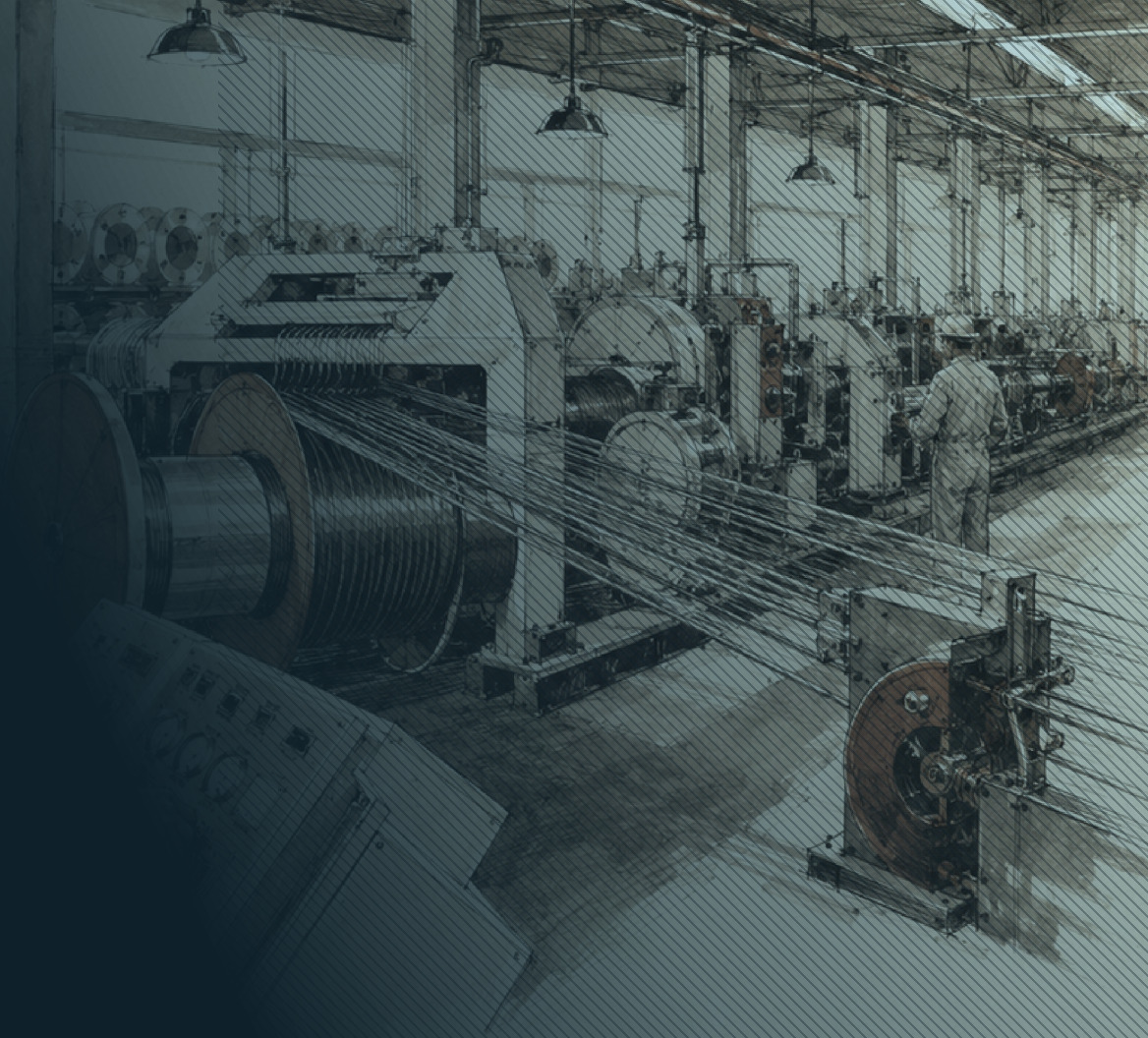




PLAYBOOK

# EMPLOYEE OWNERSHIP AS ECONOMIC DEVELOPMENT

A Development Finance Playbook for States

Julien Rosenbloom · July 2026

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## ACKNOWLEDGMENTS

The author thanks Jack Moriarty, Arundhati Punj, and Frank Giuliano. Errors remain the author's own.

## SUGGESTED CITATION

Rosenbloom, Julien (2026). *Employee Ownership as Economic Development: A Development Finance Playbook for States*. Lafayette Square Institute.

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Published at [www.lafayettesquareinstitute.org](http://www.lafayettesquareinstitute.org).

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## EXECUTIVE SUMMARY

## Business succession is the largest economic development risk most states are not yet managing.

The United States is entering the largest transfer of business ownership in its history. Roughly 6 million small and medium-sized businesses will change hands by 2035 as their baby boomer owners retire; more than 1 million of them are viable candidates for sale, holding as much as \$5 trillion in enterprise value. The default outcome is not a sale but outright closure: of the roughly 510,000 small businesses that exited the market in 2022, 92 percent closed outright and just 5 percent were sold. Every closure takes with it jobs, the state's tax base, supplier relationships, and productive capacity that no business attraction strategy can win back. Business succession is the largest economic development risk most states are not yet managing.

Employee ownership is a proven response built precisely for this exposure. Five decades of evidence show that employee-owned firms grow faster, lay off fewer workers in downturns, default less often, and build substantial retirement wealth for workers who contribute no capital of their own, all while keeping ownership and decision-making anchored in the communities where these firms operate. The model has advanced under Republican and Democratic presidents and governors alike. And yet it remains rare, with roughly 6,500 ESOPs nationwide and new plan formation averaging just 269 per year for a decade.

The growth of employee ownership is constrained in part by a lack of access to capital.<sup>1</sup> Because employees bring no capital of their own to an employee ownership transaction, a sale to them must be financed against the company's own cash flow, and in the status quo, the gap between what a lender will provide and the purchase price falls to the seller, who takes back a deeply subordinated note and waits years to be paid. Compared to a strategic or financial buyer paying the full price at closing, that is not a competitive value proposition. Employee ownership finance policy therefore has two objectives that must be pursued together: give the selling owner liquidity on par with any other buyer and minimize the cost of capital to the employee-owned firm.

As states consider the right toolkit to expand employee ownership, they do not need to invent anything. In 1976, a federal Economic Adjustment Assistance grant to New Jersey was re-lent by the state's development finance authority to the employees of the Okonite Company; the loan was repaid, the fund revolved ninefold, and Okonite remains 100 percent employee-owned today. This playbook outlines how to build that capacity with better tools than 1976 had: a federal authority expressly written for the purpose, a maturing private market of specialized employee ownership funds, and five decades of evidence on how these companies perform. It outlines a state finance toolkit composed of four

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1. The ESOP Association, "Access to Capital: A Barrier to ESOP Creation" (Washington, DC: The ESOP Association, May 9, 2025).

complementary instruments: transaction-level capital, credit enhancements and cost-of-capital tools, institutional capital mobilization, and tax incentives.

Around the toolkit, the playbook specifies what a working program requires: the non-state financing tools that complete the capital stack; capitalization sources matched to the instruments each can lawfully fund; the institutional capacity to run the program, anchored by a Director of Employee Ownership and an advisory commission; the ecosystem that generates a pipeline of viable transitions; and an implementation roadmap that begins with administrative action states can take now and sequences toward a durable legislative core.

The diffusion of artificial intelligence across the American economy makes the case for this kind of investment even more urgent. The small and medium-sized firms approaching ownership transitions are the same firms whose margins AI adoption stands to expand over the coming decade, and in a conventional firm those gains can come at the expense of the workers themselves. In an employee-owned firm, where the distinction between capital and labor collapses, employee owners hold the capital claim: productivity gains flow into their ESOP accounts rather than to an outside investor, and the firm has a structural incentive to deploy technology in ways that augment its workforce rather than replace it.

The succession wave will not recur at this scale for a generation, and it will resolve either by default or by design. The states that build this capacity will retain their anchor businesses, broaden ownership, and help decide who owns the next era of American enterprise.

# 1

## Introduction

In 1976, the Okonite Company was 98 years old and in the throes of a succession crisis. Founded in Passaic, New Jersey, in 1878, it was the oldest cable manufacturer in the country and made the insulated wire and cable that carried electricity through American cities, the Statue of Liberty, and Thomas Edison's Pearl Street Generating Station. The company had changed hands three times in a decade before landing in the portfolio of the notorious conglomerator James "Jimmy" Ling's Omega-Alpha, Inc., a Dallas conglomerate that entered into federal receivership in December 1974.<sup>2</sup> Okonite was a profitable, well-managed, and strategically useful company, but due to its parent company, it was about to be liquidated or sold off by a bankruptcy court a thousand miles from its plants. This was the last thing that Passaic County needed, with unemployment having run between 23 and 25 percent for most of the prior year.<sup>3</sup>

Okonite's president, Victor Viggiano, had read a newspaper account of a \$5 million federal award by the U.S. Economic Development Administration (EDA) that helped the employees of a South Bend, Indiana, machine toolmaker buy their company the year before. He called his congressman, Robert Roe, who happened to chair the House subcommittee overseeing EDA to explore how the federal government could similarly finance a sale of Okonite to its employees.<sup>4</sup> The structure that Congressman Roe, EDA, and Okonite assembled was, by the standards of any era, a sophisticated innovation of development finance. The EDA awarded a \$13 million grant to New Jersey's Department of Labor and Industry; the state channeled those funds through the New Jersey Economic Development Authority (NJEDA), which re-lent them to Okonite's newly formed employee stock ownership trust at 3 percent interest over 25 years, with a 2-year moratorium on principal. Above that sat a \$27 million, 5-year bank facility at 11 percent from a syndicate of seven banks led by Bank of America.<sup>5</sup>

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2. Joseph F. Sullivan, "Employees To Buy Factory," *The New York Times*, Feb. 29, 1976, p. 324.

3. Sullivan, "Employees To Buy Factory." In 1975, Okonite's company profile was roughly \$160 million in sales, a \$23 million payroll, and \$40 million invested in New Jersey plants and equipment.

4. Sullivan, "Employees To Buy Factory." Rep. Robert A. Roe (D-NJ-8) chaired the House Public Works Subcommittee on Economic Development. The *Times* article renders the Indiana company as "South Bend Tool Company"; the company was South Bend Lathe.

5. Lowenstein, Alan V. *Lowenstein: New Jersey Lawyer & Community Leader* (Piscataway, NJ: Rutgers University Press; New Brunswick, NJ: New Jersey Institute for Continuing Legal Education, 2001), 397, 400-401 (the \$20 million syndicate credit put in place September 30, 1975 and raised to \$27 million; the Bank of America-led syndicate of seven banks; the initial \$31 million of bank debt, the syndicate facility plus the North Brunswick mortgage, repaid within five years). The 11 percent rate is as reported at closing; Sullivan, "Employees To Buy Factory." The *Times* reported a \$25 million bank layer and a \$38 million purchase; those figures reflect the February 1976 accepted bid, when roughly \$25 million of the \$27 million facility was available for the purchase and the balance covered working capital. By closing, Okonite had committed the full facility to the purchase, and the final price was \$44 million.

The price itself was set by open auction in the Omega-Alpha bankruptcy. The trustees accepted the ESOP's \$38 million all-cash bid in February 1976, but the auction reopened in June, when Italian cable manufacturer Pirelli returned with a \$41 million all-cash offer. The EDA grant could not be increased further and the syndicate would go no higher than \$27 million; Viggiano instead committed to managing the business so that the entire facility could fund the purchase, bringing available funds to \$40 million, still \$1 million short of Pirelli. The final layer was a \$4 million first mortgage on Okonite's North Brunswick plant, placed in equal shares with Franklin State Bank and Fidelity Union Trust Company. The plant was an aging, single-purpose facility that no institution would lend against on its own; the loan closed only because NJEDA guaranteed 50 percent of it, with Okonite pledging a \$250,000 certificate of deposit to each lender to secure the guarantee. On June 29, 1976, the ESOP submitted its fifth and final bid of \$44 million in cash plus a waiver of its claims against Omega-Alpha, topping Pirelli, and the sale closed the following day. The three layers together financed a \$44 million purchase, won at open auction against strategic buyers, that turned roughly 1,900 workers into employee owners.<sup>6</sup>

Three design details warrant more attention than they received at the time. First, the federal money was structured to revolve: once Okonite repaid its loan, NJEDA would lend the funds out again “to aid other ailing industries,” with half reserved for distressed counties and half available statewide.<sup>7</sup> Second, the deal capitalized NJEDA as a modern development finance institution. Until 1976, NJEDA had arranged some \$250 million in financing for New Jersey companies entirely as a conduit for private lenders. The Okonite award gave the Authority lendable capital of its own for the first time in its existence.<sup>8</sup> This is not just a matter of historical reconstruction. Today, the loan sits on NJEDA's own records as EDA Award No. 01-19-01468 – the “OKONITE RLP,” dated May 26, 1976, made under Title IX of the Public Works and Economic Development Act. It was the first of 5 revolving loan funds awards that NJEDA reports were initially capitalized at \$21.4 million and went on to support nearly 850 loans exceeding \$200 million: a 9:1 ratio of lending to capitalization.<sup>9</sup>

Third, NJEDA's role was not confined to lending, but also consisted of strategic credit enhancements. In guaranteeing half of the North Brunswick mortgage, NJEDA stood behind private lenders on a contingent basis and secured its own exposure with cash collateral posted by the borrower. In a single transaction,

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6. Lowenstein, New Jersey Lawyer & Community Leader, 396-404 (the competing Pirelli and Ocifint offers; the trustees' February 13, 1976 acceptance of the ESOP's \$38 million bid; Pirelli's renewed \$41 million all-cash offer of June 2; the \$4 million first mortgage placed in equal shares with Franklin State Bank and Fidelity Union Trust Company, closed June 24, 1976, made possible by NJEDA's guarantee of 50 percent of the loan, secured by Okonite's pledge of a \$250,000 certificate of deposit to each lender; the fifth and final bid of \$44 million cash plus waiver of claims on June 29; and the June 30, 1976 closing).

7. Sullivan, “Employees To Buy Factory.”

8. Sullivan, “Employees To Buy Factory” (“For the first time, the Economic Development Authority will have funds of its own to use in making loans.”).

9. New Jersey Economic Development Authority, *Board Book*, June 9, 2021, “Request for Release of USED A Federal Interest in Revolving Loan Funds” and Exhibit 1, “NJEDA Consolidated Title IX Fund Individual Programs” (listing EDA Award No. 01-19-01468, “OKONITE RLP,” award date May 26, 1976, under the Public Works and Economic Development Act of 1965, Title IX; five RLF awards “initially capitalized with \$21,374,606” that “revolved and were used successfully to provide nearly 850 loans exceeding \$200MM”). The same volume records NJEDA's statement that it “has had a successful experience in managing USED A RLF moneys since 1976.”

the state through NJEDA deployed both funded capital (the re-lent federal grant) and a credit enhancement (a partial guarantee backed by pledged deposits), the same complementary pairing this playbook's toolkit contemplates five decades later. The guarantee is also why the deal closed at all: it converted an unmortgageable plant into \$4 million of senior private credit at the precise moment the auction demanded it.<sup>10</sup>

New Jersey's Commissioner of Labor and Industry, Joseph Hoffman, described the transaction at the time as "a classic exercise in true capitalism. It makes capitalists out of workers."<sup>11</sup> He was a Democratic appointee describing a Republican-era federal agency's largest-ever employee ownership investment, made under a tax innovation championed by Democratic Senator Russell Long of Louisiana that was then barely 2 years old. Employee ownership arrived in American development finance as bipartisan infrastructure, and it has remained so ever since.

The purchase of Okonite by its employees closed in June 1976. The company's own history states it plainly: "In June 1976, Okonite became the largest company in the United States to be owned by its employees through an [Employee Stock Ownership Plan]."<sup>12</sup> Fifty years later, the company is still there and 100 percent employee-owned. From its Ramsey headquarters and six plants across the country (including in Paterson, New Jersey, where it was operating at the time of the ESOP buyout), Okonite today supplies cable to electric utilities across distribution, transmission, and generation, and to wind farms, solar farms, and data centers.<sup>13</sup>

The workers who bought their company to escape a conglomerate's bankruptcy built one of the most durable and essential manufacturers in the United States, and the institution that financed them, NJEDA, is today one of the most capable state development finance agencies in the country.

Okonite was not a one-off transaction for a state or municipal government, and certainly not for the federal government. It was the second execution of an emerging federal template (the Wall Street Journal at the time called Okonite "the first concern to set out on the specific trail blazed by South Bend Lathe," the 1975 Indiana transaction in which a \$5 million grant to the City of South Bend was re-lent to an ESOP on nearly identical terms).<sup>14</sup> The template involved federal economic adjustment capital (usually in the form of an EDA grant) passing through a state or municipal conduit, which was then re-lent as a revolving loan to a newly established ESOP. This approach persisted into the early 1980s, but it was never

10. Lowenstein, New Jersey Lawyer & Community Leader, 401 (New Jersey EDA's interest in the transaction, including that repaid interest and principal "would be available to the New Jersey EDA for re-loan to other New Jersey enterprises," and the guarantee structure).

11. Sullivan, "Employees To Buy Factory."

12. The Okonite Company, "About Us," [okonite.com/about](http://okonite.com/about) ("In June, 1976, Okonite became the largest company in the United States to be owned by its employees through an Employees' Stock Ownership Trust."). Contemporaneous accounts record the federal funding being presented by Rep. Roe on June 30, 1976.

