A Co-operative Solution to the Job Crisis

Worker Co-op Buy-out Guide

1

co-op ventures worker co-op

Prepared for:
Western Labour - Worker Co-operative Council
March 2009

Forward

In recent years a growing number of working families have been threatened by workplace closures. Stress factors in the forestry, manufacturing, and food processing industries in particular have accelerated the rate of job loss in rural communities in Western Canada. The Western Labour - Worker Co-operative Council ("WLWCC" or the "Council") was formed in 2006 to support worker-driven interventions in situations of plant closure and threatened jobs.

Partners in the Council include the Canadian Labour Congress (Prairie Region), the Canadian Worker Co-operative Federation, Co-op Ventures Worker Co-op, and the Ohio Employee Ownership Center. Lynn Williams, President Emeritus of the United Steelworkers has played a key role in bringing these organizations together. The partners in the Council believe that the need to act is urgent.

This guide has been developed to build the capacity of workers to respond quickly. Whether unionized employees want to explore buying-out a business as a worker co-operative or as another type of employee-owned enterprise, this guide can help.

It features basic information on how co-operatives work, how co-operatives work for workers through union supported worker buy-outs, and how you can get started. We hope it gives you an idea how the co-operative model can meet your members needs, how the buy-out process can happen, and what your first steps need to be.

Acknowledgements

Co-op Ventures Worker Co-op and the project partners on the Western Labour - Worker Co-operative Council would like to acknowledge the Ohio Employee Ownership Center, the United Steelworkers Worker Ownership Institute, and the Canadian Worker Co-operative Federation.

This project was made possible by funding from the Innovations and Research component of the Co-operative Development Initiative (CDI), a federally-funded program managed by the Co-operatives Secretariat at Agriculture and Agri-food Canada. The partners gratefully acknowledge the support of the Co-operatives Secretariat.

This guide has been produced with the collaboration of:

CWCF FCCT

Ohio Employee Ownership Center
OEOC

Canadian Labour Congress
Congrès du travail du Canada
Western Region

Alberta Federation of Labour

co-op ventures worker co-op

Secrétariat aux coopératives
Co-operatives Secretariat

What is a Co-operative?

A co-operative is an organization formed by people coming together to meet their common needs. Locally owned and democratically controlled by the members who use its services, a co-operative is founded on a common idea - that people know what's best for them and can work together to achieve their goals. Co-operatives empower individuals by enabling them to pool their resources and share risks. The co-operative alternative also encourages healthier and stronger communities.

Co-operatives are active in every sector of the economy, including finance, insurance, agri-food and supply, wholesale and retail, housing, health, and the service sector. They can provide virtually every product or service, and can be either non-profit or for-profit enterprises. Like trade unions, co-operatives are based on the values of self-help, democracy, equality, and solidarity. Co-operative members believe in the ethical values of honesty, openness, social responsibility, and caring for others.

How is a Co-operative Different From Other Forms of Business?

Co-operatives and credit unions are member-driven, community-based organizations. They care about the needs of their members and the quality of life in their communities as well as the bottom line. They bring many obvious benefits to their members such as sharing costs or financial dividends. Member-owners can contribute to social, economic and community development. Perhaps most importantly, membership provides common ground and support to reduce isolation, and build confidence and skills. Trade unions and co-operatives have a long and productive shared history together in Canada. In fact, many co-operatives and credit unions across Canada were started by the labour movement, mostly prior to the late 1970's.

Co-operative organizations differ from other businesses in three key ways:

1. A Different Purpose: Co-operatives and credit unions meet the common needs of their members, whereas most investor-owned businesses exist to maximize profit for shareholders.

2. A Different Control Structure: Co-operatives and credit unions use a system of one-member/one-vote, not one-vote-per-share. This helps them to serve common interests and to ensure that people, not capital, control the organization.

3. A Different Allocation of Profit: Co-operatives and credit unions share profits among their member-owners on the basis of how much they use the organization, not on how many shares they hold.

