the majority-owned companies added new techniques of employee participation after becoming an ESOP, compared to 38% of minority-owned companies, and majority-owned companies were almost twice as likely to have added three or more techniques (21% vs. 11% of minority-owned). The majority owned firms were also more likely to have nonmanagerial employees on the board of directors, (35% vs. 10% of minority-owned firms), and all the nonmanagerial directors in majority-owned firms were elected by the employees, as compared to half of those in minority-owned firms.

The majority-owned firms were far more likely to be rated as organizationally well-developed or “mature”—33% vs. 8% of minority-owned companies. Majority-owned companies didn’t stand out from other companies before they became ESOPs, so the shift to majority employee ownership seems the likely cause of the changes.

All these differences in management style added up to differences in operations and performance. Majority ownership was associated with a sharp decline in grievances in unionized firms. On an index of seven quantifiable aspects of operational performance, including absenteeism, product quality, employee turnover, productivity, customer service, profitability and production costs, the majority-owned companies were comparable to the minority-owned companies: 20% of them reported a strong positive impact of the ESOP, as compared to 24% of minority-owned companies. On an index of eight qualitative aspects of operational performance, including manager-worker communication, on-the-job performance, worker job satisfaction, motivation, working conditions, employee participation, labor-management relations and employee attitudes, 29% of the majority-owned companies reported a strong positive impact of the ESOP, as compared to 24% of minority-owned companies.

Eighty-five percent of majority-owned companies reported increased interest in decision-making, as compared to 49% of minority-owned companies. Overall, majority-owned firms performed a little better than minority-owned companies, and this good performance was in spite of majority-owned firms’ greater frequency of ESOPs created under the threat of shut-
Ohio's Employee-Owned Network

Upcoming Events

**Leading & Managing Owners – Linking Ownership to Profitability**
A continuing monthly series for leaders, running in southwest and northeast Ohio, explores ways you can promote effective communication and participation.

**Teaching about Profit & Loss**
Friday, October 18  Dayton, a.m. session
Tuesday, October 22  Kent, a.m. session
Learn how to explain P&L concepts and how the P&L can be used to set targets for operations improvements.

**Team Leadership & Team Decision-making**
Friday, October 18  Dayton, p.m. session
Tuesday, October 22  Kent, p.m. session
Explore basic group processes and approaches to building consensus.

**Teaching about your Balance Sheet**
Friday, November 15  Dayton, a.m. session
Tuesday, November 19  Kent, a.m. session
Learn how to explain the terms and concepts on the Balance Sheet and how to set targets for improving stock value and use of working capital.

**Team Leadership & Team Problem-solving**
Friday, November 15  Dayton, p.m. session
Tuesday, November 19  Kent, p.m. session
Explore brainstorming, symptoms vs. problems, identifying a problem, analyzing solution criteria, and action planning.

For more information or to register for Network programs, contact Karen Thomas at 330-672-3028 or oeoc@kent.edu

Other Network Events

**Employee Ownership Basics: An Orientation**
Friday, September 13  Dayton
Thursday, September 19  Kent
A highly interactive session in which participants play The ESOP Game, learn how ESOPs work, and explore the meaning of life (in an ESOP!).

**ESOP Fiduciary Training**
Wednesday, December 4, Kent
A session for trustees, ESOP administration committees, and Directors.

**ESOP Administration Forum**
Thursday, December 5, Kent
An update on relevant tax, legal, and fiduciary concerns.

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Employee-Owned Company Seeks Manager

Small, 100% employee-owned company is seeking a General Manager for its manufacturing facility. This is a fast paced, multi-task environment. You must be a self motivated, energetic, hands-on individual with manufacturing and sales/marketing experience. Applicant must demonstrate organizational skills and have strong financial background or be willing to learn. Attention to detail a must. Familiarity with an ESOP environment a plus. Send résumé to PO Box 1583, Mansfield, OH 44901.

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The Real World of Employee Ownership, by John Logue and Jacquelyn Yates, can be purchased from Cornell University Press or from the Ohio Employee Ownership Center.

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The Ohio's Employee-Owned Network’s Mission is to provide a forum for those working at all levels in employee-owned businesses to learn from each other how to make employee ownership work more effectively at their firms; to organize networking opportunities, roundtables, and training sessions which address the unique challenges of ESOPs.

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down or job loss—25% of majority-owned as compared to 9% of minority-owned firms.

