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Hybrid Cooperatives Challenges and Advantages

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The cooperative movement is made up of diverse types of organizations: worker cooperatives, retail consumer cooperatives, credit unions, and housing cooperatives are all vastly different from each other. Each type of cooperative has strikingly different characteristics, strengths and weaknesses.

For example, one characteristic of consumer cooperatives in the United States in recent years is success. They include highly visible retailers such as REI and a vibrant sector of cooperative grocery stores. Cooperative groceries are generally outperforming the grocery sector as a whole, and have both nurtured and benefited from trends supporting natural foods. Some observers, however, suggest that consumer cooperatives are not necessarily better employers than conventional grocery stores, and there are examples of substantial labor-management conflict in cooperative groceries. While most consumer-cooperative groceries are worker-friendly, nothing about their structure ensures a voice for employees.

By contrast, the governance power of workers in worker cooperatives means that they remain committed to the welfare of their employees. Unlike consumer cooperatives, the worker cooperative sector in the United States has yet to thrive. Despite the remarkable and enduring success of some prominent worker cooperatives, many have failed to remain viable businesses in the long term and the sector as a whole is growing slowly.

These contrasting problems present an obvious and intuitive solution: why not remedy the problems of consumer cooperative by adding a component of worker ownership? Why not address the challenges of worker cooperatives by recruiting consumers as owners? This combination—the hybrid cooperative—has deep conceptual appeal, bolstered by the public success of hybrid cooperatives such as Weaver Street Market in Carrboro, North Carolina.

The purpose of this paper is to explore the definition and appropriate uses of a hybrid cooperative structure, making use of Weaver Street Market as a brief case study.

Definition

The Canadian Co-operative Association refers to “multi-stakeholder” cooperatives as part of its description of the Canadian worker coop sector. In such multi-stakeholder cooperatives, it says, “membership is made up of different classes of members such as workers, consumers, producers, investors and/or other possible stakeholders.”¹

To formalize this description, I propose the following definition of a hybrid cooperative: “an organization that follows the seven cooperative principles and that has more than one class of members, each of which has distinct rules for membership, patronage, and participation in governance.”

Throughout this paper, I will use the terms “hybrid cooperative” and “multi-stakeholder cooperative” interchangeably. I will use the phrase “single-class cooperative” or “traditional cooperative” to refer to a cooperative with a single class of members.

In practice, the two most likely classes of members in a hybrid cooperative are workers and consumers, although there are arguments (and, in some cases, examples) of vendors and investors. Most of the example in this paper will focus on worker- and consumer-ownership, although the arguments apply to other combinations of membership classes.

As an aside, another rarely discussed category of potential members in a hybrid cooperative is other cooperatives. The idea of “a coop of cooperatives” could easily accommodate hybrid structure: for example, a warehouse supporting a number of cooperative gas stations could itself be a hybrid cooperatives owned by the gas stations and its own workers.

Before discussing advantages and disadvantages of hybrid cooperatives, we’ll begin with a brief overview of three major parameters in their design.

Membership: The definition of a hybrid cooperative allows for completely separate mechanisms by which different stakeholders become members of a coop. In a worker/consumer hybrid cooperative, for example, worker members may pay a larger membership fee than consumer members. Unlike consumer members, worker members are often required to demonstrate appropriate skills and experience, serve a probationary period, and learn about the cooperative movement.

Patronage: The cooperative must decide whether each class of members will receive the same amount of patronage as each other class. If not, it must determine a fair and mutually acceptable way to allocate patronage among member classes. Within each membership class, hybrid cooperatives will have different formulas and inputs to

¹ <http://www.coopscanada.coop/aboutcoop/cancoopsectorprofiles/worker/>

determine patronage. Patronage to worker owners may be determined by hours worked, while patronage to consumer members may be driven by dollars spent at the cooperative. The timing of patronage payments and possible retention of patronage may also be different among different member classes.

Governance: Determining representation on the board of directors and the role of membership meetings is unlikely to be simple. Does each member class have equal representation on the board? If so, the board will need a tie-breaking mechanism. Do the members classes have their meetings jointly or separately? If separately, how do the membership classes communicate with each other?

Advantages

Hybrid cooperatives have a number of advantages.

Philosophical: The most obvious advantage is the conceptual simplicity of the hybrid cooperative idea. It neatly reflects and gives structure to the extensive literature on organizational stakeholders and provides an elegant solution to the arguments about the shortcomings of single-class cooperatives.

Facilitate Participation: Advocates of cooperatives tend to believe that involving more people in more decisions (within reasonable limits) creates better decisions. Where consumers may have little ability or little interest in being part of the decision making process of a worker cooperative, a hybrid cooperative structure gives consumers both a reason to participate and a structure through which to do so.

Encourage Loyalty: Employee owned companies in the United States often have lower employee turnover rates than their peers. Introducing worker ownership to a consumer cooperative could decrease worker turnover. Conversely, the experience of consumer cooperatives is that consumer members tend to be more frequent shoppers. A component of consumer ownership may increase customer loyalty in worker cooperatives.