There are many benefits that come from successful co-operatives. The ones that will apply to your situation will be as unique as your co-operative itself. All co-operative and credit unions however, are based on principles-driven development. Unlike the private, public or voluntary sectors, co-operative organizations are guided by seven principles:

1. Voluntary and open membership;
2. Democratic member control;
3. Member economic participation;
4. Autonomy and independence;
5. Education and training;
6. Co-operation among co-operatives;
7. Concern for community.

- Collectively, there are over 10,000 co-operatives and credit unions in Canada, providing products and services to over 10 million Canadians.
- 17 million co-op and credit union memberships are held by Canadians.
- 70,000 Canadians are leaders on co-operative and credit union boards of directors and committees.
- Co-operatives employ over 150,000 Canadians.
- Canadian co-operatives, credit unions and caisses populaire have $275 billion in assets.
- Non-financial co-operatives have annual revenues of $29.5 billion.
- Insurance co-operatives administer over $16 billion in assets for over 10 million policyholders.

What Does the Co-operative Movement Look Like?

Co-operatives in Canada represent a large and diverse heritage of Canadians working together to build better communities based upon co-operative principles. Co-operatives play an important role in many regions and economic sectors. These include financial products, insurance, agriculture, fisheries, housing, health care, retail, communication, day care, student co-ops, publishing, travel, funeral homes and more.

Co-operatives are about ordinary people working together to meet their common needs. Around the world over 800 million co-operative members are making their communities a better place. People working together build co-operatives that provide services to members, that create employment and that give democratic control to the members. Co-operatives come together under the umbrella of the Canadian Co-operative Association (CCA), the Conseil Canadien de la Coopération et de la Mutualité (CCCM) and internationally under the International Co-operative Alliance.

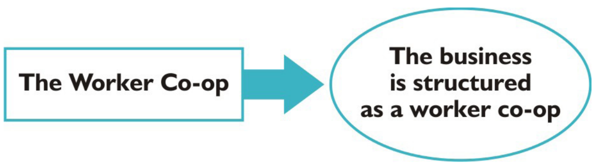
What are the Different Types of Co-operatives?

There are five key types of co-operatives:

1. Worker co-operatives:

The purpose of these co-operatives is to provide their members with work. They are owned by their employee-members.

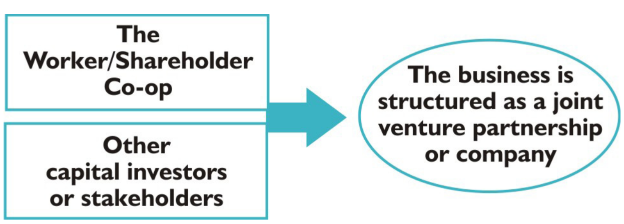
Examples: forestry, production and manufacturing, tourism, communications and marketing, etc.



2. Worker-shareholder co-operatives:

These are incorporated co-operatives that hold partial ownership of the business in which the co-operative's members are employed. Because of its share capital, the co-operative may participate in the management of the business and the workers may influence work organization.

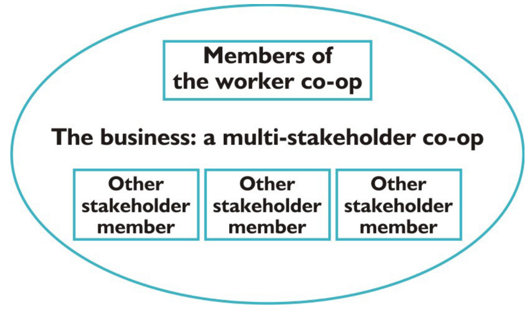
Examples: production and manufacturing, technology, etc.



3. Multi-stakeholder co-operatives:

The membership of these co-operatives is made of different categories of members who share a common interest in the organization.

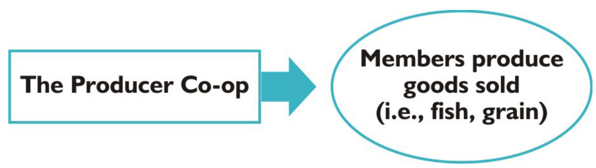
Examples: home care services, health services, community services, etc. Typically member classes include workers, consumers and/or non-profit community organizations.



