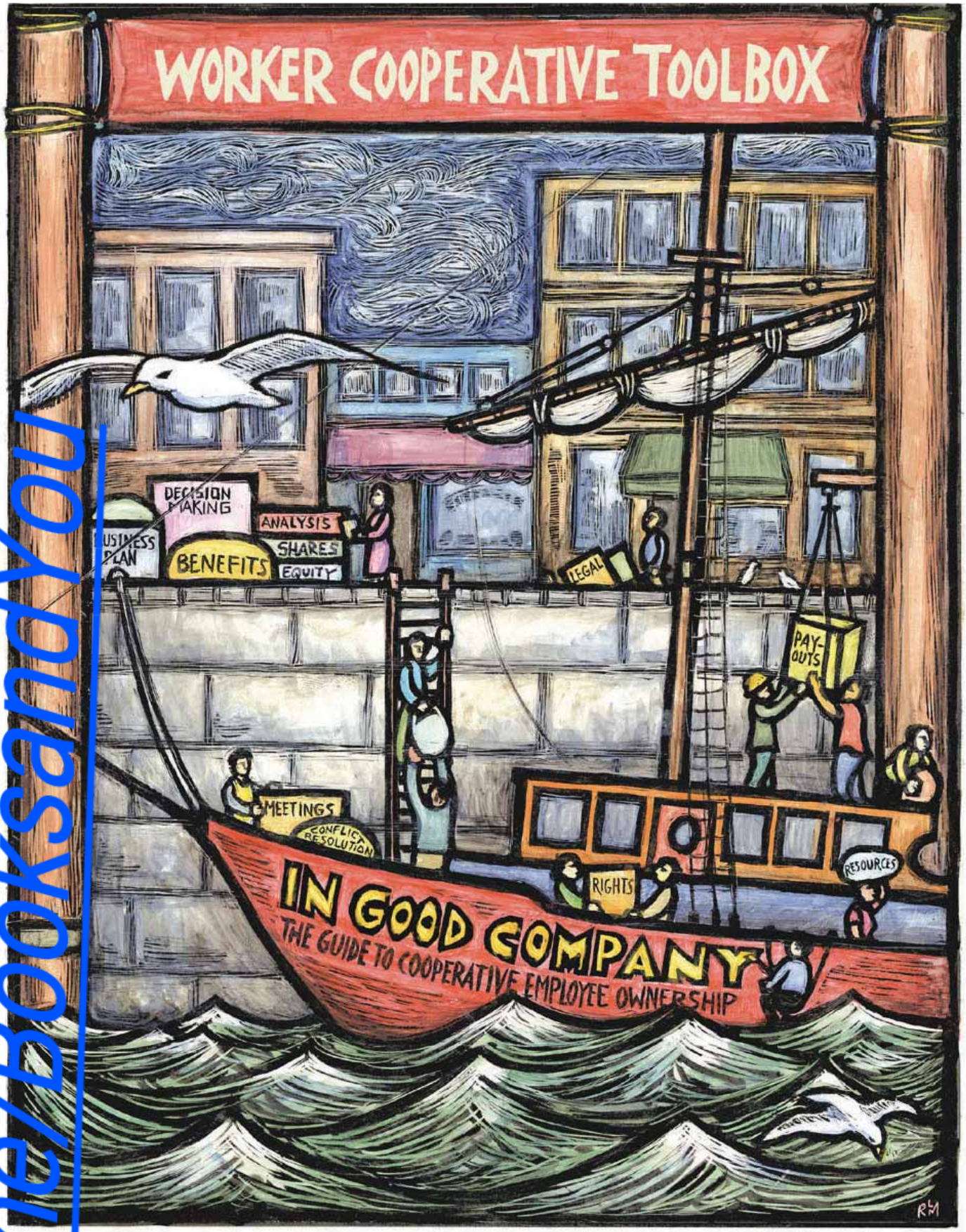


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WORKER COOPERATIVE TOOLBOX

In Good Company: A Guide to Cooperative Employee Ownership

Published by Northcountry Cooperative Foundation
in partnership with Northcountry Cooperative Development Fund
with special funding from the United States Department of Agriculture

Acknowledgments

This publication is one in a series of toolboxes published by the Northcountry Cooperative Foundation. Funding for the development and production of this toolbox was provided by a grant from the United States Department of Agriculture.

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Thanks to:

Margaret Lund, Northcountry Cooperative Development Fund
Kerstin Larson, Volunteer in Service to America (VISTA)
Newell Lessell, ICA Group
Tom Pierson, consultant
John McNamara, Union Cab
Emily Anderson, consultant
Don Jamison, Vermont Employee Ownership Center
Kim Rice, Volunteer in Service to America (VISTA)
John Logue, Ohio Employee Ownership Center
The University of Wisconsin Center for Cooperatives
Rural Cooperatives Center at the University of California–Davis

Cover illustration by Ricardo Levin Morales.

About the Publisher

Northcountry Cooperative Foundation (NCF) is the nonprofit, educational affiliate of the Northcountry Cooperative Development Fund (NCDF). NCDF was founded in 1978 by a group of natural foods consumer and worker cooperatives whose members wanted to invest their capital in business activities that supported their values. What began as a simple tool for self-preservation—a handful of co-ops lending money to each other because no one else would—soon grew into one of the first community-development loan funds in the country, and a model for community-based capital control.

Since its founding, NCDF has made millions of dollars in capital available to a range of small consumer, worker, housing, and producer cooperatives and their members, playing an instrumental role in the success of these enterprises. From its beginning as a collaboration of local cooperatives, NCDF has grown into a regional network of more than one hundred community-based, democratically owned and governed enterprises.

NCF, as the nonprofit arm of NCDF, was formed to more effectively carry out and expand the educational and technical assistance activities with which NCDF has long been involved.

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INTRODUCTION

THE PURPOSE OF THIS GUIDE

In today's dynamic marketplace, employee-owned cooperatives can provide a wide variety of workers with business-ownership opportunities offering a range of benefits that are hard to find in any other corporate structure: democratic governance, enhanced job security, and profit sharing based on labor input. Employee-owned businesses can also provide unique economic benefits to local communities by generating locally based economic activity and anchoring capital in a community. Because worker co-ops are owned by employees rather than investors, they create a situation where engaged, local ownership can flourish, rather than absentee ownership. Local ownership keeps more dollars revolving in the local economy, creates jobs, provides a wide range of goods and services, and offers a forum to strengthen civic society.

Worker cooperatives are easy to set up and run, allow for a great deal of flexibility, and are applicable in almost any business sector. Home health-care workers, teachers, computer programmers, machinists, bakers, ship builders, car-repair technicians, engineers, carpenters, cooks, taxi-cab drivers, and retail salespeople have all organized their businesses as employee-owned cooperatives. An existing business can be converted to an employee cooperative structure, or an interested group of individuals can start an entirely new business as a co-op. The options are limited only by the creativity and needs of community leaders, residents, and entrepreneurs. This guide was created by NCDF to assist potential co-op members and their partners in choosing, planning, organizing, and supporting new and existing employee-owned cooperatives.

Throughout the guide, we will use the terms "employee cooperative" and "worker cooperative" interchangeably.

CO-OP BASICS

WHAT IS A CO-OP?

The International Cooperative Alliance defines a cooperative as "an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." It is, essentially, an enterprise formed by a group of people who join forces and work together to solve a problem or reach a goal that they all share. In a cooperative, only members are permitted to own common shares of equity. All cooperatives are owned and governed democratically, applying the principle of "one member, one vote."

Cooperative members come from all walks of life, and they are all ages and belong to all income groups. People form and join cooperatives to meet all sorts of needs, and they buy and sell all kinds of products and services, ranging from child care to groceries to agricultural products to financial services. There are cooperative day-care centers and cooperative burial societies. There is probably a cooperative somewhere in the country to meet every kind of need imaginable.

Cooperatives are differentiated from other business entities in three ways: member ownership, member control, and member benefit. A cooperative is an enterprise where ownership, control, and benefit are all held by the same group of people: the cooperative members.

JOINT OWNERSHIP

Co-op members are not just customers, employees, or users of the business—they are also the business owners. In an investor-owned business, owners are concerned mainly with making money. In a cooperative enterprise, by contrast, member-owners are concerned not only about whether the enterprise is making money, but whether the business is meeting the needs of its member-owners. These needs may be economic (making a fair wage), non-economic (contributing to a healthy environment, or setting an example of worker participation in business management), or some combination.

DEMOCRATIC CONTROL

Participation in the decision-making process is one of the primary ways business owners exercise their rights as owners. In a typical investor-owned company, each investor casts votes in direct proportion to the number of shares the investor owns—that is, more shares equals more votes equals more control. In a cooperative ownership structure, by contrast, control is vested with each member, not each share of stock. This means that each member casts one vote in any business decision that is put before the membership, regardless of the number of shares owned. Cooperatives are operated according to the democratic principle of "one member, one vote."

Co-ops are led by member-elected boards of directors. The co-op's manager or other top staff report directly to the board. Since the board members are the ones who will be leading the organization and making key decisions on behalf of the membership, the most important vote that any co-op member makes is for the board of directors. In a worker co-op, all members engage in electing their top leadership. In an investor-owned business, by contrast, the board of directors is typically composed of top company management, plus some outsiders.

MEMBER BENEFIT

Cooperatives are operated for the benefit of their members. Like any business, a cooperative must make at least as much money as it spends, but spending decisions are also based on delivering the greatest value to members. In an investor-owned business, profits are distributed based on the number of shares owned. In a cooperative, net income (income over and above expenses) is redistributed back to the members based on some equitable system. This system is called "patronage" and the redistributed profits are called "patronage rebates," "patronage refunds," or sometimes "patronage dividends." Members are "patrons" of the co-ops, and profits are redistributed back to members based on how much business they do with the co-op (that is, how much they "patronize" it). In a producer co-op, this might be how much grain, milk, or other product the farmer-member markets through the cooperative. In a consumer co-op, patronage refunds would generally be based on the total annual purchases from the co-op. In a worker co-op, patronage is measured based on an equitable formula of labor input, either according to hours worked, pay level, seniority, or some combination of all three (see p. 33). Thus, while a conventional investor-owned business provides returns based on capital input, a worker cooperative provides returns based on labor input.

Because cooperatives are operated for the benefits of members and not as speculative investment vehicles, they function essentially at cost. This fact means that cooperatives enjoy the attractive tax benefit of single taxation. In an investor-owned corporation, profit is taxed at the corporate level before it is distributed to members as dividends. Individual stock owners must then pay tax a second time on this income at their individual level. In a co-op, by contrast, only profits that are kept by the company as retained earnings are taxed at the corporate level. Earnings that are passed through to members are only taxed once, at the individual level.

COOPERATIVE PRINCIPLES

Equity. Equality. Self-help. Self-responsibility. Democracy. Solidarity. These are the values on which the modern cooperative movement was founded and the basis for the organization of every cooperative enterprise in the world today.

The Cooperative Story

The origins of the modern cooperative movement can be traced to the city of Rochdale, England, at the beginning of the Industrial Revolution. In 1844, a group of industrial trade unionists, tired of the poor quality and high prices of goods sold through the company store, set out to make things right. The Rochdale Society of Equitable Pioneers opened its first cooperative store on Toad Lane.

From the outset, the group's purpose was more noble than simply selling quality, affordable provisions and clothing. It also proposed the building of houses "in which those members desiring to assist each other [in] improving their domestic and social conditions, may reside." The group also recommended "the formation of worker cooperatives to help the unemployed; the purchase of land for common cultivation; and the promotion of education and sobriety." While some of these early efforts were more successful than others, the clarity, consistency, and breadth of these cooperative principles are striking. From the beginning, these co-op pioneers envisioned cooperatives as a way to give ordinary people

> Cooperatives are based upon the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others.
>
> — International Cooperative Alliance website

greater control over their lives, to improve their economic conditions, and to protect them during hard times. These principles, developed more than 150 years ago, live on today in the thousands of cooperative institutions that exist throughout the United States and the world.

Is there any relationship between worker co-ops and the labor movement?

The original Rochdale Pioneers were trade unionists, of course. During the Industrial Revolution, worker cooperatives and trade unions were both organized to address radical changes in the workplace. Early worker cooperatives in the United States were often the product of parallel trade union organizing; by the 1880s, the Knights of Labor, the leading national labor organization of the day, had established over one hundred cooperatives. Cooperatives were an important part of that organization's organizing strategy for bettering the lives of working people. Links between the two movements also spread in Europe. With the end of World War II, the two major U.S. trade union federations merged into the AFL-CIO, and the new organization stopped organizing efforts to create cooperatives as a means of owning and controlling businesses and instead concentrated on improving working conditions in privately owned companies. In the last twenty-five years, some U.S. unions, such as the Steelworkers, have accepted and advocated worker cooperatives and ESOPs as strategies for creating and saving jobs, but the examples have been few. In Europe, however, formal connections between cooperatives and trade unions remain, and in some areas of the world cooperatives are working together with trade unions to form new worker cooperatives: COSATU in South Africa is one strong example of such a development.

Co-ops Today

Any type of business can be a cooperative. In the United States the largest co-ops are often agricultural co-ops and credit unions. Indeed, since the beginning of our nation, farmers and ranchers have joined together to pool the funds and manpower necessary to process or harvest their goods. Credit unions are often developed by employees of large organizations to provide financial services to their members. The largest worker co-op in the United States is Cooperative Home Care, a worker-owned home health-care agency in the Bronx, New York, with 550 members.

Co-ops also abound internationally. In Quebec (Canada), Northern Italy, India, and Japan, for example, cooperatives play a significant role in the national and regional economies. The most famous worker co-ops in the world are the Mondragon cooperatives in the Basque region of Spain, an association of over one hundred cooperative enterprises, forming an entire cooperative economy in which factories, schools, banks, retail stores, and services operate on a cooperative basis.

The Mondragon Cooperatives

"The now extensive Mondragon Cooperative Corporation (MCC) was started in the late 1950's, building on the philosophies of José María Arizmendiarrieta in the Basque region of Spain. Now the eighth largest business corporation in Spain, the MCC has grown from a loose organization of only a few industrial worker groups to an association of over 100 grass roots cooperatives with more than 3,000 worker owners. It is by far the largest worker cooperative system in the world and is often held up as an example of the great potential and flexibility the worker cooperative model holds."

—University of Wisconsin Center for Cooperatives Bulletin no. 5 "Worker Cooperatives"

People have certainly been initiating cooperative endeavors throughout the ages. The most significant contribution of the Rochdale Pioneers is that they established a set of ethics, known as the seven cooperative principles, that are still the root of co-op philosophy today. The current articulation of these seven principles, approved by the International Cooperative Alliance (ICA) at a 1995 meeting that celebrated the 150th anniversary of the modern cooperative movement, is as follows:

1.Voluntary and Open Membership

Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership without gender, social, racial, political, or religious discrimination.

2. Democratic Member Control

Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives, members have equal voting rights (one member, one vote), and cooperatives at other levels are also organized in a democratic manner.

3. Member Economic Participation

Members contribute equitably to, and control democratically, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members allocate surpluses to any of the following purposes: developing their cooperative, possibly by setting up reserves, part of which would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. Autonomy and Independence

Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. Education, Training, and Information

Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefits of cooperation.

6. Cooperation among Cooperatives

Cooperatives provide the most effective service to their members and strengthen the cooperative movement by working together through local, national, and international structures.\

7. Concern for Community

Cooperatives work for the sustainable development of their communities through policies approved by their members.

WHAT IS AN EMPLOYEE-OWNED OR WORKER-OWNED CO-OP?

THE BASICS

The key differences between a worker cooperative and a conventional business are the elements of control and ownership. In a conventional corporation, the rights to elect the leadership of the organization and share in its profits are based on capital. The number of shares owned determines the amount of influence and control, as well as the amount of profit earned. In an employee-owned cooperative, the employees both own and control the business. The rights to elect the board of directors and share in the company's profits are based on being a member of the company's workforce and purchasing a member share. Each cooperative member has one vote in the board election and shares in the profits on the basis of an equitable formula established in the company bylaws. Management controls the daily operations in both a worker cooperative and a conventional company. In a worker cooperative, however, the members as owners have the right to select management, a task that is typically (though not always) delegated to the board of directors.

> Democracy is a method for people to govern themselves, not a method for property owners to govern their property.
>
> David Ellerman

Worker cooperatives are the only legal business structure that guarantees workers an equitable share in company proceeds. It is also the only business structure that consciously promotes and facilitates self-determination: in a worker cooperative, members really do control their own destiny.

It is important to note that a cooperative is an ownership and governance mechanism. The employee-owners share an objective and contribute equitably to and benefit equitably from the capital of their cooperative. The employee-owners share the full range of risks and benefits that come with business ownership, including deciding how the net income or net losses are allocated. They also share in governance and control of the enterprise, electing the board of directors democratically and making important decisions about the future of the business. Ownership by employees does not dictate a particular management style, however. Worker co-ops typically, although not always, have a more participatory and less hierarchical management culture than conventional businesses do; they often solicit input and grant workers key decision-making roles in the everyday operations of the business. Some worker co-ops even manage the entire enterprise in a consensus-based collective manner. In any case, the management structure is determined entirely by the board of directors and can also be adapted over time to address changes in the business. **The key is that the shared ownership and governance structure of a cooperative allows its employee-members to dictate for themselves the benefits they seek to share and enjoy.**

Rights and Responsibilities of Worker-owners[1]

Financial participation rights
- Investment of labor
- Share in profit

Financial participation responsibilities
- Investment of labor
- Productivity
- Membership fee/capital requirement
- Share in risk

Governance participation rights
- Vote for board of directors (one member, one vote)
- Serve on board of directors
- Participate in decision making

Governance participation responsibilities
- Communicate, share information
- Learn about business and industry
- Develop leadership, accountability, and mutual trust
- Balance individual needs/interests with business needs/interests, and also often with community needs/interests

Divisions of Power in a Worker-Owned Cooperative

Worker-owner Members	Board of Directors	Chief Executive Officer (CEO)
Adopt and amend bylaws.	Defines yearly goals as well as policies necessary to implement goals.	Prepares budgets, production plans, marketing plans, and all other plans necessary for the implementation of the goals and policies approved by the board.
Elect Board of Directors.	Selects CEO, defines duties, and sets salaries.	Defines duties of division and department heads.
Ratify annually and review semi-annually the goals of the business plan.	Controls finances: 1. Ratifies financing plans/budgets 2. Approves changes in above.	Hires/fires within framework of personnel policies. This power may be delegated.
	3. Approves loans.	
Ratify any drastic alteration of the business plan or philosophy.	Ratifies personnel policies with the exception of hiring/firing. In the latter case, recommends policies to the membership, who then make the final decision.	Coordinates the implementation and administration of all policies.
Review any sale or purchase of any major asset, such as a building.	Evaluates performance of the CEO.	Evaluates employees. This power may be delegated.

