



**BEYOND PAYCHECK-TO-PAYCHECK:**  
WEALTH-BUILDING STRATEGIES FOR VENTURE CAPITAL FUNDS TO USE WITH  
PORTFOLIO COMPANIES AND THEIR EMPLOYEES

**PREPARED BY**

Anne Claire Broughton

Executive Director

SJF Advisory Services

**ASSISTED BY**

Elizabeth Irons

Jessica Thomas

Jennifer Pawlowski

**FUNDED BY**

The F.B. Heron Foundation

The Rockefeller Foundation

---

---

## Table of Contents

<b>EXECUTIVE SUMMARY .....</b>	<b>1</b>
<b>I. INTRODUCTION .....</b>	<b>6</b>
A. THE EXIT CHALLENGE FOR CDVC FUNDS .....	6
B. BEYOND PAYCHECK-TO-PAYCHECK PROJECT OVERVIEW .....	8
C. BRIEF HISTORY OF MISSION-DRIVEN VENTURE CAPITAL.....	9
D. CURRENT STATE OF CDVC .....	11
E. EXIT OPTIONS FOR CDVC FUNDS.....	12
F. CDVC FUND SURVEY RESULTS.....	12
<b>II. MAKING THE CASE FOR EMPLOYEE ASSET BUILDING AND EQUITY OWNERSHIP .</b>	<b>17</b>
<b>III. BROAD-BASED STOCK OPTIONS .....</b>	<b>21</b>
A. INCENTIVE STOCK OPTIONS VS. NON-QUALIFIED STOCK OPTIONS .....	23
<i>Case Study: CV Finer Foods (World Harbor)</i> .....	26
<i>Case Study: MinnCorp.</i> .....	26
<i>Case Study: Alpine Medical</i> .....	27
<i>Case Study: DDF Cosmetics</i> .....	28
<i>Case Study: Ryla Teleservices</i> .....	29
<i>Case Study: CitySoft</i> .....	29
<i>Case Study: White Wave/Dean Foods</i> .....	30
<i>Case Study: "Engaged Industrial Services" &amp; "Steady Manufacturing Corp."</i> .....	31
B. PHANTOM STOCK AND STOCK APPRECIATION RIGHTS .....	32
C. RESTRICTED STOCK .....	34
<b>IV. ESOPS .....</b>	<b>35</b>
OVERVIEW .....	35
<i>Case Study: Cumberland Gap</i> .....	38
<i>Case Study: McKay's Nursery</i> .....	38
<b>V. IDAS AND HOME OWNERSHIP ASSISTANCE .....</b>	<b>40</b>
A. INDIVIDUAL DEVELOPMENT ACCOUNTS .....	40
CDVC Fund Participation in IDAs.....	41
B. HOMEOWNERSHIP ASSISTANCE .....	46
CDVC Funds' Experience with Homeownership Assistance.....	47

---

---

<b>VI. RETIREMENT PLANS AND PROFIT SHARING .....</b>	<b>49</b>
A. RETIREMENT PLANS.....	49
B. PROFIT SHARING & BONUS PROGRAMS.....	50
<b>VII. FINANCIAL LITERACY PROGRAMS.....</b>	<b>52</b>
OVERVIEW.....	52
CDVC Funds' Experience With Financial Literacy Training .....	52
<b>VIII. CONCLUSIONS AND NEXT STEPS.....</b>	<b>54</b>
A. MARKETING TOOLS.....	54
B. DOCUMENTING RESULTS .....	54
C. NEXT STEPS.....	54
<b>APPENDICES .....</b>	<b>BEYOND PAYCHECK-TO-PAYCHECK APPENDICES</b>



SJF Advisory Services is a nonprofit that provides workforce development and sustainable business assistance to growing companies that employ low-wealth individuals. SJF Advisory Services is committed to efforts, such as this report, that contribute to the advancement of the CDVC field.



SJF Ventures, a \$17 million mission-driven venture capital fund based in Durham, NC and Philadelphia, PA, finances and assists companies in the Eastern United States that generate social, environmental and financial gains. To date, the fund has invested \$9.2 million in 16 companies that have created and retained a total of 1,600 jobs.

---

#### ACKNOWLEDGEMENTS

The authors would like to acknowledge the contributions and support of the following individuals and organizations: Luther Ragin at the F.B. Heron Foundation, Betsy Biemann at the Rockefeller Foundation, the SJF Ventures staff and Investment Committee, the SJF Advisory Board, Chad Sclove of Isoph, Andrew Foster at the Duke Community Economic Development Law Center, Erica Schohn of Skadden, Arps, Slate, Meagher & Flom, Melissa Koides, CFED Consultant, Chuck Shannon of United Way of Denver, Brian Schmitt at CDVCA, Paul Christiansen and Nan McIntyre at Shorebank Enterprise Group, Joe Killackey at Urban Growth Partners, Nat Henshaw at CEI Ventures, Elmer Parlier at Kentucky Highlands Investment Corp., Pete November at Pacific Community Ventures, Tom Van Hale and Greg Sandbulte at Northeast Ventures, Elyse Cherry at Boston Community Capital, Richard Ross at the West Virginia Jobs Investment Trust, Chuck Lacy at Barred Rock, Steve Mercil at the Minnesota Investment Network Corp., Tom Loy at MetaFund, Nina Orville and Janet Pickering at NYCIC, Alan Branson at the Enterprise Corporation of the Delta, Vic Russo of Ben Franklin Technology Center, Joel Steiker at Murex, Rick Krieger at ACENet, Paul Benedict at Adena Ventures, Bill Taylor at Mountaineer Capital, and Fred Beste at Mid-Atlantic Venture Funds.

---

#### LEGAL DISCLAIMER

This report contains an analysis of various types of employee benefits and equity compensation tools and how they may be applied to community development venture capital funds and their portfolio companies. This report, however, is not intended as, nor does it constitute, legal, benefits or tax advice. Before implementing any of the tools or strategies described in this report, you should consult a lawyer, tax advisor or professional benefits consultant to determine how the use of any of these tools or strategies will affect your fund, company and employees.

---

---

## **EXECUTIVE SUMMARY**

Community development venture capital (CDVC) funds seek to invest in businesses that benefit economically distressed communities and individuals. After working to help grow these companies, CDVC funds then exit their investments within about four to six years through sale of the company, an initial public offering, new private equity financing, or management buy back in order to achieve a financial return. The most common fund exit is through a company sale, which may in some cases result in relocation of the business and a subsequent loss of jobs for the very population these funds seek to serve. A key question in the CDVC industry, which we address in this report, is how best to help low-wealth employees build assets during employment and share in the financial benefits of a CDVC fund exit event.

Obviously, the question of sharing gains upon fund exit is moot unless the company is financially successful. It is critical for both investors and employees to have companies expand profitably and succeed in their markets. Therefore, CDVC funds give a great deal of technical assistance to their companies in the areas of management and board recruitment and development, mergers and acquisitions, financing, and growth strategies. They also assist portfolio companies with workforce performance and advancement issues, which are the primary focus of this report.

SJF believes that properly designed workforce initiatives can accelerate business success. We recognize, however, that building sales and profitability are the core agenda of any early stage enterprise and its employees. And, of course, company management has to be strong to help the company succeed, and they have to be supportive for these employee asset-building strategies to be effective.

This report is focused on building financial assets for low-wealth employees. Of equal or greater importance is building transferable skills, along with life skills and self-esteem. SJF worked with these issues separately as part of the New Horizons in Workforce Development Initiative, facilitated by the Community Development Venture Capital Alliance (CDVCA). The other participants were The Reinvestment Fund, Coastal Enterprises and Shorebank Enterprise Group. The result of the project is a handbook describing best practices in providing workforce development and human resources assistance to enhance the performance of companies funded by community development venture capital funds. The handbook is available from SJF and CDVCA.

## **METHODOLOGY**

This study focuses on how to use equity and workforce assistance to generate employee and company gains. The U.S. venture capital industry had about \$253 billion under management at the end of 2002. Of that, community development venture capital, at about \$550 million under management, represented only a very

---

---

small portion. However, CDVC funds use the same investment tools and practices as conventional venture capitalists and are often investing at an earlier stage, which may give them more influence in setting up equity compensation tools to generate gains for employees at every level. CDVC funds also have a social mission and are therefore interested in and focused on sharing investment gains with employees at all levels.

Because of these factors, SJF chose to focus on CDVC funds for this report. We surveyed 17 CDVC funds (along with an SBIC, a traditional venture capitalist and an entrepreneurial development entity) on tools they were using or considering to help build assets of low-wealth employees of portfolio companies. We then researched and documented strategies such as individual development accounts (IDAs), homeownership assistance, and a wide variety of equity-based compensation such as broad-based stock options and ESOPs. We are applying these strategies as appropriate with SJF Ventures portfolio companies. Most of the case studies in the report are taken from CDVC fund portfolio companies, and a few others unrelated to CDVC are also included for illustrative purposes.

We also put together several frameworks to help other VC funds evaluate which of these tools would work best with specific portfolio companies, drafted marketing pieces which explain these tools and their rationale to entrepreneurs, and put together a list of resources for entry-level employees using these tools.

We hope this report will spur a lively conversation within the CDVC and VC fields and look forward to continuing to work with these issues and hear from other funds' and companies' experiences.

## **SUMMARY FINDINGS**

Key findings from the initiative are summarized below, by chapter.

### **I. AN INTRODUCTION TO THE PROJECT AND ITS CONCEPTS, WITH A BRIEF PERSPECTIVE INTO THE BROADER MISSION-DRIVEN VENTURE CAPITAL FIELD**

- Engaged entry-level workforces are integral to the business model most CDVC portfolio companies. Although 52% of CDVC fund exits are via company sale, a majority of portfolio companies continue operating at the same sites, some with enhanced job creation, wages, and benefits, after CDVC fund exits.
- CDVC funds are part of the larger mission-driven venture capital field that has been developing since 1960 and includes CDFIs, minority investment funds, and new markets venture capital funds.
- As of the end of 2003, there were 68 active community development venture capital (CDVC) funds with a total of \$550 million under management, while an additional 11 funds were in development.

- 
- 
- Most of the 20 funds surveyed were open to some form of asset building for low-wealth portfolio company employees. Some funds are using equity ownership; others are more in favor of profit sharing and bonuses. Several either operate IDA programs or link employees to local nonprofit IDAs. Many stressed that there is no “one-size-fits-all” in asset building – individual companies’ needs, histories, and strategies must be taken into consideration.

## **II. MAKING THE CASE FOR EMPLOYEE ASSET BUILDING AND EQUITY OWNERSHIP**

- The key factor in moving out of poverty goes beyond a dependable income to the accumulation of assets such as savings accounts and homes.
- Properly implemented employee ownership can lead to better company performance (and, ultimately, higher financial returns to investors) largely because of the sense of responsibility and focus on bottom-line company success felt by all employees.
- Equity ownership such as stock options may be even more effective when coupled with a system of open-book management whereby all employees fully understand the company’s business model and goals, and what it will take both from them individually and as a whole for the company to achieve success.

## **III. BROAD-BASED STOCK OPTIONS**

- Up to 10 million U.S. employees receive stock options. This number is growing in both private and public companies despite recent scandals involving large public corporations.
- Financial literacy programs are essential to explain to low-wealth employees the value of stock options, how they work, how they are valued and how they can offer the potential for long-term growth capital gains.
- It is possible to design a cash-less exercise for all types of stock options by cashing out enough options to pay for the exercise of shares and taxes due. This is an excellent strategy for entry-level employees.
- Many CDVC funds surveyed believe that it is important at the time of investment to set aside some percentage of fully diluted stock (between two and ten percent, depending on the fund and company) to be distributed across all employee levels.

## **IV. EMPLOYEE STOCK OWNERSHIP PLANS (ESOPs)**

- ESOPs are used to grant liquidity (often with substantial tax advantages both to the seller and the company) to a departing owner, founder, or major shareholder while assuring that the business will continue to operate. They are also used as an employee incentive or benefit plan.

- 
- 
- If a closely-held company plans to stay private, is growing at a steady but not meteoric rate, is profitable and has at least 20 employees, and does not expect to experience a liquidity event (such as going public or being acquired) in the near term, then an ESOP could offer an attractive exit alternative for a CDVC fund. However, not many CDVC funds have used this alternative to date.
  - As with broad-based stock option plans, ESOPs are even more likely to improve corporate performance when combined with opportunities for employees to better understand how the business operates and to participate in decisions affecting their work.
  - Only two CDVC funds surveyed, CEI Ventures and Kentucky Highlands, have portfolio companies currently involved in ESOPs. Several other funds are very interested in ESOPs, with a few actually specifying the establishment of an ESOP as a mutual goal in some portfolio company term sheets.

## **V. IDAs AND HOME OWNERSHIP ASSISTANCE**

- There are currently at least 15,000 Individual Development Accounts (IDAs) in almost 300 IDA programs nationwide, and more than 20,000 individuals have IDAs or have graduated from IDA programs. Pilot IDA programs, most notably the American Dream Demonstration, have shown that low-wealth individuals can effectively save using this strategy.
- Two of the CDVC funds surveyed operate or plan to operate IDA programs (CEI and Pacific Community Ventures) and four others (SJF Ventures, Enterprise Corporation of the Delta, Shorebank Enterprise Cleveland and The Reinvestment Fund) have linked portfolio companies with local nonprofits offering IDAs.
- Some organizations, notably the United Way of America, recommend bundling IDAs with other asset building strategies such as the Earned Income Tax Credit and financial literacy training.
- The proposed Savings for Working Families Act, a subset of the CARE Act, if enacted, would provide for approximately \$350 million in federal income tax credits to financial institutions, equating to more than 300,000 IDAs and providing a stable and ongoing source of funds.
- Homeownership assistance could include forgivable, deferred, or repayable loans and matched savings to help employees pay for costs associated with home-buying such as down payments or closing fees.
- The Barred Rock Fund and Murex Investments are the only two CDVC funds surveyed that have attempted to offer homeownership assistance. They offered it together at one joint portfolio company, with limited success.



---

---

## **VI. RETIREMENT PLANS AND PROFIT SHARING**

- Retirement Plans include plans such as 401(k)s or SIMPLE IRAs that allow employees to make pre-tax salary deferrals and allow employers to take a tax deduction on any matching contributions they provide.
- Twelve of the organizations surveyed (81% of funds) have portfolio companies with 401(k) or other retirement plans.
- A number of CDVC funds surveyed advocate profit sharing and bonuses as effective immediate strategies for motivating and rewarding portfolio company employees at all levels.

## **VII. FINANCIAL LITERACY TRAINING**

- Financial education is a pre-requisite for most, if not all, of the asset building strategies discussed in this report. Studies have shown that more than a million American households file for bankruptcy each year, and that average credit card debt is up to \$7,000 per household.
- Many low-wealth employees need basic financial literacy training in order to assist them in entering into the economic system through establishing bank accounts (saving and checking), as well as reducing debt and saving for goals such as continuing education or purchasing a home.
- Of the CDVC funds surveyed, six (43%) offer either direct financial literacy training or a connection to outside financial literacy providers.

## **VIII. CONCLUSIONS AND NEXT STEPS**

- The tools described in this report (broad-based stock options, ESOPs, IDAs, retirement plans, and profit sharing and bonuses) can be effective ways to help build assets for low-wealth portfolio company employees while also making those companies more successful.
- A useful follow-up would include annual updates over the next three to five years focusing on actual results from CDVC fund exits from portfolio companies.