13. The Okonite Company, "About Us."

14. John J. Ryan, "How and Why U.S. Helped 500 Workers Take Over a Machine-Tool Manufacturer," *The Wall Street Journal*, Aug. 16, 1976, p. 28.

a formal program. Indeed, the federal government's role in directly financing employee ownership was opportunistic and case-by-case, and when this template was tested at scale, the federal government withdrew. In 1979, the Carter administration had reserved \$100 million in federal loan guarantees for an employee ownership purchase of the shuttered Campbell Works of Youngstown Sheet & Tube in Ohio, a transaction that needed roughly \$245 million. The administration declined to close the difference, the buyout collapsed, and Youngstown's steel infrastructure was gradually dismantled.<sup>15</sup>

In the decades that followed, states carried the thread of development finance for employee ownership unevenly. Connecticut lent its own appropriated capital into employee buyouts.<sup>16</sup> A wave of states placed employee ownership revolving loan funds into statute, and then, with remarkable consistency, never capitalized them.<sup>17</sup> The federal-state development finance architecture returned in earnest only in 2021, when Congress appropriated \$10 billion for the State Small Business Credit Initiative (SSBCI 2.0) and the Treasury Department expressly authorized its use for transitions to majority employee ownership.<sup>18</sup> Once again, state-administered federal capital was being provided to finance conversions to employee ownership. Notwithstanding limited uptake of SSBCI 2.0's employee ownership provisions, the revival of this model in 2021 bookended a single idea, nearly 50 years apart.<sup>19</sup>

This playbook exists because the conditions that made Okonite's employee ownership conversion necessary have returned at a scale that could not have been imagined in 1976, and because the financing capacity that made an employee-owned Okonite possible has not.

McKinsey estimates that by 2035, roughly 6 million American small and medium-sized businesses will face ownership transitions as their baby boomer owners retire. By their calculations, more than 1 million of them are viable candidates for sale, representing up to \$5 trillion in collective enterprise value.<sup>20</sup> On our current trajectory, the default outcome for these businesses is not a sale to employees, a financial buyer, or a competitor, but outright closure: of the roughly 510,000 small businesses that exited the

15. Staughton Lynd, *The Fight Against Shutdowns: Youngstown's Steel Mill Closings* (San Pedro, CA: Singlejack Books, 1982), 67, 78 (recording the September 27, 1978 White House commitment of "at least \$100 million in Federal loan guarantees for economic development in the Youngstown area," and EDA's March 30, 1979 denial on the ground that the proposal "would require \$245 million of Federal government loan guarantees," a sum "well in excess of the \$100 million amount which had been set as the maximum loan guarantee for any one company under the special steel program").

16. Connecticut Office of Legislative Research, *Employee Buy-outs*, Report 98-R-0380 (1998) (documenting Connecticut's lending of appropriated capital into employee buyouts, including a state Department of Economic Development loan to the Ansonia Copper & Brass employees and a Connecticut Works Fund guarantee on a People's Bank loan to the New Haven (Coastline) Terminals employees in 1996).

17. Michigan Public Act 217 of 1985 (repealed by 2002 Public Act 196); Massachusetts General Laws ch. 23D, § 16; ch. 392, Laws of 2023 (Washington). See Table 1.

18. The State Small Business Credit Initiative was created by the Small Business Jobs Act of 2010, Pub. L. No. 111-240, tit. III (roughly \$1.5 billion), and reauthorized and expanded to approximately \$10 billion ("SSBCI 2.0") by the American Rescue Plan Act of 2021, § 3301; codified at 12 U.S.C. § 5701 et seq.

19. U.S. Department of the Treasury, *State Small Business Credit Initiative Capital Program Policy Guidelines* (rev. Oct. 7, 2022), 21 (the employee ownership exception, conditioned on the employee entity holding a majority interest on a fully diluted basis at close). On the program structures available for employee ownership and their limited early uptake, see Chapter 5.

20. Ken Yearwood and Shelley Stewart III, with Nathan Marks and Nick Noel, *The Great Ownership Transfer: A New Era of Business Stewardship*, McKinsey Institute for Economic Mobility (Feb. 2026).

market in 2022, 92 percent closed outright, and just 5 percent were sold. A market with more aligned exit options for retiring business owners, by the same analysis, could retain up to 12 million jobs.<sup>21</sup> For a state development finance agency, this economic exposure is a harrowing and hidden risk: every closure or out-of-state sale carries with it a loss of jobs and an erosion of the tax base, supplier relationships, and productive capacity that no firm recruitment strategy can win back. For all of the focus by state leaders on business attraction, business succession is an economic development risk hiding in plain sight.

Employee ownership is a proven solution built precisely for this exposure. Five decades of evidence shows that employee-owned firms grow faster, lay off fewer workers in downturns, are less likely to default, and build substantial retirement wealth for low- and moderate-income workers, all while anchoring businesses in the communities that incubated them. The constraint on the growth of employee ownership has never been the evidence, nor demand. It is simply math. A sale to employees must be financed against the company's own cash flows; by design, the workers buying the business do not risk personal capital. In today's market, that means the seller typically self-finances a substantial portion of the transaction and waits years for their proceeds. Relative to the strategic or financial buyer that would provide the bulk of that liquidity at closing, this is a structural disadvantage that imposes an artificially low ceiling on employee ownership and suppresses it to a fraction of its total addressable market.

Closing this capital gap is a generational imperative for American development finance, which has grown as a domain for its discipline of using limited public capital and credit support to shape private markets in the public's interest. Indeed, states invented much of this discipline, and continue to possess its institutional chassis: development finance agencies, state treasuries, SSBCI allocations, credit enhancement programs. And, on the evidence of the last 5 years, states are increasingly willing to use the tools: since 2021, employee ownership legislation has been introduced or enacted in states as different as Washington, Colorado, Illinois, Indiana, Wisconsin, New York, and New Jersey.

This playbook is written to guide states through the development finance imperative at hand. It does not ask states to invent anything from whole cloth that they have not tried before. Instead, it tasks them with rebuilding, modernizing, and scaling a capacity that American development finance demonstrated 50 years ago, and to do so with better tools than were available in 1976, including a federal SSBCI authority expressly written for the purpose, a maturing private market of specialized employee ownership funds, and five decades of evidence on how these companies perform.

The chapters proceed as follows:

- **Chapter 2** establishes what employee ownership is and what the evidence shows about firm performance, worker outcomes, and broader economic impacts.

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21. Yearwood et al., *The Great Ownership Transfer*.

- **Chapter 3** explains the financing gap, offering insight as to why employee ownership models are structurally uncompetitive without market shaping and outlining what the capital stack of a typical transition looks like in the status quo.
- **Chapter 4** assembles a toolkit that takes up each financing instrument in turn: transaction-level tools, credit enhancements, institutional capital mobilization, and tax incentives, each with full design parameters.
- **Chapter 5** takes stock of the suite of federal programs that complement state-level development finance for employee ownership: SBA 7(a) lending, SSBCI 2.0, and federal grants.
- **Chapter 6** considers the sources of capitalization for the toolkit, ranging from state appropriations and philanthropic capital to tax credit monetization and SSBCI 2.0.
- **Chapter 7** details the institutional capacity necessary to bring employee ownership expertise in-house and steward a comprehensive statewide strategy.
- **Chapter 8** outlines the role of the broader employee ownership ecosystem (state centers, lenders, and other stakeholders) in cultivating a pipeline of viable candidates for employee ownership.
- **Chapter 9** provides an implementation roadmap for the state ready to bring all of these tools together.

50 years ago, a state development finance agency made its first loan and helped nearly 2,000 workers buy the company where they worked; since 1976, Okonite has paid out more than \$300 million in ESOP distributions to its workers.<sup>22</sup> That loan was repaid, the fund revolved ninefold, and today, the company is still employee-owned and the agency still holds the award in its records. This playbook asks development finance agencies to revive this ambition with better-honed tools and the scale this moment demands.

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22. Frank Giuliano, testimony before the New Jersey Senate Economic Growth Committee (June 2026).

# 2

## Overview of Employee Ownership

Employee ownership is a distinctly American tool capable of building generational wealth, fortifying national economic security, and improving firm performance. Three structures account for nearly all forms of broad-based employee ownership in the United States: Employee Stock Ownership Plans (ESOPs), worker cooperatives, and employee ownership trusts (EOTs).

An ESOP is formally a retirement plan governed by the Employee Retirement Income Security Act of 1974 (ERISA), which created the structure with broad bipartisan support, and is the only such plan that can borrow money to buy stock in the company that sponsors it.<sup>23</sup> At once an employee retirement plan and a corporate finance vehicle, this distinct configuration is what lets the ESOP acquire a departing owner's company on the workforce's behalf. With approximately 6,500 ESOPs in the United States, they are by far the most common form of employee ownership.<sup>24</sup> Worker cooperatives, owned and governed by their members on a one-person, one-vote basis, are far fewer and tend to be much smaller (as of 2025, there were at least 820 known worker cooperatives in the United States).<sup>25</sup> Employee ownership trusts (EOTs) are a newer perpetual form of ownership, where the trust holds the company perpetually on behalf of employees. It is primarily a profit-sharing vehicle and does not involve individual share ownership and capital appreciation.<sup>26</sup> Both worker cooperatives and EOTs are important forms of employee ownership, particularly for firms so small that an ESOP's fixed costs are prohibitive (businesses with fewer than 20 employees are generally too small for an ESOP and better suited to these structures).

Because most ESOP trusts borrow money from external investors—banks, selling shareholders, and investment firms, for example—they are, by definition, leveraged transactions. The mechanics of a leveraged ESOP involve establishing a trust for the employees,<sup>27</sup> borrowing money to buy out the owner's shares, and repaying the acquisition debt through future cash flow. As the debt is paid down, shares are released proportionally into employees' accounts until the ESOP (and therefore the workers) owns the company outright.<sup>28</sup> A core feature of the ESOP is that employees put in no capital of their own,

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23. Jack Moriarty, *Financing the Growth of Employee Ownership: Policy Landscape Report*, Lafayette Square Institute, "How Do ESOPs Work?"

24. National Center for Employee Ownership, *Employee Ownership by the Numbers* (updated 2026).

25. Democracy at Work Institute and U.S. Federation of Worker Cooperatives, *2025 Worker Cooperative State of the Sector* (2026).

26. Morgan Stanley, *Employee Ownership Investing: Supporting Wealth Creation* (May 2026).

27. Moriarty, *Financing the Growth of Employee Ownership* ("all full-time employees are required to be eligible for the ESOP plan").

28. Moriarty, *Financing the Growth of Employee Ownership*.

nor should they. Their equity in the company is funded by the company's free cash flow and comes on top of their wages,<sup>29</sup> rather than coming at the expense of a payroll deduction. This is also why employees cannot finance the transactions themselves and why the transaction must be underwritten according to the ability of the business to repay the acquisition loans. Another core feature is the repurchase obligation: when an employee leaves, the company must buy back their vested shares.

The federal tax code makes this structure attractive to both the seller and the newly formed ESOP. A retiring business owner can defer capital gains on the sale of their business to an ESOP, and a company wholly owned by an ESOP and organized as an S corporation owes no federal income tax on the ESOP's share of earnings (more details in the Tax Incentives portion of the State Finance Toolkit chapter).<sup>30</sup>

The empirical evidence around employee ownership shows that it functions as a comprehensive strategy for building worker wealth, improving firm performance, and strengthening economic resilience. ESOP participants hold more than double the retirement assets of workers at comparable conventional firms.<sup>31</sup> For low- and moderate-income workers, their ESOP account is frequently the largest financial asset they hold, and because of the mechanics of the leveraged ESOP transaction, they come to own it without foregoing any discretionary income.<sup>32</sup> As for firm performance, research shows that ESOP firms experience significantly higher sales growth compared to non-ESOP firms.<sup>33</sup> As for employment, one study shows that ESOP employment growth rates were 3.8 percent higher per year in the post-ESOP period than pre-ESOP projections suggested.<sup>34</sup> The economic resilience evidence is similarly compelling. In the 2014 General Social Survey, 1.3 percent of employee owners reported having been laid off in the prior year, against 9.5 percent of other workers. In another study, Kurtulus and Kruse find that employee-owned firms shed fewer jobs and survived at higher rates through both the 2001 and 2008-2009 recessions.<sup>35</sup> Decades of research on ESOP firm performance and broader economic benefits show that employee ownership represents a strategic investment in economic resilience and dynamism, firm performance, and worker wellbeing.

29. The academic literature finds a modest wage premium for workers at ESOP companies; see Douglas Kruse, "Does Employee Ownership Improve Performance?," IZA World of Labor (2016).

30. Internal Revenue Code § 1042 (the selling owner's capital gains deferral) and the S corporation ESOP federal income tax exemption.

31. Nancy Wiefek and Nathan Nicholson, *S Corporation ESOPs and Retirement Security*, National Center for Employee Ownership (Dec. 2018).

32. Janet Boguslaw and Lisa Schur, *Building the Assets of Low and Moderate Income Workers and Their Families: The Role of Employee Ownership*, Institute for the Study of Employee Ownership and Profit Sharing, Rutgers School of Management and Labor Relations (2019).

33. National Center for Employee Ownership, "Research on Employee Ownership," nceo.org (ESOP companies' sales growth 3.4 percent per year higher in the post-ESOP period than pre-ESOP projections suggested).

34. National Center for Employee Ownership, "Research on Employee Ownership," nceo.org (employment growth 3.8 percent per year higher in the post-ESOP period than pre-ESOP projections suggested).

35. National Center for Employee Ownership analysis of the 2014 General Social Survey (1.3 percent of employee owners reporting a layoff in the prior year, against 9.5 percent of other workers); Fidan Ana Kurtulus and Douglas Kruse, *How Did Employee Ownership Firms Weather the Last Two Recessions?* (Kalamazoo, MI: W.E. Upjohn Institute, 2017).

# 3

## Employee Ownership's Financing Gap

For the past decade, there have been about 6,500 ESOP companies in any given year, with new plan formation averaging just 269 per year.<sup>36</sup> Indeed, despite employee ownership's strong economic track record and broad bipartisan support, it has struggled to scale. A lack of reliable, abundant, and affordable private capital is impeding the growth of employee ownership.

Employee ownership is overwhelmingly the product of business succession. As an owner considers their exit options, financial and strategic buyers are frequently the most attractive; after all, these are buyers who will provide sellers with the bulk of the proceeds of their sale upfront. But those two pathways too frequently risk job loss or firm relocation out of state, and for the small businesses to whom these buyers are not flocking, the greater risk is outright closure altogether. Notwithstanding these evident risks, in the status quo, even those owners most keen on rewarding their employees or preserving their legacy by selling to an ESOP are often deterred from doing so for lack of liquidity.

This is largely due to the structure of the conventional ESOP transaction. Because workers bring no capital of their own, their stake is financed against the business itself and repaid through future cash flow. There is limited equity capital to finance these transactions, so they are usually financed through some combination of the following:

- **Senior debt:** A bank lends against cash flow and collateral, which in practice reaches two to four times EBITDA, enough at typical valuations to cover 40 to 60 percent of the purchase price.<sup>37</sup>
- **Long-term subordinated seller note:** This subordinated note usually requires the seller to be repaid over five to ten years and could constitute as much as 60 percent of the sale.

Compared to a strategic or financial buyer, which provides the vast majority of the seller's liquidity at closing, the subordinated seller note requires that the retiring business owner wait up to a decade to collect the proceeds of a business they built often over a lifetime. This is simply not a competitive value proposition for many business owners. The ESOP transitions that do happen, then, occur because of an unusually patient and motivated seller willing to subordinate their own immediate liquidity to the goal of

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36. National Center for Employee Ownership, *Employee Ownership by the Numbers* (updated 2026) (new ESOP formation averaging approximately 269 plans per year, 2019–2023).

37. SES ESOP Strategies, “ESOP Financing” (senior lending of roughly two to four times EBITDA, sufficient at customary valuations to finance 40 to 60 percent of the purchase).

employee ownership. That is a commendable business owner, indeed, but not a recipe for scale.

In order to scale, employee ownership must be more competitively positioned relative to a financial or strategic buyer. Broadly construed, employee ownership finance policy has two objectives to achieve this<sup>38</sup>:

1. Create conditions for investors to generate competitive, risk-adjusted returns by deploying capital that offers liquidity to selling owners on par with strategic or financial buyers, and
2. Minimize the cost of capital to the employee-owned firm.

Though these objectives are obviously in tension with one another, the tools in this playbook offer a menu of options for a state to supply or mobilize cheap enough capital while still driving competitive returns for its providers. Public capital can accept a below-market return, in part due to its long-term, patient orientation, and in part because the return on employee ownership is a public one. Credit enhancements lower the risk that a private lender carries so that they can supply more capital at lower cost to the ESOP. Institutional capital, pooled and deployed at scale, earns a competitive return across a diversified portfolio while providing substantial liquidity to the seller. These strategies are legible to development finance agencies because they have long been deployed to address a textbook challenge of development finance: a class of fundamentally creditworthy transactions that the private market underserves because the market is too thin, too new to the asset class, or unwilling to move first at scale.

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38. Moriarty, *Financing the Growth of Employee Ownership* (“the twin objectives of employee ownership finance policy are 1) to create conditions for investors to generate competitive risk-adjusted returns by deploying capital that offers liquidity to selling owners on par with non-ESOP buyers while 2) minimizing the cost of capital for the ESOP company”).

# 4

## The State Finance Toolkit

States have never more urgently needed to address employee ownership's financing gap, nor have they ever been more prepared. The looming wave of business succession—constituting millions of businesses, trillions of dollars in enterprise value, a default outcome of firm closure—means that every year the challenge goes unaddressed, the life's work of retiring business owners is shuttered, and the already fragile tax base of most states is eroded. No business attraction strategy can offset or reverse that. States must create more pathways to employee ownership.