[1] From Frank T. Adams and Gary B. Hansen, "Putting Democracy to Worker: A Practical Guide for Starting Worker-owned Businesses."

Another forms of employee ownership:

Employee Stock Ownership Plans

Employee stock ownership plans (ESOPs) also provide employees with a successful ownership model that allows them to own shares of stock in their company without having to pay taxes on the shares until they retire or leave the company. The goal of an ESOP is not necessarily to provide employees with direct control over their company. Instead, it is to broaden the ownership of wealth to motivate employees and increase productivity.

While sometimes simply added as an employee benefit, many ESOPs are instituted primarily as an ownership succession strategy, as the ESOP allows certain tax benefits for an owner who sells at least 30 percent of company stock to an ESOP.

In an ESOP, the company sets up a fund for the benefit of the employees. This fund, or ESOP, borrows money from a bank and passes it to the company as capital. Annually, the company passes profits or wage concessions from employees to an employee stock ownership trust (ESOT), which pays off the loan. As the loan is repaid, the company deposits the value of the repaid loan in stock into individual employee accounts based on wage levels or seniority. The company is provided substantial tax benefits, as an ESOP allows the company to repay both principal and interest out of pretax earnings. Employees do not have access to the stock until they leave the company or retire, at which time they are taxed on their earnings.

While ESOPs provide employees with stock ownership, it is rare that employees benefit from control of governance or operations. Most often, employees don't have the ability to vote their shares of stock, elect directors, or oversee management. Instead, the employee stock ownership trust owns and votes the stock. Voting rights, when they exist, are based on shares of stock owned, rather than membership. ESOPs are most often employed for large companies (more than twenty-five employees). Employee stock ownership plans are governed by complex retirement plan laws. As such, they require annual stock appraisals, periodic legal revisions to stay current with changing ESOP laws, a third-party administrator, and an ESOP trustee. These added administrative costs make an ESOP structure cost-prohibitive for smaller businesses and new companies.

It is possible for ESOPs to be organized in a more democratic manner. Democratic ESOPs are financed in the same way that non-democratic ESOPs are. However, employees also have the ability to appoint the trustees of the employee stock ownership trust, and the trust is directed to vote its shares on any issue according to the outcome of an employee vote. Employees in a democratic ESOP may also have a voice in major policy decisions on a one-member, one-vote basis.

WHEN DOES AN EMPLOYEE CO-OP MAKE SENSE?

A successful employee-owned cooperative doesn't have to be big or small, or be in a certain sector of the economy. Employee ownership can be successful in virtually every line of business. However, successful employee-owned cooperatives do have some things in common. If you are aware of these characteristics, you can make a wise decision about whether or not this structure makes sense for you. **A key characteristic of successful cooperatives is the ability to find a balance between entrepreneurial business acumen and an understanding and commitment to the principles of shared ownership.** The following are indications of this balance:

- Your members have a clear commitment to and understanding of worker-ownership and cooperative principles.
- Your members provide a product or service that is in demonstrated demand by the market; you have a viable business concept.
- Your co-op has access to adequate financing, including meaningful capital contributions from members, in the form of cash, labor, or both.
- Your co-op selects and develops a quality management team, either by recruiting from outside the firm or by consciously developing from within. Quality managers do not have to have MBAs, but they do need to have a firm understanding of the business and the environment in which it operates.
- Your co-op provides membership to individuals with the technical skills and knowledge to make the business a success, and provides those individuals with the tools and environment necessary to succeed.
- Your co-op places an emphasis on electing experienced directors with a clear commitment to building a fiscally sound organization and working on behalf of the membership overall.
- Your co-op can aggressively position itself for changes in operations, markets, and member needs.

This list represents an ideal set of circumstances that may or may not ever be present in full and at the same time in real life. Don't let it discourage you; let it inspire you. Hard work and perseverance can be powerful forces.

Because continuity is vital to effective governance, worker cooperatives typically do not work well in industries where there is a high amount of turnover, or where almost all labor is seasonal. That said, some worker co-ops have been started (particularly in the building trades) specifically to counter industry-wide trends toward high seasonality and turnover, and have concentrated on providing their members with the benefits of year-round work.

CO-OP CASE STUDY

Builders' Commonwealth

Builders' Commonwealth is a design-build construction cooperative of 44 member owners who have been serving Duluth, Minnesota, for over 30 years. At Builders' Commonwealth, all members are owners. There are no employees at the cooperative, and all owners take "draws" from the cooperative's monthly earnings instead of wages, a system the co-op feels reinforces the notion of "ownership" instead of "employment."

The cooperative distributes profits and losses to owners on an annual basis. This is based upon the year's financial performance. At the close of their fiscal year, the cooperative's owners meet and vote on that year's profit disbursement. Owner advance rates are set and adjusted by an elected Personnel Committee. This committee determines "advance rates" for hourly work by each member. The committee also coordinates the hiring of new members. Advance rates are set based upon skill and productivity. Seniority, inflation, and the results of annual peer reviews all factor into annual increases.

At Builders' Commonwealth, every member-owner is a Board Member. The Board elects a four-member Executive Committee whose responsibilities include setting policies and approving capital purchases. A Management Committee is made up of department managers and they are responsible for the day-to-day mechanics of operating the business. The Executive Committee conducts policy overview and approves managers' expenditures in excess of $1,000. All of Builders' committee members are compensated on an hourly basis. Sometimes this reimbursement is capped, such as a two-hour max for meetings, etc. This strategy keeps the discussion moving forward.

Arno Kahn, a founder of the Cooperative, says that the principle difference between Builders' Commonwealth and corresponding conventional business is that "we want everyone to feel like an owner and behave like an owner. They're self-supervising, and self-motivating. All members work to the best of their ability to enhance the reputation and profitability of the organization." The hardest thing about the worker-ownership model for Builders' Commonwealth is that new owners are unfamiliar with the lack of disciplinary tools at the co-op and the emphasis on peer review. New managers also must acculturate to a different way of supervising member-owners.

Arno Kahn attributes the cooperative's long-term success to the members. They like what they do, are proud of doing a good job, and tend to stay with the job longer than the industry average.

Clarifying shared objectives and priorities is also important. Objectives may be to provide a product or service in a marketplace, to develop a cooperatively owned workplace, or to fulfill a community need. There may also be secondary objectives that are worth defining, such as providing the opportunity to own and control a business or creating a satisfactory workplace. All are worthwhile goals. Being in basic agreement about goals will help your co-op start and stay on the right track.

A cooperative may be a good structure in the following situations:

- **A new start-up business.** When there is a group of people with shared business ethics who want to own and control a business democratically, an employee-owned cooperative may be an appropriate business structure.
- **A conversion from an existing conventional business when the current owner is retiring.** When a small business owner considers leaving the business for retirement or other reasons, he or she may consider selling to the employees. A retiring owner may be able to realize significant tax benefits by doing so (see Appendix F). A conversion from a conventional business to an employee cooperative is most appropriate for a business has fewer than twenty-five employees (for larger businesses, a democratic ESOP may be more advantageous); has employees who have made a long-term commitment to the business; and is a place where the relationship between owners and employees is strong.
- **Saving a business from closing**. Employee ownership may be a viable way to save a division or site of an investor-owned business that is being closed due to insufficient (but not negative) profitability.
- **Hybrid worker-community ownership: "Solidarity cooperative."** Though a fairly new concept in the United States, several cooperatives in Quebec, Canada, have pursued a hybrid ownership structure in which patrons, employees, and other interested parties share joint ownership of a business. This is particularly relevant for co-ops where both employees and patrons have a particularly high stake in the business, such as co-ops that provide early childhood education or home health care, or rural businesses that may provide the only access to fuel, groceries, or medical services in a region. In such a structure, patrons, employees, and regional stakeholders sit on the board of directors according to a ratio set out in the cooperative's bylaws.

An employee cooperative is a business enterprise, and as such, it requires careful planning, analysis, and market research to succeed. While basic business planning and feasibility analysis are beyond the scope of this book, many good references exist that can help you with this part of your work. A basic business plan outline is included in Appendix C.

Also keep in mind that the right advisors can make the difference between, if not success and failure, at least ease and difficulty. Cooperatives are a specialized area of legal, accounting, and tax practice. Make sure your advisors know the relevant law. For help finding advisors who are knowledgeable about cooperative law and practice, contact your state association of cooperatives, the National Cooperative Business Association, or cooperative advisory groups, like the Northcountry Cooperative Development Fund. Given their uniquely democratic nature, cooperatives will also often benefit from advice in the area of process and governance. A good consultant can save you a lot of time getting where you want to go. Find one with particular expertise in the area of participatory management and inclusive decision making if that is what you want for your co-op.

FUNDAMENTAL ELEMENTS OF AN EMPLOYEE COOPERATIVE

A cooperative structure provides for democratic control of two interdependent, yet distinct, aspects of the business: the financial ownership of the cooperative and its governance. A co-op should have a well-articulated system of member participation in each of these two uniquely democratic aspects of the business. In addition, each co-op must make decisions on a range of other issues that in turn affect both ownership and governance. Structuring a cooperative to allow for perpetuity and growth requires key decisions in the following areas:

- Legal form
- Membership
- Governance
- Capital structure
- Allocation of profits
- Stock valuation and repurchase practices
- Dissolution
- Management

Some of these decisions may seem daunting, but they are important and even accessible if you take them one by one. A co-op is an organization designed to operate in perpetuity; as such, it is worth thinking about how the cooperative will look in ten, twenty, and even thirty years, after several generations of leadership have come and gone. Co-ops are fluid organizations, designed at their best to receive input from many quarters. You will need to think hard about what things about your co-op could change over time, and what things are essential to the nature of the enterprise and should remain the same. If you don't decide these things at the beginning, you may be forced to decide them later on when you don't expect to, such as when there is a crisis, or after philosophical changes occur with new worker-owners who have entered the business. **It is worth the time and trouble to proactively design your cooperative in the best way possible so you can deliver the benefits your members desire.**

A word about culture: every organization has one, whether it chooses it proactively or accepts it passively. Culture is the institutional attitude toward organization, community, competition, and authority. Two main factors determine the culture of a cooperative: the industry within which it operates, and the people who make up the membership. Co-ops, unless they are very small, will eventually hire people who care more about a stable paycheck than they do about the "movement." These folks will influence the culture. If one of the reasons for starting the co-op was to provide an alternative to "business as usual" in a particular industry or in society in general, these values must be codified both in word and practice. The time to have the maximum effect on creating the culture you want in your cooperative is at the very beginning, when everyone coming in has a shared sense of enterprise and belief. Similarly, the best time to formally introduce a new member into the values and culture of the cooperative is during his or her first days.

A cooperative structure is not second nature to many people. In today's business climate, working collaboratively rather than hierarchically with a group of people sharing common interests is relatively uncommon. **To start shaping your group's development into an employee-owned cooperative, begin by modeling best practices from the start: set agendas, run business-like meetings, document important decisions, divide up responsibilities, be accountable to each other, educate yourself, celebrate, be honest, be kind, keep an open mind, set priorities, and try for what you really want.**

LEGAL STRUCTURE

A cooperative is governed by a set of legal documents that must be structured according to the statutes governing cooperatives in the state where the business will be located. Each state has slightly different requirements, so check with an attorney who is familiar with cooperative law in your state. To incorporate, you will be required to name your cooperative and file articles of incorporation with the office of the secretary of state. Many states require that the word "cooperative" be in a cooperative's name. It is advisable to develop the cooperative's bylaws at the same time.

Formal incorporation shields individual members from responsibility for the co-op's debts. If a legally incorporated co-op fails financially, the workers stand to lose their initial investment and any profits accumulated in their internal capital accounts, just as any business owner would. But personal assets are generally not at risk in a worker cooperative unless a worker has chosen to put them at risk through a personal guarantee on a loan.

Articles of Incorporation. The articles of incorporation constitute the legal document that establishes the cooperative as a legal business entity, subject to the laws of the state in which the co-op is chartered. The articles state the name under which the co-op will operate and the purpose of the corporation. They are the backbone of the co-op and can be difficult to amend.

The articles also define the classes of stock that the cooperative is allowed to issue and how many shares of each kind. Cooperatives can only issue one class of common stock (to members), but may be able to issue other classes of stock, such as preferred shares.

Articles of incorporation should enable the corporation to function on a cooperative basis, allow the project to operate at cost, and allow for patronage rebates to members. Properly constructed, the articles allow the cooperative to operate, for tax purposes, under subchapter T of the Internal Revenue Code, which provides for a single level of taxation, which minimizes tax cost.

The articles should state the purpose of the corporation, which should be articulated in general terms. For example, as an employee-owned cooperative, you might state that the cooperative's purpose is "to engage in any lawful activity primarily for the benefit of the employee-members."

The articles must also provide for their own amendment and for the operation of the corporation through its board of directors. The following are sample sections of a co-op's articles, based on Minnesota law:

Articles of Incorporation

Article I	Name
Article II	Location of Principal Place of Business
Article III	Location of Registered Office
Article IV	Name and Address of Resident Agent
Article V	Purpose
Article VI	Number of Directors
Article VII	Capital Stock
Article VIII	Distribution of Dividends
Article IX	Names of Incorporators and Initial Directors
Article X	Membership Termination
Article XI	Duration

Bylaws. The bylaws of the corporation state how the corporation will operate, how meetings will be held, how many directors will serve on the board, the structure of membership meetings, and other rules of the corporation. **The bylaws are the basic blueprint for how the co-op will operate, and the place where the members of the co-op really define for themselves the institution they are creating.** The bylaws generally can be amended by a majority vote of the membership, but given

the importance of the document and the elements it contains, many co-ops set the standard for changing the bylaws much higher, at 75 percent or more. Amendment procedures are outlined in the bylaws. Board members, in particular, should be familiar with the bylaws, which should be reviewed on an annual basis.

The following are sample sections of a co-op's bylaws:

Bylaws

Article I	Name and Location of Corporation
Article II	Purpose and Powers
Article III	Membership and Membership Shares
Article IV	Internal Capital Accounts
Article V	Member Meetings
Article VI	Directors
Article VII	Officers
Article VIII	Committees
Article IX	Financial Regulations
Article X	Seal
Article XI	Waiver of Notice
Article XII	Repeal or Amendment of Bylaws
Article XIII	Dissolution and Property Interests of Members

Cooperative bylaws spell out the particulars of cooperative functioning. Bylaws should do the following:

- Set voting rights.
- Allocate power between the general membership and the board of directors.
- Provide details of the cooperative's operations.
- Provide guidelines for amending the bylaws.
- Define membership, including who is eligible and how much shares will cost.
- Set forth the relationship between the individual member and the corporation.
- Set forth the distribution of capital account funds at termination from the cooperative and at dissolution of the cooperative.
- Provide for the establishment of operating rules, which may be more fluid and easier to change than the text of the bylaws.

In addition to worker co-ops, employee stock ownership plans (ESOPs) are a common shared ownership strategy (see pp. 10). Worker-owned companies can also create their own brand of employee ownership through a conventional vehicle, such as a partnership or limited liability company. A relatively new innovation in cooperative law is the formation of cooperatives that allow for membership based on invested assets, in addition to traditional patron members. In Minnesota, the relevant statute is 308b, so these kinds of co-ops are sometimes called 308b co-ops.

The table on pages 18 and 19 outlines some of the differences in ownership structures.

CO-OP CASE STUDY

South Mountain Company

South Mountain Company is an environmentally conscious construction company in West Tisbury, Mass., that can participate in every aspect of the development process from design to construction.

The company began in 1975 as South Mountain Woodwork, a custom cabinetry shop. In a fully equipped woodworking shop they continue making cabinets, millwork, and built-ins. It became a sole proprietorship owned by John Abrams in 1984. After two years he converted it into a cooperative with three members.

Today with 15 owners and another 15 on track to become members, the company employs a management structure familiar to for-profit enterprise: four departments managed by individuals or small teams. A committee structure handles executive, production, design, and personnel matters.

Managers or teams are responsible for day-to-day management decisions that must be made quickly. The board of directors makes the more deliberative policy/governance decisions—accepting new owners, compensation, profit sharing, planning, expansions, new ventures, investments, donations, and involvement in community projects. All worker-owners serve on the board.

Owners evaluate employees annually. After five years and 7,500 hours worked an employee becomes membership-eligible. The process is transparent and clearly defined. If approved by the board of directors, they must invest equity of $11,000—enough to require a commitment. An employee may take up to 36 months to pay in their equity. After 50 percent is paid, they become full members of the co-op with voting rights and profit-sharing benefits. When a member decides to leave the co-op, their investment is paid out to them over a 10-year period (or a prorated amount for shorter periods) to preserve the financial stability of the cooperative. Certain profits are held in an “Internal Capital Account” and are, for the most part, only accessible to employees upon their departure from the company.

Cooperative member John Abrams has this advice for worker co-ops:

- Transition to cooperative ownership slowly with a long probationary period, to gauge commitment and allow an employee to get used to worker ownership
- Employee ownership is not a panacea; a dysfunctional business will be a dysfunctional co-op. However, worker ownership provides an avenue for fairness, transparency, and shared responsibility.