4. Producer co-operatives:

Some co-operatives process and market their members' products and services directly while others may also sell the input necessary to their members' economic activities.

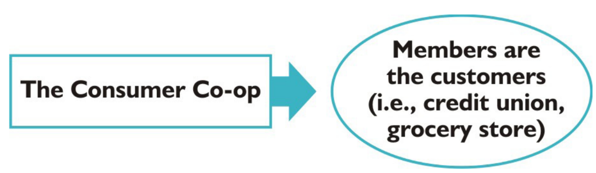
Examples: Agricultural co-operatives, fishery co-ops etc.



5. Consumer co-operatives:

They provide their members with goods and services for their personal use.

Examples: Food co-operatives, credit unions, housing co-operatives, insurance co-operatives, etc.



The Council sees the most potential for unions with the first three types of co-ops listed above: worker co-ops, worker-shareholder co-ops and multi-stakeholder co-ops, all of which involve the workers. Worker co-ops are the main focus of the rest of this Guide.

How Do Co-operatives Work for Workers?

What do the Labour and Co-op Movements have in Common?

The shared history of the labour and co-operative movements in Canada is built on the three pillars of common interest and philosophy.

1. Democratic membership (the members of the union and of the co-op typically overlap, in whole or in part);
2. Based in the community; and
3. Interested in creating a better world.

As times change, these pillars also provide solid foundations for worker-led responses.

How can Union-Supported Worker Buy-outs Work with the Worker Co-operative Model?

This section of the guide is about worker co-operatives, a model commonly used to save jobs and defend communities. Many labour unions have supported worker buy-outs of unionized businesses, particularly when they are seen as the best or only way to save union members' jobs. These include the United Steelworkers of America and the Confédération des Syndicats Nationaux in Québec. The experience built-up by these union organizations, and by others around the world, shows that unionized worker ownership can be successful.

How Worker Co-operatives Work

The main purpose of a worker co-operative is to create jobs for its members by building and operating a viable enterprise. If circumstances are right, workers can respond early to a shut-down plan, and having sufficient time is crucial for the buy-out attempt to succeed. Rather than wait on the sidelines, the employees can take direct action to develop a worker co-operative, and position themselves to take responsibility for their future. As individuals they may not have the skills or financial resources to become sole entrepreneurs. However, collectively, they likely have the knowledge and relationships, both internally and externally, to continue developing their enterprise and benefiting their communities.

Because the employees develop the policies that determine the co-operative's daily and long-term operation together, trust, communication, and co-operation are vital to the firm's success. Each member will purchase a membership share, and has one vote regardless of how much money he/she has invested in the co-operative. The co-operative's assets are collectively owned. Surplus earnings (profits) are allocated according to policies established by the co-operative where typically a portion is paid out to the workers and a portion is retained in the co-operative's reserves (retained earnings) for the future development of the co-operative.

Like any business, the worker co-operative must generate a profit to grow and develop. The worker co-operative usually has social and environmental bottom lines as well as a financial one. Wages and working conditions are important but financial sustainability, member development, and support for the future of the broader community are drivers as well. If the workers have significant participation in decision-making, their firm can build competitive advantages like higher levels of efficiency and commitment. The competitive advantage, combined with the commitment to long-term employment means worker co-operatives, are excellent vehicles for balancing worker values and interests with business effectiveness and efficiency.

Research demonstrates that employee/management buy-outs have a good rate of success. A well thought-out development and implementation plan is required to ensure commitment and clarity of roles. The opportunity for an employee/management buy-out will be greatly enhanced if the existing owner-manager has developed and maintained an open and trusting relationship with the employees and managers.

How do Workers Govern their own Firms?

The democratic principle of one member/one vote is one of the main reasons that many groups form co-operatives. However, making decisions democratically, holding productive meetings and working as a group are all skills that members must acquire. They must also be knowledgeable about all aspects of the co-operative's operation in order to contribute effectively to the decision-making process.