A state can finance employee ownership transactions in several different and complementary ways, best understood in four different categories in which a state's resources are committed in different ways:

- **Transaction-level capital** (section A) puts the state's money directly in an employee ownership transaction. A revolving loan fund lends state dollars onto the borrower's balance sheet in a senior or junior position, and a loan participation ties them to a private lender's loan, buying into the lender's facility or lending a companion loan alongside it. In both instances, these are funded assets that the state must underwrite, service, and collect—either directly or through a contracted intermediary.
- **Credit enhancement and cost-of-capital tools** (section B) does not involve direct public participation at the transaction level but positively influences the transaction's terms. These tools generally put the state in a contingent position behind a private lender through a loan loss reserve, a loan guarantee, or collateral support, or they lower the borrower's cost through an interest-rate buydown or a linked deposit.
- **Institutional capital mobilization** (section C) deploys the state not as a lender, but as a Limited Partner (LP). A fund of funds commits a portion of the state's investment portfolio on a fiduciary, market-rate basis to private funds that finance employee ownership transitions. This mobilizes institutional capital at a scale no single loan can reach.
- **Tax incentives** (section D) commit no capital at all, instead foregoing revenue to change the post-tax economics of a sale to make employee ownership more attractive to a retiring business owner.

These tools are complementary to one another, occupying different points in the capital stack and taking different forms of public exposure. For that reason, they sometimes belong in different parts of state government and draw on different sources of funding; a comprehensive state program assembles these tools rather than choosing one among them.

The table below maps the toolkit against the objectives of employee ownership finance policy. No single instrument serves every objective, underscoring the need for states to assemble a toolkit rather than selecting a single tool.

TABLE 1

Objectives of employee ownership finance<sup>39</sup>

| POLICY OBJECTIVE                                                              | REVOLVING LOAN FUND | LOAN PARTICIPATION | LOAN LOSS RESERVE | LOAN GUARANTEE | COLLATERAL SUPPORT | RATE BUYDOWN / LINKED DEPOSIT | FUND OF FUNDS | TAX INCENTIVES |
|-------------------------------------------------------------------------------|---------------------|--------------------|-------------------|----------------|--------------------|-------------------------------|---------------|----------------|
| Enable seller liquidity on par with private equity and strategic alternatives | ✓                   | ✓                  |                   |                |                    |                               | ✓             | ✓              |
| Create competitive risk-adjusted returns for investors                        |                     |                    | ✓                 | ✓              | ✓                  |                               | ✓             |                |
| Minimize the cost of capital to the employee-owned firm                       | ✓                   | ✓                  | ✓                 | ✓              | ✓                  | ✓                             |               | ✓              |
| Create long-term sustainability for the employee-owned firm                   | ✓                   |                    |                   |                |                    | ✓                             | ✓             | ✓              |

Source: chapter 4 of this playbook. Note: check marks indicate the objectives each instrument serves; empty cells indicate the instrument does not serve that objective.

## A. Transaction-Level Capital

To understand the role of transaction-level tools, consider how employee ownership transactions (and ESOPs in particular) are generally financed. In a conventional ESOP transaction, a senior bank will lend

<sup>39</sup>. Adapted from Jack Moriarty's presentation at the 2026 Mid-Year Fellows Workshop in Honor of Louis O. Kelso hosted by the Rutgers Institute for the Study of Employee Ownership and Profit Sharing.

against the company's cash flow and collateral; in practice, this is two to four times EBITDA, which is usually between 40-60 percent of the purchase price.<sup>40</sup> Everything below the senior lender must be lent from elsewhere, and in traditional employee ownership buyouts, that usually comes from the seller, who takes back a deeply subordinated note for the balance and waits years to be paid.

The tools in this section improve the economics of the employee ownership transaction by lending into two different parts of the capital stack. The revolving loan fund supplies the capital (senior or junior) with the state as lender of record, replacing or shrinking the seller note, depending on the size of the fund. The loan participation ties state dollars to a private lender's loan, whether the state buys into the lender's facility or writes a companion loan alongside it. It deploys only where a private lender is already in the deal and stretches the lender's capacity rather than substituting for it. These approaches can operate independently or, as the illustrative examples later in this section show, together in a single transaction. In both cases, the state's capital crowds in private capital. It takes the position the private market will not; that is, the junior layer no lender will hold or the senior capacity no single lender will stretch to. In filling it, the state draws in the private dollars that close a transaction the unassisted market left alone would have lost.

## Revolving loan fund

A revolving loan fund is among the oldest and most legible tools in American development finance, and the simplest to describe: a pool of capital held by a public lender that makes loans, collects repayments into the same pool, and then lends the money out again. With conservative underwriting and responsible stewardship, a single capitalization at a sufficient scale works indefinitely and is self-replenishing. New Jersey's experience with the arithmetic of revolving loan funds is instructive: five revolving loan fund awards from EDA initially capitalized at \$21.4 million supported nearly 850 loans exceeding \$200 million over their lives.<sup>41</sup>

An employee ownership-specific revolving loan fund departs from the generic RLF template in minor but important ways. A conventional small business RLF will usually lend secured senior debt to borrowers who cannot obtain credit elsewhere. An employee ownership RLF can do that for the smallest firms (and should, as discussed below), but it can also lend in a junior position: subordinated to the senior lender, but senior to the seller's note. This part of the capital stack is scarce (and for very small businesses, even senior debt can be scarce), pricing employee ownership out of competitive transactions that currently tend to go to financial or strategic buyers and resulting in outright closure for the firms without such buyers. In today's market, the junior position is usually occupied by the concessionary seller note, representing a major impediment to scale. The state revolving loan fund that occupies this position

40. SES ESOP Strategies, "ESOP Financing"; Jack Moriarty, *Financing the Growth of Employee Ownership: Policy Landscape Report*, Lafayette Square Institute, "The Financing Gap."

41. New Jersey Economic Development Authority, *Board Book*, June 9, 2021, Exhibit 1 (five EDA revolving loan fund awards initially capitalized at \$21,374,606 that "revolved and were used successfully to provide nearly 850 loans exceeding \$200MM").

disarms a seller's largest objection (i.e., waiting years to fully realize the proceeds of their sale) and turns it into a financeable layer of the transaction without displacing a single dollar of private capital.

Framed that way, an RLF's purpose is not only to finance the deals before it but to build the market from behind. The junior capital market for employee ownership is nascent. A fund that lends into it repeatedly does for the employee ownership capital market what development finance and public capital have done for others. The deep, liquid markets in which municipal and school debt now trade are not pure artifacts of the free market, but the product of decades of public policy, with public institutions lending first and private capital following.<sup>42</sup> An employee ownership RLF exists in that same tradition: patient public capital that proves an asset class until a private market forms behind it.

### Learning from authorized employee ownership RLFs

Though at least four states have authorized revolving loan funds for employee ownership, just one has capitalized theirs (Minnesota, whose Community Wealth-Building Loan Program includes employee ownership as an eligible use case). This carries a lesson that should discipline the design parameters that follow: across four decades, states have sporadically authorized employee ownership RLFs and almost never capitalized them.

As Table 2 shows, the only state money actually lending is Minnesota's \$3 million pilot, which is not employee ownership-specific, and Colorado's small conversion cost loan program, which addresses a challenge separate from the RLF described in this section. More often than not, states have enacted funds that have never made a loan. This has been true since Michigan and Massachusetts authorized RLFs in the 1980s to address plant closures. The lesson is structural, and compels capitalization as the central design consideration of an RLF, for an authorization that does not also resolve capitalization will not, by itself, lend.<sup>43</sup>

42. Yakov Feygin, Advik Arun, and Chirag Lala, *Revolving Loan Funds*, Center for Public Enterprise (Aug. 2024), 14–15 (the depth of established public finance markets is “a policy outcome,” and revolving institutions enable “learning by doing ... through which critical asset markets are formed and deepened”).

43. Sources for Table 1: Michigan Public Act 217 of 1985 (repealed 2002); Massachusetts General Laws ch. 23D, § 16; ch. 392, Laws of 2023 (Washington); Minnesota Laws 2023, ch. 53 (Community Wealth-Building Grant Pilot); Indiana Senate Bill 175 (2025) (died in committee); New York Senate Bill 962 (2024), continued as S.339 (2025–26); Colorado OEDIT Employee Ownership Loan program; New Jersey Senate Bill 4218/Assembly Bill 5016.

**TABLE 2**  
**State revolving loan funds**

| STATE         | INSTRUMENT                                                        | AUTHORIZED                      | CAPITALIZED?                                                          | STATUS (2026)                                          |
|---------------|-------------------------------------------------------------------|---------------------------------|-----------------------------------------------------------------------|--------------------------------------------------------|
| Michigan      | Employee-Owned Corporation Revolving Loan Fund (P.A. 217 of 1985) | 1985                            | Appropriation clause, but no record of lending                        | REPEALED, 2002                                         |
| Massachusetts | Employee Ownership Revolving Loan Fund (MGL c. 23D, § 16)         | 1980s                           | Never; “monies designated by the board” only                          | UNCAPITALIZED                                          |
| Washington    | EO revolving loan program (ch. 392, Laws of 2023)                 | 2023                            | Never; contingent on “the successful award of federal funding”        | UNCAPITALIZED                                          |
| Minnesota     | Community Wealth-Building Grant Pilot (Laws 2023, c. 53)          | 2023                            | Yes; \$3M one-time appropriation; not EO-specific                     | OPERATING                                              |
| Indiana       | EO resource center + revolving loan fund (S.B. 175, 2025)         | — (died in committee)           |                                                                       | DEAD                                                   |
| New York      | EO buyout lending revival, up to \$100M (S.962 → S.339)           | — (Senate-passed 2024; pending) |                                                                       | PENDING                                                |
| Colorado      | OEDIT Employee Ownership Loan (conversion costs)                  | Administrative                  | Yes (modest pilot)                                                    | OPERATING                                              |
| New Jersey    | Employee Ownership Revolving Loan Fund (S4218/A5016)              |                                 | Bill sets no figure but allows capitalization from a range of sources | Passed the Legislature and awaits Governor’s signature |

Source: state statutes and program records cited in chapter 4. Note: statuses as of 2026.

## Capitalization and sizing

A durable fund needs a capitalization plan with two features: it should be statutorily scoped to accept capital from any source that might fund it, and at least one source should be committed at enactment. New Jersey’s bill (A5016/S4218) addresses the capitalization question as well as any in the country, allowing the fund to be credited with state appropriations, federal dollars, philanthropic gifts, NJEDA program revenue, and loan repayments (the details of each capitalization source for an RLF and every other instrument in this toolkit is the subject of Chapter 6).<sup>44</sup> The enabling statute in any state should open all of these doors, if not more. Insofar as a revolving loan fund may contemplate accepting philanthropic investments in the form of program-related investments (PRIs) or mission-related investments (MRIs), its authorizing statute should consider whether the implementing agency is already permitted to enter into loan agreements with third-party capital providers in its enabling statute.

<sup>44</sup>. New Jersey Senate Bill 4218/Assembly Bill 5016 (permitting the fund to be credited with state appropriations, federal funds, philanthropic gifts, NJEDA program revenue, and loan repayments).

<sup>45</sup> Recoverability of PRIs and MRIs is a necessary design consideration to ensure external capital providers have a flexible range of options through which they can seed a revolving loan fund. In the event that an agency's enabling statute is silent on its ability to enter to such agreements, the revolving loan fund legislation should include, among the other sources of capitalization listed above, loans, program-related investments, or other recoverable investments, subject to such terms of repayment and return as the agency may agree. Alternatively, the legislation may instead provide the agency the express authority to enter into funding agreements with public, private, and philanthropic capital providers for the purposes of the revolving loan fund. These agreements may provide for repayment from monies in the fund, including loan repayments and interest income, on a senior or subordinate basis, and may establish reserve accounts within the fund.

The revolving structure also shapes which money is best suited to seed the fund depending on a state's fiscal health. Since a repaid loan returns to the pool, capital used to seed the fund is not spent the way grant money is spent; instead, it becomes a standing asset that finances transaction after transaction, making one-time and nonrecurring money (e.g., a budget surplus, a settlement windfall, or released legacy federal capital such as EDA RLF interest) particularly well-suited to the purpose.

How large an RLF should be capitalized has several considerations. A tier-one fund for worker cooperative and small ESOP lending is viable at \$2 million to \$5 million; an EDA grant plus match reaches that scale, loans run roughly \$100,000 to \$750,000, and at the smallest end the fund is often the only lender, because no lender is present. A larger fund finances a larger volume of small businesses: a \$15 million to \$25 million fund can finance several times the annual deal flow of the "starter" fund, write the occasional larger junior position where required, and still hold a prudent single-borrower limit near ten to fifteen percent of capital depending on the design of the fund.

### **Economic impacts of an RLF**

The figures below model a generic employee ownership fund at three capitalization levels over ten years. They are illustrative and fund-specific rather than state-specific, because the mechanics that drive them (deployment pace, loan size, a low default rate, and the private capital each subordinated dollar leverages) are properties of the design, not of any one state's economy.<sup>46</sup>

The lending multiplier in Table 3 best captures the promise of the RLF. Repaid principal plus interest is re-lent, so a one-time capitalization finances far more than its face value (in the example scenarios shown, it would reach cumulative lending of between 2.6 and 3.4 times the fund's initial capitalization over a decade). And with the cost per job in the low thousands of dollars for the \$10 million and \$50 million fund

<sup>45</sup> The enabling act of NJEDA, for example, expressly empowers it to contract for and accept loans of funds from any source, public or private, and to comply with their terms and conditions (N.J.S.A. 34:1B-5(j)), alongside its general powers to enter into contracts and to establish and maintain reserve funds. This enables private and philanthropic sources to provide PRIs and MRIs without A5016/S4218 creating a new authorization to do so.

<sup>46</sup> Lafayette Square Institute, New Jersey employee ownership revolving loan fund impact model (2026) (ten-year projections under stated assumptions; illustrative of the tool's design rather than realized results).

scenarios against the tens of thousands common to conventional job attraction incentives, the modelling suggests an employee ownership RLF is a particularly efficient development finance instrument.

TABLE 3

Economic impacts of various RLF capitalization scenarios (state: New Jersey)

| CUMULATIVE OVER TEN YEARS   | \$5M FUND | \$10M FUND | \$50M FUND |
|-----------------------------|-----------|------------|------------|
| Firms financed              | 29        | 27         | 47         |
| Cumulative lending          | \$13.03M  | \$33.98M   | \$170.19M  |
| Lending multiplier          | 2.61×     | 3.40×      | 3.40×      |
| New employee owners         | 1,051     | 2,717      | 12,341     |
| Jobs created                | 125       | 351        | 1,517      |
| Average wealth per employee | \$35,139  | \$40,809   | \$39,535   |
| Cumulative wealth created   | \$36.94M  | \$110.88M  | \$487.92M  |
| Private capital catalyzed   | \$43.43M  | \$113.26M  | \$567.29M  |
| Cost per job                | \$13,100  | \$6,057    | \$2,834    |

Source: illustrative fund model described in chapter 4. Note: cumulative over ten years; scenarios are fund-specific rather than state-specific.

## Design considerations

### Underwriting and eligibility

The qualifying transaction for any employee ownership RLF should be majority employee ownership through an ESOP, worker cooperative, or employee ownership trust, with capital available for the acquisition itself and, within limits, the transaction-related and post-transition working capital and advisory costs.<sup>47</sup> Minority transactions face fewer capital constraints and by definition require less liquidity for the seller. For the smallest businesses that banks will not lend to, there is an absence of senior debt that loans in even the smallest RLF tier can fill. But, as has been discussed, the constraint that suppresses employee ownership is not senior credit; more than a dozen commercial banks maintain dedicated ESOP lending groups, and nearly 300 new ESOPs form each year, overwhelmingly bank-financed.<sup>48</sup> The binding

47. New Jersey Senate Bill 4218, § 8(c) (eligible uses, including transaction-related and post-transition sustainability needs).

48. Susan Hoesly (Verit Advisors), “ESOPs Offer Relief in Today’s Constrained Financing Environment,” The ESOP Association (Mar. 2023); National Center for Employee Ownership, *Employee Ownership by the Numbers* (updated 2026).

constraint in this segment of the market is the junior layer, whether that be unitranche financing or structured equity (e.g., subordinated debt with stock warrants). A fund confined to microloans to the smallest businesses would leave that constraint untouched, while a fund that lent senior to bankable small businesses would duplicate a functioning market. Consequently, RLFs should lend with the following discipline: the fund should lend junior where its additionality is structural and crowd-out is absent, because the capital it displaces is the seller's own concessionary paper. Where lenders are absent, it may lend senior. Where a lender is present, the fund should rely on, not duplicate, the senior lender's diligence, reserving full underwriting for the deals where it lends alone.

### **Pricing and tenor**

The pricing of a state employee ownership RLF depends on its size and objectives. Every loan the RLF makes must be priced below the private market, as the instrument's purpose is to provide attractively priced debt and reduce the cost of capital to the employee-owned firm. The fund's breakeven rate covers expected losses, servicing, and inflation, and is the rate against which the fund's pricing should be benchmarked. Priced at or above breakeven, the fund preserves or grows its real capital, and a single capitalization can lend in perpetuity; priced below it, every loan pays part of its subsidy out of the fund's own capital, and a portfolio built exclusively around those terms will eventually stop revolving.

The fund's standard rate should sit at or above breakeven and lending below breakeven should be confined to very specific priorities (for example, NJEDA's 3 percent Okonite loan sat 800 basis points below its own bank loan, in part because it was in a distressed region and addressing an acute economic risk). Regardless of pricing approach, tenor should be 10 to 15 years, with amortization shaped around the senior facility.

### **Loss treatment and sustainability**

The evidence on ESOP lending and debt sustainability is favorable and clear. An analysis of 1,232 leveraged ESOP bank loans across three large banks over 2009 to 2013 (including the Great Recession) found loss-imposing defaults at roughly 0.2 percent annually, with losses equal to 1.5 percent of portfolio value, against comparable mid-market default rates of 2 to nearly 4 percent per year.<sup>49</sup> For the state development finance agency, this means that expected losses on well-underwritten employee ownership credit appear genuinely low, and materially below comparable conventional lending. Firm survival research for employee-owned firms corroborates the direction of this trend.