EMPLOYEE OWNERSHIP COMPARISON Source: The ICA Group

Issue	Worker Cooperative	Worker Cooperative 308b	ESOP	Custom Worker Ownership Plan
Ownership structure.	One share per person common stock. Can also have preferred stock (return on preferred stock is limited).	Can have both member shares and investor shares.	Very flexible. Ranges from equal distribution to a complex formula based on salary, years of service, and hours worked. Allocated according to predetermined formula. Can be full or partial ownership	Not regulated. Can be based on any formula chosen.
Legal structure.	Simple, but not familiar to all attorneys. The ICA group has a set of model bylaws available. Can be organized as an LLC or a C corporation if articles and bylaws are structured appropriately.	Recognized in Minnesota. Similar forms exist in a handful of states. A new form, so will not be familiar to many attorneys.	Relatively complex, but familiar to many attorneys.	Regular C corporation, S corporation, or LLC
Regulation.	Little except for tax issues.	Little except for tax issues.	Highly regulated.	No additional regulation.
Voting rights.	One person, one vote.	One person, one vote if it is going to be a true worker cooperative. Patrons must retain at least 50 percent voting control on board of directors.	One person, one vote or one share, one vote. One share, one vote on supermajority issues.	One person, one vote or one share. one vote. One share, one vote on supermajority issues.
Adding new members.	Co-op sets probationary period.	Co-op sets probationary period.	Everyone over 21 with one year of service becomes a member. ERISA requirements ensure that allocation policy will be clear.	Not regulated. Requires careful planning to ensure that model is dynamic and provides clear blueprint for how new members will be added and how future stock allocations will be handled.
Allocation of profits.	Based on hours worked or wages earned. May take into account other factors, such as seniority.	Profit allocation for patrons based on patronage. Profit allocation for investors based on shares held. Investor members can receive no more than 85 percent of profit, regardless of ownership stake.	Based on shares held.	Based on shares held.
Tax implication to company of paying dividends.	Cooperative pays members a patronage refund, which is a return on patronage, not capital. These payments are deductible at the corporate level.	Can elect to be taxed as partnership under subchapter K and avoid taxation at the association level. Alternatively, if meeting test of operating on a cooperative basis, could elect subchapter T.	Tax deductible.	Not tax deductible for C; LLC taxed as partnership has only shareholder-level taxation.
Tax implication to individuals of paying dividends.	Can be paid out or into “internal capital account” of individual. Complex accounting options. Patronage refunds are taxed as ordinary income.	For members, patronage dividend would be taxed as ordinary income.	Taxed as divided income with a maximum rate of 15 percent.	In C, taxed as dividend income with a maximum rate of 15 percent.

EMPLOYEE OWNERSHIP COMPARISON Source: The ICA Group

Issue	Worker Cooperative	Worker Cooperative 308b	ESOP	Custom Worker Ownership Plan
Need to withhold Social Security on dividends declared for worker-owners.	In dispute.	Same as worker cooperative.	No.	No.
Worker owner sale of stock.	Not permitted. When members leave, they must sell back to the company (or an incoming member).	Same as worker cooperative. Investor stock sales controlled by Articles.	Usually not permitted. When a member leaves the company, must offer them an opportunity to sell their stock back to the company.	May or may not be permitted.
Valuation of individuals' "ownership stake."	Book value.	Book value.	Fair market value based on independent appraisal. Independent appraisal must be performed annually.	Valuation method can be book value, independent appraisal, or pre-agreed formula.
Valuation of company if sold to a third party.	Fair market value.	Fair market value.	Fair market value.	Fair market value.
Costs: -Set up. -Annual maintenance cost.	 $5,000–$20,000. None.	 $5,000–$20,000. None.	 $20,000–$35,000 (more if complex) $7,500–$15,000	 $5,000–$20,000 None, unless chosen design requires annual valuation
Potential tax benefits to seller.	The law states that the seller can defer capital gains tax on the proceeds of the sale if they are invested in "approved securities." To date (June 2006) this has only been done once.	If meets cooperative test, would be the same benefit as worker cooperative.	Can defer capital gains tax on the proceeds of the sale if they are invested in "approved securities." At least 30 percent of sale proceeds to employees	None.
Outside equity investors.	Can only invest in preferred stock. May be difficult to attract investors because of limited return and control.	Permitted, but cannot receive more than 85 percent of profit regardless of ownership stake.	Permitted. The stock held by the ESOP trust must (in general) be voting common stock with the greatest dividend and voting rights of any class of common stock or preferred stock that is convertible into such voting common stock.	Permitted with no restrictions.
Potential for seller to retain partial ownership after sale to workers.	Seller can participate as preferred shareholder and/or hold a single share of common/membership stock (like all other members) if working in the cooperative.	Yes.	Yes, but seller's holding must be outside of the ESOP	Yes.
Bank financing.	Cooperatives are not well known to banks. Fewer options for bank financing.	Structure will likely be unfamiliar to banks.	Well understood by banks. In a C corporation, ESOP, loan interest, and principal are tax deductible, improving cash flow, which is attractive to lenders.	Well understood by banks.

MAKING MEMBERSHIP MEANINGFUL

WHO CAN BE A MEMBER OF A WORKER CO-OP?

Upon incorporation, every co-op makes the crucial decision of who the "patrons" are that the co-op is designed to serve, and therefore who is eligible to be a member of the cooperative. In a worker- or employee-owned cooperative, it is obvious that the employees are the class of individuals from whom the membership is drawn, but there are some important decisions to be made around membership. One decision is whether every employee be allowed to be a member. In general, the democratic nature of cooperatives argues for a broad approach to membership, one that gives the opportunity for membership to the widest range of employees possible. That said, many worker co-ops have good reason to choose a more restrictive membership policy. For example, a co-op in a very seasonal industry that experiences a great shift in the demand for labor from season to season may choose to offer membership only to those employees who work year-round, because those employees are arguably the most committed, and understand the business best.

While some worker co-ops allow new employees to become members and thus enter into a decision-making role from their first day, many worker co-ops institute a probationary period of at least six months to allow both the co-op and the employee to see if worker-ownership in the co-op is a good fit. This approach allows prospective members to learn about the co-op and the duties and obligations of membership before they sign on for the responsibilities of business ownership. Some worker co-ops give every employee who makes it past the probationary period a chance to join, while others leave that decision up to a vote of the membership. Some allow workers to vote as members while in the process of purchasing the required membership share, while others make employees wait until their shares are paid in full before they can vote.

Another important issue to decide is whether the CEO or other top management staff will be allowed to become members of the co-op. Most worker co-ops feel that, as with any other employee, the loyalty and engagement of the CEO is key to the success of the business, and that ownership is a way to facilitate that engagement. Some worker co-ops, however, feel that allowing the general manager to also be a co-op member concentrates too much power in one set of hands. In other co-ops, such as those that operate in the home health-care or home-cleaning industries, the general manager or CEO really performs a fundamentally different function than that of the cooperative membership at large—scheduling workers, ensuring contracts are followed, paying the bills, and so forth, but not performing the fundamental work of the co-op in the same way that other members do. In such cases, some co-ops treat the general manager as "hired expertise," rather than as a full-fledged member. For similar reasons, some worker co-ops decline to offer membership status to marketing personnel; they see them as performing a vital function for the co-op, but not one that defines its essential nature. Some co-ops allow management staff to be members, but not to serve on the board.

Whatever your co-op decides about membership status, **it is critical that membership policies and the membership process be fair and transparent.**

In a larger co-op, where not all members are on the board, co-op members will need to be educated about the co-op model, their co-op in particular, and how to participate effectively in a democracy. Remember, few people—regardless of their education level—are taught these skills in school. Exercising effective democracy for the benefit of themselves and their peers will likely be a new experience for most of your members. **Be sure to incorporate plenty of learning opportunities for members into your co-op process.**

GOVERNANCE AND DECISION MAKING

Selecting the Board

The greatest threat to the survival of a cooperative is a poorly performing board of directors.

Being a positive participant in effective cooperative governance is the most important job a co-op member has. All cooperatives, whatever the kind, share the basic premise of one member, one vote. All cooperative members share equally in voting for the board of directors, and also by law must be allowed to vote on major decisions affecting the cooperative's future, such as a sale, merger, or dissolution of the business, as well as any changes to the bylaws. Beyond that, however, cooperatives enjoy wide latitude in structuring how other decisions affecting the business will be made.

Six Traditional Major Areas of Responsibility of the Board of Directors

1. **Mission:** Determine the organization's mission and set policies to ensure the fulfillment of the mission.
2. **Fiscal:** Establish fiscal policy and ensure the ongoing financial integrity and viability of the organization.
3. **Leadership:** Hire, evaluate, and if necessary, fire, the Executive Director.
4. **Supervision:** Provide ongoing supervision, direction and support for the Execution Director.
5. **Strategic Planning:** Provided the long rand vision and plans for the organization, and develop priorities and policies to pursue and implement these plans.
6. **Public Image:** Represent the organization to the public and advocate for the organization.

The Board of Directors should not:

- Become involved in day to day operations;
- Hire or supervise staff other then Executive Director; or
- Micro-manage the Executive Director or the staff.

Directors of a cooperative business have the same legal responsibilities as directors of any other corporation or business. The exact legal obligations of boards of directors vary from state to state, but most state statutes encompass the basic dues of care, loyalty, and obedience. Because of the unique nature of cooperative businesses, however, board members must attend to some additional duties. Unlike investor-owned businesses, which are often focused solely on making a profit, co-ops operate profitably to meet the needs of their members. Co-op directors must know what those needs are. They also must ensure that the members are educated about cooperatives and about their rights as members. **The board has an official responsibility to communicate with member-owners about the financial health of the organization and about the plans and vision of the board.**

When a new cooperative is formed, the corporate bylaws will reserve certain decision-making rights for the membership as a whole. Any other decisions, by definition, may be made by the board of directors. In practice, certain other issues might be taken to the membership at large for input. When setting up a co-op, it is important to outline how decisions will be made: When will the group as a whole make decisions? What kinds of decisions can board officers or committees make? How will such decisions be made? Will approved decisions require collective agreement or a simple majority?

Challenges in Co-op Governance

It is worth the time and trouble to design a governance system carefully. The responsibilities of various groups in the organization (such as the/membership, the board, management, and special committees and task forces) should be specifically spelled out, and it should be clear to all which person or group is to deal with which issues. Failure to clarify such matters early invites confusion and misunderstanding later on, when "hot" issues come up. Indeed, in coops where there is no well-constructed and well-understood governance system, it is common to observe:

- Managers making policy decisions on their own, because neither the board nor the membership has the power and the means to direct management behavior.
- Managers who are hamstrung by boards of directors or members who overrule them (or rebel against their decisions) rather than guide them with clear policies and objectives.
- Co-ops plagued with conflict in trying to decide a controversial matter because no clear decision-making procedures have been established.

Avoid the "Twin Trap of Powerlessness," sometimes seen in democratic organizations:

So much structure and bureaucratic procedure that members cannot actually use the power they formally have.

VS.

So little structure that there is no available means to make a difference.

Source: Emily Anderson, independent consultant

Many people join worker cooperatives in search of a work practice that is more participatory than a traditional hierarchical workplace. As such, many worker co-ops practice consensus decision making exclusively, or at least strive for it. This process often means it takes longer to reach a decision, but it may take less time to implement the decision because members have already debated and understood the reason for the action. Other co-ops look to different kinds of decision-making models depending on the decision, delegating everyday decisions to staff teams, allowing majority rule for most board or membership decisions, but reserving consensus decision making for those things that could have a significant effect on the future of the co-op.

Directors of the co-op are legally responsible for careful, honest decision making. **Timely and accurate communication is key to building trust and avoiding misunderstanding.** Clarifying roles, meeting policies, and decision-making processes from the beginning will help create a situation where everyone shares the same expectations. When in doubt, consult with others, and when differences of opinion occur, use them as an opportunity to clarify your policies and strengthen your board process. See Appendix D for a guide to the characteristics of effective meetings and Appendix B for a board orientation outline.

Who sits on the board and how they are elected are also important considerations: the cooperative model allows for several ways of structuring a cooperative. Smaller cooperatives often choose a structure that allows for all co-op members to sit on the cooperative's board of directors. Other co-ops allow for a smaller number of representative directors, sometimes elected from different work groups and sometimes from the membership at large. Some cooperatives allow for outside directors or advisors who bring certain skills or experiences, such as financial or marketing expertise, that are necessary for the success of the co-op. This is a common practice in ESOP companies, and—while not common in cooperatives—it has much to recommend it. Some co-ops retain all board

Board of Directors Code of Conduct

As a co-op director, I pledge to do my best for the co-op and will:

- Devote the time needed to fulfill the responsibilities of the position.
- Attend all regular and special board and committee meetings.
- Be prompt, attentive, and prepared for all board and committee meetings.
- Contribute to and encourage open, respectful, and thorough discussions by the board.
- To enhance board understanding and cohesiveness, attend and actively participate in the board's training sessions and annual planning retreat.
- Consider the business of the co-op and its members to be confidential in nature.
- Disclose any personal or organizational conflict of interest in which I may be involved, and refrain from discussing or voting on any issues related to that conflict.
- Be honest, helpful, diligent, and respectful in my dealings with the co-op, other directors, and the co-op's management, staff, and members.
- Refrain from becoming financially involved or associated with any business or agency that has interests that are, or could be perceived to be, in conflict with the co-op's interests.
- Work for continued and increased effectiveness in the co-op's ability to serve its member-owners.
- Be a team player and agree to abide by the majority action of the board, even if it is not my own personal opinion.
- Present the agreed-upon view of the board of directors, rather than my own, when I speak on behalf of the co-op to employees, members, shoppers, and the general public.
- Refrain from asking for special privileges as a board member.
- Work to ensure that the co-op is controlled in a democratic fashion and that all elections are public, fair, and open to the participation of all members.
- Strive at all times to keep members informed of the co-op's status and plans and of the board's work.
- Continually seek opportunities to learn more about the co-op and its operations and about my responsibilities as a board member.

As a co-op director, I agree to abide by this Statement of Agreement in both letter and spirit.

_____ _____

Signature Date

voting rights for members, but invite outside experts in as "advisors" to the board. Whether or not non-members are allowed on the board is a function of state statutes as well as the bylaws.

Another key decision is how board members will be compensated. For some co-ops, meetings are held during the workday and wages are paid accordingly. At other co-ops, meetings are considered volunteer time. Other co-ops decide to split the difference, starting the meeting late in the afternoon or very early in the morning so it straddles the workday. Outside board members or advisors generally receive some compensation for their time. Whatever you decide, consult your attorney to make sure your meeting practice does not conflict with state labor law.

A board of directors may be structured as a powerful decision-making body or, alternatively, it may be simply a body required for legal purposes, with all members making the policy decisions relating to the cooperative's operations. Keep in mind, however, that even if your board will serve largely as a "figurehead" body, directors will nonetheless have legal responsibilities and obligations relating to the fiscal health of the cooperative, as well as responsibility for the corporation's compliance with the law in terms of taxes, human resource decisions, and other areas of the law.

LEARNING TO PROMOTE SOUND, FAIR GOVERNANCE: QUALITIES OF AN EFFECTIVE BOARD MEMBER

Good boards don't just happen, they are made. An active, thoughtful, and directed nominations process is a key element that differentiates effective boards from ineffective ones.

Before recruiting individuals for your board, think about what the board as a team is charged with doing, and what will make the board as a team most able to fulfill its leadership responsibilities in ways that will benefit the entire co-op. The board members must be able to work together to fulfill the board's responsibilities while representing the diverse interests of the co-op. It is important to consider how leadership roles can be shared among people so that the skills and experiences of each person complement those of the others.

First decide what skills and qualities you want this group to have, and then determine what skills and qualities are lacking in the group. Target your recruitment so you can fill in these gaps.

Some members will stand out immediately as good candidates for the board. Others will have more subtle qualities that make them potentially good candidates. Individual board members must provide the pieces that fit together to form an effective group, but no individual board member is required to have every skill or leadership quality necessary to the group as a whole. One board may need a person with particular skills and experience, while another may need someone very different. **The goal is to build an effective group; each individual is only one piece of this equation.** The following types of people may be good board candidates:

- People who have **participated actively** at co-op meetings or events.
- People who have **shown initiative, diplomacy, knowledge, and judgment** in addressing issues facing the co-op or another group.
- People who are demanding change and will **take on responsibility** for initiating it.
- People who **help a meeting simply by being there**—through their people skills, organizational skills, sense of humor, or positive spirit.
- People who **inspire trust** or are seen as team builders.
- People who are **good listeners**.

People enjoy having their strengths recognized by their peers.

Keep in mind that all boards will need training to carry out their duties effectively—training in financial management, group process, cooperative legal issues, and so forth—and that adults learn differently than young people do. See Appendix E for tips on adult learning.

A final note on good governance in a worker-owned cooperative: the sidebar outlines some of the personal characteristics of an effective board president, but the ideas listed are true for all board members. **Striving to create something really special for and with your fellow workers is what can make serving on the board of a worker cooperative a uniquely rewarding experience.**

Personal Characteristics of an Effective Board President

Commitment to Service — Above all, the president must be committed to his or her role as a servant of members. An effective servant does not always do the leading, but implements the will of members.

Vision — The co-op looks to the president for inspiration. Members want to hear how good the cooperative can be. A good president looks for the positives and talks about them. The president must visualize how the board, committees, and volunteers function separately, and also how they work together to achieve the co-op's goals.

Perspective — The president needs to be able to step back from the day-to-day activities and assess what is happening, as if for the first time. That includes having a sense of humor.

Impartiality — An effective president is able to remain objective and open-minded in all discussions. He or she must be willing to listen to intensely different points of view.

Caring — The president must care for the conduct of the co-op and for the well-being of its members. A strong president has the ability to affect others positively and to generate enthusiasm in others.

STOCK PURCHASE, ALLOCATION, VALUATION, TRANSFER, AND DISSOLUTION

Initial Buy-In and Transfer

Cooperatives are enterprises defined by their democratic ownership and governance structure. One of the most important decisions cooperative members make is how ownership in the co-op will be passed from one generation of members to the next.

Terminology

Equity: the money invested in a cooperative by its member/owners. Equity, or net worth, represents the member/owners claim against the assets of the cooperative.

equity = net worth = total assets – liabilities
(total worth of co-op) (claims of outsiders)

Equity assumes the most risk and is subordinated to other forms of financing provided to a company; the owners stand to lose it if the co-op fails.

Member Shares: Members may purchase shares of common or preferred stock; or in coops incorporated as non-stock associations, certificates of membership or of equity may be sold. Member Shares are the most common form of equity capital.