This governance process starts when the members elect directors, who, in turn elect officers (president, vice-president, secretary, treasurer).

Co-operatives operate democratically, but you can't stop in the middle of the workday to discuss every decision which must be made. There is a time and a place for each discussion to take place. Good collective decisions require well-researched information and good communications between the board of directors, management, and membership. Democratic structures will have to be developed to ensure the process works effectively. One of the main democratic functions of any co-operative is the Annual General Meeting.

Annual General Meetings

- The board of directors reports to the membership, reviewing the past business year and the year's financial statements.
- The board seeks approval of its recommendations for surplus allocation.
- The business plan and budgets for the coming year are presented for discussion and approval.
- An auditor is appointed.
- The membership elects a new board.

Board of Directors' Meetings

Co-operatives hold board meetings at regular intervals. Directors' meetings may take place monthly or quarterly and may also be held for special or specific decisions.

- Management reports to the board, which in turn provides direction to management.
- The board evaluates the co-operative's financial position.
- The board makes or changes policies as required.
- Board members discuss long-term goals and strategy.

Employee ownership creates an expectation of democracy and democratic processes. Corporate documents (by-laws and articles of incorporation), provincial law, and labour agreements are used to establish the governance rights of members regarding the rules on voting and corporate decision-making structures, including the structure of the board of directors.

While this is a very simplified explanation, it provides the nuts and bolts of the democratic process in a co-operative. Employee ownership involves a long-term transformation of roles. The roles of management and the union in the new company, and their joint relationships, will be similar within employee ownership as well. Management in an employee-owned company must provide leadership towards fulfilling the company's mission, and lead with a team approach that recognizes, respects and rewards democratic member participation.

Information on pages 5-7 have been adapted with the permission of the Canadian Worker Co-op Federation: www.canadianworker.coop/english/4/index_e431.html

The Union Role in Worker Ownership

The union and worker co-operative each have distinct roles to play in the launch and operation of the new worker-owned firm.

Workers at the firm are members of both the union and the worker co-operative. Through the democratic process of the co-operative and their elected board of directors, they hold management directly accountable for long term direction of the firm. As members of the union, they have a voice that ensures management operates appropriately on a day-to-day basis.

The union's traditional role of negotiating working conditions with management and ensuring their fair application through a grievance procedure can continue effectively in a worker co-operative. Indeed, in a worker co-operative the union should have the opportunity to work even more effectively on behalf of its members. As joint owners, there is a positive outcome for all when fair working conditions are in place.

In a worker ownership situation the union will have the responsibilities of a union in a traditional workplace, including bargaining wages and working conditions through collective agreements. But it will have added new roles as well. The union becomes a voice in the ongoing democratic debate about the direction of the firm. This role is different than in traditional workplaces, but the union can still bring its perspective to the table. It is just that, unlike in regular workplaces, the table is a democratic one.

In employee-owned companies, the union has the opportunity to exercise influence in many areas which were previously management prerogatives, such as selecting the CEO (through participation on the Board of Directors), and approving major capital expenditures, new product development and business strategy.

The union may share responsibilities with management to address problems, plan improvements, and meet performance goals. It can also work in tandem with managers to co-ordinate and oversee operations.

The union may co-lead joint steering committees and team efforts. The union continuously offers feedback on the "people" impact of current practices and provides a safe atmosphere for constructive disagreement and open debate on new ideas. The union can anchor this influence in the contract and reinforce it in the corporate bylaws. A genuinely democratic firm needs multiple voices and this is the role of the union, especially in larger firms of 30 or more workers.

At times this dual role of worker and owner may require making some hard choices between short-term employee benefits and long-term member benefits. Managing these trade-offs effectively will ensure long-term business success and keep morale high among members on a day-to day basis. Leadership and members must be prepared to support initiatives that will secure outcomes that balance the interests of workers and their firm.

The truth is that while buy-outs are hard work, they are not rocket science. While there are only a few examples of union-led buy-outs in Canada, there are hundreds of plants in the USA and thousands of plants the world over which were threatened by shut-down and are open today because employees bought them. In those workplaces the union plays a crucial role in the success of the firm.