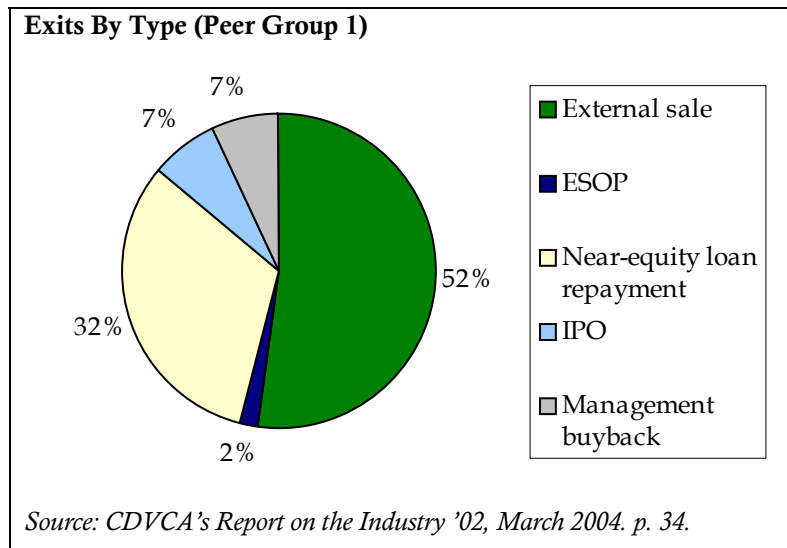
---

---

## I. INTRODUCTION

### A. THE EXIT CHALLENGE FOR CDVC FUNDS

Community development venture capital (CDVC) funds add business and workforce value to portfolio companies, help foster growth, and then exit their investments, often via a company sale. Observers of the CDVC field have feared that the acquisition of portfolio companies might be equated with a loss of the very



entry-level jobs CDVC funds had worked to create and improve. Clearly, the majority (52% based on the most recent data from CDVCA) of CDVC fund exits are via external sale, but we found in the course of our in-depth survey of 17 CDVC funds that a large portion of the roughly 90 CDVC fund portfolio companies exited to date continued operating in the same geography after CDVC fund exit, with limited loss of jobs. Indeed, many have added jobs and improved wages and benefits. From the company's and

employees' perspective, the fund exit (in which CDVC funds return capital to their investors), is often just another phase in the ongoing development of the company.

**EXIT: A FINANCING EVENT THAT ALLOWS A COMPANY TO REPAY – IDEALLY WITH INVESTMENT GAINS – ITS VENTURE CAPITAL INVESTORS.**

### THE WORKFORCE MAKES COMPANIES VALUABLE

A key lesson from this research is that skilled workforces are integral to most CDVC portfolio companies and are often maintained after CDVC fund exit. Sharing gains, employee ownership, and asset building are relevant to any type of fund exit – not just to provide benefits when there may be job losses. Sharing ownership doesn't have to mean dividing a limited "equity pie" into smaller slices, diluting management and investors; it can mean helping to make the pie bigger by sharing it more broadly. (See case studies in Chapter III for examples.)

---

---

## **EMPLOYEE ASSET BUILDING**

Recent industry research has focused on the importance of asset-building as a fundamental step on the path out of poverty for low-wealth individuals. Because of the lack of safety-net for asset-poor individuals, even living wages are not enough to protect against relatively predictable events such as emergency health-care expenditures, and many low-wealth individuals thus have a tenuous grasp on sustainable living conditions. Additionally, higher levels of asset-ownership have been connected to positive social characteristics such as civic involvement, lower incidences of joblessness, and marital stability. As we discuss at length in Chapter II: “Making the Case for Employee Asset Building and Equity Ownership,” broad-based company ownership improves overall company performance. The CDVC sector’s focus on helping low-wealth individuals accumulate assets is a critical element of its larger community development mission.

## **BUSINESS ADVANTAGE**

Having employees who build their skills and assets while employed, and also own a part of the company through broad-based stock options, profit sharing or ESOPs, can be a key component to business success. Employees who are well compensated and see a path to advancement are more likely to stay over a longer period of time. Higher retention rates translate to lower hiring and training costs. In addition, employees who own a piece of the company and how doing their jobs well contributes to the overall bottom line are more engaged and work harder for business success.

The Saratoga Institute estimates that the cost of a departing employee is one and a half times annual salary plus benefits. For example, an employee with a \$50,000 salary and benefits amounting to \$15,000 who leaves will cost the company 1.5 times \$65,000, or \$97,500<sup>1</sup>. According to Jack Stack in *A Stake in the Outcome*, at companies with a culture of ownership “there’s a sense of pride, identity, direction, and purpose. People know they’re part of something bigger than what they do on a day-to-day basis. They belong to something, and it belongs to them. They have ownership, and it’s a two way street.”<sup>2</sup>

CDVC funds aim to achieve a “blended return” consisting of both financial and social components.<sup>3</sup> They are able to provide entrepreneurial assistance in underserved areas, along with venture capital investment in companies that might not attract the attention of conventional venture capital. After investment, CDVC funds help add value to the company through management, operational and workforce-related assistance, which may include asset building for entry-level employees. After about four to seven years, CDVC funds exit these

---

<sup>1</sup> Rutgers University Graduate School of Management and Saratoga Institute study, 2002.

<sup>2</sup> Stack, Jack and Bo Burlingham, *A Stake in the Outcome: Building a Culture of Ownership for the Long-term Success of your Business*. Doubleday, 2002, p. 4.

<sup>3</sup> Emerson, Jed, “The Blended Value Map: Tracking the Intersects and Opportunities of Economic, Social and Environmental Value Creation,” 2003.

---

---

investments so as to provide a financial return to the CDVC fund's investors. This is often done through sale of the company; though it could also be via an initial public offering (IPO), management buy-back, new private equity financing, or purchase of the investor's shares by an ESOP. This project is an attempt to identify some tools to help employees build wealth and participate in the financial upside of fund exits, regardless of what form the exit takes and whether or not their jobs still exist after CDVC fund exit.

## **B. BEYOND PAYCHECK-TO-PAYCHECK PROJECT OVERVIEW**

The goal of the Beyond Paycheck-to-Paycheck initiative is to develop tools that CDVC funds and other equity investors can use with portfolio companies to ensure that all long-term employees of those companies build assets during employment and/or share in the gains of a company sale or other exit event, thus strengthening social returns. SJF Advisory Services has documented specific tools to share with other funds by:

- 1) Investigating and compiling best practices for low-wealth employee gains on investor exit, including broad-based stock option plans, employee stock ownership plans (ESOPs), Individual Development Accounts (IDAs), retirement plans, profit-sharing plans, severance packages and other methods.
- 2) Creating a framework to help CDVC and other VC funds match companies with appropriate employee asset-building strategies. This framework considers such issues as rate of company growth, industry sector, likely form of exit, and likelihood of job losses upon sale.
- 3) Implementing these best practices as appropriate with SJF portfolio companies, with the help of employee benefits consultants. Creating a library of legal documents that can serve as a template as CDVC and other VC funds work with other companies.
- 4) Developing marketing and educational pieces for prospect and portfolio companies which outline a range of tools for use in employee asset building, and so help make the case that having employees share in long-term gains strengthens the chances of business success.
- 5) Documenting tools and case studies from the initiative, including sample templates for asset building plans, for use by CDVC and other VC funds.
- 6) Upon SJF Ventures exit from portfolio companies, working to assure shared gains by all employees.

SJF Advisory Services was formed to help promote self-sufficiency for low-wealth individuals by assisting sustainable enterprises to create, retain and enhance long-term jobs for the residents of economically distressed communities. As part of the Beyond Paycheck-to-Paycheck Initiative, SJF surveyed 17 CDVC entities (23 separate CDVC funds under management) as well as three traditional equity investors (for a total of 20 funds surveyed) to get a sense of existing mechanisms to assist entry level employees of portfolio companies in building assets and, where possible, participating in the upside of investor exit. (See Appendix A and the chart on page 13 for the funds surveyed.)

---

---

## C. BRIEF HISTORY OF MISSION-DRIVEN VENTURE CAPITAL

**MISSION-DRIVEN VENTURE CAPITAL:** INVESTMENT FIRMS FOUNDED TO PURSUE A SOCIAL OR ENVIRONMENTAL MISSION THROUGH FINANCIALLY SUCCESSFUL FUNDS.

It may be helpful to put CDVC investing into perspective before moving on to the specific tools developed through this initiative. The concept of mission-driven investment has been gaining momentum in the United States for the past several decades. Stimulated by the premise that gaps remain in the offerings of the traditional financial services sector, and that attractive business opportunities exist in underserved markets such as the inner city, a number of funds and investment programs have developed to leverage both public and private sector resources in order to meet capital needs.

As early as the 1960s, community development corporations (CDCs) received federal funding to support a range of community development activities, including business and economic development, workforce training, and housing programs. Over time, CDCs took an increasingly active role in business development, ultimately investing capital directly in outside entrepreneurs in return for an equity stake in the business. In the late 1970s, the Kentucky Highlands Investment Corporation (KHIC) led the field in this activity. At around the same time, state-sponsored venture capital programs emerged in Massachusetts and Connecticut in the early 1970s as an economic development mechanism, partially in response to a declining private venture capital market. These geography-specific funds were intended to spur local job growth and expand the state's tax base. Of these, Massachusetts Community Development Finance Corporation had an explicit focus on low- and moderate-income populations. As of 2000, more than 30 states were operating such funds, while 19 other states offered tax credits or other financial incentives to spur local equity investments.<sup>4</sup>

In 1958, the Small Business Investment Company Act introduced Small Business Investment Companies ("SBIC"), privately owned investment funds that are licensed and regulated by the U.S. Small Business Administration ("SBA"). While SBICs are generally organized and operated like other venture capital funds, they can receive up to two-thirds of their total capital from the SBA, typically at below-market rates. In return for this funding, SBICs are required to invest in small businesses and to abide by other SBA regulations. In July 1997, the Community Reinvestment Act was revised to allow financial institutions' investments in SBICs to satisfy its Investment Test, a requirement to which all banks with total assets of \$250 million or more are subjected. Since the revision of the CRA, the number of banks investing in SBICs, and the amount of capital

---

<sup>4</sup> Rubin, Julia Sass. "Community Development Venture Capital: A Double-Bottom-Line Approach to Poverty Alleviation," presented at *Changing Financial Markets and Community Development* Federal Reserve System research conference, April 4-6, 2001. p. 5

---

these banks are investing, has markedly increased.<sup>5</sup> However, SBICs rarely focus specifically on serving low-wealth citizens and communities.

The Minority Enterprise Small Business Investment Company (MESBIC) program was started in 1969 to meet the capital needs of minority entrepreneurs. The program created several hundred privately-owned firms eligible to receive funds at subsidized rates from the SBA with the primary mission of financing small businesses owned by minorities. These investment companies were subsequently renamed Specialized Small-Business Investment Companies (SSBIC), and their target market was expanded to include all small businesses located in the inner city. The US Government stopped licensing new SSBICs in 1995. Several of these ultimately failed and were forced to close, but 59 SSBICs were still active in September 2000, with a combined total of \$143 million in private capital under management.<sup>6</sup> These funds are represented by the National Association of Investment Companies (NAIC), the industry association for investment companies dedicating financial resources to investment in an ethnically diverse marketplace. NAIC member firms (including but not limited to SSBICs) represent more than \$4 billion in capital under management and include leading private equity firms, small-business investment companies backed by the U.S. Small Business Administration, and investment companies chartered by state and local governments.<sup>7</sup>

Although the National Community Capital Association (NCCA) sees the origin of community development investing some twenty-five years ago, in the era of bank redlining and the subsequent Community Reinvestment Act, the NCCA's 2001 study of the Community Development Financial Institution (CDFI) sector links the rapid growth of the sector in the 1990s to the creation of the CDFI Fund in 1994. Since the launch of the Fund, the number of CDFIs, including community development venture capital funds, has doubled while assets under management by these institutions has more than tripled.<sup>8</sup> CDFIs use a broad spectrum of financial tools (including debt and equity investments) with the primary goal of "revitalizing distressed local and regional economies, countering structural and systemic causes of poverty, and creating wealth and opportunities for economically disadvantaged people and communities."<sup>9</sup>

For example, many funds surveyed for this report were started by CDFI loan funds, including Coastal Enterprises, The Reinvestment Fund, Boston Community Capital, and Kentucky Highlands. Even CDFIs that have not started equity funds, such as the Self-Help Credit Union, recognize that asset building and home

---

<sup>5</sup> Reich, Mark. "SBIC Investing Provides an Attractive Option to Banks," published on Ironwood Capital's web site 2001 ([http://www.ironwoodcap.com/about\\_news\\_SBIC.htm](http://www.ironwoodcap.com/about_news_SBIC.htm)).

<sup>6</sup> Rubin, Julia Sass. "Community Development Venture Capital: A Double-Bottom-Line Approach to Poverty Alleviation," presented at *Changing Financial Markets and Community Development* Federal Reserve System research conference, April 4-6, 2001.

<sup>7</sup> [Http://www.naicvc.org](http://www.naicvc.org).

<sup>8</sup> Pinsky, Mark. "Taking Stock: CDFIs Look Ahead After 25 Years of Community Development Finance," *Capital Xchange Journal*, prepared for The Brookings Institution Center on Urban and Metropolitan Policy, December 2001, p. 6

<sup>9</sup> *Ibid*, p. 3

---

---

ownership are important strategies in moving people out of poverty. To date, Self-Help alone has provided \$102 million in home loans to underrepresented groups.

In December 2000, the New Markets and Community Renewal Initiative was passed, with provisions for a New Markets Tax Credit intended to spur \$15 billion in equity investment in low- and moderate-income rural and urban communities, and for several New Markets Venture Capital firms, with matching funds provided by the Small Business Administration for investments and technical assistance for small businesses in the same communities.

**PRIVATE EQUITY FUNDS ARE INVESTMENT PARTNERSHIPS OF \$100 MILLION OR GREATER THAT SPECIALIZE IN VENTURE CAPITAL, LEVERAGED BUYOUTS, MEZZANINE INVESTMENTS, BUILD-UPS, AND DISTRESSED DEBT.**

Private equity buyout funds are experiencing significant growth, so this may be an increasingly popular CDVC fund exit vehicle. For example, SJF Ventures has two current potential exits via this route in 2004. Over the past ten years, the private equity industry has increased the size of its leveraged buyout investments, and mega funds able to finance such investments have increased. One 2004 Harvard Business School statistic shows 24 funds greater than \$2 billion each. So if a CDVC fund exits its portfolio company via private equity fund buyout, employees who own options in the company may find their options have increased in value, but may not yet be in a position to exercise those options.

In order to successfully invest venture capital in small businesses, Dr. Timothy Bates notes that mission-driven venture capital funds must be “professionally managed, well-capitalized investment companies operating on a sufficiently large scale to diversify risks and hold down operating costs. In addition to having experienced, highly capable management, the CDFIs that profitably make equity-capital investments in small businesses possess strong private capitalization and a scale of operations in the \$10 million-plus total asset range ... These CDFIs do not rely on debt capital as a primary source of funds.”<sup>10</sup>

#### **D. CURRENT STATE OF CDVC**

As of the end of 2003, there were 68 active community development venture capital (CDVC) funds with a total of \$550 million under management, while an additional 11 funds were in development. The industry has enjoyed significant growth over the past ten years. Since 2000, CDVC capital under management has grown more than 62 percent, even as the general investment community has suffered in the challenging economic environment. CDVC funds continue to invest in geographic areas and industry sectors that are not the primary targets of the traditional venture capital community. In 2002, the sector's focus on creating and

---

<sup>10</sup> Bates, Timothy. “Government as Venture Capital Catalyst: Pitfalls and Promising Approaches,” *Economic Development Quarterly*, Vol. 16, No. 1, February 2002. p. 50.

---

---

retaining quality jobs for people without advanced degrees led to substantial investments in the manufacturing (39%) and service (20%) sectors. At the end of 2003, CDVCA estimates that the 68 actively investing CDVC organizations had invested approximately \$220 million, maintaining 22,000 jobs, and adding nearly 15,000 more. Two out of three of the jobs added went to low-wealth individuals.<sup>11</sup> For comparison, in 2003, conventional VC investments totaled \$18.2 billion in 2,715 companies,<sup>12</sup> and 113 venture capital funds raised \$10.8 billion.<sup>13</sup>

## **E. EXIT OPTIONS FOR CDVC FUNDS**

Substantial research has been done to explore alternative exit options for CDVC funds. In 2000, Boston Community Capital, with funding from the Ford Foundation, published a report titled “No Exit: The Challenge of Realizing Return on Community Development Venture Capital Investments,” as the first phase in the development of a reliable exit mechanism. BCC published a follow-up report in 2002 titled “Realizing Return: A Proposal for the Development of an Exit Vehicle for the Community Development Venture Capital Industry.” Based on an analysis of a number of possible exit options, BCC decided that a publicly traded holding company would be the most attractive option and would avoid the pitfalls inherent in many of the other exit strategy options.

BCC is currently creating a business plan for the publicly held company and is talking to fund managers about what characteristics of the publicly traded company would make it most attractive. In addition, the organization is exploring having the publicly traded company buy up companies from traditional VCs; that is, if a traditional fund is closing out and has some companies that could be successful but aren’t yet ready for exit, they have an option to sell to the publicly traded company. This institution has the potential to create a secondary market for VC and CDVC investments by providing another exit avenue.