Retained Earnings: Surplus earnings from the current year and previous years which members agree to leave in the co-op as a form of permanent capital. When patronage rebates are allocated to members, retained earnings are the portion of the net margin which remains mafter the allocation. Retained earnings are generally subject to taxation. Dividends paid on the basis of equity shares are made from retained earnings. Retained earnings are another form of equity, representing surplus earnings accumulated over time. Although unallocated to specific members, they are part of the member/owners claim against the assets.

equity = net worth = member shares + retained earnings

Net Margins: Revenue less costs; net profit.

Allocate: To assign to the members of a coop a portion of the net margins. This allocation is the patronage rebate or refund. To allocate is not the same as to distribute. Allocation refers to the entire patronage refund. Distribution refers to the cash portion of the patronage refund.

Patronage Rebate: The portion of net margin returned to the members of co-op in proportion to their use of the co-op. Also called patronage refund or patronage dividend.

Source: Emily Anderson, independent consultant

In a cooperative, as in a conventional investor-owned firm, ownership of the corporation is represented by ownership of shares of stock.[2] In a cooperative corporation, common shares may only be held by members of the co-op. (Although preferred shares may be held by nonmembers, they do not ordinarily include voting rights.) Practices vary widely among different worker co-ops regarding how shares of stock are purchased, valued, and transferred, and what would happen to company assets in the event of dissolution.

Most worker co-ops require an initial share purchase to become a co-op member. The price of this share can range from less than fifty dollars to thousands of dollars. Some co-ops set the entry price at a fairly nominal level to make ownership accessible to all workers. This is particularly true in industries where profit margins are slim and where business ownership and the self-determination it allows—typically unavailable to the everyday workforce—are in themselves compelling reasons for members to join and stay with the co-op. Home care and taxi services are examples of industries where co-op members have decided to set the initial share price quite low to facilitate widespread membership. Other co-ops set the initial share purchase requirement much higher—the cost of a good used car, for example, or the equivalent of a dollar an hour for the first year of employment—arguing that the co-op needs to set share values at a level that will ensure employee commitment.

Many co-ops also allow new members to buy their shares over time through payroll deduction. Some co-ops allow members to buy in through "sweat equity" or working for free to build the co-op. This has the attraction of opening up membership widely, but makes it difficult to raise the cash needed to make start-up purchases. It has the added disadvantage of being difficult to accurately record for accounting purposes. Other co-ops create their own unique systems for maintaining a constant flow of member equity, such as Union Cab in Madision, Wisconsin, which assesses members a "shift charge" of three dollars in new member equity for every shift they drive. These funds are used for capital projects or to retire old equity.

Allocation of net margin

While some co-ops limit share requirements to this initial purchase of stock, most worker-owned co-ops also define in their organizational documents how the returns of the business will be divided among the members. A word about the following sections: setting a formula for the allocation of net margin, making a determination of stock value, and facilitating the distribution of company gains to members in an equitable fashion can be complex topics. In some industries—particularly high-growth and high-profit ones—these will be key decisions affecting the entire future of the cooperative. In other industries, however, where there is typically not a lot of net margin to distribute, creating a complicated system for the distribution of gains may not ultimately be of much benefit to members. A co-op is not a better co-op because it has a more complex system of value distribution. A co-op is a better co-op because it effectively meets the needs of its members. Cooperatives are a beneficial ownership mechanism in part because of their unique flexibility. **A co-op does not have to be complicated to meet the needs of its membership, but the ability to tailor important elements of the ownership structure for the good of the membership is one of the things that helps co-ops to serve their members well.** All co-ops, however, whatever the stock buy-in system, must decide what would happen to the common assets if the co-op were to go out of business. Dealing with this issue in a fair and straightforward manner is a real way of signaling respect for the value of the members' labor input over time.

[2] Co-ops can also be organized on a non-stock basis with patronage returns allocated directly into capital accounts rather than directed toward the purchase of shares of stock.

Co-ops typically divide their net margins or profits between two accounts: a collective account of retained earnings that belong to the cooperative as a whole, and a second set of funds that are allocated to each member's ownership account. The member capital accounts in turn are divided between a cash portion (generally required to be at least 20 percent to allow members cash to pay the tax liability on their returns from the business) and an allocation made in the form of company stock or shares into an "internal capital account" held by the cooperative in the name of the member. When a co-op is started, one of the key decisions that members must make is the process for revolving, repatriating, or returning the funds in these internal capital accounts to members. Many worker co-ops revolve member equity out according to a set schedule (after five years, for example, so in the sixth year of work a member might receive back their share of the profits of the first year), while others require members to keep their entire capital account in the company until they retire or otherwise leave. Because tax is generally paid at the time of allocation into a particular member's account, when members do receive the value of their capital account, the funds come to them tax-free.

These two kinds of accounts are sometimes referred to as "divisible" and "indivisible" equity because one portion is divisible among the individual members (the capital accounts), while the other portion (the retained earnings) is not divided, but used instead as a whole for the benefit of all members. Each is considered equity for the business, but the one acts as more or less permanent capital for the business, while the other represents the value of each member's contribution to the business, which at some point they will expect to take with them. The benefit of collective reserve accounts is that they allow the co-op to invest in assets and strategies that will be to the long-term benefit of all members, without having to worry about future obligations to repurchase members' shares. The disadvantage is that collective reserves don't necessarily contribute to member engagement. The existence of large collective reserves also leaves the cooperative open to the threat of purchase by a competitor if current worker-members are persuaded to sell the business because it is the only way they can access the financial success of the business they have built (as represented by the collective earnings).

One advantage of individual capital accounts is lower tax liability; the taxes on allocations made to an individual's account are paid by the individual, whose tax rate is generally lower than the corporate tax rate paid on collective reserve accounts. Another advantage is that such accounts create the opportunity for higher member engagement as members see their contributions to the business translate directly into higher capital account balances. The disadvantage of member capital accounts is that member stock must eventually be repurchased and revolved, meaning that the co-op has a continuing repurchase liability that it must plan for financially. In high-growth businesses, this repurchase liability can create a tremendous financial strain on the cash flow of the cooperative if cash is needed to fund the working capital needs of the business. Of course, each co-op can determine the rate at which member shares are revolved, and some require members to keep their shares in the business for a long time. However, if the co-op allocates patronage returns to individual accounts in one year but does not revolve that equity out for, say, ten or twenty years, it creates a situation where members have a tax liability in the year that the allocation is made, but they do not see the financial benefit of that ownership for decades, setting up the cooperative for a strain of a different kind.

It is important to note that any financial losses must also be allocated. Typically losses are first allocated to collective reserve accounts. Then, if the losses exceed the collective reserve, the additional loss will be deducted on some proportional basis from each individual member's account. It is also important that the board of directors makes any proposition to revolve member equity on a regular basis contingent on the financial health of the co-op; if the co-op has losses, or other large

financial obligations, it cannot afford to endanger the financial health of the entire co-op to cash out individual members' shares.

Some co-ops deal with their cash flow and repurchase liability issues through the use of "non-qualified" versus "qualified" allocations. Qualified allocations are patronage returns that are allocated to individual member accounts, creating a tax liability for the member in the year the allocation is made. Nonqualified allocations are patronage returns that are allocated to members' accounts as a whole (not kept as permanent retained earnings for the co-op), but upon which the co-op has opted to pay tax at the corporate level. The co-op can then set a longer timeline for redemptions of these shares, and allocate them to individual members only when it has the cash flow to handle the repurchase liability. Because members have not had to pay tax on the allocation in the meantime the way they would with qualified distributions (and therefore were able to retain more of the cash portion of the distribution for themselves), they may be willing to be more patient about redeeming these shares. Another strategy for dealing with repurchase liability is, after five years or whatever the equity revolving period has passed, to offer members the option of converting their redeemed shares to preferred shares instead of getting the money in cash. The co-op would then pay a quarterly or annual dividend on the preferred shares going forward. This would cost the co-op money of course, but it would also enable the co-op to keep the funds as equity on its balance sheet. The issuance of preferred shares depends on each co-ops bylaws, so of course, as in all matters with financial and tax implications, make sure you get sound advice from a profession who is familiar with cooperative law in your state.

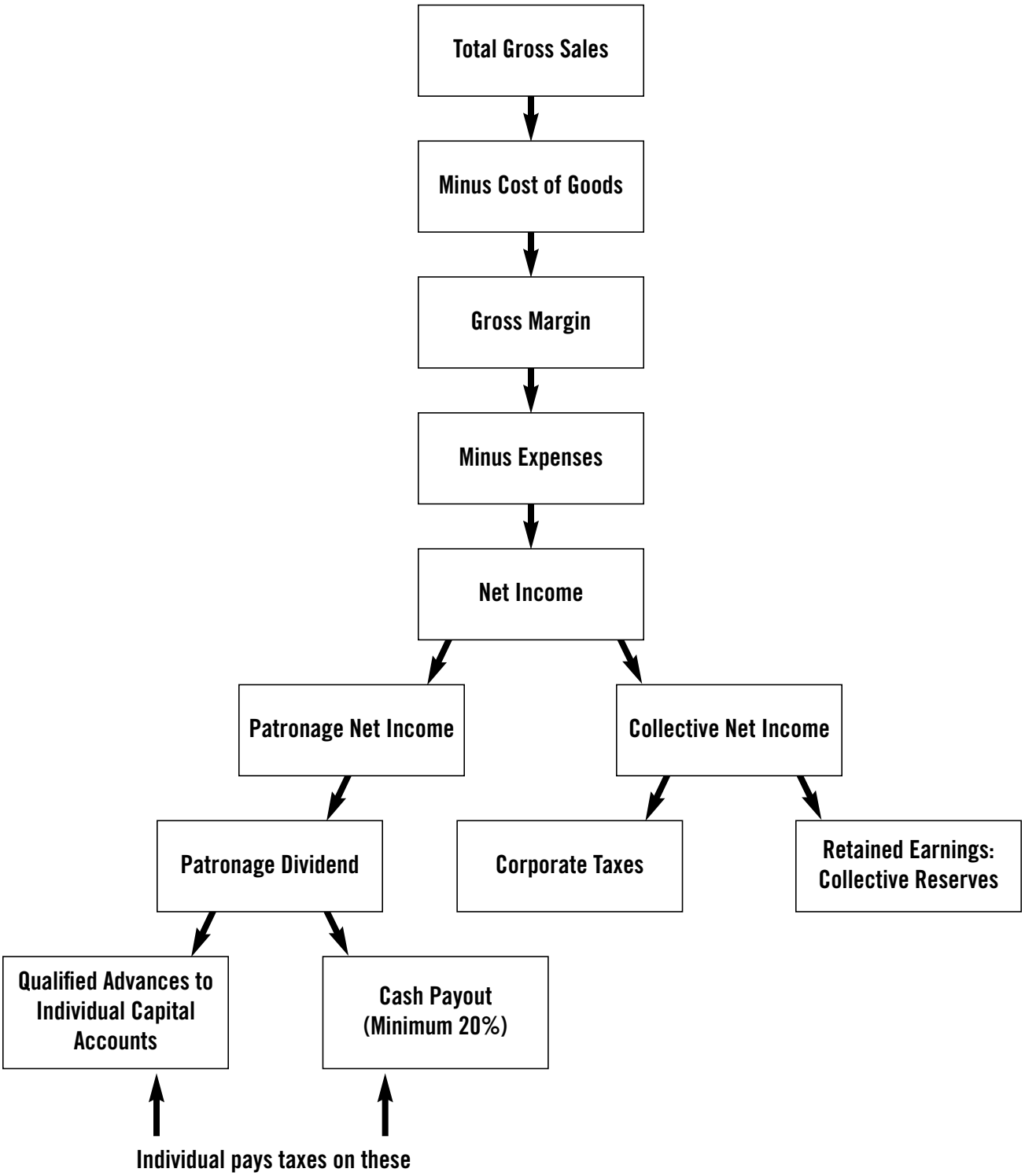
Keeping Your Cooperative Alive: The Importance of Retained Earnings and Equity Capital

The best way to ensure your co-ops continued existence is to have extra money available to meet long term capital needs and crises. Member Equity is important to your cooperative business for several reasons:

1. It provides a cushion against emergencies.
2. It is a source of funding for future capital needs.
3. It can be used to obtain bank financing. It represents the dollar amount of commitment of members to the cooperative.
4. It is a source of capital that isn't borrowed from outsiders; it is a more "permanent" (stable) capital and doesn't need to be repaid in regular installments.
5. It allows the cooperative more operational flexibility; it can allow the cooperative to behave in a more entrepreneurial (taking advantage of opportunities) way.
6. It ensures adequate cash flow for inventory, investment in and maintenance of equipment, investment in and maintenance of physical plant (building), reasonable markups and reasonable wages.
7. It prevents overdependence on debt financing.

Source: Emily Anderson, independent consultant

PATRONAGE DIVIDENDS



How this division between collective and individual assets is made depends a great deal on the industry, size, philosophy, and stage in life of the individual business. Cooperatives that are just starting out will need to make heavy allocations to a collective reserve account in the early years to build up capital and ensure there is enough money to cover early losses and other unexpected start-up expenses. Cooperatives in heavily capital-intensive industries will also have to invest funds in equipment and other collective assets to do their work. Any cooperative anticipating the need to borrow money will have to prove that it has savings of its own, either through collective retained earnings accounts or through member capital accounts that are committed to staying in the business for at least the duration of the loan. Similarly, co-ops that are growing at a fast pace will need internal capital to fund this growth.

A final consideration is the fundamental reason that the co-op was started to begin with. The Mondragon cooperatives in Spain, for example, were started in the 1950s as a way to create employment for a very depressed community. They have been extremely successful in this objective and members place a high value on ensuring the future health of the cooperatives so they will be around to provide employment for future generations. To this end, the Mondragon co-ops typically allocate 50 to 70 percent of profits to collective retained earnings (higher than most U.S. cooperatives), and also require that members keep their individual funds in internal capital accounts until they retire. This strategy ensures that the cooperative has plenty of capital for growth. Members agree with this system because the value they see in the co-op has as much or more to do with the continuing existence of the business (providing job opportunities for their children and grandchildren) as it does with individual gain from cooperative ownership.

Other cooperatives, however, particularly ones that employ relatively low-wage workers in a labor-intensive industry such as cleaning or home health care, may opt to return the majority of profits to members in the form of cash or capital accounts that are revolved on a much more frequent basis because their key objective as a cooperative is to enhance the income of member-owners. Each co-op will choose between collective and individual accounts for itself, and a different allocation may be made each year, depending on the co-op's circumstances. Most attorneys suggest that some kind of allocation parameters be set out in the co-op's bylaws, however, so be sure to consult an attorney on this and other financial matters. As you can see, these issues can get complex. It is absolutely vital to get proper legal and tax advice on these matters, as there are differences in co-op statutes from state to state.

A final thought is that some co-ops also decide to allocate funds annually to the community at large, either to help build other co-ops or to contribute to their community in general. This is in following with the sixth and seventh cooperative principles of "cooperation among cooperatives" and "concern for the community." Organic Valley, a producer-owned organic dairy cooperative, for example, typically allocates 45 percent of earnings to members, 45 percent to the co-op, and 10 percent to other cooperative or community ventures. Collective Copies of Amherst, Massachusetts, also gives regularly to the community.

CO-OP CASE STUDY

Collective Copies

Collective Copies was founded in 1983 during the long and slow death of Gnomon Copies, an investor-owned business in Amherst, Massachusetts. After working conditions led employees to unionize and strike (and win!), Gnomon Copies was evicted and forced to close. Former employees opened Collective Copies and the shop has been a worker-owned collective ever since, now with a second shop in the nearby town of Florence.

The cooperative has written bylaws and policies that the collective approved as a body. They believe that cooperatives can avoid a great deal of conflict by creating an atmosphere where each member believes that the policies are clear and fairly enforced.

During a new employee's three-month apprenticeship, co-op members decide whether to offer him or her full membership. An employee may participate in profit sharing during the apprenticeship but does not have voting rights. Currently, all 13 workers are also owners and serve on the board, which meets once a month. Collective Copies functions as a true collective, with committees handling day-to-day administrative activities as well as areas such as copyright clearance. Most decisions are by consensus, although a majority vote may be used when necessary. A conflict-resolution committee or hired meditor mediates disputes over contentious issues such as starting the second shop.

Collective Copies was able to raise enough capital at start up to buy equipment, rent space, and pay wages without initial assistance from a financial institution; instead, workers and community members financed the collective by providing loans. Members also raised capital with marketing strategies like a prepaid copy program, in which customers would receive 10 percent off their order when prepaying.

A membership in the collective costs $250, which is taken out of a member's paycheck five dollars at a time—enough to give the owner a share without being a barrier to membership. When a member leaves the co-op, their share investment is returned, but does not accrue interest.

Benefits include paid vacation, health and dental coverage, long and short term disability and sharing in annual dividends by hours. In addition, the co-op distributes 10% of their net profits throughout the local community and invests 15 percent of profits as retained earnings in a reserve account.

Another important decision that all worker co-ops must make when they start out is the method by which earnings will be divided among individual employees' accounts. The allocation among different members' accounts follows a formula that is typically laid out in the co-op's bylaws. Return in all cooperatives is based on patronage, not on capital. Patronage in a worker cooperative is defined as labor input, but the way that labor input is calculated can vary between co-ops. Some use hours worked, others use W-2 earnings, and some use a combination of the two. Some co-ops also use a seniority measure (up to a cap) in cases where the co-op is the result of a conversion from a conventionally owned company, in recognition of the value that past labor had in creating the value of the current company. Whatever the formula, each member's allocation will be made up of an amount proportionate to the amount of each member's labor input (however measured) relative to total labor input:

$$\frac{\text{Member A's labor input}}{\text{Total member labor input}} \times \text{Total \$ to be allocated among all Number of members} = \text{Member A's allocation for the year}$$

Valuation

For companies whose stock trades in a public stock market, valuing shares is easy. Valuing stock in a privately held company, however, is notoriously difficult because there is no established market for it. Companies converting from conventional corporate status (sole proprietorship, partnership, or a limited liability company, for example) have the additional complication of needing to set a value on the stock of the departing owners. Companies where employees own stock through an employee stock ownership plan or ESOP (see p. 10) are required by law to have an annual outside evaluation of stock value made by a competent expert. These analysts typically take into account such factors as earnings before taxes of the previous several years, typical price/earnings ratios for the industry, and other factors such as changes in management and market, which might typically affect stock value. This is an effective, but expensive method for determining the value of employees' ownership stake. Occasionally, employee-owned companies will set up their own formulas for setting a numerical value on company stock.