This trend is instructive for how a development finance agency should design around sustainability. A \$20 million mezzanine tier fund writing \$1 million to \$3 million junior loans at 12 year maturities may originate roughly \$2.5 million to \$3 million a year from repayments alone. Sustainability pricing at, say, 300 basis points above a senior lender's rate would cover an annual loss assumption, servicing, and inflation, while

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49. Corey Rosen and Loren Rodgers, *Default Rates on Leveraged ESOPs, 2009–2013*, National Center for Employee Ownership (2014) (1,232 leveraged ESOP bank loans across three large banks; loss-imposing defaults of roughly 0.2 percent annually and losses equal to 1.5 percent of portfolio value, against comparable mid-market default rates of roughly 2 to 4 percent per year).

explicit-subsidy pricing may not. Depending on the junior rate of an explicit-subsidy-priced RLF, such loans may functionally be a slowly amortizing grant, which a legislature may still rationally choose (it should just be clear-eyed about what it is choosing).

### Case study: NJEDA's 1976 Okonite loan

The design considerations above have been operationalized by states before. Consider, again, the federal-state structure that financed the Okonite purchase. Table 4 deconstructs the transaction as a term sheet mapped against the design elements discussed thus far.

The pricing of the Okonite loan was an explicit choice by NJEDA: the public tranche lent at less than a third of Bank of America's senior rate (a defensible subsidy given that Passaic County's unemployment rate was running between 23 percent and 25 percent at the time). The maturity structure (25 years for NJEDA with a principal moratorium beneath a 5 year private loan) was also explicitly solving an ongoing challenge for ESOP financing: the company's cash flow must service both the acquisition debt and fund the ESOP, so the junior layer provided by the state RLF must be patient.

**TABLE 4**  
**Terms of NJEDA's 1976 Okonite loan**

| ELEMENT            | TERM                                                                                                                                                                                                         | KEY TAKEAWAYS                                                                                                                  |
|--------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------|
| Capital source     | \$13M EDA grant to NJ Department of Labor & Industry                                                                                                                                                         | Federal grant capitalizes a state-administered fund (a pathway that is still open today)                                       |
| Lender of record   | New Jersey Economic Development Authority (NJEDA)                                                                                                                                                            | Development finance agency placement                                                                                           |
| Borrower           | Employee Stock Ownership Plan (ESOP)                                                                                                                                                                         | --                                                                                                                             |
| Position           | Beneath a \$27M five-year syndicated bank facility at 11 percent (Bank of America-led, seven banks) and a \$4M first mortgage on the North Brunswick plant                                                   | Public capital junior to private senior, as recommended in this section                                                        |
| Rate               | 3 percent fixed                                                                                                                                                                                              | 800 bps inside the senior rate, an explicit subsidy by NJEDA                                                                   |
| Tenor              | 25 years, with a 2-year principal moratorium                                                                                                                                                                 | Long amortization sized to the ESOP's repurchase and debt service reality                                                      |
| Credit enhancement | NJEDA guaranteed 50 percent of the \$4M mortgage placed with Franklin State Bank and Fidelity Union Trust Company; Okonite pledged a \$250,000 certificate of deposit to each lender to secure the guarantee | NJEDA also stood behind private lenders on a contingent basis, pairing funded lending with a guarantee in the same transaction |
| Revolving covenant | Repayments re-lent "to aid other ailing industries"                                                                                                                                                          | The fund continues to lend in perpetuity                                                                                       |

Source: contemporaneous records of the 1976 transaction cited in chapter 1 and Alan V. Lowenstein, *New Jersey Lawyer & Community Leader* (2001), ch. 14. Note: terms as reported at closing.

## Loan participation

In a loan participation, the state lends alongside a private lender on a single transaction through one of two structures:

1. A purchase participation, in which the state buys an interest in a loan that a private lender originates and takes its share of principal, interest, and collateral proceeds while the bank remains the lender of record, the underwriter, and the servicer; or
2. A companion loan, in which the state originates a separate second loan to the same borrower, which it can make only in tandem with the private lender's loan.

Whether a state participates in a senior or subordinated position is largely a design choice. A purchased share can rank *pari passu* with the bank (equal in repayment priority) or subordinate to it, and companion loans are usually subordinate. Subordinated loans are common across the federal State Small Business Credit Initiative (SSBCI) program inventory, from West Virginia's Subordinated Debt Fund and Wisconsin's WHEDA Subordinate Loan Participation Program to the Vermont Economic Development Authority's companion loan program, which has lent in a subordinate, fixed-rate position since the mid-1990s.<sup>50</sup>

The structure is thoroughly precededented in state development finance; it is one of the U.S. Treasury Department's approved SSBCI program types for employee ownership, and it is how the Finance Authority of Maine supported the Bell Street Builders cooperative conversion in 2023, the first SSBCI-financed worker cooperative buyout in the country.<sup>51</sup> No state, though, runs a dedicated loan participation instrument built just for employee ownership.

Whereas a revolving loan fund can be structured to fill a mezzanine capital gap in employee ownership finance, a senior, *pari passu* loan participation addresses the constraint on how deep a lending institution can lend into an employee ownership transaction; collateral coverage requirements and hold limits often cap senior lending capacity below what a mature business's positive cash flows could reasonably support. A state participation of 30 to 50 percent of the facility would let the lender roughly double its effective capacity, bring in a second institutional lender, and trim the blended senior cost of capital to the employee-owned business. A subordinated participation or companion loan works slightly differently, filling the junior layer itself, with the private lender required under SSBCI to keep at least 20 percent of the transaction at its own risk (the state may fund up to 80 percent).<sup>52</sup>

50. U.S. Department of the Treasury, *SSBCI Program Profile: Loan Participation Program* (May 17, 2011), 1–3, 6 (the two structures, with companion loans “usually subordinate”; the Vermont Economic Development Authority's companion loan program); Office of the Comptroller of the Currency, *Frequently Asked Questions Regarding the State Small Business Credit Initiative*, attachment to OCC Bulletin 2024-1 (Jan. 2024), 6; U.S. Department of the Treasury, *State Small Business Credit Initiative Fact Sheet* (June 2023), app. A (program inventory, including West Virginia's Subordinated Debt Fund and Wisconsin's WHEDA Subordinate Loan Participation Program).

51. U.S. Department of the Treasury, *SSBCI Quarterly Report through September 30, 2023* (Dec. 18, 2023) (the Finance Authority of Maine's Grow Maine loan participation financing the Bell Street Builders cooperative conversion).

52. *SSBCI Program Profile: Loan Participation Program*, 3 (the state may fund up to 80 percent of a loan; the private lender must retain at least 20 percent of its own capital at risk).

Which lending position is most effective at addressing a transaction's financing gap largely depends on the firm's market segment. For the smallest businesses, where no institutional lender may be present at all, expanding senior credit is additive. In larger transactions that would ordinarily carry a large subordinated seller note, a larger senior facility would only modestly help, while a subordinated participation could more meaningfully reduce the note's size.

Loan participations and loans originated from a revolving loan fund carry very clear similarities, especially to a borrower. The ultimate distinction between the two rests not with a loan's lien position (both instruments can sit senior or junior in the capital stack) but with deal selection. A participation happens only where a private lender is already participating in a deal, so it reaches transactions that lenders are already financing but cannot fully hold. An RLF, on the other hand, can originate on its own terms if preferred and can lend where no lender ordinarily would, especially to the smallest businesses. Though states will vary on a case-by-case basis as to which tool is most strategic, most would likely be better served by an RLF, all else being equal. The RLF is the more durable pool of capital, as it outlives SSBCI's deployment window and faces no federal co-lender requirement, among other reasons. Still, layering a senior participation with a junior loan from an RLF could itself be an effective lending strategy, as the next subsection shows.

### **Layered capital strategies: RLF and loan participation**

Treated separately, each transaction-level tool addresses one layer of an employee ownership loan. Deployed together, and combined with the credit enhancements of the next section, they enable a development finance agency to assemble the competitive financing that today only the rare and patient seller can provide.

Consider a company selling to an ESOP for \$10 million. The baseline leaves the seller self-financing as much as 60 percent of the deal, which is by definition a concessionary exit.

- Where a lender will provide a senior loan but the subordinated seller note is simply too large, an effective intervention is a senior loan paired with a junior loan from the RLF (or a subordinated participation): a subordinated junior loan fills the middle of the stack and could cut the seller note from, say, 60 to 25 percent.
- Where the lender is constrained by collateral or other limits rather than by credit, the answer is a senior loan with a loan participation from the state: a *pari passu* share that enlarges the senior facility and shrinks the seller note to 40 percent while keeping the state in a senior position (or, as the next section discusses, in a contingent position with a guarantee or collateral support, which expands the lender's capacity without funded capital at all).

- Where both conditions are true (a subordinated seller would be too large *and* the lender is constrained in how much it can lend), the answer is a senior loan with a pari passu loan participation and a junior loan from the RLF. The net effect in the illustrative example being considered is that the seller note is reduced to a mere 10 percent so that the owner receives 90 percent of their proceeds at closing. In this approach, the ESOP sale suddenly looks like the sale to a strategic or financial buyer that the owner was likely considering.

## B. Credit Enhancement and Cost-of-Capital Tools

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Where transaction-level capital puts the state's own money into a deal, the tools outlined in this section change the economics of the employee ownership transaction without funding it on a dollar-for-dollar basis. This section's tools differentiate themselves in whether they shift *risk* or shift *price*.

A credit enhancement shifts loss risk off of the private lender and onto the state. As a result, the lender makes a loan it would otherwise avoid or makes a loan they were going to make anyway larger because the state has agreed to absorb some share of the loss in the event of default. A loss reserve, collateral support, and a guarantee all fall into that category. In each case, the state's exposure is contingent: it costs nothing unless a loan defaults, which is exactly why credit enhancements leverage public capital so efficiently.<sup>53</sup> A cost-of-capital tool, on the other hand, shifts price, not risk. An interest rate buydown or a linked deposit lowers what the borrower pays while leaving the lender's exposure untouched.

### Loan loss reserves and portfolio insurance

A loan loss reserve is the portfolio-level tool (often called a Capital Access Program) in which the borrower and lender (and sometimes the state) contribute a small premium on a loan into a reserve that the lender draws against in the event of a loan default. The reserve is replenished or increased as new loans are enrolled, and once it is exhausted, the lender bears subsequent default losses itself. With a loan loss reserve, the state does not underwrite an individual loan. It sets program/contribution parameters and matches premiums while the lender underwrites loans. A modest reserve supports a multiple of itself in lending, and the lender's own premium contribution keeps it partly at risk, making it among the most capital-efficient enhancements a state can run.

The tool has a lengthy track record in development finance, dating back to 1986, when Michigan created the first Capital Access Program (CAP).<sup>54</sup> Since then, roughly two dozen states and municipalities have operated one and the structure was prominent enough that the Small Business Jobs Act of 2010 wrote it into SSBCI as its own statutory category.

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53. At the state level, these contingent liabilities must still be fully appropriated: a state generally must reserve or appropriate against its guarantee and reserve exposure when the commitment is made, so a credit enhancement carries a real, scored cost at enactment.

54. U.S. Department of the Treasury, *Report on Capital Access Programs* (2001) (the first CAP established by Michigan in 1986; surveying programs across some two dozen states and municipalities).

<sup>55</sup> California's CalCAP for Small Business is the largest program operating today and illustrates the standard parameters of the instrument: the lender and the borrower each contribute 2 to 3.5 percent of the enrolled loan into a loss reserve account held at the lender, the state matches the combined contribution dollar for dollar, and the pooled reserve covers up to 100 percent of the loss on any enrolled loan, up to the reserve's balance. Loans up to \$5 million qualify, with up to \$2.5 million enrollable per borrower over three years. Under SSBCI 2.0, states have allocated a smaller share to CAPs than to any other major program type, with just 4 percent of SSBCI funds going to CAPs across a dozen programs compared to 28 percent going to loan participation programs.<sup>56</sup> This is largely because states have gravitated toward instruments that let them underwrite individual transactions, at least with SSBCI.

Unlike many of the other instruments in this playbook, it is often best for states to avoid a *dedicated* CAP/loan loss reserve just for employee ownership. A loss reserve depends largely on a high volume of similarly sized loans, enrolled steadily, with no single loan large enough to exhaust the reserve. Employee ownership transactions generally produce the opposite, with a small number of large acquisition loans concentrated among a few lenders, so a standalone reserve would hold too few loans to absorb even one default. Instead, employee ownership loans should be enrolled in the state's existing small business CAP, where the pool is large enough to absorb a hypothetical loss. SSBCI-funded CAPs can enroll them under the employee ownership carve-out, subject to the CAP's tighter limits (borrowers with 500 or fewer employees and loans of \$5 million or less). The reserve ratio should be set against a conservative loss assumption, and program rules should specify how the reserve is replenished and who bears losses once it is exhausted.

## Collateral support

Collateral support addresses the reason that lenders cap the size of a senior loan in an employee ownership transaction, which is the shortage of collateral that would otherwise securitize the loan. Employee ownership acquisition loans are necessarily cash flow loans. The company's assets (equipment, receivables, real estate, etc.) rarely cover the purchase price, so senior lenders have a ceiling against which they can lend. Collateral support raises that ceiling, with the state placing a cash deposit with the lender pledged as additional collateral against a specific loan. This allows the borrower's collateral coverage to clear a lender's threshold and increase the size of the loan the lender is willing to underwrite.

Colorado's Office for Economic Development and International Trade (OEDIT) operates the clearest precedent in the country for a collateral support program engineered to improve employee ownership finance. The Cash Collateral Support program, administered by the Colorado Housing and Finance Authority as program manager and funded with roughly \$35 million of SSBCI 2.0 capital, deposits cash

<sup>55</sup> Small Business Jobs Act of 2010, Pub. L. No. 111-240, §§ 3005–3006 (codified at 12 U.S.C. §§ 5704–5705) (defining approved state capital access programs separately from all other credit support programs).

<sup>56</sup> Council for Community and Economic Research, *SSBCI 2.0's Implementation Across States and Other Jurisdictions* (Aug. 2023) (analyzing Treasury capital program summaries as of June 2023: capital access programs at roughly 4 percent of allocated capital program funds across 12 programs; loan participation at roughly 28 percent).

into the account pledged as collateral on a qualifying loan. The deposit is structured as a last loss protection: on default, it “is available to the lender only after all other collateral secured by the loan has been liquidated,” which keeps the lender’s incentive to responsibly underwrite intact. For most projects, the deposit is the lesser of 35 percent of the loan amount, \$1 million, or the size of the demonstrated collateral shortfall, on loans up to \$20 million for a 3-year initial term against a 4 percent borrower fee.

Colorado’s program is a strategic credit enhancement in that it names employee ownership first among its qualifying uses: projects “supporting employee ownership, including loans to existing employee-owned companies and loans supporting the transition to an employee-owned structure” may receive a deposit of up to the lesser of 80 percent of the loan, \$3 million, or the shortfall. Across all uses, the program reports a portfolio of 376 loans supporting roughly \$200 million in lending without a loss of capital, evidence that last loss cash collateral can widen lenders’ boxes at modest realized cost.<sup>57</sup>

Beyond the template and design parameters of Colorado’s program, the parameters that decide whether collateral support is the right tool for a state’s employee ownership credit enhancement suite are coverage depth, term, and what level of credit it covers. Coverage must be deep enough to clear a collateral shortfall on a cash-flow-heavy deal (which is why Colorado’s 80 percent tier exists), and any state adopting the model should adopt the enhanced tier for employee ownership at the outset. In designing the term for collateral support, a state should either match the support term to the senior loan or commit in program rules to extensions of the term so that support does not leave when there is still collateral shortfall risk. Finally, the last loss structure should be retained, as it preserves responsible and conservative lender underwriting.

## Loan guarantees

The loan guarantee is perhaps the most familiar credit enhancement and, for a state with limited capital to deploy but a willingness to stand behind private lending, among the most efficient. The state guarantees a defined share of a private lender’s loan: if the borrower defaults, the state pays that share after the lender has pursued its ordinary remedies. Unlike collateral support, no cash leaves the state’s general fund or an agency’s account at closing; the exposure is purely and genuinely contingent until a default occurs. This is what lets a guarantee support a large volume of lending against a small reserve (it helps to think of a loan guarantee and the loan participation of the previous section as the contingent and funded versions, respectively, of the same concept).

States already run guarantee programs at scale, most of them federally funded: under SSBCI 2.0, 28 loan guarantee programs drew roughly 17 percent of allocated capital program funds, about \$1.4 billion as of mid-2023.

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57. Colorado Housing and Finance Authority, *Cash Collateral Support Program Guidelines* (the standard deposit of the lesser of 35 percent of the loan, \$1 million, or the demonstrated shortfall; the enhanced employee ownership tier of up to the lesser of 80 percent or \$3 million; the last loss structure).

<sup>58</sup> California's Small Business Loan Guarantee Program, administered by the California Infrastructure and Economic Development Bank (IBank) through a network of nonprofit financial development corporations, guarantees up to 80 percent of loans and lines of credit as large as \$20 million, with a maximum guaranteed amount of \$5 million.<sup>59</sup> Oregon's Credit Enhancement Fund covers up to 80 percent of a private loan, with insurance exposure of up to \$6 million per loan.<sup>60</sup> Georgia's Small Business Credit Guaranty covers 50 percent of loans up to \$1 million; the uncovered half satisfies SSBCI's 1:1 private financing requirement and keeps the lender's capital at risk.<sup>61</sup> None of these programs is specific to employee ownership, but each can, in fact, enroll an employee ownership conversion loan under the SSBCI carve-out. Doing so would be a template for a state adding employee ownership to an existing guarantee program rather than building one from scratch.

A transaction may carry a guarantee from any of three sources, and only two of them are programs the state builds. The federal 7(a) guarantee is obtained by the lender, not the state, and guarantees the lender's senior loan; a state may lend subordinate to a 7(a)-guaranteed loan, but it cannot purchase a participation in one.<sup>62</sup> The SSBCI-funded loan guarantee program and the state-backed loan guarantee are the state's guarantee instruments. Table 5 compares all three sources of a loan guarantee in an employee ownership transaction.