## **F. CDVC FUND SURVEY RESULTS**

As part of this project, SJF surveyed 16 CDVC entities (23 separate CDVC funds under management) as well as three traditional equity investors (for a total of 19 funds surveyed) to document existing mechanisms to assist entry level employees of portfolio companies in building assets and, where possible, participating in the upside of investor exit. (See Appendix A for the funds surveyed.)

---

<sup>11</sup> Community Development Venture Capital Alliance.

<sup>12</sup> "Venture Capital Finishes At A Solid \$18 Billion For 2003," Price Waterhouse Coopers, January 27, 2004.

<sup>13</sup> "Venture Capital Fundraising Picks up in Fourth Quarter after Two Dormant Years," National Venture Capital Association, February 2, 2004.



Fund	Location	Geography Target	Portfolio	Notes
ACENet Ventures Fund	Ohio	Central Appalachia (27 counties)	25	Non-profit sub. of Appalachian Center for Economic Networks (ACENet)
Ben Franklin Technology Partners	Pennsylvania	Pennsylvania	200	Entrepreneurial development services and early-stage financing
Boston Community Loan Fund I and II	Massachusetts	Massachusetts (esp. Boston)	20	Affiliate of Boston Community Capital
Coastal Enterprises, Inc.	Maine	Maine	12	Non-profit community development corporation
Coastal Ventures I and II	Maine	Maine and national	33	Fund managed by CEI Ventures, a subsidiary of Coastal Enterprises
Enterprise Corp. of the Delta	Mississippi	Arkansas, Louisiana, Mississippi	8	Private, non-profit community development financial institution
Kentucky Highlands Investment Corp.	Kentucky	Southeastern Kentucky	N/A	First community development venture capital fund (1972)
Metafund Corporation	Oklahoma	Oklahoma	12	Non-profit community development financial institution
Mid-Atlantic Venture Funds	Pennsylvania	Mid-Atlantic US and national	49	Conventional venture capital fund
Minnesota Investment Network	Minnesota	Rural Minnesota	25	Invests equity directly and indirectly, by organizing fund pools
Mountaineer Capital LP	West Virginia	West VA and nearby states	9	Licensed as Small Business Investment Company
Murex Investments, Inc.	Pennsylvania	PA, New Jersey, Delaware	11	New Markets Venture Capital co.; sub. of <i>Resources for Human Development</i>
Northeast Ventures Corp.	Minnesota	Northeastern Minnesota	29	Non-profit CDVC affiliate, <i>Iron Range Ventures</i> , focuses on iron mining area
New York Community Investment Co.	New York City	New York State	52	Currently investing out of NY Small Business Venture Fund
Pacific Community Ventures I and II	California	California (esp. Bay Area)	N/A	Formerly Silicon Valley Community Ventures
ShoreBridge Capital, Ltd.	Ohio	Cleveland-area	9	Managed by Shorebank Enterprise Group
SJF Ventures	NC and PA	Eastern United States	15	Non-profit affiliate, <i>SJF Advisory Services</i> , provides technical assistance
The Barred Rock Fund	Vermont	Northeastern United States	11	Collaborates with Hot Fudge Social Ventures
TRF Private Equity	Pennsylvania	Urban markets in Mid-Atlantic US	14	Two funds: DVCRF Ventures and Urban Growth Partners
West Virginia Jobs Investment Trust Board	West Virginia	West Virginia	22	Public venture capital fund

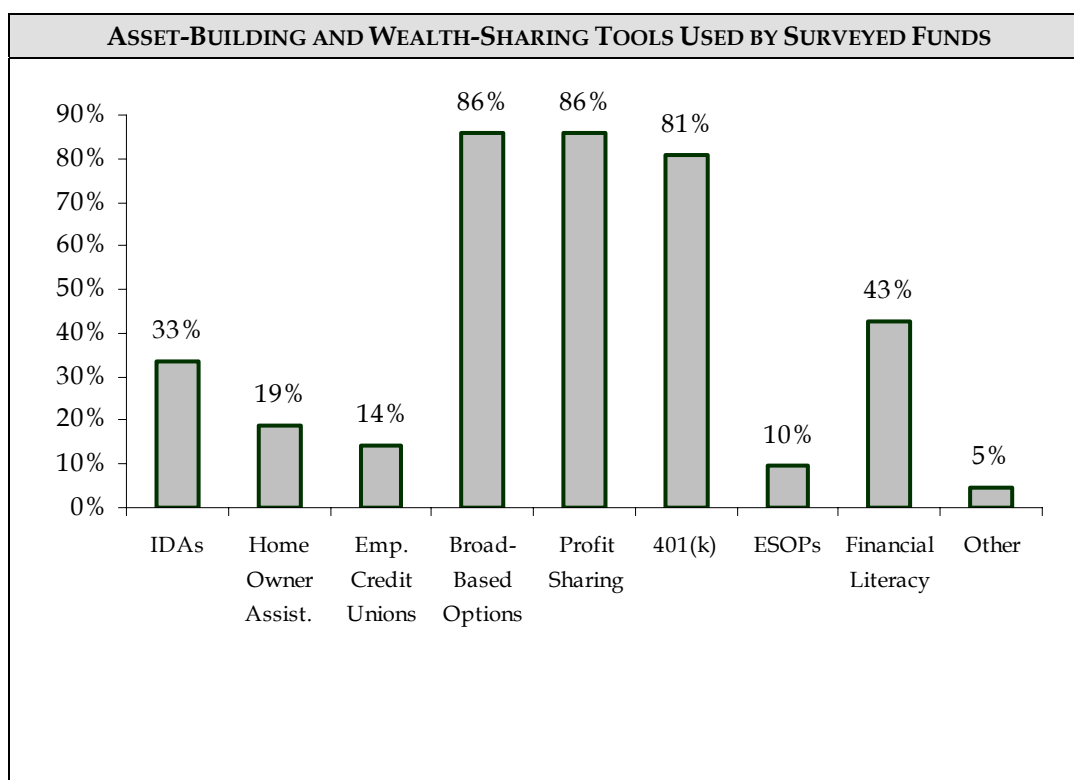
This best practices survey focused on asset building initiatives such as broad-based stock option plans, Employee Stock Ownership Plans (ESOPs), Individual Development Accounts (IDAs), retirement plans, profit-sharing or bonus structures and financial literacy programs. Additionally, SJF Advisory Services surveyed several portfolio companies of CDVC funds to better understand asset-building initiatives in place at those companies. A few have been included in this report as case studies. Survey results are summarized here and then described in more detail throughout the text in the appropriate sections.

---

---

## SUMMARY FINDINGS

Most funds surveyed share the goals of maximizing financial returns, retaining jobs, especially in economically distressed locations, and enabling employees at all levels to share in the gain upon fund exit, but these goals are prioritized differently based on individual fund parameters. Some funds, such as SJF Ventures, invest across a broad geographical area, and are primarily focused on attaining the best possible financial results while simultaneously encouraging asset building and advancement for portfolio company employees. Other funds have more narrowly focused investment areas, including Northeast Ventures, which invests in a seven-county area in Northern Minnesota, and ShoreBridge Capital, which provides debt financing for companies in and around Cleveland, Ohio. These funds, while being open to a wide range of possible exits, place a high value on retaining jobs in their target geography while maximizing financial returns.



Many of the CDVC funds surveyed have experience in exiting portfolio companies, and can speak directly to the issue of sharing financial benefits from the exit with employees. Chuck Lacy, president of the Barred Rock Fund in Vermont, stressed the importance of making sure that all employees share in the benefits generated by a company sale. Even funds that have yet to exit an investment have kept the issue of providing benefits, and shared exit up-side, to low-wealth employees at the forefront of their strategic thinking. For example, Pacific Community Ventures (PCV) is developing programs to deal with future exits and has worked with a human resources consultant to help develop broad-based compensation programs for several of its portfolio companies. Additionally, several CDVCs specify in portfolio company term sheets that a certain amount of

---

---

equity be dedicated to some type of 'to-be-determined' share program with all employees, not just top executives.

In general, CDVC fund managers surveyed said most portfolio company CEOs are open to the idea of creating wealth building initiatives for entry level employees. In addition to thinking about ways in which to share the financial benefits of the actual exit with all employees, most CDVC funds are dedicated to assisting non-management employees in accumulating assets during the period in which the fund is invested in its portfolio companies. Among the 20 funds surveyed, broad-based stock option plans, 401(k)s and profit sharing/bonus plans are established and utilized more often than other provisions to help generate asset building. However, the structure of broad-based option plans and how deep in the organization they actually reach varies widely.

### **EQUITY INCENTIVES**

A number of funds have helped their portfolio companies structure equity-based incentive compensation programs designed to align company and employee goals and provide an important asset-building mechanism for employees. Northeast Ventures' Greg Sandbulte says that "incentive compensation of all types is very attractive." Northeast has helped its companies structure performance-based compensation programs that involve stock awards, cash, or both, some of which have targeted middle- and upper-management only and some of which have been more broad-based in scope. According to Sandbulte, some of these plans have been tied to the company's revenue and profitability, and some have been very simple.

Bill Taylor, managing general partner of Mountaineer Capital in West Virginia, said that his fund only wants to use options if they will serve as an effective incentive – that is, if there is a sense that employees will value them. Mountaineer tries to make sure an option program is put into place in almost every company in which they invest, often building an option agreement into the term sheet. Each option plan has two parts: non-qualified (for consultants and other contributors, such as board members, who are not eligible for qualified) and qualified, for employees. The fund has been successful at negotiating these plans with management.

Other funds have found, in many cases, that stock option plans were already in place at the time of investment, but via participation on board compensation committees, CDVC fund managers were able to either encourage the adoption of more broad-based option plans, or help structure existing plans to apply to all employees, not just top management.

All but one of Barred Rock's nine portfolio companies, for instance, have a stock option plan in place, some of which hold options in reserve and a number of which have already been issued. Finally, some funds have started to explore more creative alternatives to traditional incentive stock options, such as phantom stock, which serve much the same purpose as ISOs but do not require employees to pay cash in order to exercise the option and do not dilute the equity value of the company.

---

---

## **IDAs AND ESOPs**

Individual Development Accounts (IDAs), home ownership assistance, employee credit unions, financial literacy programs and ESOPs were not used as frequently by the 20 surveyed funds. One fund, Coastal Enterprises in Maine, operates an IDA program for the state of Maine through its parent nonprofit. This is marketed to the whole state and not specifically to employees of companies invested in by the organization's two venture capital funds. In addition, PCV in California is developing an IDA program in conjunction with local nonprofit and bank partners, but it will be specifically targeted to employees of PCV portfolio companies. Other CDVC funds, such as SJF Ventures, have linked portfolio company employees to existing IDA programs offered by local nonprofits.

A few CDVC funds surveyed have had experience with ESOPs, and some, such as CEI, have gone so far as to target ESOPs with certain portfolio companies as a "mutual goal" of the fund and company in initial term sheets. Northeast Ventures' Sandbulte views ESOPs as an attractive exit strategy for companies with modest year-to-year growth, predictable cash flows, and workforces of 25 or more. While these companies might not appeal to financial buyers, they are often good candidates for strategic sale exits. According to Sandbulte, Northeast Ventures would be willing to sacrifice some – though not much – of the financial upside of a strategic sale that would relocate the company in order to secure the local jobs with an ESOP exit strategy.

## **NO ONE-SIZE-FITS-ALL**

Finally, while substantially all of the funds recognize the importance of asset-building, some are addressing the issue using both direct and indirect approaches – Barred Rock, for instance, feels that health insurance is their number one priority, because without health insurance employees cannot expect to save any portion of their incomes. "There's no point since some time down the line a medical emergency will arise and wipe out savings," says Chuck Lacy. A key point that a number of funds emphasized was the importance of developing workforce performance and incentive plans that fit the needs of the particular companies, rather than using a one-size-fits-all approach.

---

---

*“For the vast majority of households, the pathway out of poverty is not through income and consumption, but through saving and accumulation.” – Michael Sherraden*

## **II. MAKING THE CASE FOR EMPLOYEE ASSET BUILDING AND EQUITY OWNERSHIP**

Community development venture capital funds encourage portfolio companies to pay employees competitively and, where possible, a living wage for the local geography. This, along with good benefits, opportunities for skill building and a clear career path, can allow employees to advance from entry-level jobs into higher-level and more lucrative positions. However, even with a dependable income, individuals cannot always move out of poverty. Studies have shown that the key factor in moving out of poverty is accumulation of assets such as savings accounts and homes. As a result, CDVC funds are increasingly focused on helping their portfolio companies develop effective asset-building programs targeting low-wealth employees. The CDVC funds surveyed for this report have diverse perspectives on how best to accomplish this goal, and are using a variety of tools.

Asset-building can hold powerful social impact for low-wealth employees, with the potential for strongly positive secondary impacts on these employees’ families and communities. According to Michael Sherraden, Benjamin E. Youngdahl Professor of Social Development at the Washington University and one of the first champions of matched savings in the early 1990s, “social policy for the poor has been focused almost entirely on income ... [yet] for the vast majority of households, the pathway out of poverty is not through income and consumption, but through saving and accumulation. When people begin to accumulate assets, their thinking and behavior changes ... [B]ehavioral effects of asset accumulation are likely to include more long range planning, better care of property, increased learning about financial affairs, and increased social and political participation.”<sup>14</sup> Other research bears out the positive impact of asset-building, indicating that financial assets can have positive health effects and increase marital stability, while home-ownership can reduce the length of temporary periods of unemployment by a minimum of 11.6 weeks.<sup>15</sup>

The other key point made by Sherraden in his seminal 1991 book *Assets and the Poor: A New American Welfare Policy*,<sup>16</sup> which proposes the creation of IDAs as a vehicle for savings, is that the U.S. tax code is set up to support asset accumulation for the middle and upper classes (via home mortgages, retirement plans, and other vehicles), but not for the poor.

---

<sup>14</sup> Sherraden, Michael. Testimony: “Assets and the Poor: Implications for Individual Accounts and Social Security.” Center for Social Development, Washington University in St. Louis, 2001. p2

<sup>15</sup> Oliver, Melvin and Thomas Shapiro. *Black Wealth/White Wealth*. Routledge. March 1997.

<sup>16</sup> Sherraden, Michael, *Assets and the Poor: A New American Welfare Policy*, M.E. Sharpe, March 1991.

---

---

There is a long tradition in the CDFI lending community of the importance of asset building. One leader in the field is the Self-Help Credit Union, which specializes in providing home loans for customers traditionally underserved by banks, including those who have difficulty obtaining financing with a conventional lender because of credit or other problems. As Self-Help's website states, "Owning assets, such as a home, can enable a family to send a child to college, start a business, or weather a financial crisis. Ownership provides communities with a solid foundation on which to grow and prosper."<sup>17</sup>

*"[Equity is] one mechanism that can absolutely change people's lives. It can make their lot easier. It can help them send their children to college. It can enable them to buy a home. It can support the charities they care about. It can give them something to look forward to in retirement. It can significantly enhance their quality of life in many ways."<sup>18</sup>—Jack Stack*

One possible cost associated with utilizing equity-based compensation vehicles in a private firm is related to establishing the awards' per share value. Unlike in a public corporation, where the market sets the value of the firm's equity, private firm equity must be valued either using a formula or an independent appraisal, and then must be periodically revalued in order to assess the fair price for employees who wish to exercise their options or sell their shares.<sup>19</sup> Private firms must also put into place systems that restrict the sale of company stock back to the company, in order to prevent cash flow stress associated with large blocks of stock being sold at once.<sup>20</sup> Administrative costs like this, along with the costs incurred to educate the workforce about the value and logistics of equity compensation, can add up.

## **EMPLOYEE OWNERSHIP**

Equity ownership beyond the management level is a powerful tool for the CDVC industry, as a performance incentive, an asset-building tool, and a channel for allowing all employees to share in the financial upside of CDVC fund exit. Properly implemented employee ownership can lead to better company performance (and, ultimately, higher financial returns to investors) largely because of the sense of responsibility and focus on bottom-line company success felt by all employees. Equity ownership also provides a unique opportunity for non-management employees to share in any exit upside along with management and investors. This issue is particularly important when considering exits that might entail job loss, as the conversion of equity to cash upon a liquidity event can provide a nest-egg or safety-net during post-exit job search, but is relevant to all types of fund exits – even those where the jobs remain.