Cooperatives typically do not try to mimic the determination of a market rate of value for their internally held member stock (though they could), but instead simply value funds in internal employee accounts based on the actual dollar value at the time the allocation was made; for example, $575 in patronage allocated in 2000 is still worth $575 in 2005, regardless of the financial performance and other value factors of the business. Sometimes co-ops will add an inflation or interest factor of 1 to 3 percent per year. This system is widely used and has the not-insignificant value of simplicity on its side. It has the additional value of controlling the cost of shares, and thus keeping ownership accessible to regular workers. It is not a perfect system, however.

For a fast growing or highly successful business, this literal allocation of profit dollars does nothing to capture the ongoing value of the business, and therefore tends to severely underestimate the value of a successful business over time. Large, very successful cooperatives have often eventually made the decision to sell to a competitor at market value and cease to be a co-op because the total dollar value of the stock in members' accounts was so clearly and substantially below the market value of the assets that made up the cooperative and selling the business was the only way to realize the present value of those future earnings.

For some co-ops, this may never be an issue, either because the value of the business may never attract a sales offer, or because what the cooperative has to offer in terms of a more participative, rewarding, and value-based work environment may far outweigh any financial benefit to ownership. For others, however, it is worth putting some thought into a system that would allow the business to grow and succeed over time as a cooperative enterprise. Different dissolution rules as well as differ-

ent valuation rules can make it less tempting for future members to dissolve the co-op, by, for example, requiring that past as well as present members share in the residual value (see below).

Dissolution

In its bylaws, a co-op must decide what would happen to its assets if it were to go out of business. Most co-ops are structured so that the assets would be divided among the existing equity holders at the time of dissolution. Other options exist, however. The organizing documents of Nature's Bakery in Madison, Wisconsin, for example, require that assets be divided not only among current employees, but among any and all past employees as well, under the supposition that all workers contributed to creating the present value of the company being sold. Other co-ops that were started for some kind of social purpose require that any assets remaining after the bills have been paid and capital accounts have been redeemed be given to a nonprofit or to another cooperative. In Italy, when a worker co-op is dissolved all indivisible equity, by law, must be passed to another cooperative or to a cooperative support organization.

List of Key Decisions for a Worker Cooperative

- Who is on the board?
- How long is their term?
- Who are the officers, and how are they chosen?
- How are board members elected?
- What kinds of decisions does the board make?
- Will we have outsiders or advisors on our board?
- What kinds of decisions are reserved for the membership as a whole?
- What is the share requirement for ownership?
- Are there other requirements for membership, such as a probationary period?
- What should be the amount of the initial membership fee?
- What are the options for paying the initial membership fee (cash, loans, payroll deduction, etc.)?
- Will we allow for nonmember employees?
- How are new members chosen and oriented?
- How is compensation set?
- How is performance reviewed?
- How is patronage determined?
- How much is retained versus paid out per year?
- How are shares transferred? How is patronage paid out? Over what period?
- How will our business be managed?
- Will the general manager, if we have one, be permitted to be a member?
- Will board members be compensated for their time spent performing board functions?
- How often will the membership at-large meet (must be at least annually?)
- Can members call all-member meetings?
- In the case of the conversion of an existing business, how will financial compensation and/or protection be provided for the selling owners?

GOVERNANCE VS. MANAGEMENT

It is vital that all co-op members understand and be able to articulate the difference between *governance* and *management*. **Governing bodies dictate the strategic direction, spearhead resource development, maintain financial accountability, and develop leadership potential within the membership. Managing bodies implement the governing body's strategic direction and fulfill the cooperative's administrative tasks.** Both are skills that can be learned, but they are very different. Governance and management can be done by distinct entities, such as in a cooperative with an elected board of directors and a management structure, or by the same body, such as in a collective where all members sit on the board of directors and committees of those directors take care of daily operations.

A cooperative may decide to pair its cooperative governance structure with a more conventional, tiered management structure, including a general manager or CEO, department supervisors, and nonsupervisory member-employees. It may hire outside management, or it may promote managers from within the existing membership. However, all members of the cooperative are typically eligible to run for the board of directors, which in turn oversees the manager.

A cooperative that uses a collective governance and management structure includes all members in policy and operational decisions. Most management structures in collectives are flat, and they implement consensus-based decision making rather than majority-based or position-based decision making. Committees of members may run specific areas of the business, such as accounts receivable and payable, benefits administration, finance, or specific committees related to doing the business of the cooperative, such as supply ordering and accounts development. Employee accountability is achieved through peer example. Some collectives also promote an equal pay rate for all positions.

The size of the business and the industry also play a role in the type of management system that will work best. Workforces of more than two or three dozen workers will typically find the need for some kind of central organizational management structure, even if not a typical one. Also, businesses that run on twenty-four-hour shifts would find it difficult to institute a collective management structure, as members would never be all together at the same time.

Democracy is direct in a collective management structure as workers typically have direct influence over a wide range of decisions. The creativity and flexibility possible in a nontraditional management arrangement, however, must be weighed against the co-op's need for continuity. Cooperatives, however they are managed, are business enterprises designed to meet the needs of their membership. As such, they must be self-perpetuating by both design and practice, which means that even a nontraditionally structured workplace must have some structure or practice for passing along policies and practices from one generation of workers to the next. There is much to be learned from more formal management skills and approaches, simply applied.

An employee who sits on the board of directors does so not to represent his or her particular work team against all others, but to make decisions and offer input that is valuable to the enterprise as a whole. The board, after all, is made up of business owners. Because of the sometimes confusing or competing roles of employees as directors versus employees as supervisors or supervisees, it is highly advisable to have a well-thought-out employee compensation and performance review structure in a worker cooperative. **Clear outputs, expectations, and standards of conduct can go a long way toward heading off potential problems.**

CO-OP CASE STUDY

Pelham Auto Service

Pelham Auto Service began as a partnership in 1972. In 1977, after other employees indicated interest in the possibility of ownership, the company converted to a worker cooperative in order to retain employees and create an equitable work space. They have 11 co-owners and three employees. The last founding member retired in 2000, but the co-op continues to operate smoothly, and business is better than ever.

All eleven members meet as the board of directors biweekly or monthly, with decisions made by majority vote (each member has one vote).

An employee becomes eligible for membership after one year, when the co-op holds a full membership meeting; a simple majority decides whether the employee becomes a member (with voting rights only). After three years, a member is eligible for profit-sharing: net profits disbursed by hours worked and distributed monthly or bimonthly during the next year, typically $1,500 per year.

Profit-sharing is an attractive part of ownership at Pelham Auto. Each year they disburse a certain amount of their net profit, according to what other improvements the shop might need as well as any savings the company may need to accrue. The shop also provides 100 percent of all employees' health coverage. The cooperative is able to create family wage jobs that provide a superior level of compensation, flexibility, health care coverage and ownership than equivalent positions in conventional auto repair shops. This, in turn, helps reduce turnover to levels far below industry average. Owners stay longer and work harder because they have a vote in the way that the business is run, and they appreciate the flexible schedule: they can come and go when they want as long as they get their work done.

The next challenge for the co-op is their aging workforce. They hadn't been doing any long term or strategic planning, but as many members near retirement, they've begun to address issues of sustainability at their monthly board meetings.

Some elements of such a system would include the following:

Personnel policies approved by the Board of Directors. Personnel policies are what the management or membership uses to hold each other accountable. This document, which outlines how personnel issues will be handled, must be approved by the board of directors and should have been at least reviewed by the entire membership. Each member should have a copy of the policy. As the policy is amended or updated, copies should be easily available to members.

Basic Elements of a Personnel Policy

The organization's structure (including an organizational chart)

- Equal employment opportunity policy
- Hiring procedures
- Evaluation process
- Discipline procedures
- Grievance procedures
- Termination procedures
- Equity pay-out policy in the case of departing employee (termination and otherwise)
- Length of commitment expected
- Business hours
- Holidays
- Definition of full-time and part-time employment
- Compensation, including pay dates, pay scales, periodic raises, cost-of-living increases, bonuses, policy on advances
- Overtime policy
- Vacations
- Sick leave
- Other types of leave
- Fringe benefits
- Standards of employee conduct, including conflict of interest; confidentiality; alcohol, smoking and drug use; intellectual property; contact with the media, and so forth

Job descriptions for every position. Making sure that all employees have job descriptions will help everyone to do their best work and enable employee-members and their supervisors to have shared expectations for the work they do.

Standard Elements of a Job Description

Overview of the business seeking employee-members

Summary and purpose of the position, including to whom that position will report

Responsibilities of the position, followed by corresponding duties

Knowledge, skills, and abilities required to fulfill duties of the position

CO-OP CASE STUDY

Union Cab

Union Cab grew out of a bitter fight between taxi drivers, unions, and the taxi cab companies in Madison, Wisconsin. When the companies closed their doors rather than unionize, the displaced workers decided they had the expertise required to make a worker-owned taxi cab company work.

That cooperative became Union Cab, now one of the biggest cab companies in Madison with 200 member-owners. All non-probationary employees are members paying $25 to join. At the end of the year, the cooperative typically returns 50 – 60% of profits to members based upon wage level and hours worked.

Union Cab has a nine-member board of directors with three alternates. Any member is eligible to run for the board of directors except those in management positions. Board members are paid hourly for their time. Union Cab uses its board of directors to determine wages and pay scales. They currently have three pay scales and provide a commission for their salespeople. Managers are on salary, but all other member-owners are paid hourly.

The cooperative has a traditional management structure. A workers' council (on which every non-management member-owner must serve on a random, rotating basis) deals with workplace grievances and other management-related issues.

The equitable structure of the cooperative model makes Union Cab stand out from its conventional business competitors. The highest paid Union Cab employees earn only 2.5 times as much as their lowest paid members and employees have access to a health insurance plan, a rarity in the industry. This equity and transparency makes owners committed to the business. Additionally, the financial surplus that is shared between members makes them a better, more sustainable source of employment than competing cab companies without making them any more expensive to customers.

The most difficult aspect of the cooperative model is educating new members about their ownership in the company, and changing their mindset from one of an employee, to one of an owner.

John McNamara, a longtime co-op member attributes its long-term success to owners' willingness to make sacrifices, including a pay cut when necessary, to keep the company afloat. This commitment has helped the co-op succeed, so that recently they've been able to "claim [their] rightful place at the top of the market.

"We kind of grew up, I guess," he says.

A well-articulated and impartial avenue for resolving conflict. To balance the sometimes competing interests of directors, employee-owners, and supervisor-owners, many cooperatives establish a social or grievance committee. These committees are often made up of members at large who serve rotating terms. When a conflict arises, they are the body that attempts to resolve the conflict or make recommendations to the management (or board if necessary) regarding the conflict.

Methods to ensure accountability. The cooperative may decide that managers and employee-owners must bring all grievances, including requests for disciplinary action, to a committee created for that purpose. Other cooperatives may give managers the right to provide discipline, which worker-owners may be able to appeal to the grievance committee.

As two noted co-op experts (Greene and Berhtoud) put it, "Co-ops reflect the triumph and struggle of democracy." **Disagreement and conflict are as much a part of democracy as the power of collective action. Managing disagreement and resolving conflict in a productive fashion are part of crafting an effective democracy.** While everyone knows the consequences of destructive conflict, the advantages of constructively managed conflict include greater understanding, enlightenment, and consensus.

HIRING AND FIRING IN AN EMPLOYEE-OWNED COOPERATIVE

The hiring process in worker cooperatives varies greatly, but in every case it is vitally important. Worker-members in a cooperative are hiring their future business partners. Some cooperatives choose to involve all members throughout the hiring process, while others delegate the process to the board of directors or a hiring committee. Still others create a hiring committee that presents each candidate to the general membership, who makes the final decision. What you decide may depend on your size, the kind of position you're hiring for, and the philosophy of your cooperative.

Federal laws prohibit discrimination based on race, color, religion, sex, or national origin. State laws may also prohibit discrimination based on other factors. Consult with an attorney about how best to make sure you are in compliance with both state and federal law.

Once a person is hired, it is important to ensure performance and accountability among members of the co-op. Everyone needs to be able to depend on everyone else. When performance is not as expected and cannot be corrected, worker co-ops need to be prepared to document poor performance and ask unproductive members to move along, if necessary. Terminations are always a delicate matter, and are probably more so for worker cooperatives. It is absolutely necessary that a worker co-op has a clear policy regarding how an individual's membership may be terminated, including policies on how funds in individual capital accounts will be paid out. Consult a lawyer when crafting your policies.

COMPENSATION

A few worker cooperatives still structure their enterprises as nonwage co-ops, where all workers are self-employed and any compensation received is, in fact, an advance on his or her portion of the patronage return of the business. This system, which is in some sense a more "pure" workers cooperative (all workers are owners, simply sharing in the profit of the business), has come under increasing scrutiny by the government. It is difficult to offer benefits under this scenario and it can be disadvantageous to workers for other reasons. Before embarking on this path, it is best to consult with an experienced attorney and make sure that you understand all the implications of this choice.

While few worker cooperatives require that all workers be paid the same wages, many, including the Mondragon cooperatives, institute a limit on the range of pay offered. Typically this limit is

CO-OP CASE STUDY

Isthmus Engineering

Isthmus Engineering, a 23-year-old firm in Madison, Wisconsin, began as a partnership focused on engineering and converted into a worker co-op as a way to spread ownership more widely.

The cooperative currently has 25 member-owners and 24 non-member employees. Owners must work at the cooperative for at least two years before applying for membership. The Co-op requires a 90 percent vote to take in a new member, and if approved they must buy a share in the cooperative at $10,000 for which the member must provide their own financing.

All worker members are on the board of directors. They elect an executive committee who works with the general manager on policy decisions and strategic planning. Day to day operations are facilitated by the general manager. All other company-wide decisions are made at biweekly membership meetings. Executive committee members are not compensated for their time.

Isthmus Engineering operates on a wage-based system. Non-members are paid according to industry standard. Member-owners' salaries are set by a ballot vote with every member voting on every other member's salary. One hundred percent of year-end surplus is returned to members. Patronage disbursement is based on a combination of hours worked and W-2 earnings.

Personnel issues are resolved largely in membership meetings— "Talk about rough," comments member John Kessler. They've tried many methods; most years, everybody reviews everybody, but they may try a peer group review system since the company is big enough that not everybody knows each member's performance. Firing members takes a simple majority. Member owners hold a secret ballot annually to determine whether or not there are owners that need to be singled out for special review. This mitigates surprise needs to remove owners.

The biggest difference between Isthmus Engineering's cooperative structure versus a conventional structure, according to Kessler, is "one member, one vote—that's what it all boils down to." Many owners are frustrated that decision-making takes so much time. However, he counters, they usually come up with a decision that works in the best interests of the business and its' owners.

The cooperative's biggest strength comes from its ability to find and maintain a highly talented group of engineers. Despite the industry increasingly being outsourced overseas, they've maintained a strong client base, which Kessler attributes to the high skill and commitment of the member owners.

expressed as a ratio between the wages of the highest-paid workers and the lowest-paid workers. If the maximum ratio were 3:1 for example, and the lowest paid worker made $25,000 per year, the highest paid worker could not make more than $75,000 per year.

Benefits are another area where worker cooperatives have had great effect in countering the trends in an industry. In typically high-turnover, low-wage industries, worker co-ops have led the way in offering health insurance and other benefits to workers who traditionally would not have access to these benefits.

EXPANSION AND GROWTH

At some point in their lives, most businesses will see an opportunity to grow strategically. To do this, most will require extra capital, which will mean a loan from a bank or other lender. Many worker co-op members are reluctant to approach conventional lenders, nervous that banks may not understand the worker co-op structure. Luckily, there are many community development loan funds around,[3] as well as a new national loan fund for worker co-ops that are just getting started (contact NCDF for details).

In general, when working with a lender, you want to make it easy to say yes to your loan request and difficult to say no. You do this by trying to put yourself in the lender's shoes, understanding his or her perspective and the constraints under which he or she works. Remember the following when communicating with your lender:

- Be honest and straightforward about your business and its financial past and prospects.
- Be open to input from your lender, who often has had a lot of experience working with different businesses.
- Ask for what you need. Don't be afraid to advocate for yourselves and your business.

Here's what you should expect from your lender:

- **Attention.** Lenders should recognize the value of your accounts and the relationship you bring to them.
- **Engagement.** Lenders should ask you good questions about your business, show interest in you and your industry, and come down to your shop and see how you work.
- **Flexibility.** Worker co-ops are unusual. Your lender should recognize this and help you fit your business into their parameters. They should not expect you to change core elements of your business to fit into their "box."

See the next page for the 5 C's of credit

[3] See www.communitycapital.org for a list of community development loan funds and credit unions.

5 C's of Credit

Many lenders are taught "the 5 C's of Credit" in banking school, and they still provide the core analytical framework for most small-business lending decisions:

- **CHARACTER** – Since your loan will be to a cooperative entity and not to an individual person, you will need to convince your lender that your co-op itself has sufficient "character." You can demonstrate this through the credit relationships you have built, but more convincing will be the structure and practice of your cooperative—your well-thought-out policies, procedures, minutes, and other documents that will convince your lender that your co-op is a place where everyone takes responsibility, and will show that your co-op is perpetuating itself by design and practice so that your lender can be assured that the co-op will still be around years from now, when the loan is due.
- **CAPITAL** – It is often true that you have to have money to borrow money. A lender always wants to know what resources a borrower is putting into the deal. If you want to borrow money, it helps a lot if the co-op can demonstrate a history of earnings retained for the good of the cooperative .
- **CAPACITY** – To a lender, even more important than your having money is your ability to make money. When applying for a loan, you must demonstrate that your cooperative has the ability to pay it back. Knowing your industry, business, ratios, sales figures, and what products or department you make money on all demonstrate to the lender that your management staff has a handle on your business and knows what makes it go.
- **COLLATERAL** – Having a strong balance sheet with lots of available collateral helps a lender feel secure in making the loan. Some lenders will also ask for personal guarantees from co-op members; to avoid this, you will have to make extra sure the other factors in the credit analysis are strong.
- **CONDITIONS** – Being smart about local market conditions, as well as industry trends, will convince your lender that you have the ability to manage risk and deal with changing market variables.