Where a particular employee ownership transaction fits the 7(a) program, the loan guarantee sits with the private lender at no cost to the state, and to the extent that there is any role for the state, it is mostly in stacking financing and additional credit enhancements around the 7(a)-guaranteed layer of the transaction. The state can provide its own guarantees through an SSBCI program or its own state-backed program. The SSBCI-funded guarantee reaches larger transactions and the worker cooperatives that 7(a) still cannot serve, contingent on the SSBCI match and leverage requirements and sunset conditions. The state-backed guarantee is a residual instrument that is not bound by federal rules and, depending on program design, can cover the exact share of a loan that a particular deal requires, but it does draw on the state's own credit capacity and must be reserved against.

The design parameters that keep a loan guarantee program disciplined are coverage share and pricing. Coverage should be capped well below 100 percent (a guarantee of 50 to 80 percent of principal is

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<sup>58</sup>. Council for Community and Economic Research, *SSBCI 2.0's Implementation Across States and Other Jurisdictions* (Aug. 2023) (28 loan guarantee programs drawing roughly 17 percent of allocated capital program funds, approximately \$1.4 billion, as of June 2023).

<sup>59</sup>. California Infrastructure and Economic Development Bank, Small Business Loan Guarantee Program materials (guarantees of up to 80 percent of loans and lines of credit up to \$20 million; a maximum guaranteed amount of \$5 million; delivered through participating financial development corporations).

<sup>60</sup>. Business Oregon, Credit Enhancement Fund program materials (coverage typically up to 80 percent of the loan; maximum insurance exposure of \$6 million per loan).

<sup>61</sup>. Georgia Department of Community Affairs, Small Business Credit Guaranty program materials (a 50 percent guarantee on loans up to \$1 million).

<sup>62</sup>. *SSBCI Program Profile: Loan Participation Program*, 1 (SBA-guaranteed loans may not be purchased in participation; a state may make its own direct loan subordinate to an SBA-guaranteed loan).

typical), with the precise figure set against the program's loss tolerance and the lender's demonstrated appetite. A guarantee should also carry a fee to defray expected losses and to confine the enhancement to deals that genuinely need it; A guarantee should not be applied to loans that a lender would make without it.

TABLE 5

## Sources of loan guarantees for an employee ownership transaction

|                                     | SBA 7(A) (FEDERAL)                                                                                                                                                  | SSBCI-FUNDED STATE PROGRAM                                                                                                                                  | STATE-BACKED (OWN CAPITAL)                                                                         |
|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|
| <b>The state's role</b>             | None to build or fund. The lender obtains the loan guarantee and the state may route deals to 7(a) lenders and position its own layers around the federal guarantee | Designs and administers the program; approves enrollment of each loan                                                                                       | Authorizes, reserves against, and issues the guarantee itself                                      |
| <b>Backing</b>                      | Federal full faith and credit                                                                                                                                       | State program funded by the state's SSBCI allocation                                                                                                        | The state's own appropriation, reserve, or credit                                                  |
| <b>Coverage</b>                     | 85 percent of loans up to \$150,000; 75 percent above, to a \$5 million loan maximum                                                                                | Set by program design, with the lender keeping at least 20 percent at risk (Georgia 50 percent; California and Oregon up to 80 percent)                     | Set by the state on a program or per-deal basis                                                    |
| <b>Transaction limits</b>           | \$5 million loan ceiling                                                                                                                                            | Borrowers of 750 or fewer employees; loans up to \$20 million                                                                                               | Set by the state via executive decision or statutory authorization                                 |
| <b>Employee ownership use case</b>  | Eligible for ESOPs; the personal guarantee requirement still excludes most worker cooperatives                                                                      | Available for majority employee ownership conversions under Treasury program guidelines; personal guarantee policy is the state's design choice             | Set by the state                                                                                   |
| <b>Principal conditions</b>         | Credit Elsewhere Test; guarantee fee                                                                                                                                | 1:1 private match per transaction; roughly 10:1 program leverage; funds revolve within the approved program; window for new deployment closes by March 2028 | A contingent liability the state must reserve or appropriate against; no federal conditions        |
| <b>Employee ownership precedent</b> | Used for 17 ESOP transactions from 2018-2021                                                                                                                        | U.S. Treasury SSBCI guidelines                                                                                                                              | Connecticut Coastline Terminals (1996): about \$3.7 million guaranteed of a \$10 million bank loan |

Source: program authorities and records cited in chapter 4. Note: coverage and limits as of 2026.

The two cost-of-capital tools discussed below lower the borrower's price without altering the lender's risk and are complementary to the range of credit enhancements a state development finance agency may

consider. In most states, the following tools are in the remit of a state treasurer, not an economic development or development finance agency.

## Interest rate buydowns

An interest rate buydown addresses the second of the twin objectives of employee ownership finance policy: it lowers the cost of capital to the new employee owners. The state pays a lender as a lump sum into escrow at closing or a stream over a set period in exchange for a reduced rate to the borrower. The lender's yield is unchanged, the borrower's interest rate falls, and the difference is the state's cost. In this way, unlike the previous tools discussed, an interest rate buydown represents a genuine subsidy.

States and localities have used interest rate buydowns and interest subsidies for decades to lower borrowing costs for manufacturers, farmers, and small businesses. The Bank of North Dakota, for example, buys down the rate on loans to value-added agricultural businesses that have borrowed from an outside lender.<sup>63</sup> A state offering a buydown for an employee ownership transaction is therefore repurposing a mature, low-risk instrument.

Unlike most other tools in this chapter, a buydown is not a tool meant to close a financing gap. It lowers the price of a loan that already exists and does not necessarily function to make a previously unbankable deal bankable. The revolving loan fund, the loan participation, and the credit enhancements above make a transaction *possible*. The buydown (and the linked deposit strategy outlined next) makes a financed transaction more *affordable* to the newly established ESOP or worker cooperative that now carries the acquisition debt. It is most effective as a time-limited cost reduction over the first few years after closing, when acquisition debt is heaviest. There are relatively few design considerations: the size and duration of the reduction, whether it is delivered as an escrowed lump sum or a stream over a period of time, and the same majority employee ownership eligibility test other tools should use.

## Linked deposits

A linked deposit program addresses the same policy objective (i.e., a lower cost of capital for the employee-owned firm) by a slightly different route. The state—oftentimes its treasurer—places a deposit with a participating bank at a below-market rate, and the bank passes the savings through to the borrower while bearing the full credit risk exactly as it otherwise would have. In this case, the state's cost is the yield it forgoes by depositing at a below-market rate. This strategy is well established (Ohio's GrowNOW and Missouri's MOBUCK\$ programs run general small business versions, capped as a share of the state's cash management portfolio), but no state operates a program targeted at employee ownership.

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63. Bank of North Dakota, value-added agriculture rate buydown program (buying down the rate on a loan a borrower has secured from an outside lender), as described in Charles Yang et al., *Reimagining Economic Development*, Center for Public Enterprise (June 2025), 8.

The five tools discussed in this section are not ranked substitutes as much as they are a menu sorted by what the state puts at stake and what financing impediment the transaction needs addressed. Table 6 compares the tools and considers when each is most appropriate for deployment into a transaction.

**TABLE 6**  
**Credit enhancement toolkit considerations and applications**

| TOOL                         | SHIFTS | STATE BALANCE SHEET COST          | BEST FIT TRANSACTION                         | LEAD PRECEDENT                   |
|------------------------------|--------|-----------------------------------|----------------------------------------------|----------------------------------|
| <b>Loan loss reserve</b>     | Risk   | Funded reserve (idle capital)     | A portfolio of small, similar EO loans       | SSBCI Capital Access Programs    |
| <b>Collateral support</b>    | Risk   | Funded deposit (tied up for term) | Collateral-short, cash-flow ESOP loans       | Colorado Cash Collateral Support |
| <b>Loan guarantee</b>        | Risk   | Contingent (reserve only)         | A single, sizeable, otherwise-bankable deal  | N/A                              |
| <b>Interest-rate buydown</b> | Price  | Funded subsidy (spent)            | An already financed deal with tight coverage | N/A                              |
| <b>Linked deposit</b>        | Price  | Forgone deposit yield             | Treasurer-led rate relief on bankable loans  | Ohio GrowNOW                     |

Source: chapter 4 of this playbook. Note: precedents named are the lead examples discussed in this section.

If a deal will not be financed because the seller note is too large, none of these tools is the answer; that is the job of the revolving loan fund. If it is financeable but the lender will not extend enough senior credit because collateral falls short, collateral support is the precise instrument. If a capable lender will make the whole loan but for the loss exposure and default risk, a guarantee is the most capital-efficient response. And only once a deal is ready to be financed are the price tools relevant, lowering the newly employee-owned firm's cost of capital through its early years. The tools also layer, as with the previous suite of tools, which is where an agency can assemble a comprehensive development finance toolkit from contingent and low-cost instruments: a senior loan taken to full capacity by a guarantee, a junior loan from an employee ownership RLF shrinking the seller note, or a buydown over the first 3 years. In those

64. Ohio Treasurer, GrowNOW program materials (a rate reduction passed through to the borrower; Ohio Revised Code § 135.61 caps linked deposits at twelve percent of the state portfolio); Missouri State Treasurer, MOBUCKS program (pass-through of the rate reduction required); Indiana House Bill 1038 (2025) (an ESOP linked deposit program, which died in committee).

scenarios, each is doing the one job it is uniquely suited to while keeping the state's funded exposure limited to the layer where funded capital is absolutely necessary.

## C. Institutional Capital Mobilization

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The first two sections of the toolkit placed the state inside individual transactions as either a lender or guarantor. This subsection describes the state differently, instead as an institutional investor committing a capped share of its own investment portfolio. In this strategy, the state acts as a limited partner (LP) to professionally managed funds that in turn finance employee ownership transactions. The state underwrites no single deal, instead selecting and monitoring fund managers who build their own portfolios. That shift from lender to anchor investor makes this both the highest-leverage instrument (particularly from the vantage point of scale and building a nascent capital market) and the one that demands the most discipline.

Whereas, say, a revolving loan fund recycles its capital one transaction at a time, the fund-of-funds commitment described below is multiplied first by the private capital a manager raises alongside the state, and again by the capital that a credible anchor like a state draws into the market over time. Every other tool can rest partly on an economic development rationale: a legislature may capitalize a revolving loan fund, for example, because business succession is a firm and job retention risk, which is reason enough. A treasurer or an investment board, because of their fiduciary obligations, cannot commit the state's investment assets on that basis alone. They are held to fiduciary standards considering risk-adjusted returns, portfolio fit, and a prudent selection and monitoring process for funds. The policy and economic benefits of employee ownership, however real, are an externality of a sound investment in this instance. The nature of these fiduciary obligations and the associated performance targets are variable depending upon the source of the asset pool (for example, pension assets vs. a state working capital pool).

### Theory of the case

A fund-of-funds invests not in individual companies but in other investment funds. The state commits as LP, the fund-of-funds commits to a portfolio of specialized underlying funds, and those funds make the individual investments, with layers of professional management between the state's balance sheet and any single deal. Applied to employee ownership, the underlying funds are the specialized vehicles that have emerged to finance employee ownership transitions with senior and subordinated debt, mezzanine capital, and structured equity. It is a real and growing segment of the capital markets, with over two dozen funds as of 2026 managing roughly \$865 million.<sup>65</sup> Still, that is an employee ownership capital market measured in the hundreds of millions against a demographic wave and market opportunity measured in

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65. Ownership Capital Lab, *2025 State of the Employee Ownership Fund Marketplace* (Dec. 2025) (approximately two dozen active or emerging employee ownership funds managing roughly \$865 million in combined assets; anchor and institutional capital identified as the binding constraint).

the trillions, by McKinsey's estimate.

The incumbent investment funds report that their binding constraint is not a shortage of viable transactions (to the contrary), but a shortage of anchor institutional capital willing to commit at the scale and time horizon the strategy requires. This is exactly what a state investment portfolio, with its scale, duration, and return orientation, is built to supply. Put simply, a state LP commitment sends a powerful demand signal to institutional investors and emerging funds alike, since a credible capital allocator validating a nascent asset class draws other institutional capital into that asset class.

### **Case study: Illinois Growth and Innovation Fund**

No state has yet built a fund-of-funds dedicated to employee ownership, but one state has shown, across a decade and two asset classes, that a state investment portfolio can be deployed as a fund-of-funds to deepen an underserved private market using the same authority and architecture that an employee ownership analogue would require. The Illinois Growth and Innovation Fund (ILGIF) is an evergreen vehicle through which the State Treasurer invests a ring-fenced, capped share of the state's investment portfolio—specifically, its non-pension asset pool drawn upon for the working capital needs of state agencies and other operations—in private venture, growth equity, and credit funds with a focus on Illinois companies. (The State Treasurer also administers a similar fund for infrastructure as an asset class, the FIRST Fund).

Two features of ILGIF's design transfer directly into a potential employee ownership fund of funds. The state invests through fund managers rather than directly into deals, holding relationships across dozens of managers and approaching a hundred underlying funds, which is how it diversifies and how it stays out of underwriting individual transactions. And rather than requiring its managers to invest only in Illinois (which would cut against geographic diversification imperatives, distorting portfolio construction and depressing returns), it requires each manager to deploy a multiple of the state's committed capital into Illinois companies over the fund's life. This represents a contractual floor that crowds in private investment while leaving the fund managers free to build their own diversified portfolio.

As of the end of 2024, the fund reported a net internal rate of return of 10.4 percent and a net multiple of 1.37.<sup>66</sup> These represent investment outcomes competitive with the private markets, earned while serving an in-state mandate at no fiscal cost to the state.

ILGIF did not create the Illinois venture market (Chicago companies were raising well over a billion dollars a year before ILGIF launched). But it did deepen a narrow, underserved segment of the venture market (early-stage capital, emerging and diverse managers, and in-state investment opportunities) by acting as an anchor LP and using its commitment to crowd in private capital behind it. And it was so successful at doing so that it stood up a second portfolio fund-of-funds, the FIRST Fund, on the same statutory and

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66. Illinois Growth and Innovation Fund, *2024 Annual Report* (a net internal rate of return of 10.4 percent and a net multiple of 1.37 as of December 31, 2024).

operational design but for in-state infrastructure and real estate assets.

Illinois is no longer alone. In 2025, Oklahoma directed its Treasurer to create an “Invest in Oklahoma” program placing the Treasurer’s investable cash balances into Oklahoma-based private equity, venture, and growth funds. California offered a slightly different approach, too, with its Infrastructure and Economic Development Bank investing as an LP in venture funds targeting priority sectors, a standing demonstration that a state can take an LP position in private funds to steer capital toward policy goals.<sup>67</sup>

## The instrument

An employee ownership development fund applies this tradition to a new asset class: the state commits a capped share of its investment portfolio as an anchor LP to a fund-of-funds managed by a professional investment manager, which in turn invests in the specialized funds financing employee ownership transitions.

Illinois State Representative Will Guzzardi’s Employee Ownership Development Act (HB 4955) would do just that. It directs the state to commit a portion of its non-pension investment portfolio to professionally managed funds investing in employee ownership transactions.<sup>68</sup> Because only a public investment officer acting under a fiduciary standard can authorize the tool, the case for it has to be built on investment merits. More specifically, it rests on three propositions:

1. That the underlying funds pursue legible institutional strategies against cash-flowing middle-market companies, which should interest any investment committee.
2. That a small, capped, diversified, long-duration allocation of this sort is the kind of position a public investment officer adds to improve a portfolio’s risk-adjusted profile (leveraged ESOP buyouts have historically defaulted at much lower rates relative to comparable middle-market credit).<sup>69</sup>
3. That the structure is no longer untested, with ILGIF, FIRST Fund, Invest in Oklahoma, and the California Infrastructure and Economic Development Bank compiling a decade plus of competitive net returns.

The design parameters follow from these propositions. The natural home for a state-level fund-of-funds is the office that already manages the state’s investment portfolio (most often the treasurer). Portfolio management should be contracted to a professional manager, because the state’s comparative advantage is as an allocator and mandate-setter, not a private markets direct investor. The in-state investment requirement must be calibrated to recognize the nascency of the employee ownership capital market. Requiring that all of the state’s capital be invested in-state would force the construction of

67. Oklahoma House Bill 2765 (2025), codified at 62 Okla. Stat. § 89.2 (“Invest in Oklahoma,” investing the Treasurer’s cash-balance amounts in Oklahoma-based private equity, venture, and growth funds); California Infrastructure and Economic Development Bank (IBank), venture-fund limited-partner investments.

68. Illinois House Bill 4955, 104th General Assembly (2026).

69. Rosen and Rodgers, *Default Rates on Leveraged ESOPs, 2009–2013*.

an undiversified portfolio and undermine the fiduciary case, so the state should obligate the underlying funds to deploy a conservative multiple of the state's commitment into the state over the fund's life while permitting national diversification. Eligibility should direct capital to funds whose transactions produce broad-based, majority employee ownership.

## D. Tax Incentives

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The tools considered so far supply capital or lower its cost or risk. The tax incentives in this subsection work along a separate register. They put no dollar directly into the transaction, but instead change the post-tax math of the decision to sell. The goal of tax incentives in an employee ownership context, much like the other tools, is to make a sale to an employee ownership structure more attractive than the tax code would otherwise make it relative to a sale to a strategic or financial buyer. Tax incentives are a complement to the broader financing toolkit: a capital gains tax break will not close a deal that no institution will finance, and a revolving loan fund will not move an owner who keeps more after taxes by selling to a competitor. They also differ in how their cost is borne. A tax incentive is foregone revenue and scored by a fiscal note, rather than an asset that recycles or a contingent liability.