---

<sup>17</sup> [Http://www.self-help.org/aboutus/whoweare.asp](http://www.self-help.org/aboutus/whoweare.asp).

<sup>18</sup> Stack, Jack and Bo Burlingham, *A Stake in the Outcome: Building a Culture of Ownership for the Long-term Success of your Business*. Doubleday, 2002, p. 13-14.

<sup>19</sup> McMillan, John D. and Hoyt W. Doyel. "Sharing Stock in Private Companies," *Personnel Journal*. Vol. 69, No. 6 June 1990.

<sup>20</sup> Todd, Paula H. "What Privately Held Companies Should Know About Stock Compensation Plans," *Compensation and Benefits Review*. Vol. 23, No. 6. Nov/Dec 1991.

---

---

Numerous studies have shown that companies with broad-based employee ownership, where employees have some decision-making power and also fully understand how their role contributes to the overall financial success of the endeavor, perform better than those without those components. The research of Rutgers professors Sesil, Kruse and Blasi, for example, indicates that firms that grant broad-based stock options to employees perform better than otherwise similar firms that do not grant options broadly. This finding holds across the economy, in high-technology firms and in union and non-union firms.<sup>21</sup>

In another book by some of the same authors, Blasi, Kruse and Bernstein call their model “partnership capitalism” or “stock option capitalism.” “Employees assume some of the risk of ownership in return for a claim on part of the wealth they help to create. Investors, for their part, risk parting with some of their ownership in the hope that doing so will create even greater wealth than they had before. ... The goal of partnership capitalism, then, is to get employees to think of themselves as owners. Doing so motivates employees to work smarter or harder, bringing about a more productive company and, ultimately, rewarding employees and outside shareholders alike.”<sup>22</sup>

To be specific, comparing the performance of American companies that use the “partnership approach” with those that do not shows “a one-time, but permanent, boost in a company’s productivity of about 4 percentage points, compared to what it would have been without employee ownership. Total annual shareholder returns go up by an average of about 2 points.”<sup>23</sup>

Watson Wyatt’s second Human Capital Index study of more than 400 North American large public companies also confirms these results. “Superior human capital practices are not only correlated with financial returns, they are, in fact, a leading indicator of increased shareholder value.”<sup>24</sup> And “...the best performing companies did not simply have better-funded programs, they had entirely different programs than the poorly performing companies. The high performers employed certain programs (e.g., broad-based stock options) that low performers did not.”<sup>25</sup>

*“When employees are motivated and given more leeway to make decisions on their own, it spurs innovation and performance from the bottom up... They’re also more likely to remain at the company for the long haul, reducing expensive turnover and helping the company retain needed skills. In addition, the prospect of economic gain from the company’s stock helps them to focus on*

---

<sup>21</sup> Sesil, James C., Douglas L. Kruse, Joseph R. Blasi. “Sharing Ownership via Employee Stock Ownership,” Discussion Paper No. 2001/25, World Institute for Development Economics Research (WIDER). July 2001. p14.

<sup>22</sup> Blasi, Joseph, Douglas Kruse and Aaron Bernstein, *In the Company of Owners: The Truth About Stock Options and Why Every Employee Should Have Them*, Basic Books, 2003, p. xiii.

<sup>23</sup> *Ibid*, p. xiv.

<sup>24</sup> *Human Capital Index: Human Capital as a Lead Indicator of Shareholder Value, 2001/2002 Survey Report*, p.1.

<sup>25</sup> *Ibid*, p. 4.

---

---

*the company's broadest objectives, with an eye to what's most likely to turn a corporate profit<sup>26</sup>.*—Blasi, Kruse & Bernstein

---

## **OPEN-BOOK MANAGEMENT**

Jack Stack, the CEO of SRC Holdings Corporation (formerly Springfield ReManufacturing Corporation), helped his company grow from a small, struggling concern in 1982 with a \$.10 share price to a large and successful company with shares each worth about \$87 today. Strategies that helped to make the company a success include broad-based stock ownership, participatory decision-making, and open-book management. He is one of the authors of *The Great Game of Business*, tools for open-book management. In his book, *A Stake in the Outcome*, Stack outlines some strategies for making employee ownership work.

Stack's Ownership Rule #1 is: "The company is the product. If you want to build a culture of ownership, people have to understand that they have a direct role to play in creating the kind of company they want, and that creating such a company is their responsibility and the ultimate goal of the enterprise, the end result of all their efforts."<sup>27</sup>

But ownership alone is not enough, says Stack – developing a system of "ongoing business education" is key. "It's all about leveraging the informal training process, using the regular routines of the company to promote continuous learning. A bonus program may help you hit certain goals and put some extra money in the pockets of your employees, but you'll miss the greatest potential benefit if you don't make the connection to learning. ... Nobody can think and act like an owner without understanding the basic rules of business, and most people don't understand them."<sup>28</sup>

Other researchers concur with the need for both actual equity ownership and some degree of open-book management for effective employee ownership. "The two fundamental aspects of ownership include: firstly, the rights of 'residual rights of control,' which is the right to make decisions ... secondly, the right to 'residual returns,' which is the right to revenues left over after all obligations have been met. According to Milgrom and Roberts, it is the combination of these two rights [that] provides the individual incentive effects of ownership. The combination is seen to be the most powerful incentive due to the fact that the person making the decision bears the financial results of their decision."<sup>29</sup>

---

<sup>26</sup> Blasi, Joseph, Douglas Kruse and Aaron Bernstein, *In the Company of Owners: The Truth About Stock Options and Why Every Employee Should Have Them*, Basic Books, 2003, p. 38.

<sup>27</sup> Stack, Jack and Bo Burlingham, *A Stake in the Outcome: Building a Culture of Ownership for the Long-term Success of your Business*. Doubleday, 2002, p. 10.

<sup>28</sup> Ibid, p. 8.

<sup>29</sup> Sesil, James C., Douglas L. Kruse, Joseph R. Blasi. "Sharing Ownership via Employee Stock Ownership," Discussion Paper No. 2001/25, World Institute for Development Economics Research (WIDER). July 2001. p5.



---

---

*Companies find option programs attractive because they offer a powerful financial incentive to employees without burning cash; shareholders like them because they believe that option programs align employee long-term interests with that of the company; and employees appreciate that option programs allow them to control the timing of income for tax purposes and to benefit from increases in the market value of the company's stock.*

### III. BROAD-BASED STOCK OPTIONS

**BROAD-BASED STOCK OPTION PLANS:** PROGRAMS WHICH ALLOW EMPLOYEES AT ALL LEVELS THE OPPORTUNITY TO BUY COMPANY STOCK AT A SPECIFIED PRICE DURING A PARTICULAR PERIOD ONCE THE OPTION HAS VESTED.

#### OVERVIEW

Conventional venture capital firms often include a requirement for a management option plan of up to 20% of the fully diluted stock of a company in which they are investing. If the management team is mostly in place and already has equity incentives, for example, through founder stock, the option plan percentage may be lower. However, if significant management team additions are anticipated, a higher amount may be set aside to attract top quality talent willing to work for somewhat less cash compensation in pursuit of an equity gain. These options plans have primarily focused on the most senior management positions. CDVC firms have been innovators at encouraging a more expansive view of option plans that involves all long term employees and provides a more broad based incentive plan, as described in this chapter.

The past decade has seen substantial growth in the use of broad-based stock option plans, much of it in high-tech firms. As of 2001, The National Center for Employee Ownership (NCEO) estimates that up to 10 million U.S. employees receive stock options. In 1999, 1.7% of all private industry employees received stock options, according to a pilot survey of stock option incidence conducted by the Bureau of Labor Statistics of the U.S. Department of Labor. The proportion of non-executive employees offered stock options ranged from 0.7% for those earning less than \$35,000 to 12.9% of those earning \$75,000 and above. The percentage of employees who received stock options also ranged by industry, from 0.2% in nondurable manufacturing industries to 5.3% in durable manufacturing industries, and by geographic region, from 1.1% in the Northeast to 2.1% in the West. After-hire grants--grants offered to employees after the initial hiring (or signing) phase of employment--made up the majority of stock option grants.<sup>30</sup>

---

<sup>30</sup> "Pilot Survey on the Incidence of Stock Options in Private Industry in 1999," US Department of Labor, Bureau of Labor Statistics. October 11, 2000. (<http://www.bls.gov/ocs/sp/ncnr0001.pdf>)

---

---

Companies that offer stock options tend to be larger, with greater numbers of employees and higher levels of sales and capital intensity. Companies with stock options are more likely to be found in manufacturing (including high-technology) and service sectors than in retail or wholesale trade.<sup>31</sup>

## **EXPENSING OPTIONS**

Recently, stock options have been called into question somewhat, in large part due to the corporate scandals at Enron and WorldCom as well as the declining stock market (and related decline in the value of equity-based compensation). This report will not deal with most of these issues except for the following brief summary, as they are generally not relevant to the private companies in which CDVC funds invest.

*“Clearly, stock options helped drive the extraordinary 10-year bull market that abruptly ended, and it also appears that stock options, given their motivational power, could help end the current bear market and recession. However, potential dilution levels, as measured by overhang (options already granted plus those remaining to be granted, divided by total shares outstanding), are higher than ever, and a very large percentage of these options are underwater ... Looking ahead, the use of stock options for motivating employees to think like owners will continue, and firms will also increase their use of direct stock ownership.”<sup>32</sup>—Richard Beal*

The Financial Accounting Standards Board (FASB) announced at its October 29, 2003 meeting that, in line with the International Accounting Standards Board (IASB), it would be instituting new standards for equity compensation expensing, effective in 2005. Under the new standards, companies would be required to expense stock options according to a specifically mandated accounting method. Only equity awards granted after the effective date of the new rules will be affected.<sup>33</sup> Legislation has been put forth to mitigate the impact of these new standards on lower-level employees and small businesses, although the results of the passage of these new standards and/or the legislation remain unclear.

In August 2003, Deloitte and Touche published a survey of 196 public and private companies' plans for equity compensation programs in response to the new option expensing regulations. Of the respondents, most of which are in the technology sector, 69% of public companies and 96% of private companies currently offer options to 90% or more of their employees. Following the regulatory shift, 45% of these public companies and 70% of these private companies have no intention of changing their option programs.<sup>34</sup>

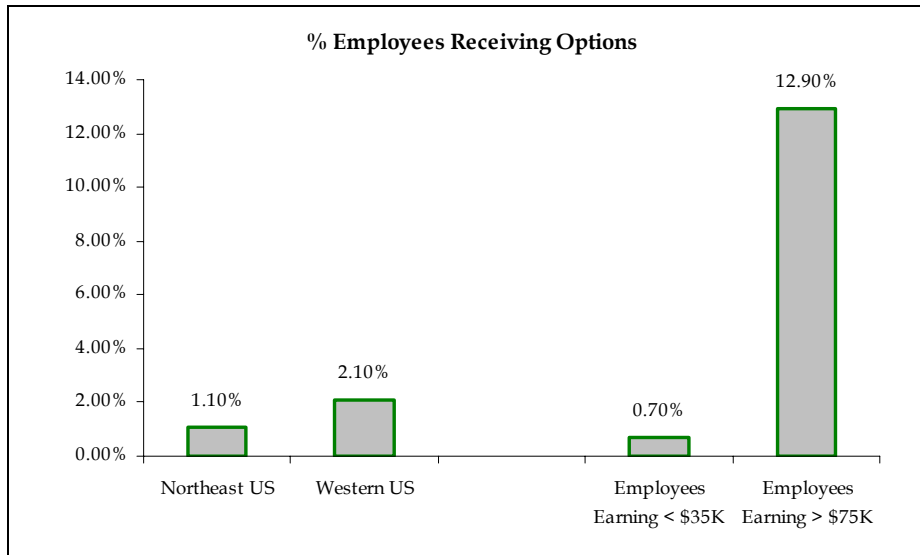
---

<sup>31</sup> Sesil, James C., Douglas L. Kruse, Joseph R. Blasi. “Sharing Ownership via Employee Stock Ownership,” Discussion Paper No. 2001/25, World Institute for Development Economics Research (WIDER). July 2001. p10.

<sup>32</sup> Beal, Richard F. “Designing Compensation for the New Realities,” *Financial Executive*. Financial Executives Institute, Morristown, NJ. March/April 2002.

<sup>33</sup> Employee Ownership Report, January / February 2004.

<sup>34</sup> “Will Broad-Based Equity Survive Expensing? 2003 Deloitte & Touche Stock Compensation Surveys: Looking Beyond Options,” Employee Ownership Report. Volume 24, Number 1. January/February 2004.



Source: US Department of Labor, Bureau of Labor Statistics

Many entry-level employees do not have much income and value cash in hand over stock options that may never have worth. Financial literacy programs are essential to explain to employees the value of stock options, how they work, how they are valued and how they can offer potential long-term growth options and incentives. In the ideal scenario, all employees fully understand the benefits of having stock options and are therefore motivated to work harder to ensure company success. It is important to note that stock options are extra, not offered in lieu of salaries, bonuses and profit sharing.

#### A. INCENTIVE STOCK OPTIONS VS. NON-QUALIFIED STOCK OPTIONS

**INCENTIVE STOCK OPTION (ISO):** AN OPTION TO PURCHASE COMPANY STOCK AT A SPECIFIED PRICE FOR A SPECIFIED PERIOD OF TIME. ISOS CAN ONLY BE USED FOR COMPANY EMPLOYEES AND THE EXERCISE PRICE MUST BE SET AT FAIR MARKET VALUE AT THE TIME OF THE AWARD. ISOS QUALIFY FOR FAVORABLE TAX TREATMENT.

There are two primary classes of stock options: incentive stock options (ISOs) and non-qualified stock options (NSOs). To be clear, “incentive stock option” is not a general term used to describe stock options used as incentives for employee performance. Rather, it is a legal term that refers to a special type of stock option that meets the requirements of IRS Code Section 422. These requirements include: (1) the option price must not be set at less than the fair market value of the company’s stock at the date of award; (2) the option may only be granted to an employee of the company; and (3) the option may not be exercisable for a period longer than ten years from the date of issue, and must be exercised by the employee no later than three months after termination of employment.

**NON-QUALIFIED STOCK OPTION (NSO):** AN OPTION THAT DOES NOT QUALIFY FOR FAVORABLE TAX TREATMENT.

---

---

MAY BE USED FOR EMPLOYEES, OR FOR NON-EMPLOYEES SUCH AS CONTRACTORS OR BOARD MEMBERS.  
EXERCISE PRICE MAY BE SET AT LESS THAN FAIR MARKET VALUE.

The primary advantage to employees of an ISO is exemption from regular income tax both upon receipt of the option and upon exercise, and the potential for capital gains treatment on any gain realized upon the ultimate sale of stock. Note that in order to qualify for this favorable tax treatment, employees must hold the stock for at least two years after the option is granted and at least one year after the option is exercised. In contrast, NSOs are not subject to Section 422 regulations, which gives companies considerably more flexibility when pricing options and awarding them (to non-employees such as contractors or partners, for instance). ISOs can cost a company more than NSOs, because the company is not entitled to a tax deduction in connection with amounts received by the ISO option-holder (if the option-holder qualifies for capital gains treatment).<sup>35</sup>

### **CASH-LESS EXERCISE**

Of special interest to CDVC funds is the fact that it is possible to organize a cash-less exercise for both ISOs and NSOs by cashing out enough options to provide cash to pay for the exercise of shares and taxes due. This could be an excellent strategy for entry-level employees. In the case of a private company that wishes to award ISOs to its employees, fair market value can be ascertained according to a “good faith determination” by the company’s Board of Directors.

### **OPTION PLAN USE WIDESPREAD IN CDVC**

Many CDVC funds surveyed believe that it is important to obtain agreements on the part of company management at the time of investment to set aside some percentage of fully diluted stock (between two and ten percent, depending on the fund) to be distributed across all employee levels. Twelve (81%) of the CDVC funds surveyed utilize broad-based stock options in their portfolio companies and many include such provisions in their term sheets. The West Virginia Jobs Investment Trust (JIT) is an example of a CDVC fund in which provisions for employee stock options negotiated up-front. JIT ensures that every deal includes reward incentives for non-management employees.