A LAST WORD

This toolbox offers information and examples to help worker-owners build the best co-op they can. The key element of a worker cooperative, however, is the worker. A dedicated crew of workers can overcome shortcomings in other areas. Creating a worker co-op is not just creating a business; it is creating a community. It is a rewarding, but difficult job for which you will find very little precedent. The outside business world is not necessarily going to understand or support your enterprise, and people may frown on some of your decisions. However, if you can keep your business sound (pay the bills and replace the equipment) and your vision intact, you will be doing just fine. Don't lose the joy and fun of running your own business.

We will leave the last word for Peter Barnes, a cooperator from the 1970s who offered this advice to fellow worker-owners:

WHAT MAKES WORKER OWNERSHIP A SUCCESS

Lessons from Other Worker Owners

One worker owner, Peter Barnes, who helped found the Solar Center in 1976, offers these five lessons from his experience:

1. **Your company will grow if it is successful**. Plan for growth- do not try to avoid it.

2. **All organizations, particularly a business that wants to be democratic, need leaders.** Support and reward the leaders in your company—it is a tough job.

3. **Give those with responsibility the authority they need to do the job.**
"As a matter of practice, managers given authority to perform or supervise a task will, within a democratic environment, consult others who are affected by their decisions. But they can and should be responsible for making the decisions. The test of democratic structure is not how many decisions are collectively voted on, or how many committees and meetings there are, but whether the policies that managers carry out are approved by representatives of the employee owners...."

4. **Be creative and adaptable, not tired or cynical.**
"Things are not always the way we would like them to be. Compromises have to be made. People have conflicts when we wish they wouldn't. Utopia is not around the corner..."

5. **Never forget to make the organization—and its values—self-renewing.**
"One crucial mechanism involves risk-sharing. Though the risk of any enterprise is greatest at the beginning, and is therefore borne more by founders than by others, risk never disappears - and must be continuously shared if power and responsibility are also to be continuously shared…"

"For a cooperative to remain cooperative, its leaders must consciously welcome new generations into positions of ownership and responsibility. This involves developing new leadership, and learning when and how to yield power…"

"A third aspect of self-renewal is education. New employees in contemporary America will rarely have experience in cooperative business practice… It is important that they be…brought up to speed in systematic ways, including seminars on the company's history, finances and structure."

KEYS TO SUCCESS

From Steps to Starting a Worker Cooperative*, University of California Center for Cooperatives*

Each cooperative has unique aspects and faces different start-up challenges. However, there are common areas critical to the future success of the enterprise. Studies show the main reasons that new businesses fail are insufficient financing and lack of business expertise. In addition, worker co-ops that fail do so most often because they lack:

- shared objectives;
- an effective system for worker participation in decision making; or
- suitable ownership and equity structures.

By paying careful attention to these areas you can avoid many of the problems that shut down new businesses. The following are some key areas, learned from past worker-cooperative successes and failures, hat help to ensure the success of a new worker cooperative.

1. Clearly Defined Purpose and Focus. *If you don't know where you're going, any old place will do.*

When a co-op's purpose is clear and understood by everyone involved, it is much easier to define the path (business plan) and achieve stated goals.

To succeed, the co-op must begin with a viable business idea and a specific focus, such as producing a particular product or service. Equally important, members must share the same objectives.

2. Feasible Business Idea and Thorough Business Plan. *The business plan is a road map that details where your worker co-op is going and how to get there.*

All new businesses involve risk. The purpose of the business plan is to minimize the risk and maximize the chances of success through careful research and planning.

The business plan of a worker co-op should be so accurate and comprehensive that people feel secure investing large amounts of their own money. If the members do not have enough confidence in the plan to invest their own money, no banker will.

3. Suitable Ownership and Equity Structures. *Having a financial stake in a business, receiving a meaningful share of the profits, and actively participating in decision making are powerful incentives to succeed.*

There are several ownership and equity structures that can be used in the organization of a worker cooperative. Select ownership and equity structures that help to build a strong capital base for the enterprise and a positive financial incentive system for the cooperative members.

4. Adequate Financing. *Success is more a function of consistent common sense than of genius* (An Wang: *Boston Magazine*, 1986).

Co-op members are the key source of initial financing for the worker cooperative. Money is collected from the members through the sale of membership shares—the ownership certificates of the cooperative. Equity capital supplied by the members must be sufficient to provide enough collateral to leverage additional debt financing from banks or other lending institutions, or economic-development agencies.

5. Business Advisors and Consultants Knowledgeable about Worker Cooperatives. *Many failed worker cooperatives neglected to take advantage of business and worker cooperative consulting expertise.*

Advisors and consultants can save you time and money while helping your co-op avoid predictable pitfalls. Most workers are not business experts, and worker cooperatives are complex businesses. Utilize competent legal, accounting, lending, and business-development advisors—check references and get referrals from other worker cooperatives and businesses. Someone familiar with worker co-ops should review work completed for your group.

6. Clearly Defined Roles and Procedures for Decision Making. *Although the specific decision-making structures of worker co-ops vary, they share in common the need for clear roles and procedures.*

When the worker co-op operates as a collective and does not have managers, clear procedures for decision making are important. Clearly define what types of decisions can be made by individual workers, which can be made by specified work groups, and what kinds of issues should be addressed at meetings that include all worker-members. For legal purposes, each worker-owner of cooperative corporations that are operated collectively is automatically a board member.

When the worker co-op uses a management structure, workers and managers must clearly understand their respective roles and responsibilities. Appropriate structures must be established to promote and maintain worker participation and involvement in shop-floor and boardroom decision making. Many problems associated with worker cooperatives can be avoided by ensuring that all entities—the board of directors, management, and worker-owners—clearly understand their respective roles and responsibilities.

7. Sound Business Practices. *Don't reinvent the wheel—use proven methods!*

Sound business practices include attention to finances and product quality, and recognition of the importance of the clients or customers. Develop quality-control standards to maintain consistency for products and services. Use established systems of record keeping, accounting procedures, and financial controls to prevent financial problems down the road.

8. Ongoing Education and Training for Worker-Members, Directors, and Management. *While we live in a society that emphasizes individual achievement, worker cooperatives demand working and making decisions cooperatively.*

Education and training are critical to the long- term stability and strength of a worker co-op and to its success as a business. Our society does not teach groups of people how to own and operate a business cooperatively. This deficit must be overcome if the cooperative is to succeed.

Training in how to interpret a financial statement and to comprehend all aspects of business finance is essential for worker-owners to fully understand the financial side of their business. Worker-owners and management have important leadership roles. Owners set policy and vision, and managers use their expertise to implement policies and visions with the best possible results.

Because of the unique ownership and governance structures of worker co-ops, managers have to learn how to effectively work with the workers and involve them in decision making, and worker-owners have to learn how to effectively work with managers who have been selected to supervise their work and lead their enterprise. Making this process work requires a commitment to education and training.

Source: Steps to Starting a Worker Cooperative*, University of California Center for Cooperatives*

APPENDIX A

WORKER COOPERATIVES: FREQUENTLY ASKED QUESTIONS

What is a worker cooperative?

A worker cooperative is a business owned and controlled by the people who work in it. Typically, all workers are eligible to become owners (called "members") after working for a specified period of time. To become a member, a worker must apply for membership and, if accepted, purchase a member share. Members govern the cooperative on the basis of "one person, one vote." At a minimum, members elect the board of directors and vote on major company issues.

In a worker cooperative, ownership and control of the business derive from working in the company, rather than from simply investing capital. Nonworkers are prohibited from holding membership shares, thus keeping control of the firm within the workforce. Profits and losses from the business are allocated to member-workers according to either the hours worked or gross pay. Often a portion of profits is distributed in the form of cash and the remaining portion is held in internal capital accounts. Upon leaving, a member's share is repurchased by the cooperative and accumulated profits in his or her internal account are paid out over a defined period of time.

Is there a difference between a worker cooperative and a collective?

Yes. The term "collective" usually suggests that the organization not only has a democratic ownership structure, but also has consensus decision making and very little hierarchy. The structure is very "flat." Some worker co-ops are collectives and therefore highly democratic, while others are less so. In larger and older worker co-ops, operations tend to be more hierarchical and democracy less direct. Still, at a minimum, managers of a worker cooperative are indirectly accountable to the workers through each member's vote for the board of directors. Most worker co-ops have a clearly articulated decision-making process in which workers are involved in at least those decisions that directly affect their job or the company as a whole.

What are the advantages of a worker cooperative?

The worker cooperative structure has many advantages, especially for a relatively small business. It is simple to create, relatively inexpensive to establish, and offers significant tax benefits. It is easy to understand. Worker cooperatives also build local assets and increase economic stability for worker-owners and their communities. Participatory decision making, featured in most worker co-ops, can enhance productivity, improve product and service quality, and promote the development of workers' skills.

How do you form a worker cooperative?

Whatever its social goals, a worker cooperative must first be a successful business. Just like any other business, it must serve a viable market. There must be a clear demand for the goods or services produced and the cooperative must be able to deliver them at a reasonable cost. The workforce must possess the necessary skills to manufacture the products or deliver the service. In addition, the company will need competent leadership and sufficient capital to finance its development costs, start-up, and growth.

For a start-up, a three-phase process is usually advisable. First, a feasibility study should be undertaken to determine if the initial business concept can become a viable worker cooperative. If the answer is yes, then a business plan showing how the cooperative will function, make a profit, and repay its lenders must be prepared and bylaws written. In the final phase, the business plan is used to raise the necessary financing, a manager is hired (if needed), and the cooperative opens its doors for business.

APPENDIX B

Existing businesses can be sold to, or restructured as, a worker cooperative. The value of the business needs to be determined and a means for paying the owner decided on. To help make a smooth transition, the original owner can become a member of the cooperative or provide consulting services for a time.

Adapted from the website of the ICA Group and the Vermont Employee Ownership Center.

BOARD ORIENTATION

The best way to become familiar with a co-op when joining the board as a new director is through an orientation session. Generally the board president conducts the orientation, but you may choose to hire an outside trainer to work under the board's guidance. The orientation should not be restricted to new members; it should be open to all board members.

Below is a sample outline of topics to include in an orientation. Providing board manuals for the new members will make it easy for them to follow the orientation and will bring them up to speed quickly. The orientation agenda and the board manual layout are similar. You can use the board manual as an outline for the orientation, since it contains current working documents.

Participating in an orientation requires a commitment, but it's time well spent. Have some fun with it. An orientation will increase the overall comfort level for both new and old board members and it can greatly decrease the amount of time you spend on orientation topics at your regular board meetings.

Consider implementing a mentor system for the first few months after an election, pairing each new board member with a seasoned director.

Sample Agenda for Board Orientation

1. Introductions
2. Cooperative principles, including what co-ops are and how they function
3. Vision/mission statement
4. Organizational responsibilities
   - Organization chart
   - Board job description
   - Committee structure and responsibility
   - Manager job description
5. Articles of incorporation and bylaws
   - Brief explanation of governing system
   - Legal duties
6. Policies
   - Current adopted policies
   - Drafts of proposed policies

APPENDIX C

7. Budget/financial
   - Fiscal calendar
   - Quarterly reports
   - Balance sheet
   - Income statements
   - Operations budget and capital budget
   - Budget assumptions
8. Planning and publications
   - Board planning calendar
   - Long-range planning
   - Regular report to membership
   - Membership and benefits of membership and board responsibility
9. Board operational procedures
   - Dynamics of the decision-making process
   - Good meeting management
   - Conflict resolution and problem-solving
   - Training opportunities
   - Member selection and approval process

APPENDIX D

BUSINESS PLAN BASICS

I. Executive Summary
II. Market Analysis
    A. Industry Description and Outlook
    B. Target Markets
    C. Market Test Results
    D. Lead Times
    E. Competition
    F. Regulatory Restrictions
III. Company Description
    A. Nature of Your Business
    B. Your Distinctive Competencies
IV. Marketing and Sales Activities
    A. Overall Marketing Strategy
    B. Sales Strategies
V. Products and Services
    A. Detailed Product/Service Description
    B. Product Life Cycle
    C. Copyrights, Patents, and Trade Secrets
    D. Research and Development Activities
VI. Operations
    A. Production and Service Delivery Procedures
    B. Production and Service Delivery Capability
    C. Operating Competitive Advantages
    D Suppliers
VII. Management and Ownership
    A. Management Staff Structure
    B. Key Managers
    C. Planned Additions to the Current Management Team
VIII. Funds Required and Their Uses
    A. Current Funding Requirements
    B. Funding Requirements Over the Next Five Years
    C. Use of Funds
IX. Financial Data
    A. Historical Financial Data
    B. Prospective Financial Data
    C. Historical Financial Statements
    D. Prospective Financial Statements

Appendices or Exhibits

Source: University of Wisconsin Center for Cooperatives, 2005

For a fuller outline, see www.uwcc.wisc.edu/manual/chap_6.html

CHARACTERISTICS OF EFFECTIVE MEETINGS

- The atmosphere is informal, relaxed, and comfortable. People are involved and interested. There are no signs of boredom or tension.
- There is a great deal of discussion in which everyone participates. The discussion stays relevant to the topic(s) at hand. If the discussion gets off the subject, someone quickly brings it back.
- The task or objective of the team is well understood and accepted by participants. Participants are committed to achieving it.
- Participants really listen to each other.
- Disagreement is expressed openly and without fear of conflict. Differences of opinion are honored and thoroughly explored before decisions are made. If differences cannot be resolved, participants agree to live with them and move on.
- Decisions are reached by consensus. Formal majority voting is not used.
- Criticism of ideas is frequent, frank, and phrased constructively. Participants avoid personal attacks.
- People are encouraged to express their feelings as well as their thoughts. There are no hidden agendas and few surprises, since participants are open about sharing their feelings.
- When action is agreed upon, clear assignments are made and participants accept individual accountability.
- The facilitator does not dominate interaction. Participants do not defer unduly to the facilitator. All participants exercise leadership responsibilities.
- The group is highly conscious of its own internal processes. Frequently, it will stop to examine how well it is doing and take a look at things that may be interfering with its functioning. Problems are discussed openly until a solution is found.

KEY MEETING ROLES

Meeting Facilitator

Responsibilities: To begin and end the meeting on time; to keep the meeting focused on results; to keep the meeting moving; to model and use facilitative behaviors; to keep discussion on track; to keep the discussion balanced; to summarize; to encourage all participants to contribute; and to listen, look for, and point out areas of agreement. See “Role of Meeting Facilitator,” below, for more details.

Recorder/Minute Taker

Responsibilities: To record ideas and suggestions made by participants, to record agreements and decisions reached, to seek out clarification when necessary.

Timekeeper

Responsibilities: To keep track of time spent on agenda items, to warn leader or facilitator when time is running out.

Participant

Responsibilities: To contribute to the meeting in a constructive way; to share information that is useful; to listen carefully to other points of view; and to pay attention to both task and process functions.

ROLE OF MEETING FACILITATOR

Co-op meetings don't have "someone in charge"; they have facilitators. The board president is usually the meeting facilitator, but the board can assign the facilitator role to anyone. A facilitator is a member who steps out of the decision making to focus on the meeting process, how the discussion runs. **Skilled facilitating keeps a meeting focused, moving, and productive**.

Small meetings are generally easy to facilitate; large meetings are tougher. Start small and gain experience. With practice and attention, anyone can become a great facilitator.

Here's a quick checklist of the facilitator's role:

- Make the meeting space comfortable.
- Provide meeting supplies (extra handouts, newsprint, tape, etc.)
- Start and keep the meeting on time.
- Move the group from one agenda item to the next.
- Recognize people and give them their opportunity to speak.
- Keep issues clear and manageable.
- Make sure that people stick to the issue.
- Encourage positive attitudes.
- Make sure that everyone participates.
- Sum up discussion points.
- End discussion if a decision cannot be made.

The following outlines a facilitator's job in detail. All of the listed goals are necessary, but the tools are suggestions. Experiment and learn as you go.

FOCUS

It's the facilitator's job to stay out of the debate and keep discussions on track. An unfocused meeting quickly becomes inefficient and frustrating.

1. Separate yourself (as facilitator) from the discussion. Try not to add content to the discussion. As facilitator, your role is to focus on the process.
   - If you know that you have a strong personal stake in a proposal, ask someone else to facilitate the meeting.
   - If you give any personal input, start by saying, "Stepping out of my facilitator role. . . . " It is important that people do not give your opinion more weight because you are acting as facilitator.
2. Keep the issue clear and manageable.

- Start the discussion with a time for "clarifying questions." This is a time for people to make sure they understand the issues or proposals, not to discuss them.
- Break large, complicated issues or proposals into smaller parts.
- Post the agenda or steps needed to reach a decision where everyone can see them.

3. Make sure people stick to the issue.
   - Keep a "parallel agenda" or "parking lot" if unrelated issues come up. Jot down notes of concern. Later, you can address these issues quickly, or pass them to a committee, or table them for a future meeting.
4. Keep speakers from repeating points that have already been made.
   - Write points on a large pad of newsprint or a whiteboard.
5. Keep the meeting moving. Be aware of time.
   - Set time limits for each agenda item.
   - Choose a timekeeper.
   - Remind people how much time remains. If you run out of time, have members either extend the time limit or set another time to continue the discussion. If you extend the time, have the members decide if the meeting will go longer or what will be tabled for another time.

PARTICIPATION

It's the facilitator's job to recognize speakers and get everyone involved. The more points of view that are expressed and then addressed, the stronger final decisions can be. Everyone has valid opinions. Everyone can have creative solutions.