More Access to Capital: A frequent problem for successful worker cooperatives that seek growth is an inability to raise capital. Their members are rarely sources of sufficient capital. Potential lenders are frequently unfamiliar and uncomfortable with the cooperative structure. Potential sources of equity are often legally excluded or are only able to purchase equity with limited or non-existent voting rights. These limitations contributed to the decision of Open Enterprise, Inc. (the entity that operates the retailer Good Vibrations) to leave its cooperative structure and become a corporation in 2006. It has since expanded through incremental growth and acquisitions.

With the exceptions of banks with an explicit focus on cooperatives, such as the National Cooperative Bank, most banks and other traditional lenders are unlikely to be comfortable with cooperatives, whether they are hybrid or single-class. Nonetheless,

adding a class of owners does add potential new sources of capital: the new owners themselves. We'll come back to this in the discussion of Weaver Street Market.

Structure to Address Conflict: Organizations experience disagreements and divergence of interests among their stakeholders. To the extent that all relevant viewpoints are represented, the hybrid structure provides a number of venues—the board of directors, meetings of the membership—for discussions about these conflicts to take place openly. This may provide an opportunity that did not exist before to find solutions that adequately address the needs of all stakeholders.

Stronger Ties to Community: Participation by a broader section of the community may increase the perceived legitimacy of the cooperative as a genuine representative of the community as a whole. This may facilitate support by municipal governments and non-governmental organizations that would not have been possible otherwise.

Challenges

The advantages of hybrid cooperatives are intuitive and appealing, but in practice, their implementation may prove daunting for a number of reasons.

Increased Complexity / Decreased Transparency: Creating a hybrid cooperative entails making difficult decisions, as discussed in the section on definitions. This complexity is heightened because more voices—and more diverse voices—are involved in the foundational discussions for a hybrid cooperative than for a traditional cooperative.

Assuming that satisfactory answers can be found for all of these questions, hybrid cooperatives are still simply harder to explain. This complexity has costs in terms of recruiting new members, working with potential new vendors or possible lenders.

New Areas for Conflict: One possible result of working on the membership, patronage, and governance issues is that the very attempt to resolve these issues will cause conflict. An organization which had simply accepted the division of profits, for example, may find that the discussion of the hybrid structure causes stakeholders to become aware of ways they are dissatisfied that they simply not thought about before. They may also feel that, as prospective owners, they have the right to challenge issues which they otherwise would not.

Differences Among Member Classes: Stakeholders groups vary from one another on a number of dimensions: the number of people in the class, their level of financial involvement in the cooperative, knowledge about the cooperative and its business, level of wealth, level of familiarity and support for cooperative ideals, time horizon, identification with the cooperative, etc. All of these issues make it difficult to determine an equitable and practical balance among various member types in terms of membership requirements and fees, patronage and governance rights. Stakeholder groups with less stake in the cooperative can be excluded, included with less formal power, or included with equal power: all three scenarios raise their own particular challenges. Despite the

conceptual appeal of representing various stakeholders, the reality of the task is complex.

Possible Violation of Cooperative Principles: The International Cooperative Alliance states that the second cooperative principle, democratic member control, implies that “in primary co-operatives members have equal voting rights (one member, one vote).”² This is clearly a challenge in a hybrid coop, where all members may vote, but the vote of a member of a large class (i.e., consumers) may count substantially less than the vote of a member of a small class (i.e., workers).

Possible Dominance by One Membership Class: Assuming a cooperative can navigate the difficult path to creating a fair governance structure, it is still possible that one membership class would have greater influence over the cooperative than another class. Vendors, for example, may have market power over the cooperative, or worker-members are likely to be significantly better informed about the cooperative and able to dominate discussion.

Alternatives to a Hybrid Structure

Given the challenges of creating a viable hybrid cooperative, those interested in the advantages of hybrids may wish to explore other structures that have the potential to provide those advantages without some of the challenges of a hybrid. This section gives brief examples of other models to consider.

Nominal Membership: A single-class cooperative may provide some of the advantages of membership to a class of stakeholders without creating formal membership. Bi-Mart is a chain of retail stores headquartered in Eugene, Oregon. It markets itself as “Northwest Grown... Employee Owned,” and 100% of its shares are owned by an employee stock ownership plan, or ESOP, which it established in 2004. Bi-Mart provides what it calls “member only” access to its stores: in the 1950s the membership status allowed the company to sell products below the manufacturer’s suggested retail price.

Today, those laws no longer apply, but consumers must pay a USD5.00 fee for lifetime Bi-Mart membership before they can enter a Bi-Mart store. The membership does not constitute an ownership stake or anything approaching what membership would mean in a consumer cooperative. The company’s strategy is to use the membership system to build loyalty, gather information, provide conveniences such as check cashing, and increase the connection between itself and its consumers.³

Formal Governance Power: A single-class cooperative could address the need for other stakeholders to have a voice by providing them a seat on the board. The board seat could have observer status, full voting powers, or something between the two.