CEI advocates more generally for both stock option plans and ESOPs. At the time of investment, Pacific Community Ventures (PCV) requires its portfolio companies to set aside an explicit percentage of company equity for non-management employees. The fund then provides resources, usually in the form of a human resources consultant, to help develop compensation plans that best meet the individual needs of the company. A number of funds surveyed reported that their portfolio companies have stock option plans, although they are

---

<sup>35</sup> Kroll, Arthur H. “Stock Option Strategies: Recent Developments,” *Compensation & Benefits Management*. Aspen Publishers, Inc. Summer 2002. 36.

---

---

not always broad-based. SJF Ventures has included provisions for broad-based stock options plans in most of its term sheets, with SJF Advisory Services assisting firms in developing specific plans tailored to the needs of individual portfolio companies.

### **QUESTIONING BROAD-BASED OPTIONS**

Some CDVC funds, like Kentucky Highlands Investment Corporation (KHIC), are skeptical about the use of stock option plans for entry-level employees for portfolio companies. KHIC believes that “paying” employees with stock options can be quite risky. If there is a successful fund exit, and everyone benefits financially, then stock options are useful. However, if employees are awarded options when the business is successful, but then the company fails or the exit is not financially rewarding enough to benefit all stakeholders, then the employees will receive little or no financial benefits and may feel cheated. KHIC does not believe that stock option plans are the best method to help employees build personal wealth.

The concern has also been raised that employee ownership subjects employees, especially low-wealth employees, to excessive risk, in that the value of the financial assets the employee is accumulating and the security of the employee’s job are highly correlated. However, equity ownership should be considered a separate cash flow – options are not in lieu of salaries, bonuses, and profit sharing but rather are a reward for years of service in making the company successful.

JIT has found that in struggling companies, lower level employees may question the value of options, and that distrust of management’s motives may develop. Elyse Cherry of the Boston Community Venture Fund (BCVF – an affiliate of Boston Community Capital) is concerned that stock options will burden low-wealth employees with non-liquid shares in a company where they have minimal control. Although there are stock option plans in most of BCVF’s portfolio companies, Cherry believes the most effective tool for helping low-wealth employees share in company success is profit sharing.

### **A VARIETY OF OWNERSHIP TOOLS**

There are also funds, such as The Reinvestment Fund/Urban Growth Partners, that believe in sharing the financial upside of a successful exit with all employees, but not via any one particular method. Joe Killackey, a former Managing Director of TRF Private Equity and currently a founding partner of Opportunity Growth Fund (in formation), says that the fund is “opportunistic” in terms of using particular wealth building strategies. “We’re not doctrinaire about stock options – we have them for key management, and are experimenting with a variety of ownership tools” for lower-level employees. The fund tries “to make sure there’s something for every tenured employee in terms of stock ownership or profit sharing, even phantom stock, so there is the broadest possible distribution.”

---

---

The type and number of options can depend on the industry of the portfolio company. The New York Community Investment Company (NYCIC) has funded many technology companies that often grant options to all key employees. In many cases options are granted across the board, but in these companies there are not a lot of entry-level jobs. Sales people have volume-based bonuses and often have fewer options.

A key issue to consider when using options is the dilution factor, in that every option granted potentially dilutes the interest of the investors (and initial equity-holders, such as management). Mid-Atlantic Venture Funds, a traditional venture capital investor, uses stock options broadly but more typically for management than non-management.

Many CDVC funds have had good experiences with broad-based distributions of equity proceeds on exit, including:

**CASE STUDY: CV FINER FOODS (WORLD HARBOR)**

At CEI's portfolio company CV Finer Foods (World Harbor) of Auburn, ME, a significant number of employees had ownership shares of the company when it was sold to a competitor. There was a profit from the transaction and there were some broad-based distributions even though no formal plan was in place. For instance, the office manager was awarded additional stock upon exit. CEI had a general goal to retain CV Finer Foods' jobs, and this goal was met: the acquirer not only retained employees, but built a new building and brought in more jobs from New Jersey.

**CASE STUDY: MINNCORP.**

One of the Minnesota Investment Network Corporation's former portfolio companies had a stock option program, a bonus plan and a profit-sharing plan in which the Board approved a percentage of net profits to be allocated to most employees. The company was sold to a strategic partner; it wasn't relocated and most employees who had been there more than a year received options.

---

---

## **CASE STUDY: ALPINE MEDICAL**

### Financial Impact of Exit

As part of the sale, 3% of the total equity value of the company was distributed to non-management employees, with a third going to middle management and two thirds going to line workers. A total of \$1.2 million was distributed to 125 employees (20 middle managers and 105 line employees).

At the time of DVCRF investment, 7.5% of the company's stock was set aside for senior and middle management. A founding group of employees held original stock in the company. At that time, the company also articulated its intention to provide options to non-management employees. Upon exit, many managers had received options awards. For those employees who hadn't received options, including some middle management and all line workers, another \$300,000 was set aside and distributed based on productivity. Productivity was subjectively determined by Alpine President Tom Smith, based on the effect employees had had on making the company successful. All employees received some financial benefits, ranging in size from a few weeks' pay to close to \$50,000 for one middle manager. According to Smith, the \$300,000 had not been set aside ahead of time because DVCRF and the company were not expecting the sale. The funds, therefore, came at the expense of shareholder return. In effect, stock options in this case were used as an incentive for senior managers and middle managers, rather than line employees.

### Other Impacts of Exit

Because Praxair Healthcare Services wanted to continue serving the geography that Alpine served, the acquired company was able to obtain job security for some employees. Alpine negotiated for Praxair to take over the employment contracts for employees, most of which were effective for another two years. "Our philosophy from a business perspective was that the company is only as good as the people," said Smith.

### Compensation Strategies

Smith described the company's primary compensation strategy as one designed to attract and retain high quality employees. "Philosophically, we wanted to create high paying jobs with good benefits," said Smith. "We were not solely focused on an exit strategy. We wanted to pay employees well and have the best reputation and retain people. If there was an exit, we wanted there to be money left so that employees could share in that." According to Smith, "We tried to pay people towards the high end of the pay scale. We [also] had a great benefits package in terms of what people paid out of pocket."

Alpine approached ongoing equity compensation as an incentive-based program. "We looked at how inclusive we needed to be with the stock option plan. We needed to have a bonus structure in place that could touch everyone but didn't believe that just because you were an employee you necessarily would get options. We wanted it to be performance related," Smith said.

### Lessons Learned

Although an exit was not being planned, Alpine was able to quickly take advantage of the opportunity. With the help of DVCRF, Alpine was able set up a fair plan for employees that both kept the local facility open and most jobs in place for up to two years and also made cash distributions to almost everyone. "Our role as board members was key," said Joe Killackey, a former Managing Director of DVCRF.

---

---

### **CASE STUDY: DDF COSMETICS**

In April 2004, SJF exited its stake in DDF Cosmetics, a manufacturer of upscale skin-care products with a facility in an Empire Zone in Yonkers, NY. DDF has grown from 75 employees and \$4.5 million in revenues when SJF invested in 2001 to more than 125 employees and just under \$15 million in revenues for 2003. The company sold a majority stake to North Castle partners, a private equity firm that specializes in the healthy living sectors. North Castle's investment will bolster DDF's sales and marketing capacity and also allow the company to stay on the cutting edge of advances in the industry by providing the capital required to advance research and product development. SJF realized a return of three times invested capital in less than three years as part of the transaction.

DDF pays competitive wages and offers good benefits. In addition, the company has a broad-based option plan with 35 participants, 9 of whom are senior management (holding 77% of the option pool) and 26 of whom are mid-level managers, supervisory level team members who worked their way up, or production level team members who are working their way up (who together hold 23% of the option pool). With the recent transaction, the value of these options has increased, and more non-management will be eligible for option awards in July.

### **SJF VENTURES' EXPERIENCE WITH BROAD-BASED STOCK OPTIONS**

With support from the Duke Community Economic Development Law Clinic, SJF Advisory Services has assisted five SJF Ventures portfolio companies with specific challenges related to broad-based employee stock option plans. In the first two cases, the companies had existing stock option plans put in place prior to SJF's investment in the companies, but each had questions such as how to adjust the structure of the plans in order to meet current goals for attracting and retaining both management and non-management. Issues included underwater options that had to be cancelled and reissued at a different strike price, and a mix of qualified and nonqualified options that had to be cancelled and reissued as qualified for tax reasons.

In the other three cases SJF played a key role in developing and implementing the stock option plans (see the discussions of Ryla and CitySoft below).



---

---

### **CASE STUDY: RYLA TELESERVICES**

Ryla Teleservices (the subject of the 2004 CDVCA conference case study) was SJF's first chance to devise an option plan from scratch. The CEO, Mark Wilson, wanted to reward key managers who had taken the risk to leave their jobs at D&B and come to his start-up, along with current and future managers and rank and file employees. Rick Larson, the SJF Ventures Managing Director on the compensation committee of the company's board, and Anne Claire Broughton, Director of SJF Advisory Services, poured over materials supplied by the Duke CED Law Clinic (see Appendix C, Explanation of Broad-Based Option Plans) to decide on SJF's recommendations for the structure of the equity compensation plan.

The company decided to issue restricted stock awards (RSAs) for the key managers who had taken the most risk upfront, leaving secure jobs at D&B to start this new venture. This would give them stock right away. The current and future management employees would receive incentive stock options as part of the option pool set aside at the time of SJF investment. The rank and file employees would be part of a phantom stock option plan, which would not dilute the existing option pool and also would be better from a tax standpoint for lower level employees, as the proceeds from a phantom plan are triggered at a liquidity event and are taxed as ordinary income.

An ESOP was discussed, as Mark expressed some interest in holding on to the company longer term. This would be a way both for SJF to get its money back and for employees to benefit from greater company ownership. However, as time passed it became clear that Mark would probably consider a company sale at the right time and the right price.

The Duke Economic Development Law Clinic helped secure the pro bono legal services of a local Atlanta law firm to draft the legal documentation for the equity plans, and at the time of this writing, the RSAs had been granted, the ISO implemented and the phantom plan was in process.

### **CASE STUDY: CITYSOFT**

SJF Ventures portfolio company CitySoft had a stock option plan dating back to 2001 and had long planned to issue broad-based options so that all employees could share in the company's success. However, due to the hectic pace of a small emerging business, the options were never finalized. SJF Advisory Services worked with the Board's Compensation Committee to come up with a fair method for allocating options to all employees. Most were issued ISOs, with the exception of a few key board members and one contractor who had worked with the company for many years.

SJF Advisory Services then drafted stock option agreements and a memo to explain the new allocations to the staff, and will participate in a briefing with the Compensation Committee and employees to explain the new allocations. Having the option plan in place is expected to result in broad-based distribution of the proceeds of a future exit.

---

---

### **CASE STUDY: WHITE WAVE/DEAN FOODS**

White Wave, a maker of soy products, was sold to Dean Foods in 2002 for \$189 million. Of the sale price, employees and board members received \$17 million. The award to employees was put in place before the deal was signed, and was structured to both reward employees and also motivate them to stay with the company. The plan had two parts. One was an option plan consisting of 5% of the value of the company at the time (about \$10 M) set up for midlevel management and higher, including board members. Then another \$7 million, or 5% of the sale proceeds to the five major investors in the company, went to tenured employees with at least three years of service. For every year of employment, employees received \$15,000. Of this, a third was paid in cash, a third was paid in ordinary income taxes (which is an interesting strategy when rewarding lower-level employees who might not have the cash to pay the income taxes on extra cash received through bonuses or the sale of stock), and the other third was held in escrow for two years gaining a small amount of interest while person still employed there. The company also held financial planning seminar to help employees deal with this financial windfall.<sup>36</sup>

---

<sup>36</sup> "The Deal With Dean," *Lohas Journal*, Fall 2002

---

---

## CASE STUDY: “ENGAGED INDUSTRIAL SERVICES” & “STEADY MANUFACTURING CORP.”

This report contains many case studies on how employee asset building, broad-based stock options, and workforce involvement have enhanced company performance. However, due to confidentiality issues, we have not been able to provide comprehensive financial data in the case studies.

In order to provide a more detailed financial illustration, we have created the fictional case of **Engaged Industrial Services, Inc.** and **Steady Manufacturing Corp.** Both are portfolio companies of CDVC funds, are in similar high-tech manufacturing industries in the U.S, have about five years of operations, have sales of \$20 million, and employ about 50 people. In both companies, the CDVC fund owns a 33% stake. But the two companies differ on some key points.

**Engaged Industrial Services (EIS)** has strong employee benefits such as a great training program, majority employer-paid health insurance, and a retirement plan. In addition to a management stock option plan, EIS has a broad-based incentive stock option plan (consisting of 5% of the fully diluted capitalization) to which all employees who have been with the company for more than one year belong. This is coupled with a system of open-book management whereby all employees understand the company’s business model and goals. EIS experiences very low turnover and has a very engaged workforce. The company has growing sales and a 10% EBITDA margin, and makes a high-quality product.

**Steady Manufacturing**, on the other hand, has a health insurance program to which most non-management employees don’t belong, a weak training program, and stock option plan only for management. The company spends a great deal of time and money on recruitment and training, as it has very high employee turnover. The company has stable sales and a 7.5% EBITDA margin.

### Acquisition

Both Engaged Manufacturing and Steady are profitable and become attractive to acquisition partners, and both are sold. The **enterprise sale price for Engaged Manufacturing is \$14 million** or 7X EBITDA due to its rapid growth and motivated workforce. **Steady sells for an enterprise value of \$7.5 million** or 5X EBITDA, due to a strategic fit with the buyer despite its lack of growth.

### Distribution of Proceeds

As shown in the table below, after deducting \$4 million in debt from the enterprise value proceeds for both companies, EIS shareholders receive \$10,000,000 in proceeds while Steady shareholders receive \$5,000,000 in proceeds. Essentially, EIS shareholders receive a 100% premium over Steady shareholders due to an engaged employee team that has generated stronger sale growth, more efficient production, and lower turnover costs. Thus, even though the Steady Founders retained an additional 5% stake by not distributing stock in a broad based option plan, as had the founders of Engaged Industrial, they receive \$2,500,000 less in proceeds from the company sale.

**ENGAGED INDUSTRIAL SERVICES INC. FULLY DILUTED CAP TABLE**

EXIT PROCEEDS	EIS SHAREHOLDERS	SHARES	
\$5,500,000	FOUNDERS	550,000	55
\$750,000	MANAGEMENT OPTIONS	75,000	7
\$500,000	EMPLOYEE OPTIONS	50,000	5
<u>\$3,250,000</u>	<u>VC FUND PREFERRED STOCK</u>	<u>325,000</u>	<u>32</u>
\$10,000,000		1,000,000	100

Engaged Industrial Services sold for \$14,000,000 enterprise value less \$4,000,000 in debt

Net equity value proceeds of \$10,000,000 = \$10/share

Assume three people hold management options

Assume 50 in employee option pool, each with 1,000 shares

Assume all 50 employees are fully vested and there is a nominal exercise price

Every non-management employee gets \$10,000

Founders and CDVC fund receive a premium.

**STEADY MANUFACTURING CORP. FULLY DILUTED CAP TABLE**

EXIT PROCEEDS	STEADY SHAREHOLDERS	SHARES	
\$3,000,000	Founders	600,000	60
\$375,000	Management Options	75,000	7
<u>\$1,625,000</u>	<u>VC Fund Preferred Stock</u>	<u>325,000</u>	<u>32</u>
\$5,000,000		1,000,000	100

Steady Manufacturing sold for \$7,500,000 enterprise value less \$4,000,000 in debt

Net equity value proceeds of \$3,500,000 = \$3.50/share

Assume three people hold management options

Assume no broad based employee option pool

Non-management employees receive no proceeds at company sale

Founders and CDVC fund receive substantially less than in EIS exit scenario.

**B. PHANTOM STOCK AND STOCK APPRECIATION RIGHTS**

Phantom stock option plans are favored by some CDVC funds as an alternative to traditional stock option plans for asset building among low-wealth portfolio company employees. In a phantom stock plan, real shares of company are never actually issued to employees. Rather, employees are initially credited with phantom stock “units” which have starting values that often mirror the current fair market value of the company’s stock. The employee receives no monetary benefit from the phantom stock units until a triggering event occurs (i.e., sale of the company, disability, death, retirement, or termination because of a merger). At that point, the employee then receives a cash payment equal to the value of the phantom stock units *or* to the difference

---

---

between the value of the units at the time of the triggering event and the value of the units at the time they were issued (assuming the units' values have increased over that time period). It should be noted that phantom stock plans may be set up by any corporate form and are especially well-suited to limited liability companies (LLCs) which don't have common stock.