The different types of employee ownership tax incentives available to states are shaped by the tax advantages already afforded to employee ownership by the federal government (with most of these directed at ESOPs). The federal tax code offers employee ownership three central advantages:

1. **Section 1042:** the selling owner's capital gains deferral. An owner who sells stock of a closely held C corporation to an ESOP or eligible cooperative holding at least 30 percent after the sale may defer the taxable gain by reinvesting proceeds in qualified replacement property (QRP). The gain carries over into the QRP's basis and comes due when that property is sold, unless the owner holds the replacement property until death, at which point the stepped up basis makes the deferral permanent. Beginning with sales after December 31, 2027, the SECURE 2.0 Act extends a limited version of this election to sales of S corporation stock, allowing deferral of 10 percent of the gain.<sup>70</sup>
2. **S corporation ESOP exemption:** Because an S corporation's income passes through to its shareholders and an ESOP trust is tax-exempt, the ESOP's share of earnings escapes federal income tax, so a wholly ESOP-owned S corporation pays no federal income tax at all. This is a permanent feature of the operating structure of the S corp ESOP.

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70. SECURE 2.0 Act of 2022, Pub. L. No. 117-328, div. T, § 114 (extending the § 1042 election to sales of S corporation stock to an ESOP, capped at 10 percent of the gain, effective for sales after December 31, 2027); on the basis carryover and step-up at death, 26 U.S.C. §§ 1042(d), 1014.

- 3. ESOP debt service deductibility:** Contributions used to repay the principal and interest of an acquisition loan are deductible, so a leveraged ESOP repays the debt it took on to buy the company with pre-tax dollars, an advantage no conventional buyer enjoys.<sup>71</sup>

As broad and generous as the federal tax incentives are, none of the federal incentives address soft transaction costs (e.g., costs related to feasibility studies, legal services, or valuation work) that an owner must incur simply to learn whether a sale to employees is viable.

Five states have enacted employee ownership-specific tax incentives broadly sorted into three families. The first and most common adds a state level capital gains deduction; because most state income tax codes track Section 1042, its deferral already postpones state capital gains tax in most states. The state level capital gains deduction for employee ownership allows a seller to deduct some or all of the gain on a sale, removing some or all of the gain from the state tax base outright. Missouri, for example, allows a seller to deduct half of the gain on a sale to a Missouri ESOP that holds at least 30 percent afterward. This was made permanent in 2023. Nebraska, the oldest state tax incentive on the books, offers a one-time lifetime exclusion of gain on stock acquired through employment and counts each ESOP participant as a shareholder for its eligibility test. Iowa is the broadest of the group: it lets a long-tenured employee owner of a qualifying corporation exclude the entire gain on the sale, with no ESOP requirement and no 30 percent ownership threshold, a full 100 percent exclusion that phased in for tax years beginning in 2025. It replaced a narrower 50 percent ESOP-specific deduction Iowa enacted in 2012 and repealed in its 2018 tax overhaul. Colorado, in 2025, allowed an owner who sells at least 20 percent to a qualified employee-owned business to subtract the resulting gain.<sup>72</sup>

The second category of state tax incentives, conversion cost tax credits, has no federal analogue and addresses the soft costs of getting to an employee ownership sale in the first place. Colorado runs the most developed version, raised in 2025 to 75 percent of qualifying costs and layered with companion credit for young employee-owned firms and for the nonprofits that help businesses convert. Washington enacted a comparable 50 percent credit in 2023 that is scheduled to expire in 2026. Colorado is the only state to have begun providing tax advantages in a third category with a subtraction for the income of a worker cooperative.<sup>73</sup>

<sup>71</sup>. Internal Revenue Code § 1042 (capital gains deferral on a sale to an ESOP or eligible cooperative holding at least 30 percent after the sale, with reinvestment in qualified replacement property); the S corporation ESOP exemption (the ESOP trust is tax-exempt, so a wholly ESOP-owned S corporation pays no federal income tax); and § 404 (deductibility of contributions used to service ESOP acquisition debt).

<sup>72</sup>. Missouri Revised Statutes § 143.114 (a 50 percent deduction on a sale to a Missouri ESOP owning at least 30 percent, made permanent in 2023); Nebraska Revised Statutes §§ 77-2715.08–.09 (a one-time lifetime exclusion, with each ESOP participant counted as a shareholder); Iowa Code § 422.7(42) (2026) (an exclusion phasing to 100 percent of the gain for tax years beginning in 2025, with no ESOP or 30 percent requirement, replacing the 50 percent ESOP-specific deduction enacted in 2012 and repealed in 2018); Colorado House Bill 25-1021 (a subtraction for an owner who sells at least 20 percent to a qualified employee-owned business).

<sup>73</sup>. Colorado Revised Statutes § 39-22-542 (conversion cost credit, raised to 75 percent of qualifying costs in 2025, with companion credits under § 39-22-542.5); Revised Code of Washington § 82.04.4488 (a business and occupation credit of 50 percent of conversion costs, scheduled to expire in 2026); Colorado worker-cooperative income subtraction.

**TABLE 7**  
**State employee ownership tax incentives**

| STATE      | FAMILY          | INSTRUMENT                                   | WHAT IT DOES                                                                           |
|------------|-----------------|----------------------------------------------|----------------------------------------------------------------------------------------|
| Missouri   | Capital gains   | ESOP sale deduction (§ 143.114)              | 50 percent deduction of gain on sale to a Missouri ESOP owning ≥30 percent             |
| Nebraska   | Capital gains   | Employee owner exclusion (§§ 77-2715.08–.09) | One-time lifetime exclusion; ESOP participants count as shareholders                   |
| Iowa       | Capital gains   | Employee owner exclusion (§ 422.7(42))       | Up to 100 percent exclusion for a long-tenured employee owner; no ESOP/30 percent test |
| Colorado   | Capital gains   | Owner subtraction (HB25-1021)                | Subtraction of gain on sale of ≥20 percent to a qualified EO business                  |
| Colorado   | Conversion cost | EO conversion credit (§ 39-22-542)           | 75 percent of conversion costs (plus companion credits)                                |
| Washington | Conversion cost | Conversion credit (RCW 82.04.4488)           | 50 percent of conversion costs; expires 2026                                           |
| Colorado   | Entity-level    | Worker cooperative income subtraction        | Subtraction for worker cooperative income                                              |

Source: state statutes cited in chapter 4. Note: incentives as enacted through 2025.

A state considering the role of tax incentives in rounding out a comprehensive strategy to improve the economics of the employee ownership transaction can choose among a handful of well-documented models. These should always be paired with a comprehensive financing strategy; tax incentives move the seller's decision as to who to sell to, but they do not supply the buyer's capital and an owner persuaded to explore employee ownership still confronts the financing gap the rest of this toolkit works to close. The holistic approach uses both levers together (incentives to move the seller, financing tools to fund the transaction).

# 5

## Non-State Financing Tools for the State Practitioner

A state employee ownership program's most valuable function is its stewardship of a comprehensive statewide strategy that connects various capital sources. When an owner engages with a state's Director of Employee Ownership to begin the process of understanding whether a sale to employees is feasible, the owner needs a reading of the whole capital stack available for that transaction: the senior lender, the loan guarantee that might sit behind it, the state's revolving loan fund, a possible private layer of mezzanine debt, and the residual subordinated seller note, together with the tax provisions that shape the deal's economics. Much of that stack is federal or otherwise non-state, and a practitioner must be able to speak fluently about those layers.

This chapter is organized around the role that each non-state tool plays in the employee ownership transaction. The Small Business Administration's (SBA) 7(a) product is a transaction-specific tool, essentially a federal guarantee on the business's own bank loan. SSBCI and EDA are federal authorities that capitalize the state's own programs.

### SBA 7(a) and the Main Street Employee Ownership Act

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The Small Business Administration's (SBA) 7(a) program is the federal government's flagship small business lending product. A participating lender makes the loan, and the SBA guarantees a large share of it (85 percent on loans up to \$150,000, 75 percent above that to a \$5 million maximum), which lets a lender extend credit it would not offer on conventional terms.<sup>74</sup> For a sub-\$5 million ESOP or worker cooperative conversion that a lender will not finance on its own balance sheet, that guarantee can make a previously unbankable deal bankable.

In 2018, Congress tried to make the 7(a) program work for employee ownership with the Main Street Employee Ownership Act, which introduced ESOPs and worker cooperatives as allowable ownership transition financing structures in 7(a). Though well-intentioned, early implementation has been lackluster, with ESOP loans accounting for just 17 of the nearly 32,000 change-of-ownership loans the SBA guaranteed from fiscal year 2018 through fiscal year 2021.<sup>75</sup> This was largely a consequence of federal

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74. U.S. Small Business Administration, Standard Operating Procedure 50 10 8 (eff. June 1, 2025) (a maximum 7(a) loan of \$5 million; an 85 percent guaranty on loans up to \$150,000 and 75 percent above); 13 C.F.R. §§ 120.151, 121.151.

75. U.S. Small Business Administration, *Affiliation and Lending Criteria for the SBA Business Loan Programs* (proposed rule), 87 Fed. Reg. 64724, 64729 (Oct. 26, 2022).

regulations that were misaligned with Congressional intent. Between 2023 and 2025, the SBA addressed most of the ESOP barriers. Its revised operating procedures made ESOP loans processable under delegated lender authority, waived the equity-injection requirement for loans financing a controlling interest of at least fifty-one percent, confirmed that neither the plan nor its members need guarantee the loan, and accepted the trustee's ERISA-compliant appraisal in place of a duplicative SBA valuation.<sup>76</sup> An ESOP transition today can be financed through 7(a) on delegated terms, without an incompatible equity injection or a redundant valuation.

Some limitations remain, including a personal guarantee requirement that is structurally incompatible with worker cooperatives, but 7(a) remains a real tool for ESOP transactions below the \$5 million ceiling, especially given that ESOPs are exempt from a personal guarantee due to superseding ERISA prohibitions.

## The State Small Business Credit Initiative

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The State Small Business Credit Initiative (SSBCI) is best understood as the modern incarnation of the federal-state development finance architecture that opened this playbook. It is money the U.S. Treasury Department lends to the states, which the states then lend and invest through credit programs of their own design (within the parameters of Treasury rulemaking). When small businesses receive financing that involves collateral support or a loan participation, the capital behind it is frequently SSBCI capital.

Congress created SSBCI in the Small Business Jobs Act of 2010, seeding state small business credit programs with \$1.5 billion after the financial crisis. The Biden-era American Rescue Plan Act of 2021 reauthorized and expanded it to roughly \$10 billion, a reauthorization often called SSBCI 2.0. This round of funding is being deployed by states with a horizon that ends in March 2028.<sup>77</sup>

While SSBCI funds generally cannot be used to buy out an owner's equity, Treasury's guidelines carve out an explicit exception for transactions that produce broad-based, majority employee ownership, provided the employee entity holds a majority interest, on a fully diluted basis, at close.<sup>78</sup> There are several program structures through which states can leverage SSBCI 2.0 to finance employee ownership, all of which were covered in the previous section:

- **Collateral support:** a state cash deposit that covers the borrower's collateral shortfall.

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76. U.S. Small Business Administration, SOP 50 10 7 (eff. Aug. 1, 2023), SOP 50 10 7.1 (eff. Nov. 15, 2023), and SOP 50 10 8 (eff. June 1, 2025) (delegated processing of ESOP loans; waiver of the equity-injection requirement for a controlling ESOP interest of at least 51 percent; no guarantee required of the plan or its members; the trustee's ERISA-compliant appraisal accepted); Procedural Notice 5000-858322 (June 24, 2024).

77. The State Small Business Credit Initiative was created by the Small Business Jobs Act of 2010, Pub. L. No. 111-240, tit. III (approximately \$1.5 billion), and reauthorized and expanded to roughly \$10 billion by the American Rescue Plan Act of 2021, § 3301; codified at 12 U.S.C. § 5701 et seq.

78. U.S. Department of the Treasury, *State Small Business Credit Initiative Capital Program Policy Guidelines* (rev. Oct. 7, 2022).

- **Loan participation:** the state buys a share of, or lends alongside, the lender's acquisition loan, either *pari passu* with the lender (expanding the lender's capacity) or, as in most companion loan designs, subordinate to it.
- **Loan guarantee:** the state guarantees a defined share of the private lender's loan so the lender will lend where it otherwise would not.
- **Capital access program (loan loss reserve):** lender and borrower contribute to a loan loss reserve fund, matched by SSBCI, to build a pooled reserve that absorbs first losses across a portfolio of enrolled loans.
- **Equity or venture capital program:** the state invests in, or alongside, private funds that finance employee ownership.

Each transaction in an SSBCI-funded program must be matched on at least a 1:1 basis by private capital. Over the life of the program, Treasury expects roughly \$10 in private lending or investment for every \$1 of federal funding. Importantly, SSBCI funds must move through a Treasury-approved structure; they cannot be used to capitalize a freestanding state revolving loan fund, for example. The appendix maps each SSBCI program type to the toolkit instrument it funds.<sup>79</sup>

None of the above use cases requires new statutory authority. Each can be stood up via administrative action by the state agency administering their state's SSBCI 2.0 tranches. The task of that agency, then, is to learn which of their programs run on SSBCI capital, confirm that those carry the employee ownership carve-out (or else request a program modification from the U.S. Treasury Department), and route eligible conversions to them.

## EDA Economic Adjustment Assistance

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The Economic Development Administration's Economic Adjustment Assistance (EAA) program is the federal route by which a state can capitalize a revolving loan fund that then lends into individual deals; it is the same path that financed the first transaction profiled in this playbook, the 1976 Okonite purchase, which ran on an EDA grant to New Jersey that was lent through the state's Economic Development Authority. Under EAA, the EDA can grant funds to capitalize or recapitalize a state or local revolving loan fund on a rolling basis, with a federal cost share of up to 50 percent (or as much as 80 percent for particularly distressed regions) and under an approved fund plan aligned with a state or region's Comprehensive Economic Development Strategy (CEDS).<sup>80</sup>

A state development finance agency (or other relevant agency) is an eligible applicant, alongside political

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79. U.S. Department of the Treasury, *State Small Business Credit Initiative Capital Program Policy Guidelines* (rev. Oct. 7, 2022).

80. U.S. Economic Development Administration, Public Works and Economic Adjustment Assistance program; 13 C.F.R. Part 307, subpart B (capitalization or recapitalization of state and local revolving loan funds under an approved RLF plan consistent with the regional Comprehensive Economic Development Strategy).

subdivisions, EDA-designated economic development districts, tribes, and qualifying nonprofits. Applications run through the EDA regional office on a rolling basis, so there is no annual deadline to wait for. Eligibility is place-based and the region must meet EDA's economic distress criteria (constituted by either an unemployment rate at least one percentage point above the national average over the most recent 24 month period or per capita income at or below 80 percent of the national average) or present a qualifying Special Need. A non-federal match can come from state appropriations, philanthropy, or another source, but, as a rule, cannot be matched by other federal funds. The non-federal match is combined with the federal grant to form the revolving loan fund's capital base.<sup>81</sup>

EDA approves each fund under a written RLF plan that sets the fund's financing strategy, lending policy, and portfolio standards, and the plan must be consistent with the region's CEDS. The terms of the award require that the fund leverage two private dollars for each RLF dollar lent, that the agency report semiannually, and that the agency measure the cost per job.<sup>82</sup> For an employee ownership-specific RLF funded in part by EDA, the state should write employee ownership acquisition/conversion lending into the plan's financing strategy and into the CEDS itself.

## The state/non-state capital stack in practice

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For the state practitioner, the success of any of the above programs—state or non-state—rests on their ability to assemble them. Table 8 places the federal tools in the same \$10 million ESOP transaction used in Chapter 4 and shows how a practitioner can leverage various capital sources to fill out an employee ownership transaction supported by the state.

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**81.** U.S. Economic Development Administration, Public Works and Economic Adjustment Assistance program; 13 C.F.R. Part 307, subpart B (capitalization or recapitalization of state and local revolving loan funds under an approved RLF plan consistent with the regional Comprehensive Economic Development Strategy).

**82.** 13 C.F.R. § 307.9 (RLF plan requirements, including the financing strategy and consistency with the CEDS); § 307.15(c)(1) (portfolio leverage of at least two private dollars per dollar lent); § 307.14 (reporting, semiannual and adjustable to annual with EDA consent). Cost per job is an EDA performance measure set against the recipient's own plan target.

TABLE 8

## Visualizing federal tools engaged in a \$10 million ESOP transaction

| CAPITAL LAYER                      | AMOUNT | TOOL ENGAGED                                                  | WHAT IT DOES                                                                                                                           |
|------------------------------------|--------|---------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|
| Senior loan                        | \$4.0M | SBA 7(a) guarantee or SSBCI (loan participation or guarantee) | Enables the lender to lend against cash flow it would not finance unguaranteed                                                         |
| State RLF<br>(senior/subordinated) | \$3.0M | EDA-funded RLF                                                | Fills the senior/mezzanine gap junior/pari passu to the lender, senior to the seller; capital sourced from the federal funding sources |
| Private fund tranche               | \$2.0M | N/A (private; crowded in by state anchor capital, Ch. 4c)     | Supplies additional subordinated or equity-like capital and seller liquidity                                                           |
| Seller note (residual)             | \$1.0M | 1042 election (federal tax)                                   | The thin residual seller note; the seller defers federal capital gains tax                                                             |
| Post-close operating structure     |        | S corporation ESOP exemption; § 404                           | A 100 percent ESOP S corporation pays no federal income tax; acquisition debt repaid with pre-tax dollars                              |

Source: chapter 5 of this playbook. Note: illustrative \$10 million ESOP transaction.

In this example, federal and state tools elegantly complement and augment each other:

- **The senior layer** is a private loan made larger by a federal guarantee, whether through the SBA 7(a) program or SSBCI (via loan participation or guarantee).
- **The subordinated layer** is the state's own fund, capitalized in part through a federal award by the Economic Development Administration.
- **A private fund** supplies an additional tranche where the deal can attract one; this is the layer of the transaction around which the fund-of-funds in Chapter 4 is designed to build a capital market.
- **The seller note** is significantly reduced, now a thin residual note on which the seller can defer federal taxes.
- **After closing**, the newly converted employee-owned firm is free of federal income tax, repaying its acquisition debt with pre-tax dollars.