In terms of profits relative to their industry, 33% of majority-owned companies reported improvement, as compared to 20% of minority-owned companies. Majority-owned companies were comparable to minority-owned companies in gains in stock valuation—about 30% over three years.

Majority-owned firms created more value in retirement plans for employees. Majority-owned companies tended to be smaller, but their median plan value was $37,720, as compared to $21,843 for minority-owned firms. And the majority-owned companies contributed an average of 13% of payroll to the stock plan over the two years prior to the survey, as compared to 9% of the minority-owned companies. OAW

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ESOP Association’s 10th Employee Owner Retreat

The ESOP Association’s annual national Employee Owner Retreat will be held near Chicago, at The DoubleTree Guest Suites in Downers Grove, IL. It will again be staffed by the Ohio Employee Ownership Center.

The Retreat is a three-day, off-site training seminar, where non-managerial employee owners learn from and interact with their peers from other ESOP companies. In small groups, structured exercises, and informal discussions, employee owners develop new team problem solving skills, become more knowledgeable about ESOPs and company financial statements, and gain a new perspective on employee ownership at their companies.

While any employee owner is welcome, the program is designed primarily to give hourly and salaried non-managerial employees an opportunity to learn with and from their peers. Typically participants come from outstanding ESOP companies, both service and manufacturing, where developing a culture of ownership is considered an important aspect of corporate success. Participants are often members of the board of directors, ESOP committees, problem-solving teams, and company trainers.

Sending 2 to 4 co-employees maximizes the effectiveness of the retreat experience.

Do you want your firm’s employee owners to:

… Recharge their enthusiasm
… Meet other employee owners
… Participate more effectively
… Better understand ownership

They can do all this and more at the ESOP Association’s 10th Annual

EMPLOYEE OWNER RETREAT

August 8-10, 2002
Chicago Area
(25 minutes from O’Hare and Midway International Airports)

Training conducted by the
Ohio Employee Ownership Center

To register, call the OEOC at 330-672-3028 or send an email to oeoc@kent.edu

PAST PARTICIPANTS’ COMMENTS:

“I think all employees should have the chance to go through this; this way they can hear from other companies and see how they work with ESOPs and make it work!”

“I learned more this weekend than I ever expected. Now I can look through our summary plan and actually understand it!”

“It’s a great experience!”

New Location!!
This year’s Retreat has moved to a new location — The DoubleTree Guest Suites in Downers Grove, IL. The hotel is within 20 miles of both Midway and O’Hare Airports and is a quick rail trip from Downtown Chicago!
This Issue of Owners At Work Sponsored by:

Ohio Department of Development
Labor-Management Cooperation Program

and the supporters on these pages

BUSINESS VALUATIONS, INC. ESOP VALUATION SPECIALISTS

Business Valuations, Inc. is an independent valuation and financial consulting firm. ESOP services include feasibility studies, valuation, equity allocation, securities design, and annual update valuations. Other valuation services include gift and estate tax valuations, litigation support, fairness opinions, securities analysis, shareholder buy/sell agreement valuations, and merger and acquisition consultation. Staff analysts are Chartered Financial Analysts (CFA) and/or Certified Business Appraisers (CBA).

Contacts: David O. McCoy or Steven J. Santen at: Business Valuations, Inc.
8240 Clara Avenue
Cincinnati, Ohio 45239
513-522-1300 or FAX: 513-522-3915

Candlewood Partners, LLC

Providers of Capital for ESOP owned companies.

For information, please contact Jeff Dombcik at 440-247-2800
jdombcik@candlewoodpartners.com

MEETING THE CORPORATE FINANCE NEEDS OF THE PRIVATELY HELD BUSINESS FROM PLANNING TO EXECUTION.

♦ Initial ESOP Valuation and Annual Updates
♦ ESOP Structuring and Financing
♦ ESOP Feasibility Analysis
♦ ESOP Trustee Advisory
♦ Sale or Refinancing of the ESOP Company

For more information, contact Loren Garruto at (216) 479-6876 or lgarruto@valuemetrics.com. Our Cleveland office is located at 1300 Bank One Center, 600 Superior Avenue, Cleveland, OH 44114.
Stout Risius Ross, Inc. is a leading financial advisory firm specializing in valuation, investment banking, and restructuring. The professionals at SRR have a long history of advisory service to ESOP trustees from valuations at formation and annual reporting to fairness opinions on transactions.

In addition, our investment banking services include acquisition services, capital sourcing, and repurchase financing.