There are several advantages to phantom stock plans. Firstly, the company does not have to give up any equity, and implementing phantom stock actually shelters itself from any control issues that may arise from the addition of new shareholders. Also, employees can participate in the phantom stock plan without paying any cash or deferring a portion of their salary, and are not required to pay taxes until benefits are actually received. Additionally, the company will receive a tax deduction when it pays the benefits to the employees.

One prime disadvantage of phantom plans is that employees cannot receive capital gains tax benefits and, in fact, might face a large tax burden if the phantom stock units are paid out in a single lump sum. Additionally, employees do not have control over when their benefits will be paid out. Another risk is that the value of the phantom stock units is not guaranteed to increase over time. There is also the possibility that the company may not have the necessary funds to pay out the benefits at the time of the triggering event; for example, if the company is sold or merges with another company in a stock-only transaction. Finally, the presence of a phantom plan on the company's books may represent a liability that makes the company a less attraction acquisition target.

A substantial issue to be considered when instituting a phantom stock plan is that any retirement plan that covers most or all employees and defers some payment until termination of employment can be subject to ERISA (Employee Retirement Income Security Act of 1974) regulations, which can be stringent. The clearest way to avoid these regulations is to structure any phantom stock plan as a negotiated arrangement between an employer and a single employee rather than as a group plan.

It should be noted that stock appreciation rights (SARs) can be granted in tandem with stock options so that employees receive cash needed to pay taxes associated with the exercise of the stock options.

---

---

## **SEVERAL CDVC FUNDS ADVOCATE PHANTOM PLANS**

Boston Community Venture Fund is just one of the CDVCs that advocates the use of phantom stock plans. In particular, BCVF notes that phantom stock (as opposed to restricted stock and some other equity-based alternatives) provides an incentive for employees to stay with the company, due to the absence of any intrinsic value of the award (i.e., because employees can only take advantage of the award if they stay employed by the company). Additionally, BCVF appreciates the lack of any upfront cash requirement for low-wealth employees associated with phantom stock plans (though it should be noted that any option plan can be set up with cashless exercise options). Pacific Community Ventures also uses the phantom stock model as a means of distributing equity that it requires portfolio companies to set aside for low-income employees, and SJF has some portfolio companies that have phantom stock plans. Murex is also a fan of phantom plans because of the tax benefits and the simplicity and has implemented a phantom plan in at least one of its portfolio companies.

## **C. RESTRICTED STOCK**

Restricted stock is company stock that is awarded as part of a long-term incentive program for relatively high-level employees. The recipient's rights to sell or transfer the shares are restricted for a pre-determined amount of time, and can be subject to service or performance requirements. Typically these shares are awarded at no cost to the employee. In addition to the motivation that stock awards typically supply, restricted stock has the added benefit of intrinsic value. While the value of a stock option is only ever equal to the difference in fair market value of the stock and the exercise price of the option, restricted stock will always have an underlying value. The disadvantages to the employer of offering restricted stock include the potential for share dilution, while a primary risk to the employee of receiving restricted stock is the substantial risk of forfeiture.

## **RECOMMENDATIONS FOR CDVC FUNDS**

CDVC funds should take into account the company's history and goals in implementing broad-based stock option plans. Factors such as expected fund exit and the need to attract additional capital are key. If a broad-based stock option pool is to be established, a good rule of thumb is to set aside about 10% of the total option pool for broad-based options. Adopting an "omnibus" stock option plan allowing for all the different types of options (incentive, nonqualified, phantom, restricted stock awards, etc.) gives the company the greatest flexibility. Incentive stock options are the most familiar type of option, but these can only be used for employees. Contractors and board members could receive non-qualified stock options. Funds should consult a law firm or a community development law clinic at a local law school for more detailed assistance on implementing stock option plans.

---

---

## IV. ESOPS

**EMPLOYEE STOCK OWNERSHIP PLAN (ESOP):** A DEFINED CONTRIBUTION EMPLOYEE BENEFIT PLAN IN WHICH A TRUST IS CREATED TO BUY AND HOLD COMPANY STOCK, AND SHARES OF THE TRUST ARE THEN ALLOCATED TO INDIVIDUAL EMPLOYEE ACCOUNTS.

### OVERVIEW

An employee stock ownership plan (ESOP) is a type of tax-qualified employee benefit plan in which most or all of the assets are invested in stock of the employer. An ESOP must include at least all full-time employees who have worked for the company for two or more years. Employees do not actually buy shares in an ESOP. Rather the company contributes its own shares to the plan, contributes cash to buy back its own stock, or has the plan borrow money to buy stock, with the company repaying the loan. To set up an ESOP, stock (allocated based on compensation, years of service, or some combination) is held in trust and placed in an employee's account only during the time of employment. Employees can receive dividends on the shares, but usually cannot sell shares until they leave the company, and are often prohibited from offering money to purchase the stock. The shares in employee accounts gradually vest, and full benefits are received upon departure from the company. When employees leave a privately-held company, the company has the responsibility to purchase the stock they have earned at its fair market value; employees of public companies can sell their shares on the public market.

### WHY AN ESOP?

A common reason for the establishment of an ESOP is to grant liquidity to a departing owner, founder, or major shareholder, while assuring that the business will continue to operate. There can be substantial tax advantages to owners who sell to an ESOP. If the ESOP will ultimately own more than 30% of the company and the company is a C corporation, and if the sale's proceeds are reinvested in qualified securities within a fifteen month period beginning three months before the date of the sale, it is possible for the selling owner to defer taxation on the capital gain from the sale.<sup>37</sup> A departing owner also may sell his/her stock to the ESOP gradually, allowing them to ease out of management responsibilities.

The other common reason to establish an ESOP is as an employee benefit or incentive plan. ESOPs have also been used to finance acquisitions, spin off divisions, purchase new equipment, refinance debt, or, in rare cases, to buy out failing firms that otherwise would be forced to close.

---

<sup>37</sup> "A Conceptual Guide to Employee Ownership for Very Small Businesses," National Center for Employee Ownership (NCEO) web site (<http://www.nceo.org/library/verysmall.html>).

---

---

## RETIREMENT FUNDS

The primary benefit of an ESOP account to an employee is as a cushion for retirement. So to protect the retiring employee, ERISA requires that ESOP employees who have participated in the ESOP for at least 10 years be given the option to diversify their ESOP accounts up to 25% of the value once they reach age 55. “This option continues until age sixty, at which time the employee has a one-time option to diversify up to 50% of his/her account.”<sup>38</sup> Employees receive the vested portions of their accounts at retirement, termination, disability, or death. A bill being proposed by Senators Barbara Boxer (D-NJ) and John Corzine (D-NJ) would accelerate this ability to diversify ESOP holdings, lowering the benchmark to employees aged 35 and up with 5 years of participation in the plan.<sup>39</sup> The impact of this legislation, if applied to private companies, could mean that companies are required to use cash in order to satisfy diversity requirements earlier in the life of the ESOP and company, which could put substantial stress on the company’s cash flow.

**STOCK BONUS PLAN:** EMPLOYEE BENEFIT PLANS DESIGNED TO PAY BENEFITS OUT IN THE FORM OF COMPANY STOCK.

## ORIGIN OF THE ESOP

Stock bonus plans have been around since the 1920s, but the concept of an ESOP was developed in the 1950s by lawyer and investment banker Louis Kelso, who thought that businesses would be strengthened by broad-based employee ownership. ESOPs were possible then under existing IRS rulings but it wasn’t until the Employee Retirement Income Security Act of 1974 (ERISA), which governs employee benefit plans, was passed that there was a statutory framework for ESOPs. In years following the passage of ERISA, the number of ESOPs expanded dramatically. According to NCEO, there are now “about 11,000 ESOPs and similar plans (stock bonus plans) covering over 8.5 million employees. ESOPs are found in publicly traded and closely held companies of every size; however, most such companies have over 15 or so employees due to the costs of setting up and administering an ESOP.”<sup>40</sup> While ESOPs are found in all industries, more than 25% of them are in the manufacturing sector.<sup>41</sup>

---

<sup>38</sup> ESOP Association, <http://www.esopassociation.org>.

<sup>39</sup> Rosen, Corey. “Should ESOPs Be Subject to Stricter Diversification Rules?” January 8, 2002. National Center for Employee Ownership web site ([www.nceo.org/library/boxer\\_corzine\\_bill.html](http://www.nceo.org/library/boxer_corzine_bill.html)).

<sup>40</sup> National Center for Employee Ownership, “A Short History of the ESOP,” <http://www.nceo.org/library/history.html>.

<sup>41</sup> “ESOP Facts and Figures,” ESOP Association Resource Library (<http://www.esopassociation.org/pubs/stats.html>)



---

## **ESOP AS CDVC FUND EXIT**

If a closely-held company plans to stay private, is growing at a steady rate, and does not expect to experience a liquidity event (such as going public or being acquired) in the near term, then an ESOP could offer an attractive exit alternative for a CDVC fund. According to NCEO, ESOPs work best in companies with more than 20 employees. Other ESOP experts suggest that companies with annual payrolls of less than \$500,000 are not likely to find the short-term benefits of establishing an ESOP outweigh its establishment and early operation costs.<sup>42</sup>

Due to compliance issues, ESOPs generally cost a minimum of \$20,000 to install, and several thousand dollars annually to maintain, largely because of the requirement of annual independent business valuations. ESOPs also require specialized legal and financial services, so it is important to have advisors who are knowledgeable and experienced with ESOPs. A feasibility study may be required if there is any question as to the company's ability to repay its ESOP loan. It should be noted that if a company is in a low corporate tax bracket, it will not be able to realize the full extent of the ESOP tax-shield. There are a variety of ways to fund new ESOPs, including: (1) debt financing, with tax-deductible repayment; (2) ongoing company contributions; (3) existing benefit plans; and (4) employee contributions.

As with broad-based stock option plans, ESOPs will improve corporate performance only if combined with opportunities for employees to better understand how the business operates and to participate in decisions affecting their work. Before implementing an ESOP, it is important to make sure that management is willing and able to set up such systems.

## **CDVC FUNDS' EXPERIENCES WITH ESOPs**

Only two CDVC funds surveyed, CEI Ventures and Kentucky Highlands (KHIC), have portfolio companies currently involved in ESOPs (See Cumberland Gap case study below). CEI Ventures is an advocate of ESOPs and has some portfolio companies in which an ESOP is cited as a mutual goal in the initial term sheet.

Northeast Ventures also has several companies that are candidates for ESOPs, where management is open to using this method as an exit mechanism. Tom Van Hale, Vice President of Northeast Ventures, believes that philosophically ESOPs are an attractive CDVC fund exit, particularly from the mission perspective, but also points out that implementing them is a challenge. To start a successful ESOP plan, a company needs to be performing fairly well since it will be adding debt. As well, ESOPs can only be successfully implemented at companies with a large enough payroll to sufficiently finance the project over time.

---

<sup>42</sup> Gilbert, Ronald J. "The ESOP Decision," ESOP Services, Inc. web site (<http://www.esopservices.com/decision.htm>)

---

---

For companies that are struggling to achieve profitability, ESOPs are not the best exit option. Nonetheless, many CDVC funds expressed openness to utilizing ESOPs in the future, and several funds have brought in consultants to explain the intricacies of ESOPs and their benefits. Bill Taylor of Mountaineer Capital points to the importance of an “enlightened banker” in successfully utilizing an ESOP as an exit option. According to Taylor, the ESOP process requires creative banking sources that might not be available in all geographies. Despite this hurdle, Mountaineer feels that ESOPs can be a real, reasonable exit possibility, particularly for profitable, slower-growth companies.

#### **CASE STUDY: CUMBERLAND GAP**

In 1991, the 12-year-old Cumberland Gap Provision Company of Middlesboro, KY, a producer of smoked hams and other specialty pork products, set up an ESOP with the help of Kentucky Highlands Investment Corporation (KHIC). At the same time, KHIC made an equity investment in the company. In 1996, the company repurchased KHIC’s stock but KHIC continued its involvement in the expansion of the company through a grant from the Office of Community Services to expand Cumberland Gap’s operation. In 2003, Cumberland Gap was purchased by Smithfield Foods, which intends to expand the operation of the company in Middlesboro and contribute to the local economy through providing direct employment and business development opportunities. The company had 2003 sales of \$70 million and currently employs 325 people in a facility of more than 100,000 square feet.

#### **CASE STUDY: MCKAY’S NURSERY**

McKay Nursery in Waterloo, WI is the tenth largest regional nursery in the country. The firm relies heavily on migrant labor, with more than 100 employees during the eight-month peak season. More than 90% of McKay’s seasonal employees return every year, some for the past 20 to 25 years, resulting in significant savings for the company in recruitment and training costs. Why is retention so high? In addition to getting fair wages, good housing, overtime pay, and training, McKay’s employees are included in the company’s ESOP. Because the company has grown 400% since the ESOP was established in 1984 to buy out the retiring owner’s shares, employee stakes in the ESOP can be substantial, with some migrant workers the proud owners of close to six-figure retirement accounts. The average migrant worker has been coming back each year for 15 years, and some have advanced to full time supervisors.<sup>43</sup>

#### **MORE DETAIL ON ESOPs**

NCEO divides the ESOP world into “two distinct universes: private company ESOPs and public company ESOPs.” Between 5% and 10% of ESOPs operate in public companies. These ESOPs are almost always integrated with the company’s 401(k) plan, in which case they are used to fund the company’s matches of

---

<sup>43</sup> National Center for Employee Ownership’s *Employee Ownership Report*, July/August 1997, p.5.

---

---

employee contributions to the 401(k). This integration with 401(k) plans occurs less frequently in private companies. Legally, ESOPs cannot be used in partnerships, sole proprietorships, or most professional corporations. Private companies are required to repurchase shares from departing employees, which can result in a major cash expense.

Professors Joseph Blasi and Douglas Kruse tracked all privately-held companies with ESOPs in 1988 and found they had higher survival rates than closely-matched firms without ESOPs. Among 1,176 private firms with ESOPs in 1988, 69.6% survived through 1999, compared to only 54% of non-ESOP companies in the same industries and of the same size.<sup>44</sup> It is important that firms that implement employee ownership programs also develop culture and employee mechanisms that can positively complement employee ownership.

### **WORKFORCE PERFORMANCE BENEFITS FROM ESOPs**

The National Center for Employee Ownership states that more than 8 million employees in more than 11,000 companies, mostly closely held, participate in ESOPs. Implementing an ESOP can help both a company and its employees develop a true ownership culture.

According to research conducted by Douglas Kruse and his colleagues, “Productivity improves by an extra 4-5% on average in the year an ESOP is adopted, and the higher productivity level is maintained in subsequent years. This one-time jump is more than twice the average annual productivity growth of the U.S. economy over the past 20 years.”<sup>45</sup> In addition, these researchers have found that “ESOPs appear to increase sales, employment, and sales per employee by about 2.3% to 2.4% per year over what would have been expected absent an ESOP.”<sup>46</sup>

### **RECOMMENDATIONS FOR CDVC FUNDS**

An ESOP could be a good vehicle for CDVC fund exit from a portfolio company under the right circumstances. Funds that have financial returns as their top priority might not choose this option, but for portfolio companies that are growing steadily but not at a meteoric rate, are profitable, have 20 or more employees, can afford the establishment costs and ongoing maintenance costs, have good financial and legal advisors versed in ESOPs, want to take advantage of the tax incentives, and want to involve and reward employees, an ESOP can be an a useful strategy.

---

<sup>44</sup> Sesil, James C., Douglas L. Kruse, Joseph R. Blasi. “Sharing Ownership via Employee Stock Ownership,” Discussion Paper No. 2001/25, World Institute for Development Economics Research (WIDER). July 2001.

<sup>45</sup> Kruse, “Research Evidence on Prevalence and Effects of Employee Ownership,” Testimony before the Subcommittee on Employer-Employee Relations. February 13, 2002. p5

<sup>46</sup> “Largest Study Yet Shows ESOPs Improve Performance and Employee Benefits,” National Center for Employee Ownership (NCEO) web site ([http://www.nceo.org/library/esop\\_perf.html](http://www.nceo.org/library/esop_perf.html)).