No single actor or single state assembles this entire capital stack today. This gap is the one a state Director of Employee Ownership is designed to fill (see Chapter 7). The federal toolkit is substantial, but uneven and uncoordinated: generous tax incentives, a per-transaction guarantee for ESOPs, a durable source of state credit support funding, and a tested capitalization route for RLFs. Bringing these layers together for a business that has never contemplated selling to its employees is not something the federal government does, nor is it something that it could necessarily even do well. It is, however, something a state can (and should) decide to do by building the toolkit and a team to administer it.

# 6

## Capitalization and Sustainability

The history of state-level revolving loan funds for employee ownership suggests that the hurdle for a comprehensive state employee ownership finance program is not authorizing it but funding it. Capitalization, then, is not a downstream, post facto implementation detail, but a design consideration that warrants an answer at the same time as legislative drafting. A program that does not solve this by enactment risks being a program that will not lend.

This chapter surveys the range of capitalization sources available to states across their toolkit. Each tool can be funded only by certain sources, as each source differs in the conditions attached to it and the problem it is trying to solve. A grant can capitalize a revolving loan fund but not a market-rate fund-of-funds. The state's investment portfolio can anchor a fund-of-funds, but cannot fund a subsidized loan program. SSBCI 2.0 can stand behind a loan guarantee or fund a loan participation, but cannot be deposited into a revolving loan fund.

Table 9 shows that the revolving loan fund has the widest set of capitalization sources, and the fund-of-funds the narrowest. Only philanthropic capital and state appropriations can fund all three, with philanthropic capital able to take the form of a grant, a below-market rate loan, or a market-rate investment, depending on the tool it funds.

**TABLE 9**  
**Capitalization sources for state toolkit**

| CAPITALIZATION SOURCE               | REVOLVING LOAN FUND | CREDIT ENHANCEMENT | FUND-OF-FUNDS | CONSTRAINTS                                                               |
|-------------------------------------|---------------------|--------------------|---------------|---------------------------------------------------------------------------|
| State appropriation                 | ✓                   | ✓                  | ✓             | Competes with all other spending priorities                               |
| EDA Economic Adjustment Assistance  | ✓                   |                    |               | 20-50 percent non-federal match; distress finding; RLF plan, 2:1 leverage |
| SSBCI                               | (✓)                 | ✓                  | ✓ (equity/VC) | Cannot capitalize a freestanding fund and requires private capital match  |
| State investment portfolio          |                     |                    | ✓             | Fiduciary obligations; must earn a market return                          |
| Program income/inter-fund transfers | ✓                   | ✓                  | ✓             | Agency earnings and board action                                          |
| Released legacy EDA capital         | ✓                   |                    |               | Must continue to serve an economic development purpose                    |
| Philanthropic (grant/PRI/MRI)       | ✓                   | ✓ (first-loss)     | ✓ (MRI)       | The tool's return profile dictates the instrument                         |

Source: chapter 6 of this playbook. Note: check marks indicate an eligible pairing; the parenthetical check marks SSBCI's functional (not mechanical) reach; empty cells indicate the source cannot fund the instrument.

## State appropriations

A direct state appropriation is the simplest and most flexible way to capitalize any tool, and the only one that can fund all three of the tools in Table 7. If a legislature accepts that business succession is an economic development risk worth addressing, it can capitalize any of these tools as it sees fit (for a revolving loan fund, a one-time appropriation becomes permanent infrastructure as the capital recycles).

The constraint on this source is political, as state appropriations compete with every other political priority of every other political actor in the state: schools, hospitals, pensions, and infrastructure, to name a few. A state appropriation is often a vital component of a diversified capitalization base, but because of the scale many of these tools demand, it cannot often be the lone source (nor should it be, as it would put the durability and sustainability of a program to the whims of the annual appropriations cycle, representing an annual veto point to be defunded).

## Federal grants: EDA Economic Adjustment Assistance

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The federal Economic Adjustment Assistance (EAA) grant from the Economic Development Administration is the most direct route for capitalizing a revolving loan fund if a state has a non-federal match, meets EDA's economic distress requirements, and has an approved fund plan with a private leverage target.<sup>83</sup> The federal share of the RLF covers up to half of its capitalization (or, in the most distressed regions, up to 80 percent), and the non-federal match can come from state appropriations, philanthropy, or other sources; it cannot come from other federal funds.<sup>84</sup> An EAA grant therefore can never capitalize an RLF alone, as it is designed to pull in a second source.

Because eligibility is constrained to states (or, more often, regions within a state) that experience economic distress as measured by an above average unemployment rate or below average per capita income, an RLF with an EAA-capitalized component may need to focus that sleeve's lending territory around distressed areas. There is also a "Special Need" category that makes a state eligible, which has historically been used for plant closures or the loss of a major employer.<sup>85</sup> The most durable framing for an EAA award, then, would involve a Comprehensive Economic Development Strategy (CEDS) that identifies succession-driven business loss as an economic resilience risk, positions employee ownership as a response, and fits the agency's stated priorities within the CEDS.

## SSBCI 2.0

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SSBCI is the most durable and flexible federal capitalization source, but it comes with real constraints due to its conditions on what types of programs it can fund and the amount of private capital it must crowd in.

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**83.** See Chapter 5; 13 C.F.R. Part 307, subpart B; U.S. Economic Development Administration, Public Works and Economic Adjustment Assistance Notice of Funding Opportunity (rolling applications; capitalization of revolving loan funds an eligible activity).

**84.** 13 C.F.R. § 301.4 (investment rates of up to 50 percent of project cost, rising to as much as 80 percent based on regional distress); § 301.5 (the matching share must be committed, available, and unencumbered; other federal funds generally ineligible as match).

**85.** 13 C.F.R. § 301.3 (regional distress criteria, applied to the region in which the project is located); § 300.3 (defining "Special Need," with triggers that are predominantly discrete, acute shocks); 13 C.F.R. § 303.7(b)(1) ("each CEDS must promote Regional resiliency"); U.S. Economic Development Administration, Investment Priorities ("Economic Recovery & Resilience") and CEDS Content Guidelines (naming business retention and expansion among economic resilience initiatives). EDA's priorities do not name employee ownership or business succession.

As Chapter 5 explains, its capital must be deployed through Treasury-approved structures such as collateral support, loan participation, or guarantees, and cannot be deposited into a freestanding revolving loan fund. It can, however, hold the same subordinated junior position the RLF would take through a participation or companion loan, contingent upon SSBCI's match and size requirements/limits. Table 7 records this distinction by qualifying that functionally, SSBCI can reach the *function* of an RLF, even if it is not capable of mechanically capitalizing the vehicle.

Through its equity and venture capital pathway, SSBCI can also commit capital as a limited partner in, or alongside, private funds that finance employee ownership conversions. In this way, SSBCI can help seed the employee ownership fund market.

## Program income and released federal legacy capital

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Two sources sit entirely inside the state's own development finance institutions. The first is program income: the fees and earnings a development finance agency generates across its portfolio, a portion of which its board can direct into any of the finance tools described in this playbook. It requires no appropriation, scales with the agency's activity and success, and lets the agency build the fund deliberately over several years. New Jersey's employee ownership finance legislation (S4218/A5016) explicitly contemplates this capitalization source.

The second source is released legacy capital from federal interest. Under a 2020 federal statute, a state holding a decades-old EDA revolving loan fund can request release of the federal interest seven years after final disbursement and redeploy that capital so long as it continues to serve an economic development purpose. New Jersey defederalized five such funds in 2021 (among them the original 1976 Okonite award), freeing the same federal capital that financed the first wave of conversions to finance the next.<sup>86</sup> It is a one-time source, but for a state that has it, it is capital already on the balance sheet.

## The state investment portfolio

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The investment portfolio occupies the narrowest position in the matrix because of the fiduciary requirements of the capital that would capitalize a fund-of-funds. The treasurer's portfolio is invested under an obligation to earn a competitive risk-adjusted return, which a market-rate fund-of-funds can deliver but a subsidized loan fund or a first-loss reserve, by design and by definition, cannot. A state cannot lend its investment portfolio concessionally or place it in a loss-absorbing reserve without

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86. Reinvigorating Lending for the Future Act, Pub. L. No. 116-192 (Oct. 30, 2020), 42 U.S.C. § 3211(d)(2)(B) (release of the federal interest on request, no earlier than seven years after final disbursement); New Jersey Economic Development Authority, *Board Book* (June 9, 2021), "Request for Release of USED A Federal Interest in Revolving Loan Funds" (five funds, the first the 1976 Okonite award).

breaching the standard to which it is held. It can, however, commit a small, capped share, as an anchor LP to a fund-of-funds built to earn a market return, just as ILGIF and the FIRST Fund have done in Illinois.

## Philanthropic and private capital

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Philanthropic capital, like state appropriations, can span all three tools. But unlike state appropriations, this is because it can take three distinct forms, and it is important to match the form of philanthropic capital to its exact finance tool.

A grant is the fully concessionary instrument. Because it is a gift expecting no return, it is suited to the parts of the toolkit that no repayable capital will fund. A program-related investment (PRI) is the below-market instrument. Its primary purpose is still charitable and no significant purpose is income, which permits below-market return and counts toward the foundation's required annual payout, making it a natural match for a concessionary revolving loan fund. A mission-related investment (MRI) is the market-rate instrument in the foundation's toolkit, made from the endowment and seeking both a competitive return and mission alignment. This is the philanthropic capitalization source best suited to a market-rate fund-of-funds, willing to be an early anchor LP in a nascent capital market.

Foundations and family offices are by now an established and growing class of investors in employee ownership. They have been vital LPs in growing the fund marketplace and legitimizing employee ownership investing, and can play a similar role in shaping the role of state development finance agencies in further building out the capital market for employee ownership.

## Blending capitalization sources for sustainability

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Given the range of capitalization sources, capitalization is best thought of as a sequence as opposed to a single event. There are three principles and strategic considerations that govern how capitalization is sequenced, and how these sources are blended:

1. **Aligning the capitalization source with the tool:** A program is seeded with the sources that supply capital at scale initially (e.g., state appropriation or an EDA grant) and is sustained, once lending or investing, by the sources that renew themselves, namely the repayments that recycle into a revolving loan fund, the returns that return through an evergreen fund-of-funds, or the program income an agency directs into an RLF year over year. A fund designed to recycle converts a one-time capitalization into permanent capacity.

2. **A blend of capitalization sources is more durable than any single source:** The lesson of state-level RLFs is that transaction-level tools and credit enhancements in particular must be capitalized by sources that are not solely state appropriations, which are at the whim of the annual budget cycle. This should include program income controlled by the agency, released capital already on the balance sheet, or philanthropic contributions so that the program's survival does not turn on political will.
3. **A disciplined blend of capitalization must match the toolkit:** Sustainability comes from matching each tool to the sources it can accept and assembling a capital structure across the toolkit in which the revolving loan fund is seeded by state appropriations, philanthropic investments or grants, and federal grants (and sustained by repayments and program income); the credit enhancements are funded by SSBCI; and the fund-of-funds is anchored by the investment portfolio and philanthropic mission-related investments.

# 7

## Institutional Capacity

A toolkit is only as good and useful as the institution that deploys it. The preceding chapters specified the instruments and the sources that fund them; this one turns to the state's own institutional capacity: where the program lives, who runs it, and how the programs are implemented. Institutional capacity is itself a form of industrial policy, and the most carefully designed program will accomplish nothing if no one is charged with running it and set up for success.<sup>87</sup> The authorized-but-never-capitalized funds that recur throughout this playbook are partly a capitalization failure, but they are also a state capacity failure: the statutes that authorized them named no owner, built no team, and assigned the work of implementation to no one.

### Program placement and housing the toolkit

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The employee ownership finance toolkit does not naturally live in a single place. Its instruments belong in different parts of state government because each instrument requires capacities that different agencies already hold. The transaction-level tools and credit enhancements are lending instruments, and their natural home is the state development finance agency, which already has a balance sheet, underwriting and servicing capacity, board governance, and standing relationships with lenders alongside which these programs will work. The fund-of-funds is an investment vehicle deployed from the state's portfolio under fiduciary obligations, so its natural home is with the public investment officer (usually the treasurer) who controls that portfolio. Linked deposits usually belong with the treasurer for the same reason. And the tax incentives are enacted by the legislature and administered by a state's revenue department. The feasibility study assistance, outreach, and education that surround the financing tools and build a pipeline for employee ownership belong with a state employee ownership center (in or out of government) and/or a dedicated state office.

Because no single agency alone owns and administers the toolkit laid out above, the tools risk being underutilized or unevenly deployed without a role or team responsible for making them function as a single program that a business or lender can navigate. This is the case for a coordinating role inside of state government to steward a statewide employee ownership strategy.

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87. Julien Rosenbloom, *Personnel Is (Industrial) Policy* (Washington, DC: Lafayette Square Institute, February 2026).

**TABLE 10**  
**The state development finance toolkit by agency**

| TOOL                                             | IDEAL PLACEMENT                                        | RATIONALE                                                                                     |
|--------------------------------------------------|--------------------------------------------------------|-----------------------------------------------------------------------------------------------|
| <b>Revolving loan fund; credit enhancement</b>   | Development finance agency                             | Balance sheet, underwriting, board governance, bank relationships                             |
| <b>Fund-of-funds; linked deposits</b>            | State treasurer                                        | Controls the investment portfolio and cash deposits; fiduciary mandate; private markets staff |
| <b>Tax incentives</b>                            | Legislature (enacts); revenue department (administers) | Taxing authority                                                                              |
| <b>Technical assistance, outreach, education</b> | State employee ownership center or office              | Field-facing technical assistance capacity                                                    |

Source: chapter 7 of this playbook. Note: placements reflect the capacities each agency already holds.

Currently, states with established or growing employee ownership programs place the coordination, outreach, and tax functions in an economic development department or a dedicated office; the financing tools generally live with the state's development finance agency. Consider the following examples:

- Colorado placed its Employee Ownership Office and advisory commission inside of the state's Office of Economic Development and International Trade, which is functionally Colorado's development finance agency.<sup>88</sup>
- Washington's legislation established the Washington Employee Ownership Program (WA-EOP) at the state's Department of Commerce, replete with a director, a bipartisan advisory commission, a feasibility assessment and implementation tax credit, and an authorized revolving loan fund.<sup>89</sup>
- Massachusetts split the functions, creating a legislatively authorized state center for employee ownership inside of its business development office, with the authorized revolving loan fund at MassDevelopment.<sup>90</sup>

<sup>88</sup> Merrit Stüven and Matt Helmer, *How the Centennial State Is Leading on Employee Ownership: A Profile of Colorado's Employee Ownership Office*, Aspen Institute Economic Opportunities Program (May 2023).

<sup>89</sup> Ch. 392, Laws of 2023 (Washington), codified at Revised Code of Washington §§ 43.330.590–595 (the Washington Employee Ownership Program, its director and commission, and the revolving loan program conditioned on federal funding); Revised Code of Washington § 82.04.4488 (the conversion tax credit).

<sup>90</sup> Massachusetts General Laws ch. 23D, § 16 (the employee ownership revolving loan fund, administered by MassDevelopment); Massachusetts Center for Employee Ownership, operating within the Massachusetts Office of Business Development.

- New Jersey's employee ownership programs, including its technical assistance grant and legislatively proposed advisory commission and revolving loan fund, are housed in the New Jersey Economic Development Authority (NJEDA).<sup>91</sup>

## Governance and leadership

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As the program placements above show, governance coheres the disparate pieces of the state development finance toolkit and holds them accountable. Two authorities in particular are best suited to do that work.

The first is a Director of Employee Ownership (or an office led by the director), which is a designated, accountable official within state government (ideally at the development finance agency) whose job is coordinating the toolkit and elevating the profile of employee ownership within the state. The Director serves as the state's single point of contact for a business exploring employee ownership, administers the financing programs, coordinates across other state agencies that hold pieces of the toolkit, and ultimately drives the employee ownership pipeline the tools exist to grow. Because the success of the toolkit in large part rests on the Director's remit, the role must have real authority to administer and coordinate programs, not just a mandate to promote employee ownership through outreach and education (and to the extent the latter is a function of the role, it ought to be in close coordination with the state's center for employee ownership where one exists).

The second authority is a standing advisory commission, whose purpose is to advise the Director/office, elevate the voices of key employee ownership stakeholders (including employee owners themselves) in decision-making and design, and keep the program durable across administrations. A commission of practitioners, lenders, employee owners, advisors, researchers, and other relevant stakeholders equips the program with expertise it would otherwise lack and a constituency that outlasts any single Director or administration's enthusiasm. The exact composition of a commission will vary from state to state, but Massachusetts and Washington are instructive in how they constituted theirs: a mix of representatives from state government, business associations, labor unions, worker cooperatives, ESOPs, academia, and economic development.<sup>92</sup> Such a roster balances a range of constituencies, including the government officials whose agencies hold pieces of the toolkit and the employee ownership field that grounds the program in the realities of employee ownership. The commission's value is strategic and should focus on advising on state strategy and the objectives of the program, as opposed to being responsible for approving elements of the program.

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91. New Jersey Economic Development Authority employee ownership technical assistance programming; New Jersey Senate Bill 4218/Assembly Bill 5016 (the proposed Employee Ownership Transition Program, Director of Employee Ownership, advisory commission, and revolving loan fund, each housed at NJEDA).

92. Massachusetts General Laws ch. 23D, § 16; ch. 392, Laws of 2023 (Washington), codified at Revised Code of Washington § 43.330.595 (commission membership).