1. Recognize speakers; call on people to speak in turn.
   - Keep a "stack." Write down people's names as they raise their hands and use that list to call on people in turn. People may not get to speak at the exact moment they want, but they will understand that the system is fair.
2. Make sure everyone gets a chance to speak.
   - Go around the circle, giving each person a brief, uninterrupted chance to speak.
   - Ask questions to prompt quiet members to speak.
   - Break the discussion group into smaller groups so it's less intimidating.
   - Try to have everyone speak once before anyone speaks a second time.
   - Clarify the issue under discussion as needed.
3. Encourage everyone to speak his or her mind.
   - If someone seems to be holding back, try to engage them in the discussion.
   - Give people easy ways to participate. Ask the group a question and have people show thumbs: thumbs up means agree, in favor, and thumbs down means disagree, against. Thumbs to the side means unsure, neutral.
4. Encourage creativity, especially when discussions get stuck.

- Hold brainstorms where everyone adds to a list of ideas without any evaluation. The group can discuss specific ideas after the brainstorm.

POSITIVE ATTITUDES

It's the facilitator's role to set the tone of the meeting. Good meetings are relaxed, organized, friendly, and fun.

- Keep discussions from getting too heated by scheduling breaks.
- Give positive feedback.
- Discourage nonconstructive feedback and criticism.
- Refer to points and proposals by titles, not the names of the person who presented them.
- Make the space comfortable.

PULL IT ALL TOGETHER

It's the facilitator's role to achieve clarity before the group makes a decision. This is one of the most important parts of facilitating—and often the hardest.

1. Sum up what's been said; in voting, review points of opposing proposals; in consensus, repeat points to be addressed and solutions.

- Use a whiteboard or flipchart to list points of the proposal(s).
- Review important points of the discussion (on paper or orally). This way the group can see how the decision has been reached.
- Know if or when a decision cannot be made. The people may need more facts, opinions from others, or time to think,.
- Ask members what they need or want to feel comfortable making a decision.

2. Make sure everyone understands the decision.

- Restate the decision. Ask for group approval. Make sure the recorder writes it down exactly.

BOARD MEETING FACILITATION TIPS

Good facilitation makes all the difference between feeling energized or drained by a meeting. Strong facilitation helps all members participate equally. Although leading a board discussion is usually the president's job, facilitation may be assigned to any person who has a knack for watching the clock and the agenda, and for encouraging everyone to participate in discussions.

Running meetings and managing them well is not something that anyone is born knowing how to do; it is an acquired skill that takes talent and experience. With time, each facilitator discovers his or her own strengths and style. Don't be hesitant to secure (and be willing to pay for) outside help if you need it.

The basic job of the facilitator is threefold: Begin the meeting on time, keep the meeting moving, and end the meeting on time.

Begin the meeting on time.

- Allow some time for small talk and settling in.

- Create an impromptu agenda, if necessary.
- Walk through the agenda, emphasizing desired outcomes (decision, review, or discussion) for each item.
- If agenda topics have appeared in prior meetings, establish continuity by giving a brief review of actions taken since their last consideration.

Keep the meeting moving.

- Don't move too fast or push too hard.
- Stick to the allotted times for agenda items.
- Summarize frequently to avoid confusion or misunderstanding, and bridge from one topic to the next.
- If a discussion becomes complicated or lengthy, propose a way of addressing the topic in another way or at another time.
- Keep the discussion balanced.
- Encourage all participants to contribute. The facilitator should be sensitive to everyone's needs to digest or articulate information, especially when discussing complex topics or making difficult decisions, while keeping the discussion moving and tactfully cutting short repetitive arguments.
- Listen, look for, and point out areas of agreement.

Bring the meeting to a conclusion.

- Be committed to ending meetings on time.
- Get clear agreement on action items, including who will be responsible, time frames, how progress will be checked, and how progress will be evaluated.
- Some boards routinely set aside a block of time at the end of each meeting to give members a chance to air questions or concerns. To prevent the meeting from becoming a gripe session, it helps to have ground rules for this sort of exchange.
- Time should be allowed at the end of each meeting for a meeting evaluation process. Encouraging board members to give feedback can improve teamwork and make the job of being a board member fun. All board members are responsible for helping make meetings effective.
- Set the tentative date and time of the next meeting, if appropriate.

USING THE CONSENSUS MODEL FOR DECISION MAKING

Making decisions as a group can be difficult. Voting sometimes leaves a group deadlocked, frustrated, or resentful. Often, an answer is not a simple "yes" or "no." One way a group can reach a decision that unites participants instead of dividing them is through consensus. Consensus is defined as reaching general agreement. An effective meeting facilitator will attempt to guide the group to consensus on decisions using the following techniques:

- **Encourage** the presentation of viewpoints, especially when they are conflicting. Real consen-

sus comes only after open discussion and acknowledging differences.

- **Listen** carefully for agreements and hesitations within the group. When a decision can't be made, state points of agreement and hesitation. Stating points of agreement helps group morale, may lead to agreement "in principle" on the issue, and may make it possible to agree on new ideas. Stating points of hesitation can make them clearer and allow for resolution. Many times, hesitations are based on misunderstanding and restating can end those misunderstandings.
- **Test** for agreement as soon as a decision seems to be emerging. State the tentative consensus in a question and be specific. For example: "Do we all agree that we'll meet on Tuesday nights for the next two months, and that a facilitator will be chosen at each meeting for the next one?" rather than "Do we all agree to do this the way it was just suggested?" If you are unclear about how to phrase the decision, ask for help.
    - Insist on a response from the group. Don't accept silence or grunting for consent. Participants need to be conscious of making a contract with each other.
    - Sometimes stating the perceived agreement in the negative helps to clarify the group feeling: "Is there anyone who does not agree that…?" This method is especially helpful for groups under time pressure or with a tendency for nit-picking, but it is also important for group members to be fully supportive of the decision. If you have doubts about their commitment, ask them.
    - Be suspicious of agreements reached too easily. Test to make sure members really do agree on essential points.
- **Offer alternatives** when there is no agreement.
- Ask those who disagree to offer alternative proposals for discussion and decision.
- If an agreement still cannot be reached, people may need time to reflect on the feelings behind their opinions. Propose a break or a period of silence, or postpone the discussion.
- If postponing the decision, try to reach an agreement on a process for what will happen before an item is brought up again. It is often productive for representatives of opposing factions to draft a compromise proposal together.

There are many models of consensus-based decision making, and the one described below is just one of them. The idea behind this model is to avoid having anyone leave the table feeling disgruntled, excluded, or dismissed. This model isn't appropriate for every decision you make, but it can be helpful for times where you're dealing with potentially divisive issues.

When making a decision, instead of voting "yes" or "no," have everyone express support for the decision in terms of a number between 1 and 5:

5 = I feel strongly about this and will take the lead to make sure it happens.

4 = I feel strongly about this, and will work to make sure it happens.

3 = I am okay with this.

2 = I am not okay with this, but will not stop it.

1 = I am opposed to this, and will work to prevent it from happening.

After everyone has voted, tally and share the responses with the group. Begin by asking the 1s and 2s to share their concerns. Ask them to relate their opinion directly to the values, goals, and objectives of the cooperative. Then ask the 4s and 5s to share their viewpoints and do the same thing. The goal is to share viewpoints until everyone in the group is comfortable with the decision. Even in a consensus decision-making process, the group may opt to overrule a single member or small group that stands in the way of where the others feel strongly the organization should go. Also, if there are no 5s, you may ask if the proposal is a good idea to begin with.

GROUND RULES FOR MEETINGS

It's a good idea to set some formal meeting ground rules that everyone agrees to abide by. Like the code of ethics, ground rules describe the highest level of behavior that meeting participants should practice at all times, but that may be forgotten in the heat of discussion.

- Arrive on time. Stay until the end.
- Begin all meetings on time.
- Start the meeting with introductions and an explanation of the meeting process.
- Come prepared, having read all relevant materials beforehand.
- Recognize and state when you have a conflict of interest. Do not vote on any motion in which you have a stated conflict of interest.
- Make no judgmental statements.
- Seek to understand before being understood.
- Speak respectfully. Never raise your voice above a normal speaking tone.
- Talk to the issue, not to the person.
- Don't criticize those who are absent.
- Ask questions when you do not understand. There are no stupid questions.
- Take turns speaking. Try not to speak again until everyone else has had a chance to speak.
- Don't speak at the same time. Don't interrupt.
- State your motions positively. Try to pair a solution with every problem.
- People can disagree without being disrespectful. Everyone needs to be heard and respected, but that does not mean everyone gets his or her own way.
- Talk about meeting issues at the meeting, not in the parking lot after the meeting.
- End all meetings on time.
- Thank all attendees for their support and dedication.

ROBERTS RULES OF ORDER

Robert's Rules of Order is a time-proven tool for meeting process. You don't have to be a parliamentary whiz to use basic concepts that help you stick to an agenda and finish the meeting in an hour or two. The table shown below summarizes the most commonly used parliamentary procedures. Adopting these, even informally, can often help at times when discussions stray from the business at hand, or when conflict becomes stressful.

Process	Following parliamentary procedure, one says:	Need a second?	Is it debatable?	Can it be amended?	What vote is needed?
Introduce business	"I move that . . .	Yes	Yes	Yes	Majority
Motion by committee	"Finance committee moves . . . "	No	Yes	Yes	Majority
Suspend further consideration of an issue	"I move to table the motion."	Yes	No	No	Majority
Postpone discussion for a certain time	"I move to postpone the discussion until . . . "	Yes	Yes	Yes	Majority
Amend a motion on the table	"I move to amend the motion by . . . "	Yes	Only if motion is debatable	Yes	Majority
End a debate and amendments	"I call the question."	Yes	No	No	2/3
Give closer study to something	"I move to refer the matter to the_____ committee."	Yes	Yes	Yes	Majority
Adjourn a meeting	"I move that we adjourn."	Yes	No	No	Majority

Motions that occur occasionally

Process	Following parliamentary procedure, one says:	Need a second?	Is it debatable?	Can it be amended?	What vote is needed?
Protest breach of conduct	"I rise to a point of order."	No	No	No	No vote
Vote on a ruling of the chair	"I appeal the chair's decision."	Yes	Yes	No	Majority
Suspend rules temporarily	"I move to suspend the rules so that . . . "	Yes	No	No	2/3
Avoid considering an improper matter	"I object to consideration of this motion."	No	No	No	2/3
Request information	"Point of information."	No	No	No	No vote
Take up a previously tabled matter	"I move to take from the table . . . "	Yes	No	No	Majority
Reconsider an action the vote on . . . "	"I move to reconsider	Yes	Yes	No	Majority

TROUBLESHOOTING A PROBLEM MEETING

Problem	Solution
Lack of agenda	Send a written agenda in advance to all meeting participants, increasing the odds that people will come to the meeting prepared.
Poor attendance	Were you clear about the meeting date, time, and location? Did you invite the correct people to the meeting? Did you poll participants to choose a convenient time and location?
Distractions	Be sure to choose a meeting time and location that is free from distracting sights and sounds. Make sure the seating and the room temperature are comfortable.
Late arrivals	Start the meeting on time. If you don't start the meeting on time, you're penalizing the people who were on time and rewarding the latecomers.
Socializing	Get down to business at hand and follow the agenda. Do not try to talk over the people talking on the side, but be silent until the disruption ceases.
Wandering from agenda	Make sure discussion sticks to the agenda. Bring back the strays. Use parliamentary procedure.
Meetings run late	Follow the agenda. Table items to be discussed at the next meeting or assign the work to a committee. Interrupt lengthy speakers, if necessary, and ask them to summarize. End the meeting on time.

HANDLING A MEETING MONOPOLIZER

A "monopolizer" is a person who attempts to take charge of a group, monopolizing its discussion and trying to determine its direction. Many cooperatives have a monopolizer or two. Left unchecked, a monopolizer can ruin a committee, split a board, or even destroy a co-op's sense of community.

Handling a monopolizer is a delicate matter because the co-op does not want to arbitrarily silence a member. That would be a violation of the member's right to voice a minority opinion within the democratic organization. The solution for the co-op is twofold:

- Proper use of the majority-rule democratic process.
- Effective meeting management by the meeting facilitator.

Responsibility for ensuring the success of the democratic process falls to the board, which is elected and empowered to run the meetings of the cooperative. Committee chairs have the same power delegated to them from the board.

Encourage the Democratic Process

The democratic process is designed so that organizations can get business done fairly and effectively. This includes preventing one person from taking over the agenda or making decisions without a vote. Anyone in the group can move that time limits be imposed, or that each person gets to make their point succinctly and only once. The group can adopt the process by majority vote. This not only puts clear limits on the monopolizer, but shows him or her that the group has heard enough from them.

APPENDIX E

Manage the Person and the Meeting

If someone has previously demonstrated a tendency to monopolize, a board member could speak privately with the individual before the next meeting. Ask the monopolizer what he or she wants to accomplish. Tell them that speaking too much doesn't help their case, but rather turns people off. Help them formulate a simple request they can make at the next meeting and suggest that they then stop talking unless the president calls on them again.

In a meeting, it is the facilitator's responsibility to protect everyone's right to be heard. Set the ground rules, then stick to them firmly and consistently. Make raising your hand essential. Only allow someone to speak after being properly recognized. If anyone speaks before being called on, interrupt him or her. A gavel is useful in these instances.

Even a positively inclined monopolizer can create a difficult situation. Such a person may volunteer lots of their time to the co-op and may be well liked by everyone, but feel a need to be in charge of everything. But if the situation continues, other people stop trying to get involved. Another danger is that if the monopolizer should disappear, there could be a sudden leadership vacuum. Consequently, even a positive monopolizer should be encouraged to move over a bit and let others assume important roles.

ADULT LEARNERS

BY KIM RICE

Adult Learning Styles:

Adults learn in different ways and process information according to their individual learning styles. To be effective, try to include a variety of delivery techniques based on learning styles.

Visual Learners: Prefer to see information rather than listen to instruction. To process content, they will sometimes form mental pictures of what is being said. To help visual learners, include a few of the following teaching aids:

- Diagrams
- Pictures
- Drawings
- Graphs
- Videotapes

Auditory Learners: Prefer the spoken word. Researchers include reading as an auditory process because these learners focus on hearing the words in order to learn. There are two types of auditory learners: talkers and interactive. Both need to hear the words, but an interactive auditory learner prefers to hear his or her own voice to process information. If possible, include a few of the following auditory aids:

- Story telling
- Recordings
- Reading important information aloud
- Small discussion groups

Kinesthetic Learners: Prefer to move and interact. They learn best by doing, rather than listening or watching, and will sometimes have a hard time sitting still for too long. They need to move and touch things in order to understand and process information. These aids may appeal to kinesthetic learners:

- Moving around to different tables for activities
- Role playing
- Interactive games

Tactile Learners: Learn best by writing down or drawing what is being presented. They process information by participating in interactive activities. Although there are some similarities to kinesthetic learners, these activities should focus on writing information:

- Writing on charts/graphs while listening to instruction
- Projects with written activities
- Journaling

Motivating Adult Learners

Adults bring years of life experience to the classroom, and have different reasons for taking a class. An instructor should identify these motivations and include activities that engage, interact

with, and relate to the audience.

Adult learners are self-directed and goal-oriented.

Instructors should actively involve adult participants in the learning process and serve as facilitators. Establish a friendly atmosphere and demonstrate how the course will help them in their lives.

- Establish clear goals and refer back to these goals to monitor how the class is progressing through the course.
- Show how the course objectives will help them reach their goals.
- Include opportunities to solve problems through discussions or brainstorming sessions.
- Allow each participants to be a leader of a group discussion.

Adult learners bring life experience.

Adults have accumulated years of work and life experiences. They need to connect the material to these experiences, and they want respect for what they bring to the course.

- Ask for participation from the group. Allow the audience to give examples of how a specific point applies to their life experience.
- Treat participants as equals by asking for their participation and suggestions.
- Show appreciation for comments and participation.

Adults are relevancy-oriented and practical learners.

They must see a reason for learning the material in order to apply it. Learning has to be applicable to their work or other responsibilities to be of value to them.

- Ask participants why they are taking the course and engage them in a discussion.
- Tell participants how the lesson will be useful to them in their work.
- Include a variety of activities and let participants choose projects that reflect their own interests

Retention Tips

Increasing retention is an important aspect of an adult learning program.

Research (Pike 1994) suggests that adults can listen with understanding for about 90 minutes and listen with retention for about 20 minutes. Depending on the length of your course, apply the 90/20/8 rule: a course should not run more than 90 minutes, should change the pace every 20 minutes, and involve the audience every 8 minutes. Alter these ratios to fit the length of shorter courses.

Other Considerations

Try to include the following in order to connect the material to the participants and keep the pace on track"

- Include a motivational statement to introduce the material.
- Repeat major points three times if possible.
- Move the content from the easiest material to the most difficult.
- Allow for breaks.

APPENDIX F

- Ask for participation and review often.
- Thank participants for their thoughts and comments.

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The 1042 roll-over cooperative in practice:

A case study of how Select Machine became a co-op

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Prepared for the Northcountry Cooperative Development Fund
www.ncdf.coop
Revised January, 2006

On September 30, the seven employees of Select Machine, in Brimfield, Ohio, began to purchase their company from the two retiring owners, Doug Beavers and Bill Sagaser, using an employee-owned cooperative. This purchase used a precedent-setting structure that (1) permits the sellers to take advantage of the "1042 rollover" of their capital gains while (2) structuring the sale over a period of several years, making it easy to finance and enabling the owners to transfer their managerial expertise to the other co-op members over time.

In 1984, changes in the tax law concerning Employee Stock Ownership Plans (ESOPs) created the so-called "1042 rollover" which permits owners of closely held businesses who sell 30% or more of the stock in their company to their employees through an Employee Stock Ownership Plan (ESOP) or a co-operative to shelter the capital gains from taxes by rolling the proceeds of the sale over into other qualified domestic securities within 12 months of the sale.

Today that is the number one reason for establishing ESOPs, but not one employee co-op had been established using this provision—prior to Select Machine.

Why not? The primary reason is that ESOPs' stock structure enables owners to sell part of their companies to employees, while retaining enough equity to make financing easy. The typical 1042 rollover ESOP is done as a 2 or 3 stage transaction over a 5-10 year period. By contrast, co-ops are conventionally structured as 100% employee owned. Financing a 100% leveraged transaction is extraordinarily difficult, especially if the owners are leaving and taking their management skills with them.

