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The National Cooperative Business Association • CLUSA International

Testimony of Doug O'Brien
President and CEO, National Cooperative Business Association CLUSA
House Committee on Small Business
Hearing on "Challenges and Benefits of Employee-owned Small Businesses"

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Chairwoman Velazquez, Ranking Member Chabot, Members of the Committee, thank you for the opportunity to provide written testimony to the U.S. House of Representatives Committee on Small Business about the benefits of cooperative businesses and the challenges co-ops face.

The National Cooperative Business Association (NCBA CLUSA) is the apex association of cooperative businesses across all sectors of the economy, including worker co-ops. Our mission is to protect and defend the cooperative business model and promote the use of cooperatives to help people capture economic opportunity and address economic and social challenges.

The issue of employee ownership is timely and critical to the future health of our economy and local communities. More and more people are looking to the cooperative business model as a key strategy to establish and maintain small businesses in their community - including Baby Boomers who are looking for options to sell their businesses and workers who are interested in having a stake in the business and the local economies. We also see more and more people coming together to form new businesses of nearly every type and seeking to use the cooperative business model so the workers can own, control, and benefit from the businesses where they work. One of the biggest hurdles these small business owners and workers face is the lack of an unfriendly policy environment, including the lack of access to SBA loan programs.

With the right policy support, cooperatives have gone to scale and helped transform several industry sectors in the United States. Today, one in three Americans is a member-owner of at least one cooperative business, cooperatives that exist in every congressional district in the nation. Many of you are familiar with the cooperative sectors that have gone to scale – agriculture marketing cooperatives, rural electric cooperatives, and credit unions, which are financial cooperatives. These co-op sectors have gone to scale because of the drive and collaboration of its members, as well as because of a robust scaffolding of sensible federal policy that reflects the special nature of the cooperative business structure. For nearly 100 years, Congress has enacted federal laws to help people establish these unique businesses that are owned, controlled, and benefit the members – the people who use the business. Some key examples include the Capper-Volstead Act and the Farm Credit Act for the agricultural sector; Federal Credit Union Act for consumer finance; and the establishment of the Rural Electrification Administration for rural utilities.

Of the 65,000 cooperative businesses in the United States, about 465 are worker cooperatives[1]. While worker cooperatives can certainly grow to scale, like the Cooperative Home Care

[1] Democracy at Work Institute, State of the Sector Report 2019.

Associates which now has more than 2,000 employees, the average size of a worker cooperative is 50 employees, and the median size is ten. Worker co-ops compete in the market like any other business. What distinguishes cooperatives is that they are member-owned and controlled businesses, so they operate in the best interest of its workers who are focused on the long-term viability of the business.

Employee ownership has numerous benefits. By giving workers an ownership stake in the company, cooperatives are an excellent model to promote economic mobility. As the decision-makers of the company, worker co-ops ensure each voice is heard equally. This results in higher productivity than non-cooperative businesses, higher wages for workers and less workforce turnover. Moreover, worker cooperatives have proven to be more resilient than non-cooperative businesses in economic downturns, in no small part because as owners, the workers have a vested interest in the long-term success of the business. According to research at the University of Missouri – Kansas City, 21 percent of conventionally-owned U.S. businesses fail after the first year and 51 percent of conventionally-owned U.S. businesses fail after five years. Globally, once worker cooperatives are created, "the expected survival of worker cooperatives meets or exceeds that of conventional firms."[2]

Our nation faces an immense opportunity. According to the U.S. Census, Baby Boomers are about 40 percent of the U.S. population, totaling approximately 74.9 million people. Over the next decade, 10,000 Baby Boomers will turn 65-years-old *every day.* And while many Baby Boomers work past retirement age, our economy can anticipate a massive shift as most of the people in this generation move out of the workforce. Moreover, Baby Boomers are the owners of over half of all small businesses in the United States. While some owners may choose to simply close their business, a better option – for the owner, the workers, and the community the business has served – is to convert the ownership of the business to a cooperative. Converting to cooperative ownership ensures that not only the owner earns the profits of their hard work, but that the workers who have contributed to the success of the business for so many years have the opportunity to improve their own economic standing and become owners of the business. Importantly, these conversions also ensure that necessary goods and services are still available to communities across the country who have come to depend on their local small businesses.

In recognizing the economic opportunity generated by a wave of retirements, the House Small Business Committee led the passage of the bipartisan Main Street Employee Ownership Act in 2018, the first major employee ownership law in decades. The law states,

> *It is the sense of Congress that cooperatives have a unique business structure and are unable to access the lending programs of the Administration effectively due to loan guarantee requirements that are incompatible with the business structure of cooperatives.*

The law required the Small Business Administration to, "**study and recommend practical alternatives** for cooperatives that will satisfy the loan guarantee requirements that are incompatible with the business structure of cooperatives," in coordination with lenders,

[2] Olsen, Erik K., "The Relative Survival of Worker Cooperatives and Barriers to their Creation". University of Missouri Kansas City (2013).

stakeholders and Federal agencies, and provide recommendations from the report and, "a plan to implement such recommendations."