---

---

## V. IDAS AND HOME OWNERSHIP ASSISTANCE

**INDIVIDUAL DEVELOPMENT ACCOUNTS (IDAs):** SAVINGS ACCOUNTS, IN WHICH AN INDIVIDUAL'S DEPOSITS ARE TYPICALLY MATCHED AT OR ABOVE 1:1, USED PRIMARILY FOR FIRST-TIME HOME OWNERSHIP, SECONDARY EDUCATION, AND STARTING A SMALL BUSINESS.

### A. INDIVIDUAL DEVELOPMENT ACCOUNTS

#### OVERVIEW

Individual Development Accounts are subsidized savings accounts designed to help low-wealth employees build assets for long-term economic security. Qualified savings in IDAs can be matched at or above a rate of 1:1 by third parties such as state and local governments, financial institutions, foundations, and, or a lesser extent, employers. IDA account holders generally utilize IDAs to buy first homes, pay for post-secondary or vocational education, or to start a small business. Financial literacy training accompanies participation in IDA programs. Local non-profit community organizations often can provide these training programs as well as administrative support.

According to the Corporation for Enterprise Development, there are currently at least 20,000 IDAs in almost 500 IDA programs nationwide. In testimony given by Michael Sherraden to the President's Commission on Social Security in October 2001, "IDAs demonstrate that the poor can save and benefit from progressive asset accumulation. The data show that poverty level IDA participants have net savings of \$25 per month. IDAs were matched at an average ratio of 2:1, so that participants accumulated an average of \$75 per month or \$900 per year."

#### TYPES OF IDA PROGRAMS

There are multiple variations of IDA program structures, most community-based and run by some combination of non-profits and/or public agencies, but some more recent IDA programs are being tested that are connected to employers or unions. Employer-based programs have been slower to develop because the match is considered equity compensation and is taxed accordingly, both on the employer and employee sides. Additionally, the cost to set up an IDA program, and the administrative costs of running it, can be prohibitive. To date, there are only a handful of employer-involved IDA programs.

Many employers prefer to refer employees to existing IDA programs run by community nonprofits. Employers sometimes choose to make tax-deductible contributions to these programs. To get the tax

---

---

deduction, their contributions must benefit all program participants, not just their employees. However, some employers are more interested in knowing that their contributions will directly benefit their employees than in getting a tax deduction. They have the option of setting up an IDA program through a local nonprofit that is just for their employees. In one program, companies contribute to infrastructure that is shared by the entire community-based IDA program, but their matching funds may be earmarked for their employees.

*“One in three adult Americans and two in three adult African-Americans have zero assets – no homes, savings accounts, or retirement funds that accumulate value over time. Half of all Americans have less than \$1,000 in assets. As many as one in five Americans have neither a checking nor savings account at a financial institution.”<sup>47</sup> Employees who earn less than \$8 per hour are much less likely than other employees to have benefits such as a job-related health insurance, paid leave, access to flexible schedule options, or dependent care benefits.<sup>48</sup>*

### **CDVC FUND PARTICIPATION IN IDAS**

Although most CDVC funds surveyed in the course of this project are open to the idea of IDAs, only two funds have started their own IDA programs (detailed below) and four others (SJF Ventures, Enterprise Corporation of the Delta, Shorebank Enterprise Cleveland and The Reinvestment Fund) have linked portfolio companies with local nonprofits offering IDAs. Other CDVC funds recognize their benefit, but expressed concerns about the costs and administrative requirements associated with setting up IDA accounts.

Coastal Enterprises Inc. (CEI) in Maine and Pacific Community Ventures (PCV) in California have both initiated IDA programs. CEI offers a statewide IDA program rather than one limited to its portfolio companies. CEI both administers and recruits for the IDA program and works with local banks and credit unions to manage the accounts. These accounts are matched 1:1 using mostly grant funds, with no match required by the employers. CEI conducts the required financial literacy training statewide, and markets all of these services on a community-wide basis.

PCV is currently developing an IDA program for employees of its portfolio companies. These companies currently employ approximately 300 people in manufacturing, distribution, and food production, and most of them qualify for IDAs. PCV plans to develop 100 accounts over a three-year period, and has partnered with the Assets for All Alliance, which has extensive experience in administering 1,000 IDA accounts. PCV, which will match 2:1, will recruit the account holders and handle case management, while Assets for All will administer the accounts, through Lenders for Community Development. All accounts will actually be held at Citibank. Financial literacy training will be provided by Consumer Credit Counseling Service or a similar

---

<sup>47</sup> Corporation for Economic Development (<http://www.cfed.org>), Individual Development Accounts, “IDAs in Action.” As quoted in “State Action – Issues” on <http://www.cfpa.org/issues/econdev/ida/>

<sup>48</sup> *Employer IDA Initiatives: The Promise of Delivering IDAs through Employers*. Corporation for Enterprise Development. November 2002. p31.

---

---

personal finance nonprofit. PCV will not require portfolio companies to provide any of the matching funds, but will raise grants to cover the costs of matching.

MetaFund CDC considered starting an IDA program until it found out there was an existing program in Tulsa, OK. MetaFund now refers its portfolio companies to the existing program, allowing the fund to avoid the costs associated with setting up IDAs.

SJF Advisory Services has identified and made connections with two IDA programs in different locations that would be a good match for SJF portfolio company employees. Interestingly, several challenges have come up in trying to encourage these companies' employees to enroll in these programs. At one company, many employees did not earn the minimum required to participate, although they came very close. At the other company, most employees are still enmeshed in the check cashing economy and have not yet taken advantage of direct deposit. SJF Advisory Services plans to work with this company to implement basic financial education to assist employees with learning about the advantages of bank accounts and direct deposit. After this hurdle is achieved, we will initiate education on home ownership and IDA programs.

#### **RECOMMENDATIONS FOR CDVC FUNDS**

Because of the high cost of developing and implementing an IDA program, the administrative burden of operating such a program, and the tax disadvantages for both employers and employees of employer-run IDAs (IDA matches from employers can be considered compensation), CDVC funds that are serious about utilizing IDAs as an asset-building strategy should consider helping their portfolio companies find a non-profit partner to run the program, or to locate a suitable IDA program run by a nonprofit or credit union that is already in operation. A number of community development corporations have begun to offer these programs. Funds can also look to IDA coalitions on the state level, such as the "Assets for Arizona Alliance," which was formed in 2003 with the goal of establishing 10,000 IDAs in Arizona within the next five years, or the "North Carolina IDA and Asset-Building Collaborative," which was the first state IDA coalition to become a formal legal entity by receiving its 501(c)3 status, allowing the organization greater latitude in fundraising.<sup>49</sup> Additionally, a number of national organizations such as the United Way or the Fannie Mae Foundation have begun to address the IDA issue, either offering IDA programs in targeted communities or offering support resources of these IDAs.

CDVC funds may also want to follow the example of the United Way of America and bundle a package of asset building services together with IDAs. United Way found that trying to market IDAs as a stand-alone tool wasn't working, but that but employers and employees both are attracted to a broader package. United Way's Chuck Shannon feels that, without supportive federal legislation, the current IDA models are not

---

<sup>49</sup> "Assets: A Quarterly Update for Innovators," 2003, No. 4 (CEFD Newsletter). pp. 4-6.

---

---

sustainable over the long term. United Way has a set of asset building tools they have trademarked “Assets for Family Success.” This includes the following components:

1. Banking the unbanked
2. Earned Income Tax Credit (EITC)
3. Advanced provision EITC (can receive up to 40% of anticipated EITC through payroll deductions, as much as \$50/month, the hope is to help people start saving immediately)
4. Individual Development Accounts (IDA)
5. Economic literacy training
6. Asset-specific counseling (usually related to IDAs)

### **IDA PROGRAM RESULTS**

The Corporation for Enterprise Development (CFED)’s “American Dream Demonstration” (ADD)<sup>50</sup> tracked 2,634 low-wealth and very poor IDA-holders through 13 community partners for six years. These account-holders saved a total of \$1,248,678 over a span of two years. Matched at rates averaging just under 2:1, account-holders accumulated an average of \$1,543 each, with total accumulation of \$3,648,149. As of June 30, 2003, after an average of just over three years of saving, half of all account-holders (90% of accounts with significant savings) had purchased an asset.<sup>51</sup> ADD average monthly net deposits were \$19.07. Participants saved on average \$1 for every \$2 that could have been matched, making (on average) a deposit in roughly 6 of every 12 months.

A survey of 318 ADD participants conducted in 2000 revealed that the most common strategies for setting aside money for IDA deposits were changes in consumption behavior. In particular, 70% of respondents reported shopping more carefully for food, 68% ate less outside the home, and 64% spent less on leisure activities. “These findings reveal that participants are willing to alter current consumption choices for the possibility of improved well-being through asset accumulation.”<sup>52</sup>

According to analysis conducted by Michael Stegman, Robert Faris, and Oswaldo Urdapilleta Gonzalez in 2000, IDAs “have a small but significant positive impact on net savings. Two years into ADD, the median participant has saved \$117 more than she otherwise would have saved ... While these net additions to financial assets might seem small in absolute terms, they represent significant relative increases measured against documented bank account balances of this country’s low-income households, the bottom 20% of

---

<sup>50</sup> *Saving Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts.* Center for Social Development, Washington University in St. Louis. October 2002.

<sup>51</sup> *Assets 2003*, Number 4. p. 9 (CFED bimonthly publication)

<sup>52</sup> Moore, Amanda, Sondra Beverly, Marck Schreiner, Michael Sherraden, Margaret Lombe, Esther Cho, Lissa Johnson, Rebecca Vonderlack, “Saving, IDA Programs, and Effects of IDAs: A Survey of Participants.” Center for Social Development, Washington University in St. Louis. January 2001.

---

---

whom have median account balances of just \$610 ... In short, IDAs may induce net additional savings equal to a third or more of existing passbook and checking account balances.”<sup>53</sup>

## **QUALIFICATIONS**

IDA programs typically have eligibility requirements that include maximum and sometimes even minimum income thresholds, generally determined by the source of match funds. For programs utilizing federal funding through the Assets for Independence Act (AFIA) – the largest source of federal funds for IDAs – there are no minimum income requirements but the maximum qualifying income level is the 200 percentile of the national poverty standards, and income must be earned. AFIA guidelines make no reference to the widely used standard of 80% or less of area median income, which means that national poverty standards are being applied to different parts of the country. “The 200<sup>th</sup> percentile of poverty is a really low threshold for a high cost area,” says Melissa Koide, a consultant for CFED and the United Way of America. Because of this issue, some organizations don’t pursue AFI funding for their IDA programs. CFED and others are working to change the AFIA guidelines to refer to the area median income standard.

## **MATCH RATES**

A related issue is that of match rates. Although match rates can be as high as 7:1 or even 10:1, one IDA program manager found that a 1:1 match generates the highest enrollment rates, in part due to skepticism on the part of enrollees of higher match rates. Chuck Shannon sees matching in the 2:1 to 4:1 range, with 3:1 emerging as the most common. “In more highly appreciated markets, 1:1 is not sufficient to allow someone to save for a down payment on a house,” he said, adding that 4:1 is the most common match rate in Colorado where he is based, driven in part by high-priced homeownership market. He has found that if matching gets higher than 4:1, there is an incentive for people to misrepresent savings (get relatives and friends to contribute money to their accounts in order to receive matching).

## **ORGANIZING AND RUNNING AN IDA PROGRAM**

The Center for Social Development at Washington University also conducted an assessment of the design, implementation, and administration of its partner IDA programs during the ADD study’s first two years. The primary “lessons learned” in this study were: (1) diverse types of sponsoring organizations, with varying levels of experience, can successfully administer IDA programs; (2) the dedication, competence, and creativity of staff members is critical to the process; and (3) implementation and administration of IDA plans is most successful when logistics, such as enrollment requirements, are kept relatively simple. The report suggests that

---

<sup>53</sup> Stegman, Michael A., Robert Faris, Oswaldo Urdapilleta Gonzalez. “The Impacts of IDA Programs on Family Savings and Asset Holdings,” Inclusion in Asset Building: Research and Policy Symposium. Center for Social Development, Washington University in St. Louis. Working Paper 00-14, 2000.



---

---

one of the biggest early challenges is the introduction, often for the first time ever, of the “*idea* of asset-building for low-income and low-wealth populations.”<sup>54</sup> Other early implementation challenges include fundraising and other fiscal concerns, organizing program details, and managing internal and external organizational relationships.

### **COSTS, BENEFITS, AND SOURCES OF FUNDING**

IDA programs as implemented in the American Dream Demonstration cost about \$64 per participant per month (not counting matching funds). The cost is high compared to 401(k) and similar financial products, which are less than \$10 per month. However, the cost is low compared to many intensive family service programs, which can reach \$400 per month. According to Michael Sherraden, the cost of managing an IDA program once the program has been designed and implemented could shrink as low as \$30 to \$40 per month.<sup>55</sup>

If all costs and benefits are taken into account, IDAs can be considered very cost-effective. One CFED study showed that, “on average, IDAs yield a five-fold return to the community. Every public dollar invested in IDAs generates \$5, measured in new businesses and jobs, increased earnings, new and improved homes, higher tax receipts, reduced welfare expenditures, and increased educational achievements.”<sup>56</sup>

The Finance Project’s 2002 report, “Encouraging Savings: Financing Individual Development Account Programs,” highlights three basic funding sources for IDA programs: federal, state, and private resources. The “Assets for Independence Act” (AFI) established the federal dedicated funding program for IDAs. This program provides competitive federal grants to non-profits or “collaboratives” in order to help finance IDA programs.<sup>57</sup> Applicants must raise private and public (non-federal) funds in order to receive a matching federal grant (on a \$1-\$1 basis) of up to \$1 million per year.

Additionally, the Temporary Assistance for Needy Families (TANF) program allows states to elect to use their TANF funding to create IDA programs; the Department of Housing and Urban Development’s HOME Investment Partnership Program funds may be used for IDA funding if earmarked specifically for homeownership assistance; and Community Development Block Grant (CDBG) funds may also be used for IDAs at the state or local government’s discretion. In addition to federal funding sources, a number of states offer either direct support or tax credit programs designed to stimulate private support for IDA programs in

---

<sup>54</sup> Page-Adams, Deborah. *Design, Implementation, and Administration of Individual Development Account Programs*. Center for Social Development, Washington University in St. Louis. March 2002. p3

<sup>55</sup> Sherraden, Michael. “Individual Development Accounts: Summary of Research,” Center for Social Development, Washington University in St. Louis. September 2002. p7

<sup>56</sup> Binder, Ruth Ann, Carl Rist, et.al. “An Analysis of Asset Subsidies in California,” unpublished draft, (Washington DC: CFED 2001). As quoted in “State Action – Issues” on <http://www.cfpa.org/issues/econdev/ida/>

<sup>57</sup> “Encouraging Savings: Financing Individual Development Account Programs,” The Finance Project Financing Strategy Series, October 2002.

---

---

specific communities. Financial institutions' support of IDAs qualifies for Community Reinvestment Act (CRA) credit.

The Assets for Independence Act provides \$25 million per year for IDA programs, but this funding must be matched 1:1 by other funds. According to Shannon, about 50% of IDA programs get federal funding. "The fact that there is no dedicated funding is a problem. It is a very difficult funding environment, as government and foundations are all cutting back."

## **KEY LEGISLATION**

The Savings for Working Families Act, a subset of the CARE Act, recently came close to being enacted, passing both the House and Senate. If enacted, it would provide for approximately \$350 million in federal income tax credits, equating to more than 300,000 IDAs, compared to the current approximately 20,000. It would provide dollar-for-dollar tax credits for financial institutions that contribute to IDA programs, and would provide a strong, ongoing source of match funds. There is also some language in the legislation to allow other tax-paying institutions to get the tax credit, but the intent is to allow credit unions to participate. However, some in the industry hope that this language could allow for other types of structures could be set up to support IDAs, taking advantage of the tax credit. Whether or not this will be allowed depend on whether the legislation is enacted and how the regulations are written. Regardless, the tax credit could have a strong impact in motivating banks and other financial institutions to participate at a large scale in IDAs, and, very significantly, would also put an asset-building program for low-income individuals into the U.S. tax code.