COMPARING ESOPS AND CO-OPS

ESOPs have tax advantages that make them the employee ownership structure of preference in companies that are profitable, capital intensive, and employ more than 20-25 employees. Because ESOPs are Federally regulated qualified employee benefit plans, the costs of establishing them — $50,000 and up — and maintaining them — $10-15,000 annually — makes them unduly expensive in smaller, less profitable companies. Furthermore, small ESOPs have great difficulty staying in compliance with the law because they try to save money on professional advice. That eventually catches up with them in expensive Department of Labor fines and Plan corrections.

By contrast, employee co-ops are membership associations similar to agricultural co-ops and consumer co-ops. Co-ops distribute their profits to members on the basis of labor input measured by W-2 earnings, hours worked, or other measures, not unlike the way ESOP stock is distributed. Unlike ESOPs, however, members elect a majority of the board on a one-person, one-vote basis. Co-ops have fewer tax advantages than ESOPs, but they are less expensive to set up and even cheaper to maintain. They would seem an ideal employee ownership solution in smaller companies, if a multi-stage transaction model could be established.

STRUCTURING THE CO-OP BUSINESS SUCCESSION MODEL

What is needed for a multi-stage co-op purchase? With the financial support of the George and Gladys Dunlap Cooperative Leadership Program of the Nationwide Foundation, the Ohio Employee Ownership Center and the Ohio Council of Cooperatives (now part of the Mid-America Cooperative Council) sought to develop a practical model for ownership succession in small businesses using the employee cooperative as an ownership structure.

We teamed with Mark Stewart, one of the nation's leading co-op attorneys, and ESOP-specialist Eric Britton at the Toledo, Ohio, law firm of Shumaker, Loop and Kendrick, to develop the legal framework for the conversion of the company to a cooperative and for the purchase transaction to take place over time.

The model that Stewart and Britton designed calls for converting the company into a co-op which then redeems the retiring owners' stock in several steps with a valuation at each step. The owners qualify for a tax free rollover of the proceeds provided the co-op redeems at least 30% of the owner's stock. The owners' remaining equity makes the deal easy to finance, and the owners' continuing involvement for several years enables them to transfer their management skills to the other co-op members.

This model has two distinct financial advantages for the selling owners. First, they obtain the control premium on the first stock redemption, because a co-op by definition must be controlled by its members. Second, the retiring owners can be members of the co-op as long as they are working and can also receive internal capital allocations annually.

On the other hand, the selling owners have to be comfortable with a board elected on a one-member, one-vote basis and with the inherently democratic nature of the co-op.

WHY SELL SELECT MACHINE TO THE EMPLOYEES?

Select Machine was founded in 1994 by Doug Beavers and Bill Sagaser and today employs 9 people full-time, including the two owners. The company manufactures, sells and distributes machined products and equipment for installation on construction and demolition equipment.

"Bill and I set up this company to be the kind of company that we would like to work for if we were working for someone else," is the way Beavers describes the owners' philosophy. Symptomatic of the workplace practices at Select Machine is that Bill and Doug serve everyone lunch on Friday at 2 and send everyone home to have Friday afternoon with their kids. "Best place I have ever worked!" was the opinion freely offered by several of the machinists when we started talking about an employee buyout.

"What impressed me most about this group is their spirit of community within the business," says Attorney Mark Stewart who did the legal work on the buyout. "In a co-op, you need a concern for each other's welfare, just like partners have. That attitude is infectious. That's the kind of attitude they have at Select Machine."

Beavers and Sagaser had sought to sell their profitable business for months before offering it to the employees. Several interested potential buyers surfaced, but all of them wanted to buy the business for its customer list, cherry-pick the equipment, and consolidate production into underutilized facilities elsewhere. Shutting the plant and leaving their employees out of work was not why Beavers and Sagaser had built the business. Why not sell to their employees instead? They turned to the Ohio Employee Ownership Center (OEOC) for advice.

From the initial telephone discussion on 3/22/05 to completion, the deal took 6 months. See the time line attached as Addendum 1.

The OEOC staff conducted several meetings with the owners, reviewed the financials, and toured the facility to get an understanding of the business and what the transaction would entail. The owners broached the idea of ownership to the employees, and got a favorable response. We then met with the employees to explain the basics of employee ownership, what an employee cooperative is, and how the deal could be done. (Our roadmap, prepared for a meeting with the owners on 3/25/05 and then expanded for the initial meeting with the employees on 4/8/05 in provided as Addendum 2.) The employees voted to investigate the possibility of setting up a co-op, and elected a buyout committee to undertake that task.

Given the threat to the jobs if the employees didn't buy the plant, a preliminary feasibility assessment of an employee purchase was funded by a grant from the Ohio Department of Job & Family Services' Prefeasibility Study Grant Program administered by the OEOC. The study was performed by Brott Mardis, a local accounting firm, and included a valuation.

Funds for preliminary feasibility assessments of employee purchases to avert job loss are available in every state through the Federally funded Workforce Investment Act, but are only regularly used in half a dozen states.

DOING THE DEAL

With a favorable feasibility study in hand and expressed willingness from a local bank and from a revolving loan fund to finance the redemption of 40% of the owners' stock, Attorney Mark Stewart prepared an offering statement for the employees.

Unlike ESOPs, which are trusteed pension plans and whose trustee acts on behalf of the employees to buy the stock, in co-ops the members act on their own behalf. Thus members buy the company much as individuals buy used cars: it's buyer beware. ESOP participants have recourse against a trustee who pays too much. In a similar situation, co-op members' recourse is against the seller for fraudulent conveyance. So it is in the interest of both the buyer and the seller that the co-op members are fully informed in writing about the risks of the transaction.

The tool to do that is the offering statement. It describes the company, the proposed transaction, the intent of the owners to sell their remaining stock to the co-op, how the co-op will redeem the owners' stock, how the company will be managed, the various legal documents necessary to establish the co-op and complete the transaction, and the risks involved. It is not a Securities and Exchange Commission disclosure statement, but it performs the same role in informing the potential co-op members about what they may buy and the risks involved in doing so.

After reviewing the offering statement, the feasibility study and valuation, and the financial statements of the company, Select Machine employees voted to set up an employee-owned cooperative. They discussed and made key decisions about the structure of the cooperative including qualifications for membership, membership fees, and how to allocate patronage.

They set the co-op membership fee at $1000. Patronage allocations are distributed on the basis of a formula that assigns 50% to W-2 earnings (rewarding current market value of their skills), 25% to hours worked (rewarding diligence and equality), and 25% to seniority capped at 120 months (long-term contribution to the business).

With the decision to proceed, preparing the documents swung into high gear because essentially everything else has to happen virtually simultaneously: converting the company into a co-op; selecting a board and holding an initial board meeting to authorize the redemption and borrowing to fund it; executing the various legal documents related to co-op membership, members' stock subscription and the stock redemption; formalizing employment agreements; and borrowing the money to redeem the first 40% of the owners' stock.

So what exactly happened?

- The articles of incorporation of Select Machine were amended and restated to establish the firm as a cooperative under Ohio Cooperative Law. New bylaws appropriate for the cooperative were written to replace existing bylaws of the company.
- Select Machine cooperative members elected a board of five including the two selling owners —who joined the co-op as members—and three employee members.
- The board voted to authorize the stock redemption and borrowing the money to fund it.
- The documents for the transaction were prepared: the stock redemption agreement which establishes the terms and conditions for redeeming the stock from the original owners; membership and stock subscription agreements for the new co-op members; the business plan; employment agreements for the co-op members; and the owners' employment agreement

which provides them certain reserved rights as "protected shareholders" until their stock is redeemed.

Because of the fact that the 1042 rollover assumes the conveyance of the seller's stock to the employees, the stock redeemed from the owners is distributed to the other members of the co-op as membership stock in return for limited recourse notes by which the members pledge to pay for the stock with their patronage allocations and stock pledge agreements that put up the stock as collateral against the loan. Consequently, the redeemed stock is allocated among the members just as initial patronage allocations will be made.

Over time, as newer employees acquire more seniority, the weighting of the allocation formula will give them larger patronage allocations, and the stock accounts will ultimately have to be rebalanced.

Beavers and Sagaser sold 40% of their shares in this transaction and became themselves members of the co-op. To do so, they put up a portion of their unredeemed stock holdings as membership stock, equivalent to the average membership stock the other members hold.

While the patronage capital allocations for all members except the owners will go to pay down the note used to acquire their stock, the owners will simply receive their patronage allocations. After all, they already own their membership stock. So they will build their capital accounts within the co-op, but will not acquire additional stock in the process.

Beavers and Sagaser intend to sell the remaining 60% of their shares as soon as the debt to purchase the 40% has been repaid. They then intend to retire from the business. In the intervening period, they need to train other co-op members to run the business successfully. A first step in this process was writing a business plan for the transition period that spells out what functions the owners have performed for the firm and who will be trained to take over which tasks. This document, which was drafted by the OEOC's Bill McIntyre on the basis of the owners' input, creates a formal transition plan that specifies the skills and knowledge which Beavers and Sagaser will need to transfer to the other co-op members over the next few years.

National implications

"The structure of an employee co-op and its tax advantages under Section 1042 of the tax code are relatively obscure for business owners," says Stewart, "but once we have viable models of how this can be achieved, we will have a lot more co-ops set up for business succession."

The model pioneered at Select Machine should be transferable to many other small companies with under 25 employees. The employee-owned cooperative offers an attractive alternative to those owners of companies that are too small for the ESOP option and do not have family members available, willing and capable of taking over the business. The stock redemption model permits selling owners to shelter their capital gains, get a better price than they otherwise would, and see their business legacy continue.

HOW HAS IT WORKED SO FAR?

I called Dave Baird, a machinist who has been with the company for 6 years and is the co-op vice-chairman, a month after the co-op was established to get an update on where things stand.

"It's all good, John. Everyone is real excited to make this thing happen. You know that we felt good about working here before, but everyone is more enthusiastic now. I was talking to one of the younger guys yesterday on this. 'I just see the company differently now,' is what he told me."

"This co-op's an honor," Baird continued. "It's a challenge that I look forward to every day."

"We did not set out to establish a precedent or develop a model," said seller and new co-op member Beavers. "We just wanted to do what was best for the employees of our company and for ourselves. We chose the employee-owned cooperative because it made sense."

The OEOC is a non-profit program based at Kent State University providing information and technical assistance to people interested in exploring employee ownership as well as developing and delivering training material and sponsoring conferences and programs for employee-owned companies. Visit our website at www.kent.edu/oeoc/ Since it was established in 1987, the OEOC has assisted 73 companies employing over 14,100 employee-owners to become employee owned; these firms have created over $300,000,000 in equity for their employee-owners. For more information on the 1042 rollover co-operative, read our coverage of the Select Machine case and Mark Stewart and Eric Britton's articles on the subject at www.kent.edu/oeoc/OEOCLibrary/

For additional information on the 1042 rollover co-op, contact: Steve Clem, OEOC, 330-672-0335, cclem@kent.edu or Bill McIntyre, OEOC, 330-672-0332, bmcinty2@kent.edu

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For assistance on cooperative conversions in Minnesota, contact Kerstin Larson at Northcountry Cooperative Development Fund at 612-767-2123 or kerstin@ncdf.coop.

ADDENDUM 1:
TIMELINE ON THE SELECT MACHINE TRANSACTION

DATE	EVENT
3-22-2005	Owners contact OEOC; followed by meetings with OEOC staff, discussion of choices, & review of financials Owners like co-op idea & broach it with employees
4-8-2005	OEOC staff meet with employees, explain co-op and how to do the deal
4-8-2005	Employees vote to explore co-op and elect a buyout committee
April	Equipment appraisal updated
Mid-May	Feasibility study/valuation consultant hired
6-16-2005	Feasibility study and valuation completed
Late June	Extensive discussion with OEOC staff of feasibility study and implications
July 2005	Owners decide to proceed with sale to employees
7-29-2005	Initial meeting between owners and employees and co-op attorney Mark Stewart
8-9-2005	Attorney retained; offering statement prepared
August	Employees review feasibility study, offering statement, and financial statements; they vote to establish co-op and set membership criteria, fee, and allocation formula
8-15-2005	Lenders agree to loan enough for a 40% stock redemption
August-September	Documents are drawn up
9-14-2005	Amended incorporation documents and bylaws are filed with state
Mid September	Co-op board elected, meets, authorizes stock redemption and borrowing
9-30-2005	New co-op members sign memberships, stock subscription agreements, limited recourse notes, stock pledge agreements, employment agreements, and receive stock certificates
9-30-2005	Owners and co-op officer sign stock redemption agreement and owners' employee agreement
10-3-2005	Loan documents are signed and owners receive cash for stock redeemed. Select Machine begins functioning as a cooperative with 40% held as membership shares by the new co-op members and 60% held by the owners

Between 2005 and 2010, the owners will transfer their management skills and knowledge to the other co-op members. In 2010 or before, the remaining shares held by the owners will be redeemed, and they will retire

During the period between April 8 and September 30, 2005, OEOC staff met with the employees and owners at least biweekly and generally weekly.

ADDENDUM 2:
STEPS IN A 1042 CO-OP BUYOUT AT SELECT MACHINE

This memo was originally prepared for the owners and then expanded for the employees.

Date:	3-25-05 and 4-8-05
To:	Doug Beavers & Bill Sagaser, Select Machine Inc. & Select Machine employees
From:	John Logue, OEOC
Subject:	Steps in an employee buyout through an employee cooperative for getting the 1042 rollover in a multistage sale

Employee Stock Ownership Plans (ESOPs) have been the usual tool for selling businesses to employees in the US by retiring owners. However, ESOPs are expensive to put in place, generally costing a minimum of $40-60,000 to put in place and $5-10,000 annually to maintain. Worse, our experience is that small ESOPs in practice are hard to keep in compliance with the law.

Selling to employees through an ESOP or through a co-operative provides the same tax break for the seller. Co-ops are less expensive to set up and essentially free to maintain.

Here's a short road map for how to do a multi-stage sale to the employees through a co-op.

STEP	ACTIVITY
1	Discussion with and decision by owner(s) that a sale to the employees is a good idea.
2	Discussion with and decision by employees that purchasing the business from the owners over a period of years is a good idea. Determine procedures by which employees will satisfy themselves that they are knowledgeable buyers. Establish a small committee of employees to represent the employees as buyer.
3	Obtain a current equipment appraisal. We won't be able to borrow the money to buy the first chunk of Bill's and Doug's stock without an appraisal.
4	Obtain a valuation for the business to set the value of the shares to be redeemed.
5	Prepare a lease for the building at market rates. (Doug and Bill currently own the real estate separately from Select Machine, a very common way thing in small businesses. Once Select Machine becomes a co-op, there will need to be an arms-length relationship between Doug and Bill as landlords and the co-op, even though the co-op includes Doug and Bill.)
6	Prepare a description of the business that you are buying, of how you are buying it, how you are going to run it going forward (that is, your plans for the business) and what the risks are. The guys you elect and Doug and Bill will be hiring someone to prepare this with the committee. This is essentially the disclosure document on the sale (so it's similar to an offering prospectus for public company stock—but much shorter and written in English).

You should read this carefully and ask your questions. You are going to become owners of the company, and you should understand what makes the company tick and how you all and Bill and Doug will work together for some years to run the company successfully and how you will run it successfully when Doug and Bill retire.

This document becomes the basis for writing a formal business plan about how you will run the business going forward: markets, customers, suppliers, management, equipment needs, etc. This business plan should pay particular attention to establish procedures and a time line for transferring Bill's and Doug's management knowledge and skills to the other co-op members.

7 Prepare new bylaws of the company (and incorporation papers, as necessary) to reflect that it will be doing business as a co-operative. This requires two things: (a) distribution of future retained earnings annually on the basis of labor input into the company, and (b) election of a majority of the members of the board by co-op members. From the point of view of the seller(s), this also means (c) building in veto power for the selling owners as long as they have a majority financial interest in the company.

8 Establish the co-op as a membership organization. Do membership agreements. Each member gets one voting share.

Note: the sellers can be members of the cooperative and can participate in the annual allocations of retained earnings—provided you use a non-share-based system for allocating retained earnings.

9 Decision by you as a group on whether you want to buy the company from Doug & Bill and by you individually whether you want to be members of the co-op.

10 Elect the board for the co-op.

11 The board will authorize management to redeem at least 30% of the shares of the company (30% is the threshold to get the favorable tax treatment for the sellers). Presumably you will borrow money for this or will lay aside money from current revenues as employee bonuses for investment in the co-op.

Bill and Doug have a banking relationship with Huntington. The OEOC also runs a small revolving loan fund. It looks to me that it should be possible to finance redeeming a third of the stock in the company.

To get the favorable capital tax treatment, the sellers need to reinvest the proceeds in "qualified replacement property" which means stocks and bonds of American companies which produce goods and services.

12 Pay down debt taken on for first stock redemption over several years and then borrow more to redeem some additional stock or all the remainder of the stock. Repeat until all the stock has been redeemed. It is probably necessary to do another valuation at each sale.

During the three to seven years that this process is underway, Doug and Bill need to transfer their management expertise to the other members of the co-op. You've got to learn how to run all aspects of the business successfully before Doug and Bill really retire. Even when they do, the co-op may want to keep them on the board for a while as senior statesmen so you have their advice and knowledge at the co-op's disposal.

Before the last portion of Doug's and Bill's stock is redeemed, they should consider rolling the building into the company as a final step in the transaction—assuming they want to sell the building at that time instead of being landlords to a business they no longer own part of. That would let them shelter their capital gain in the building. That would give them some additional stock (reflecting the market value of the real estate that they contribute to the business) and then that stock would be redeemed and the co-op would own the real estate too. This doesn't have to happen, though. Plenty of businesses lease the property they occupy.

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It's hard for owners of small businesses to sell them for what they are worth, because part of the value of the business is the skill and knowledge of the owners working there every day. Too often the owners keep hoping that someone will show up to pay them a lot for the business—and then find when they really need to retire that the only real buyers want to buy the customer list, to cherry pick the equipment, and move production to some other place.

The goal of the transactions is that everyone will benefit: Doug and Bill benefit as sellers because they get a tax break (and as co-op members while they continue to work in the co-op) and the employee co-op members benefit from jointly owning and running a successful business right here at Select Machine.



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