For more information, contact Radd Riebe, at 216.685.5000 or rriebe@gosrr.com.

Alliance Holdings, Inc. offers closely held companies unique ways to transfer complete or partial ownership of their business. At the core of these solutions is the belief that employee ownership, through the use of a captive ESOP, provides the greatest benefits to both the selling shareholder and the employees.

Alliance Holdings is a private equity holding company owned 85% by its ESOP and 15% by an affiliate of Banc One. Interested owners of companies with an enterprise value of $5-$75 million, stable operating results, sustainable cash flow, a strong management team and are partially or entirely ESOP owned, fit well within our profile.

Using the Alliance Holdings model:
- Employees’ retirement benefits are diversified
- The selling shareholder(s) stock is acquired with cash with no lingering guarantees or pledge of proceeds
- The transaction is structured to achieve IRC Section 1042 tax treatment

Alliance Holdings assumes responsibility for the repurchase liability, administration, annual valuation, audit and fiduciary liability for the stock ownership transfer.

Contact: Leslie A. Lauer
614-781-1266
lauer@allianceholdings.com

Crowe Chizek currently provides recordkeeping and consulting services for more than 200 ESOPs nationwide. From your first contact to your last question, you will find your ESOP management team to be:
- Knowledgeable
- Accessible
- Professional
- Flexible

For more information on Crowe Chizek's recordkeeping services, please contact Kate Reid at 800-599-0359 or kreid@crowechizek.com.
GreatBanc Trust Company welcomes the opportunity to discuss the benefits of utilizing an independent ESOP trustee.

As an experienced ESOP trustee, we understand the complexities of the independent trustee’s role. Our ESOP team is led by John Banasek, CFP and Marilyn Marchetti, J.D., nationally recognized experts in ESOP transactions.

For more information on how an independent trustee may contribute to the success of your ESOP, contact John Banasek at (630) 572-5122 or Marilyn Marchetti at (630) 572-5121. Our national toll free number is 1-888-647-GBTC. We are located at 1301 W. 22nd St., Suite 702, Oak Brook, IL. 60523.

Our ESOP Services Group advises private and public corporations, selling shareholders, banks and investment bankers on implementing, structuring, and financing ESOPs to achieve business objectives. We also counsel clients on corporate, litigation, taxation, employee benefits, health law and estate planning and probate issues.

Carl J. Grassi, Esq.
(216) 348-5448  cgrassi@mhbh.com

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Blue Ridge ESOP
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INDEPENDENT ESOP TRUSTEE

Jobs and Fairness: The Logic and Experience of Employee Ownership
by Robert Oakeshott
This book, an acclaimed study of employee ownership past, present, and worldwide, is now available to readers of Owners at Work in the U.S. and Canada at a postage-inclusive price of $50.00.
“No other volume provides such detail about employee-owned businesses...It deserves a wide reading”
—Robert Taylor in the Financial Times
“By far the best summary of the range of arguments as well as the wide variety of cases and examples is Robert Oakeshott’s magisterial book Jobs and Fairness.”
—Dr. David Ellerman, Staff Economist, World Bank

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New ESOPs, New Management Methods
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Investing Pension Money with a Purpose
Promoting Labor-Friendly Investments
Capital and the Current Economic Crisis
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Update on the Crocus Fund
New Employee Ownership Funds Take Shape
Leading & Managing Owners: Teamwork
Building Better Communities: The 2002 Ohio Employee Ownership Conference
Ohioans Win ESOP Awards
OEOC Welcomes Bill McIntyre to Staff
In Memoriam: Donald K. Day
Broadening Ownership Builds Stronger Communities
Majority Ownership Improves Firm Performance
Ohio’s Employee-Owned Network Upcoming Events
ESOP Association’s 10th Employee Owners Retreat
Sponsors

Preliminary Feasibility Grants
The Ohio Employee Ownership Center (OEOC) administers the Ohio Department of Job & Family Services preliminary feasibility grant program. This program is designed to provide financial assistance for groups who are interested in contracting a study to explore employee ownership as a means to avert a facility shut down. For more information, please contact the OEOC at 330-672-3028 or oeoc@kent.edu.

The National Steel/Aluminum Retention Initiative (NSARI), administered by the OEOC, provides preliminary technical assistance to buyout efforts in the steel and aluminum industries. The program can also provide technical assistance to existing employee-owned companies in these industries. For information, call Steve Clem or John Logue, at 330-672-3028 or at http://www.kent.edu/oeoc/NSARI/.