NCBA CLUSA appreciates SBA's engagement through two listening sessions – one in-person and one virtual – to hear recommendations from the employee ownership community. Unfortunately, the report was not only disappointing in its recommendations and conclusions, but also potentially recommended additional hurdles for businesses to convert to worker cooperatives.

The report highlights the Small Business Administration's meeting with the U.S. Department of Agriculture, another federal agency that features extensive loan programs and the obligation to manage the risk of the loan portfolio. USDA's Business and Industry (B & I) Guaranteed Loan program is like SBA's 7(a) program with two exceptions:

First, in the SBA's own words, "Unlike SBA, USDA does not require each loan to be guaranteed by at least one individual or entity." Instead, USDA requires collateral from the cooperative and, in some cases, requires the co-op to sign an agreement to withhold profit-sharing until the guaranteed loan is repaid. In recognizing the strength of shared risk, USDA does not require a personal guarantee when a cooperative stake does not exceed 20 percent. That is, in co-ops of five or more, USDA does not require individuals to fulfill a personal guarantee requirement. Cooperatives are not seen as an exception at USDA, simply a different model to which USDA has outlined requirements so that cooperatives may equally participate in federal programs.

Second, a business is eligible for a USDA B & I loan guarantee only if it is located in a community with a population of 50,000 or less. That means that businesses that are located in urban areas do not have access to the sensible lending requirements used by USDA and that make it possible for co-ops to access these critical loans. This leaves cooperatives as, what we believe to be, the only business formation that the Small Business Administration does not serve. This problem will be exacerbated after the 2020 Census, in which some cities will narrowly surpass the 50,000-population threshold.

USDA's Business and Industry Guaranteed Loan program typically supports mid-size businesses to start-up, expand, or invest in things like machinery. USDA limits maximum percentages of guarantees based on the loan amount, and the borrower must meet various requirements before receiving a guarantee. While the maximum loan amount under this program is $25 million – though can be up to $40 million with the Secretary of Agriculture's approval – the average loan guaranteed through this program is $3 million.

According to the Small Business Administration[3], under the 7(a) program, SBA guarantees loans ranging from $25,000 to $5 million. Cooperative lenders report significantly lower loan amounts, with most lenders ranging from $1,000 to $2 million available to cooperatives; the National Cooperative Bank lends up to $12 million. A start-up loan for a worker cooperative typically ranges from $10,000 to $30,000. Generally, these cooperative lenders require collateral on loans, but in recognition the cooperative model, do not require personal guarantees.[4]

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[3] https://www.sba.gov/sites/default/files/SDOLoanFactSheet_Oct_2011.pdf
[4] https://institute.coop/sites/default/files/resources/DAWI%20-%20Investing%20in%20Worker%20Ownership.pdf

In the meeting between USDA and SBA, USDA recommended two options to SBA to ensure that cooperative businesses could fairly access SBA financing. First, that SBA waive the personal guarantee requirement when a loan is fully collateralized. Second, that SBA waive the personal guarantee and instead require the cooperative agree to withhold profit-sharing until the guaranteed loan is repaid. Disappointingly, SBA's response to these recommended alternatives to the personal guarantee from a Federal agency was that the options were not a personal guarantee. This response made clear that SBA was not interested in Congress' clear direction that the agency recommends alternatives to the personal guarantee.

Moreover, while SBA describes the personal guarantee as the lynchpin of the 7(a) program, SBA provides waivers to the requirement on guarantees for loans to Employee Stock Ownership Plans (ESOPs). SBA can guarantee loans made to the employee-owned business when employees own a majority stake in the company, as opposed to being limited to guaranteeing loans to the employee trust. Cooperatives, necessarily being 100-percent employee-owned, are not afforded this same benefit by SBA.

Since the SBA has clearly indicated it will not modernize its regulations to serve cooperative businesses as Congress has intended, we recommend Congress act to ensure that cooperatives have access to this critical loan program. We understand that Congress must balance the needs of small businesses while limiting the risk to taxpayers. Both USDA and stakeholders presented potential strategies that meet both of these needs. For example, guaranteeing loans to cooperative businesses without requiring a personal guarantee. SBA could implement this policy by using the business requirements and indicators that USDA uses in its Business and Industry program to ensure taxpayers are protected.

The structure of cooperatives makes the businesses more resilient, innovative, and sustainable. Yet the Small Business Administration sees the structure as an obstacle. With each member having an equal stake in the cooperative, there is no singular owner entirely on the hook. It is the shared risk among worker-owners that makes the business significantly less likely to fail than other types of business models.

Small business owners and workers face an amazing opportunity with the potential growth of worker cooperative. To help people capture this opportunity, we strongly believe the most important thing Congress can do is ensure that cooperatives have access to the SBA lending programs. NCBA CLUSA urges Congress in the strongest terms to level the playing for cooperative businesses at SBA so that these businesses owned by people in the community have an opportunity to thrive.

Again, thank you for the opportunity to provide written testimony. NCBA CLUSA stands ready to support your work on this critical issue.