## **B. HOMEOWNERSHIP ASSISTANCE**

### **OVERVIEW OF PROGRAM**

In their 2001 report, "Paycheck to Paycheck: Working Families and the Cost of Housing in America," the National Housing Conference reported that households dependent on one elementary school teacher's or one police officer's salary alone cannot afford to buy a median priced home in two-thirds of the country's 60 largest housing markets.<sup>58</sup> A housing gap becomes particularly evident when comparing black and Hispanic homeownership rates (48%) to that of whites (75%)<sup>59</sup>. Many workers can only find affordable housing at considerable distance from their jobs, creating commute times that threaten workforce productivity. Employers offer a wide variety of homeownership assistance programs (commonly called "Employer Assisted Housing," or EAH). Companies can provide financing support, including forgivable, deferred, or repayable

---

<sup>58</sup> Dee NaQuin. "No Longer Caught in the Middle," *Journal of Housing & Community Development*. EBSCO Publishing 2002.

<sup>59</sup> Ferguson, Chaka. "Blacks Face Wealth Gap, Report Says," *Raleigh News and Observer* (The Associated Press), March 24, 2004.

---

---

loans and matched savings, in order to help employees pay for costs associated with home-buying such as down payments or closing fees. In addition, EAH programs may provide non-financial support such as homebuyer education. Employers can make these assistance programs available to all employees or target specific groups, such as non-management employees or first-time homebuyers.

According to Fannie Mae, which has helped more than 500 firms start home-buyer assistance programs, forgivable loans are the most popular of these tools. The number of companies offering these programs is increasing, from 6% of employers offering a mortgage benefit in 2000 to 12% of employers in 2003. Most of these loans fall in the \$2,000 to \$8,000 range. Other companies give employees grants, or offer to match pretax dollars that workers deduct from their paychecks to save for a home.<sup>60</sup> Many companies consider these programs a key part of their retention strategy. Some firms even limit home purchases to a 10-to-15-mile radius of the office, with the dual goals of stabilizing the workforce and supporting smart growth<sup>61</sup>.

In many areas, employers get incentives such as matched grants or tax credits from state governments that view home-buyer assistance programs as a way to revitalize neighborhoods and build communities. In October 2003, the American Dream Downpayment Initiative was signed into law making up to \$200 million annually for fiscal years 2004 through 2007 available to states and local jurisdictions to assist low- and moderate-income first-time homebuyers.

The Fannie Mae Foundation also offers multi-lingual “Homeownership Education Programs” intended to increase access to affordable housing and homeownership for underserved populations. The Foundation's current educational efforts are concentrated on providing homeownership education to new Americans, Native Americans, and adult students.

#### **CDVC FUNDS’ EXPERIENCE WITH HOMEOWNERSHIP ASSISTANCE**

The Barred Rock Fund and Murex Investments are the only two CDVC funds in the SJF Advisory Services survey to have offered homeownership assistance. The two funds officially announced an option for employees in their portfolio companies to obtain no interest loans of \$7,500 for home ownership, with the caveat that the loan must be paid back in full after the employee leaves the company. Barred Rock also located a non-profit in New Jersey to provide home buying training courses. However, the funds found limited success with these homeownership assistance programs, and have since suspended them. Chuck Lacy, President of Barred Rock, stated an essential problem: if employees are unbanked, getting them into the

---

<sup>60</sup> Burt, Erin, “Golden Handcuffs,” *Kiplinger’s Personal Finance*. Vol. 57, Issue 9. September 2003.

<sup>61</sup> In 1997, Maryland introduced a state-wide EAH program, “Live Near Your Work,” in which the state, municipality, and employer combine resources to provide \$3,000 for employees who purchase homes in designated areas near their place of employment.

Jennings, Stephanie A. “Reinventing the Company Town: Employer-Assisted Housing in the 21<sup>st</sup> Century,” *Housing Facts & Findings*, Volume 2, Issue 2. Fannie Mae Foundation. Summer 2000.

---

---

economic system via checking and savings accounts may be a first priority before they will be ready to consider entering a home ownership program.

There are many examples of homeownership assistance on the loan fund side. For example, Shorebank Enterprise Cleveland, located in and focused on Cleveland, Ohio, provides targeted residential lending for eight "Priority Neighborhoods" on Cleveland's upper east side. These neighborhoods, with an aggregate population of more than 114,000, have a poverty rate of 42% (compared to 13% in the region), and only a third of the residents own their own homes (compared to almost two-thirds elsewhere in the region). An example of Shorebank's investment approach is its provision of construction financing to both community development corporations (CDCs) and small private developers. Through their connections to the CDCs they refer companies to the wide variety of home ownership assistance offered by these organizations.

#### **RECOMMENDATIONS FOR CDVC FUNDS**

Most funds may prefer to link to existing nonprofits and government agencies that provide homeownership assistance programs rather than trying to develop new programs. Financial literacy training is generally a key first step.

---

---

## VI. RETIREMENT PLANS AND PROFIT SHARING

**RETIREMENT PLANS:** PLANS SUCH AS 401(K)S OR SIMPLE IRAS THAT ALLOW EMPLOYEES TO MAKE RE-TAX SALARY DEFERRALS AND ALLOW EMPLOYERS TO TAKE A TAX DEDUCTION ON ANY CONTRIBUTIONS THEY PROVIDE.

### A. RETIREMENT PLANS

Many businesses provide retirement plans such as 401(k)s that may or may not be matched by the employer as a benefit for employees. Such plans allow employees to make pre-tax salary deferrals, lowering their overall income tax and providing a long-term vehicle for retirement savings. The advantage for employers is that such retirement plans are a part of an overall strategy for attracting and retaining employees and also that employers can also make tax-deductible contributions on retirement plans, also lowering the employer's overall taxes.

A 401(k) is a common retirement plan that is designed to provide the employee with a diversified portfolio of investments. Like ESOPs, a 401(k) plan is a tax-qualified plan that generally must include all full-time employees. Participants can choose among several or more investments, and the company often will make matching contributions. Note that most smaller companies can't afford or don't qualify for 401(k)s, but there are a number of other retirement plans that may be used by smaller firms, such as SIMPLE IRAs.

### USE OF RETIREMENT PLANS AT CDVC PORTFOLIO COMPANIES

Fourteen (78%) of the funds surveyed have portfolio companies with 401(k) plans. But many of these companies are small businesses in the early stages of growth and are not yet able to afford programs like 401(k)s. In those portfolio companies that do, employee participation and the performance levels have frequently been less than anticipated. Kelly Upchurch, President of American Health Management, a portfolio company of Kentucky Highlands, has a 401(k), but was disappointed plan participation. At that time, only approximately 50 percent of the employees had invested in the plan. Upchurch observed that many of the employees who did participate were employees with higher education and salary levels. At the time of the interview, management was considering decreasing the waiting period to try and entice hourly employees to participate.

In general, despite the less than capacity participation rates, Kentucky Highlands believes that retirement plans are one good way for low-wealth employees to build assets, especially if they are funded on the date contributions are made and title to the contributions goes immediately to the individual employees.

---

In 2003, the Barred Rock Fund helped to implement a 401(k) program for one of its portfolio companies, Sun & Earth. To date, the fund has seen many of the same trends as American Health Management, with little entry-level participation. In addition, in late 2003, Northeast Ventures hired a compensation consultant for one of its portfolio companies who suggested that 401(k)s should be implemented in year 3 or 4 of a startup company. The consultant maintained that it is possible to articulate intention at the outset, then to set up the program with no company contributions until there is sufficient cash flow to fund program start-up costs, and then to grow company contributions as cash flow benchmarks are reached. On the other hand, most of Mountaineer Capital's portfolio companies have 401(k)s, with matching rates ranging from 2% to 5%. A majority (64%) of SJF Venture's 15 portfolio companies has 401(k) plans in place and two others are gearing up to implement such plans.

## **B. PROFIT SHARING & BONUS PROGRAMS**

In a profit-sharing plan, all or certain groups of employees share a percentage of company profits, which is usually determined by a pre-arranged formula. Employees' contributions to the company's bottom line can be rewarded if there is a clear connection between effort and outcome (if individual efforts are difficult to measure, or if profit is affected by rising raw material costs, for instance, the profit-sharing plan set-up might backfire). Profit-sharing plans can work extremely well for companies in highly cyclical businesses, so that in good years employees can be paid above the market and in bad years payroll can be reduced without lay-offs or other cost-cutting measures. It is important to institute controls on a profit-sharing plan in order to ensure that short-term profits are not emphasized at the expense of long-term profits.

### **USE OF PROFIT-SHARING AT CDVC FUND PORTFOLIO COMPANIES**

The Minnesota Investment Network Corporation (Minn-Corp) had a company in its portfolio it exited that had a significant ROI from a profit-sharing program. The Board's compensation committee approved a percentage of net profits to be distributed to the profit sharing program that was then shared across all employee levels. The company was eventually sold to a strategic partner, and employees who had been with the company for more than a year received options and benefited economically from the profit-sharing program. Steve Mercil, President of Minn-Corp, has found that when linking compensation to performance, strong communication and information sharing are critical to success. Clearly defined metrics and the right team atmosphere are crucial for this to work.

Profit-sharing is also a high priority for several portfolio companies of Murex, according to Joel Steiker. In one of their successful profit-sharing programs, distribution was weighted more toward middle managers one level up from the line workers – employees with fairly modest salaries but who create a lot of value. When they hit their financial targets bonuses were allocated, by salary and by hours worked. “This type of program works well,” said Steiker. “We have done this at several companies.”

---

---

Fred Beste of Mid-Atlantic, one of the traditional venture capital funds interviewed for this report, says that profit sharing is relatively unusual in companies with which he comes in contact. However, he says that, if management of a portfolio company has been making big salary sacrifices and the company has a great year, they will consider distributing reasonable bonuses, awarded on a discretionary basis by the board.

BCVF has exited preferred stock but still has a common stock follow-on in its portfolio company CityFresh. The company has profit sharing, so employees get distributions each year.

There are other inspiring examples of profit sharing and employee involvement. One CDFI, the New Hampshire Community Loan Fund, has developed a "Vested for Growth (VfG)" financing program with the byline "long-term growth strategies based on people and quality." The purpose of VfG is to help New Hampshire-based manufacturing companies build strong, long-term growth which results in quality job creation and retention in the state. VfG provide royalty financing of \$200,000 to \$500,000 for equipment, working capital or employee buyouts. The capital is explicitly tied to a program for employee engagement to so that workers "feel, think and act like owners" through profit-sharing, open book management, competitive compensation, and deep employee involvement. VfG encourages quality programs and continuous improvement with their financed firms, and offers a discount on loan payments for companies that establish employee profit-sharing plans. The VfG program illustrates that CDFIs providing business loans are joining CDVCs as innovators in helping build employee assets and engagement at their portfolio firms.<sup>62</sup>

---

<sup>62</sup> [Http:// www.vestedforgrowth.com](http://www.vestedforgrowth.com).

---

---

## VII. FINANCIAL LITERACY PROGRAMS

### OVERVIEW

Financial education is a pre-requisite for most, if not all, of the asset building strategies discussed in this report, including IDAs, home ownership assistance, and stock option plans. According to the Initiative for a Competitive Inner City, companies are discovering more and more that at-work financial services and education can significantly improve workers' overall on-the-job performance. Employees often do not possess the skills and necessary knowledge to effectively manage their earnings, and therefore employers reap the benefits of financially educating their employees. This is borne out by a few statistics offered by Don Phin, author of "Teaching Financial Literacy: The ABCs," including the fact that more than a million American households file for bankruptcy each year, and that average credit card debt is up to \$7,000 per household.

Many low-wealth employees need basic financial literacy training in order to assist them in entering into the economic system through establishing bank accounts (saving and checking), as well as reducing debt and saving for goals such as continuing education, purchasing a home or starting a small business. Additionally, financial literacy program can help employees maximize the benefits from various profit-sharing and asset generating programs. Analysis performed on the American Dream Demonstration data indicated that a small number of financial-education hours helped to increase savings performance, but that more than 8 to 10 hours had no effect, suggesting "that financial education has positive effects on savings and that courses need not be long to take advantage of the potential benefits."<sup>63</sup>

### CDVC FUNDS' EXPERIENCE WITH FINANCIAL LITERACY TRAINING

Currently, of CDVC funds surveyed, 43 percent offer either direct financial literacy training or a connection to outside financial literacy providers. The Reinvestment Fund (TRF) has created a group within its fund to focus specifically on human capital development. In addition to helping companies expand recruitment efforts in order to reach more low-wealth urban residents, the Human Capital Group has assisted companies in the implementation of high-quality human resources infrastructure and skill development programs while improving employee benefits through both private and public means. In the case of TRF/DVCRF Ventures' investment in Pittsburgh-based Allegheny Child Care Academy, TRF and its Human Capital Group provided the following services, among a number of others:

---

<sup>63</sup> *Saving Performance in the American Dream Demonstration: A National Demonstration of Individual Development Accounts*. Center for Social Development: Washington University in St. Louis. October 2002.



- 
- 
- Annual on-site tax preparation assistance to Allegheny’s employees to improve utilization of tax benefits, in particular the Earned Income Tax Credit (which is an opportunity for some financial literacy advising);
  - A public benefits counseling program to assess workers’ eligibility for public benefits such as food stamps and credit counseling, with the goal of increasing families’ income and financial stability; and
  - Financial literacy training and eligibility to join an Individual Development Account (IDA) program to match savings.

MetaFund out-sources its financial literacy training programs to its banking partners (CRA), including homebuyer education and life skills training. Where applicable, MetaFund requires portfolio companies to sign an agreement to participate in these programs in order to receive investments. Joel Steiker of Murex believes that in order to be effective, stock options or other equity compensation need to be allocated in conjunction with a training program. “Employees need to understand their rights as owners but also their responsibilities,” he says.

CEI offers financial literacy training throughout the state of Maine in conjunction with its IDA program. The class is 4 to 5 weeks long, and includes help with things like setting a budget and setting financial goals. In addition, the organization has a statewide training partner that does home ownership counseling. CEI also recently developed an online tutorial and distance learning workbook. PCV is developing an IDA program and it is likely that Consumer Credit Counseling Service will do the financial literacy training for participants in their program.

Other CDVC funds link their portfolio companies with local nonprofit providers of financial literacy training on an as-needed basis.

---

---

## **VIII. CONCLUSIONS AND NEXT STEPS**

Community development venture capital funds have an opportunity for creating a new paradigm for growth companies to benefit their communities more broadly by building the assets of their employees. This study documents how employee engagement and asset building can contribute to business success. CDVC funds can help illustrate a path for reversing the increasing social and economic inequities that have accelerated in the U.S. economy in the last few years. These funds can demonstrate that growth companies in a diverse array of industries can rapidly create quality domestic employment and social advancement for low-wealth individuals. The tools described in this report (broad-based stock options, ESOPs, IDAs, retirement plans, and profit sharing and bonuses) are effective means for companies to create these shared gains and become national models.

### **A. MARKETING TOOLS**

SJF Advisory Services has developed several marketing pieces for portfolio and prospective companies in relation to the asset-building tools researched in the Beyond Paycheck-to-Paycheck Initiative. This includes a discussion of the use of asset building tools and other employee benefits in hiring and retaining employees, as well as some definitions of the various types of tools (Appendix I). There is also a “Resources for Employees” directory (Appendix J) containing numerous online and other resources related to stock options and financial planning.

### **B. DOCUMENTING RESULTS**

CDVC funds have begun to document not only their financial but also their social results. Such documentation will be crucial for assessing whether or not the field is achieving its desired mission results. For example, Pacific Community Ventures publishes an annual report that documents employment-related community impact. In addition, SJF Advisory Services recently conducted its third annual mission impacts survey of SJF Ventures’ 15 portfolio companies. The survey contained questions about employee compensation, benefits, training opportunities, environmental impacts, and best practices. The resulting mission impacts report is attached. The survey was useful in clarifying issues relating to SJF portfolio companies’ existing employee asset-building programs.

### **C. NEXT STEPS**

SJF is publishing the findings from the Beyond Paycheck-to-Paycheck Initiative on our website, and presented it to the CDVCA annual conference in New York in March of 2004. We are planning a major public release of the study to publicize the results broadly in the venture capital and entrepreneurial fields. The long-term social benefits projected in this report depend on implementation via CDVC fund exits over the next few years.

---

---

A useful SJF follow-up might include annual updates over the next three to five years focusing on actual business and employee results from CDVC fund exits from portfolio companies.