Getting Started

Once you've decided to form a worker co-operative to rescue or secure your jobs and become owners of the business, you will need to get the ground rules for how exactly you want to structure your new co-operative. The next step will be to begin thinking about the education of your membership, and board of directors, starting with finances.

Key decisions to be made on your co-op's structure

There are six decisions you need to make as owner/members.

1. Qualifications for membership:

- What is the probationary period of employment before a new employee becomes eligible for admission as a member? (When you are setting up the co-operative, you would usually count past employment against the probationary period.)
- What is the amount of the membership fee or membership share?
- What are the options for paying membership fees or shares (such as a deduction of X cents per hour worked vs. cash up front)?

2. Patronage dividends:

- Develop the formula for deciding how each year's profits will be allocated to members. It should be based on labour input into the co-operative. It can be measured by (1) hours worked, (2) earnings, or (3) other measures of labour input, including seniority.

You can decide on one of those above or you can "mix and match" these. It's up to you and your fellow co-operative members.

If you use seniority as part of your formula for allocation, it needs to should be capped at a reasonable level such as 5 or 10 years. (For instance, if you set a 10-year cap, employees with more than 10 years have their seniority for allocation purposes only counted as 10 years.) You may choose to count seniority in employment with the company, rather than from the start of the co-operative.

3. Board structure:

As a co-operative, a majority of the members of the board have to be elected by the members of the co-operative.

- How many directors will there be?
- How long is their term?
- You will need to specify the officers

4. Annual or special general meeting:

- When will the meetings be held?
- What are the procedures of the meeting?
- How can members call additional meetings?

5. How and when will members' share capital be paid out to:

- Members who leave , and
- Members who retire?
- What is the policy for cash share redemption for all members.

Policies or bylaws give general guidance and leave the details to the discretion of the board which needs to evaluate the financial position of the business.

6. Fiscal year:

You will need to set the date for your "fiscal year" (i.e., your accounting year).

Understanding Co-operative Finance

From an individual's perspective, initially, the value of your financial interest in the co-operative is the value of your membership share. The value of your ownership interest will build over time if the co-operative makes profits. Co-operatives typically divide their profits ("surpluses") between two accounts -- (1) a "collective reserve account" which absorbs losses if the business loses money and (2) members' accounts. Cash allocations or the redemption of a portion of each members' shares for cash may also occur based on policies established by the co-operative and the financial health of the enterprise. The board decides how each year's surpluses are divided between the collective account, the members' accounts, and members' cash allocations.

How surpluses are allocated depends in part of the age of your co-operative. New co-operatives need to build their capital and pay more into their collective reserve accounts. Your co-operative's capital needs are another major factor. This includes paying down debt or redeeming shares from previous owners selling to you. Your co-operative's profitability will also be a major factor.

Once the collective account reaches an adequate level to absorb eventual losses, most or all of the additional annual surpluses are allocated to members' accounts or distributed in cash to members.

Allocations among the members' accounts and cash allocation follows a labour-based formula laid down in the co-operative's by-laws. These are called patronage allocations. The formula is based on labour input ("patronage") into the co-operative. You can use hours worked, earnings, seniority up to a cap, or other measures of labour input.

The formula is as follows:

You divide each member's labour input (however measured) by the total input of all members, and multiply that percentage by the total dollars being allocated among all the members' accounts.

$$\frac{\text{Individual Labour Input}}{\text{Total labour input}} = X\%$$

X% Multiplied by the total allocation of surplus = Individual allocation

The individual allocation may be paid either in the form of new shares in the co-operative or cash or some of each.

Taxation

In tax terms, co-operative allocations to the "collective reserve account" are taxed from the firm at the normal corporate income tax rate. Co-operative allocations to members, however, are not taxable at the corporate level (so there's no "double taxation") but are taxable to the members as personal income. If your co-operative becomes a member of the Canadian Worker Co-operative Federation's RRSP program, your patronage allocation may be treated as a contribution to a self-directed RRSP for tax purposes.