## Operating model

Once a state settles on its program placement and approach to governance, it must make a series of decisions as to its operating model and how much to keep in-house or contract out to vendors: who leads the program, who underwrites, who services loans, who manages a fund-of-funds, and who administers technical assistance, outreach, and education. Table 11 considers the conditions under which a state should lean one way or another.

**TABLE 11**  
**Operating model considerations**

| FUNCTION                                     | LEAN IN-HOUSE WHEN                                                        | CONTRACT OR PARTNER WHEN                                                 |
|----------------------------------------------|---------------------------------------------------------------------------|--------------------------------------------------------------------------|
| <b>Program leadership<br/>(the Director)</b> | Always: this is a necessary state role                                    |                                                                          |
| <b>Underwriting</b>                          | The agency already lends, has expertise, and deal volume justifies a team | New to the asset class or low volume (bring on an external fund manager) |
| <b>Servicing</b>                             | Volume justifies dedicated staff                                          | Small fund and/or new to the asset class                                 |
| <b>Fund management<br/>(fund-of-funds)</b>   |                                                                           | Always external (state as the allocator, not manager)                    |
| <b>Feasibility, outreach,<br/>education</b>  | The office has capacity and lacks a state center for employee ownership   | A capable nonprofit or university center already exists                  |

Source: chapter 7 of this playbook. Note: conditions are indicative, calibrated to program scale and experience.

As the table shows, the operational model should roughly track the scale and experience of a given program. A small program may find itself contracting out much of the functions of underwriting and servicing and staff only a Director, while a growing one may build more functions in-house as volume justifies more resources. Staff capacity must be funded and housed in state government. The lesson of the authorized-but-not-capitalized RLF is germane here: a program that finally capitalizes its lending but fails to hire and pay necessary talent will lend either poorly or not at all.



# Ecosystem and Pipeline Development

State employee ownership policy is best thought of as resting on two legs of the same stool: the first focused on technical assistance, outreach, and education (building the pipeline of viable employee-owned firms), and the second focused on financing tools (addressing financing impediments to scaling employee ownership). Each is a fundamental and necessary complement to the other: a revolving loan fund without a pipeline of firms to finance has nowhere to lend. Yet much of the state employee ownership policy activity to date focuses on technical assistance, education, and awareness at the expense of development finance, which runs into the opposite problem: a pipeline of firms with insufficient capital to finance them.

A comprehensive state employee ownership strategy must consist of robust ecosystem and pipeline development matched to the right development finance tools. Table 12 maps the elements of pipeline development to the toolkit, with particular attention to who in the ecosystem owns each.

**TABLE 12**  
**Tools to develop a financing pipeline**

| ECOSYSTEM ELEMENT       | WHAT IT DOES                                                                                                                                   | WHO DELIVERS IT                                                                                                                                 | CONNECTION TO THE TOOLKIT                                                                                        |
|-------------------------|------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------|
| State EO center         | Provides educational materials and programming; offers pro-bono or low-cost consulting; connects interested businesses with other stakeholders | Can be nonprofit, governmental or university center (Note: these are not mutually exclusive and can involve external regranting from the state) | Front door for many business owners to learn about employee ownership; readies them to use state financing tools |
| Lender networks         | Co-finance EO deals; supply senior and specialized capital                                                                                     | Banks with ESOP groups, CDFIs, cooperative lenders, specialized investment funds                                                                | Crowded in through various financing and credit enhancement programs                                             |
| TA, outreach, education | Builds awareness; lowers feasibility, legal, and advisory costs                                                                                | State EO center and Director/Office of Employee Ownership                                                                                       | Generates demand for financing tools                                                                             |

Source: chapter 8 of this playbook. Note: delivery models are not mutually exclusive.



The most established element of pipeline development is the state employee ownership center, of which there are currently 25.<sup>93</sup> The state center is usually an external nonprofit organization or university center<sup>94</sup> that educates business owners about employee ownership, connects interested businesses and existing employee-owned businesses with a range of resources (including state resources), and advises companies during transition, among other activities. A center usually does not finance transactions<sup>95</sup>, at least not at scale; instead, it prepares the businesses that will use the financing tools.

A state's financing tools often (but not always) will operate alongside private capital. A robust market requires a base of lenders who understand these transactions, including commercial banks with dedicated ESOP lending groups, cooperative lenders, and specialized investment funds. The financing toolkit will cultivate this network of lenders and capital providers in a range of ways; consider a loan participation, which allows a bank to lend alongside the state on shared terms, or a guarantee, which derisks a lender's employee ownership loan. These credit enhancements, along with the revolving loan fund, build out a lender network not necessarily through explicit convenings and education, but by giving lenders a reason to deploy capital alongside the state's own. For lenders new to employee ownership lending, this makes a once unfamiliar form of lending more legible, and in turn creates new relationships for the Director to manage as they continue to invest in employee ownership transactions in the state.

Technical assistance, outreach, and education are the connective tissue of this work. The reality is that today, most owners still do not know that selling to their employees is an option; once they do, many are deterred by the upfront "soft" costs (e.g., feasibility studies and legal fees), to say nothing of the seller note they would need to take back. Paired with the financing tools outlined in this playbook, technical assistance and outreach educate owners and lower upfront costs to considering a transition, priming a pipeline of deals that can be financed or enhanced with the development finance toolkit.

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93. Employee Ownership Expansion Network, *2025 Annual Report* (the national network of state employee ownership centers).

94. Massachusetts is the principal exception: its legislatively authorized center operates within the state's business development office rather than as an external nonprofit.

95. The Vermont Employee Ownership Center is a modest exception, operating a small loan fund alongside its advisory and educational work.

# 9

## Implementation Roadmap

For the state ready to assemble a comprehensive employee ownership strategy that pairs targeted financing and credit enhancements with technical assistance, outreach, and education, it need not enact everything at once, nor wait for the perfect legislative moment to begin. As described below, there are several components that can be established administratively using authority that agencies already hold. These can serve as proof points for future legislative asks that deepen the program's reach.

### Statutory and legislative pathways

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The clearest administrative pathway for a development finance agency to begin quickly designing its employee ownership strategy are the SSBCI employee ownership use cases. Treasury already permits states to use their SSBCI tranches for majority employee ownership transitions, so the agency administering a state's SSBCI allocation can adopt the use case within its existing collateral support, participation, or guarantee programs with no action by the legislature. At most, these decisions may require executive or board action.

Several other steps are similarly administrable, including:

- Making employee ownership eligible under existing credit enhancement programs,
- Applying for an EDA grant to capitalize an existing RLF for the purpose of financing employee ownership transitions,
- Redeploying released legacy federal capital for the above purpose, and
- Establishing an office or director by executive order, as Colorado did before codifying them.<sup>96</sup>

The capital-intensive programs (i.e., those that require appropriations or novel investment authority) and tax incentives generally require a bill, and many of the above pathways can also be legislatively authorized if the opportunity arises. Table 13 summarizes the various administrative and legislative pathways for enacting parts of an employee ownership strategy.

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96. Stüven and Helmer, *How the Centennial State Is Leading on Employee Ownership* (Governor Polis's 2019 executive order establishing the Colorado Employee Ownership Commission within the Office of Economic Development and International Trade, later codified in statute).

**TABLE 13**  
**Administrative and legislative pathways for the state toolkit**

| GENERALLY ADMINISTRATIVE                                                         | GENERALLY LEGISLATIVE                           |
|----------------------------------------------------------------------------------|-------------------------------------------------|
| SSBCI EO carve-in within existing programs                                       | Tax incentives                                  |
| EO eligibility in existing credit enhancement programs                           | A dedicated, capitalized revolving loan fund    |
| Applying for an EDA Economic Adjustment Assistance grant to capitalize an EO RLF | A fund-of-funds vehicle                         |
| An EO office, director, or commission by executive order                         | Codification of office, director, or commission |
| Redeploying released legacy EDA capital                                          |                                                 |
| Feasibility/outreach/technical assistance programs                               |                                                 |

Source: chapter 9 of this playbook. Note: pathways are generalized; authorities are state-specific.

The above categorizations represent generalized pathways to implementation, though, of course, these authorities are state-specific: one state may be able to institute a tool administratively where another would require legislative authorization. Administrative approaches to implementation are the fastest avenue to standing up a program, but are often the least durable across administrations, which means they should usually be sequenced towards legislative codification.

## Sequencing a comprehensive employee ownership strategy

As with a state's administrative and legislative authorities to implement pieces of a comprehensive employee ownership strategy, the sequencing of standing up that strategy is entirely state-specific in that it hinges on what a state already has. The practical starting point for any development finance agency or Governor's office is to map the existing institutions and authorities against the toolkit and identify where certain programs (or elements of programs) may or may not already exist. From there, a state could follow three phases (this is illustrative and not rigid guidance):

1. **On-ramp with administrative authorities:** Begin with what a state can do administratively, usually the SSBCI carve-in and employee ownership eligibility in existing credit enhancement programs, and occasionally an office/director by executive action and feasibility study/outreach/technical assistance programs. These can happen within a year, generally cost little, and generate a pipeline for states to prove the concept and a constituency of employee-owned businesses, employee owners, lenders, and advisors who become the program's advocates.

2. **Programmatic core with legislative authorities:** Once all or some of the above elements are established, legislators should author and introduce comprehensive legislation that achieves some combination of establishing a revolving loan fund, a fund-of-funds, tax incentives, and the permanent codification of governance. This is far easier to do after a state has already provided credit enhancements or technical assistance to employee-owned businesses, as it will have already preserved companies and jobs in legislative districts and built political support in the process.
3. **Durability:** Once both the administrative on-ramp and legislative avenues have been pursued, the task of the development finance agency and its government partners is to ensure the program is largely self-sustaining through some combination of the sources identified in Chapter 6.

## Impact measurement

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A state employee ownership program should adopt an impact measurement framework that forces accountability, durability, and storytelling. In making the case for such a program, a state must first understand its total addressable market; that is, the number of firms undergoing business succession over a fixed interval that are candidates to become employee-owned. From there, it should model how each tool may penetrate that addressable market; in the case of an RLF or loan participation, this would include modeling (and later measuring, once implemented) capital deployed, deals financed, and private capital mobilized/crowded into transactions. After several years of program administration, a state can then measure itself against its outcomes, including employee owners created, jobs created or retained, and wealth built, among other metrics. The state will also be able to compare the effectiveness of its toolkit against counterfactual economic development tools (e.g., business attraction incentives) by measuring cost per job, default rate, and loss rate. Table 14 distills the measurement framework and each metric's purpose.

These metrics should be built into program evaluation from the start and should be calibrated to how states already measure the effectiveness and efficiency of other economic development and development finance programs.

**TABLE 14**  
**Impact measurement framework**

| METRIC FAMILY            | WHAT IT MEASURES                                                    | PRIMARY PURPOSE                           |
|--------------------------|---------------------------------------------------------------------|-------------------------------------------|
| Pipeline                 | Total addressable market                                            | Accountability; targeting                 |
| Deployment and revolving | Capital deployed; deals financed; lending multiplier                | Accountability; durability                |
| Outcomes                 | Employee owners created; jobs created or retained; wealth generated | Economic development case                 |
| Leverage                 | Private capital catalyzed per public dollar                         | Economic development case; EDA compliance |
| Efficiency               | Cost per job                                                        | Economic development case                 |
| Fund health              | Default and loss rate                                               | Fiduciary case; sustainability            |

Source: chapter 9 of this playbook. Note: metrics should be calibrated to how the state measures other development finance programs.

# 10 Conclusion

This playbook opened with the story of a wire and cable manufacturer's 1976 transition to 100 percent employee ownership, made possible only by a federal grant converted to state lending capital and re-lent through a development finance agency. A private lender provided debt layered above the state's, and the ESOP transaction closed on competitive, sustainable terms. The Okonite Company remains 100 percent employee-owned to this day, and the revolving loan fund that made this possible revolved as intended: the New Jersey Economic Development Authority (NJEDA), which administered the loan, went on to make nearly 850 loans against a set of five revolving loans, of which Okonite's was one.

State development finance agencies across the country have a clear and present economic imperative to rebuild the capacity that NJEDA pioneered in 1976. Over half a century of ESOP performance has shown that employee-owned firms build wealth for workers who contribute none of their own personal capital, lay off fewer workers in downturns, default at lower rates, and keep ownership and decision-making anchored in the communities where the firm operates. At a time when over half of the businesses in every single U.S. state are poised to undergo an ownership transition in the coming decade, employee ownership must be a sufficiently competitive option for retiring business owners<sup>97</sup>; absent that, states will see millions of small- and medium-sized businesses shutter or be sold to out-of-state buyers, with the job loss and tax base erosion that follows. Currently absent in most states is the robust financing architecture necessary to scale employee ownership. Fortunately, state development finance agencies today are considerably more mature and sophisticated than NJEDA was when it made its 1976 Okonite loan and are well-positioned to realize this opportunity.

The case for building this financing capacity is made even more urgent by the diffusion of artificial intelligence across the American economy. The small- and medium-sized firms approaching ownership transitions (many of them manufacturers, contractors, and service firms) are the same firms whose margins AI adoption stands to expand over the coming decade. In a conventional firm, it is reasonable to worry that such gains from automation may come at the expense of the workers themselves; an employee-owned firm, where the distinction between capital and labor collapses, reduces this risk substantially. Because employee owners capture the gains from productivity improvements, employee-owned firms have structural incentives to deploy technology in ways that augment their labor instead of replacing it. Evidence of ESOP performance in recessions bears this out, as employee-owned businesses

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97. Lafayette Square Institute, *535 Insights* (2026) (state-level analysis of business succession exposure).

have tended to retain workers during downturns at higher rates than comparable firms. In the places where automation does change the shape of work, employee owners hold a capital claim, so the gains flow into their ESOP accounts rather than to an outside investor's.

States need not wait to position employee ownership as a response to the business succession crisis and the question of who captures the gains from artificial intelligence. They can implement many of this playbook's recommendations at modest cost through existing authorities that agencies already hold; the components that do require legislation are thoroughly precedented in development finance and overwhelmingly bipartisan. Compare this to 1976, when this capacity was largely improvised as a crisis response by a handful of business leaders and government officials working to prevent the closure of a plant in a deeply distressed New Jersey community. The institutions and instruments needed to expand employee ownership exist in every single state, and the scale of this opportunity is unprecedented and may not reoccur for generations. The states that capitalize on this opportunity will be reclaiming a capability American development finance has proven it can administer, and in doing so will help decide whether workers are empowered and share in the next era of American capitalism.

## APPENDIX

# SSBCI use cases mapped to the state toolkit

The State Small Business Credit Initiative (SSBCI) is the most durable and universal federal source to begin establishing a comprehensive state employee ownership strategy, as every state has a substantial allocation that they can continue to deploy through March 2028. Because SSBCI operates only through Treasury-approved program structures rather than as a freestanding capitalization source, it is important for state to understand which SSBCI program type maps to which toolkit instrument.

Treasury's guidelines otherwise prohibit using SSBCI-supported funds to purchase an owner's equity interest, but carve out an exception for transactions that produce broad-based, majority employee ownership through an ESOP, worker cooperative, employee ownership trust, or related vehicle; the employee entity must hold a majority interest, on a fully diluted basis, at close.<sup>98</sup> Each program below is available for employee ownership only on that condition. They all also require a 1:1 private financing requirement at the transaction level, a portfolio-level expectation of roughly ten dollars of private lending or investment per federal dollar over time, recycling and reporting obligations, and Treasury approval of program design.

SSBCI funds the state's credit enhancement and participation tools, which stand behind or alongside a private lender in a specific transaction, and it can support revolving lending within an approved participation or direct lending program. However, it cannot capitalize a freestanding statutorily approved revolving loan fund as a source of fund capital. Additionally, the SSBCI equity program is a partial analogue to the fund-of-funds strategy: SSBCI can place capital into or alongside funds that finance employee ownership, but it does so under federal program rules and timelines. It is not the open-ended, fiduciary, evergreen anchor commitment that a state investment portfolio can make.

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98. U.S. Department of the Treasury, *SSBCI Capital Program Policy Guidelines* (rev. Oct. 7, 2022), at 21 (the employee ownership transition exception, conditioned on the employee entity holding a majority interest on a fully diluted basis at close); see Chapters 4 and 5.

## APPENDIX TABLE

## SSBCI program types mapped to the state toolkit

| SSBCI PROGRAM TYPE                    | WHAT IT IS                                                                                      | TOOLKIT INSTRUMENT                                                     | EMPLOYEE OWNERSHIP USE                                                                                                                              |
|---------------------------------------|-------------------------------------------------------------------------------------------------|------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Capital Access Program</b>         | Lender and borrower premiums, matched by SSBCI, build a pooled loss reserve held at the lender  | Loan loss reserve/portfolio insurance                                  | Enroll EO loans within a broader small business CAP                                                                                                 |
| <b>Loan Participation Program</b>     | The state buys a participation in, or makes a companion loan alongside, a private lender's loan | Loan participation, senior or subordinate; subordinated direct lending | Take a pari passu share to expand senior capacity, or a subordinate companion position to fill the mezzanine the seller note would otherwise occupy |
| <b>Loan Guarantee Program</b>         | The state guarantees a defined share of a private lender's loan                                 | Loan guarantee                                                         | Guarantee an EO acquisition loan so a lender will extend credit it would otherwise decline                                                          |
| <b>Collateral Support Program</b>     | The state pledges a cash deposit to cover a borrower's collateral shortfall                     | Collateral support                                                     | Cover the collateral shortfall on a cash flow-heavy ESOP loan                                                                                       |
| <b>Equity/Venture Capital Program</b> | The state invests in venture funds, or co-invests alongside them, in small businesses           | Institutional capital mobilization (partial analogue)                  | Invest in or alongside specialized EO funds, within SSBCI's rules and the majority-ownership condition                                              |

Source: U.S. Treasury SSBCI Capital Program Policy Guidelines, as cited in the appendix notes. Note: all uses are conditioned on broad-based, majority employee ownership at close.



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