² <http://www.ica.coop/coop/principles.html>

³ <http://www.bimart.com/story.aspx>

Informal Governance Power: A traditional cooperative could undertake systematic non-binding steps to provide non-member stakeholders a voice in the governance of the cooperative. A simple example might be a worker cooperative that polls its customers about product policy.

Debt with Covenants: For potential investors wary of investing without receiving an equity interest, cooperatives can attempt to borrow the money and increase the comfort of the investors by providing substantial covenants, giving the debt-holder important, and perhaps temporary or conditional, rights over the governance of the cooperative.

Non-Voting Equity: Some single-class cooperatives may consider raising capital through equity investments while preserving cooperative principles by making such equity non-voting. Equal Exchange, for example, is a worker cooperative based in West Bridgewater, Massachusetts. Over its history, it has raised over USD3,000,000 from over 300 outside investors. Such investors purchase a minimum of USD5,000 in non-voting class B preferred shares that have an annual dividend target of 5%.⁴

New Legislation: The State of Minnesota is a pioneer in new cooperative structures designed to allow cooperatives to receive outside equity investment. Passed in 2003, the Cooperative Associations Act “theoretically allows for outside Investor-Members to hold as much as 99.99% of the equity of the cooperative and receive up to 85% of the profits from the cooperative.”⁵ These laws are controversial in the cooperative community and require research beyond the scope of this article.

Case Study: Weaver Street Market

While the challenges discussed above may seem daunting, a specific example—Weaver Street Market—demonstrates the potential power of the hybrid cooperative structure. Weaver Street is a worker- and consumer-owned cooperative in Carrboro, North Carolina, that operates a restaurant and two grocery stores.

Weaver Street opened in 1988 with support from a local community development organization, the town of Carrboro, and community members. Weaver Street has weathered the opening of well-funded competitors in nearby locations, and continues to grow: sales, profits, and membership are increasing, and it plans to open a new grocery store in the near future.

Weaver Street Market uses triple bottom line accounting, measuring its social impact (in terms such as local purchasing and number of community events sponsored) and its environmental impact (such as recycling and use of green energy). Weaver Street has

⁴ <http://www.equalexchange.com/investing-in-fair-trade>

⁵ http://www.dorsey.com/files/tbl_s21Publications%5CPDFUpload141%5C353%5CMNLegislatureMay2003.pdf

nurtured the growth of a community radio station, music festivals, farmers markets, and local cooperative housing.

Membership: Consumers can become members of Weaver Street by paying a one-time fee, starting at USD75 for a single adult and rising depending on the size of the household. Employees can become worker owners, after a probationary period, by paying a membership fee which the company is able to finance through payroll deductions. Not all Weaver Street employees are worker owners: some are still in their probationary period, and some choose not to invest in ownership.

Patronage: Weaver Street currently has over 11,000 consumer owners and 90 worker owners. The financial return for those owners has been high. In his review of 2007, General Manager Ruffin Slater states:

A basic benefit of our cooperative structure is that it allows us to promote the economic well-being of our owners by returning money back to you. Our consumer owners received \$399,598 in discounts at the cash register. Based on total consumer share investment of \$1.01 million, this represented a return on share investment of 39%. Our worker owners receive a patronage dividend based on hours worked, which totaled \$151,534, or \$1.01 for every hour worked during the year. Based on a total worker share investment of \$406,048, this represented a return on share investment of 37%.⁶

Sources of Capital: While membership fees do provide some income, Weaver Street Market has used its hybrid structure as a way to encourage consumer members to make loans to the cooperative. Its community investment initiative, open to members only, allows a minimum investment of \$10,000 and pays 6% interest. Weaver Street plans to use the investment, in part, to fund the opening of a new grocery store in a nearby town.

Governance: With two classes of members, Weaver Street determined to make the collective governance power of each class equal. As a result, the cooperative *is governed by a seven-member board of directors, four of whom are directly elected by the two owner classes, workers and consumers (2 positions each). Two positions are appointed by the board itself to fill the need for particular skills or knowledge. The General Manager holds the seventh position.*⁷

The current chair of the board, Jacob Myers, is a worker-owner elected by his peers. Weaver Street Market practices policy governance[®],⁸ providing its board a structure for its activities. This approach may focus the board in a way that minimizes extraneous conflicts among its membership classes.

Conclusion

Hybrid cooperatives are an attractive idea and they have potential to make organizations stronger and better than they would be as single-class cooperatives. Still,

⁶ <http://www.weaverstreetmarket.coop/article/display.php?id=1763>

⁷ <http://www.weaverstreetmarket.coop/owner/index.php>

⁸ <http://www.carvergovernance.com/>

the challenges, up-front investment of time, and increased complexity means that they should only be used after other solutions have been considered.

The existence of success models, such as Weaver Street Market, provides future hybrid cooperatives templates and guidance for their own foundational and developmental challenges. At a minimum, I recommend that people working on establishing hybrid cooperatives invest the time and energy to create a durable structure early on. Using experienced professionals and drawing on the experience of other cooperatives can save later headaches.