Getting the value of your ownership in cash

While you can't tap your co-op capital account to buy a car when you want to, as you would your credit union or bank account, it is your personal property. It is held 'in trust' on your behalf until you resign or retire.

While the co-operative pays down the debt it took on to buy the business from the owners, the co-operative will be putting significant financial resources into paying down the loan. When the debt is paid off, the board of directors will determine what portion of the profits need to be kept in the business and what part can be paid out in cash to members. You shouldn't expect to get much cash out of the co-operative in these early years.

$$\frac{\textbf{Your labour input}}{\textbf{Total members' input}} \times \textbf{Total \$ to be allocated among all members} = \textbf{Your allocation for that year}$$

Your financial interest in the co-operative includes your membership share and your annual allocations. If the co-operative makes money, your account will grow every year, and the longer you work in the co-operative, the bigger it will become.

Initially, members' accounts stay in the co-operative, capitalizing the co-operative by buying tools, paying off borrowed money, building working capital to buy supplies and pay wages, etc. Once the co-operative has adequate capital between the collective account and the members' accounts, it may begin to pay out a larger portion of its profits (assuming there are profits) to members in cash dividends each year.

After the co-operative has paid off its debt and/or redeemed the selling owner's shares and has adequate cash for business needs, the board can choose to redeem members' shares for cash. That means that the board can decide to buy back members' shares that have previously been allocated to their accounts in prior years. That rewards people for their seniority in the co-operative.

Co-operatives that start redeeming members' shares may not do so every year, because they may have capital needs to replace old equipment or to expand the business. A co-operative may stop redeeming shares because it ceases to be profitable.

There will be a mechanism through which members who leave the co-operative will receive the value of their accounts. When a members dies, then his or her account passes into the estate, and the co-operative will cash it out to the heirs. In all cases, the co-operative will be unable to pay out shares if doing so would cause it to risk insolvency. Your co-operative's board will set the policies for these payouts.

If you need help

There are worker co-op development specialists and other professionals who are knowledgeable about worker co-operative development issues such as business planning, capitalization, by-law and policy development, member education, and training for the various roles within the co-operative. They can help you develop effective structures and strategies on both the business and governance sides. Assistance is available to employees to develop and implement the worker co-operative aspects of the employee ownership plan. The WLWCC can provide assistance in finding a qualified co-op development specialist and other professionals to meet your needs.

The Worker Co-operative Movement in Canada

Worker co-operatives in Canada are represented by the Canadian Worker Co-operative Federation (CWCF). It supports the development of worker co-operatives in Canada by providing technical assistance through its Worker Co-operative Developers' Network, term and patient capital through its small revolving loan fund (the Tenacity Works Fund), and general support to the sector through conferences, advocacy and services such as a Self-Directed Registered Retirement Saving Plan for worker co-operatives.

Information on pages 9-11 have been reprinted with the permission of the Ohio Employee Ownership Center: http://dept.kent.edu/oeoc/oeoclibrary/what_is_a_cooperative-NCDF_version.pdf

The Canadian Worker Co-operative Federation is prepared with its network of developers to provide resources and expertise in worker ownership. CWCF and the other partners in the WLWCC have resources and experience in organised worker buy-outs, and relationships with experienced professionals they can bring to bear to raise support for such a buy-out.

Call the Western Labour - Worker Co-operative Council for more information.

Hazel Corcoran, Executive Director,
Canadian Worker Co-operative Federation
(403) 276-8250;
hazel@canadianworker.coop

Sources:

Selling Your Business to Your Employees through an ESOP or a Co-op by John Logue and the Staff of the Ohio Employee Ownership Center, Unpublished.

Succession Planning Using the Worker Co-op Option by Peter Hough, Canadian Worker Co-operative Federation, 2005, p20-21.

David P. Ellerman (1988) The Legitimate Opposition at Work: The Union's Role in Large Democratic Firms Economic and Industrial Democracy 1988, p 437-453.