

CO-OPS EMBRACE DEMOCRACY

BY NANCY JORGENSEN

As we celebrate the United Nations-declared International Year of Cooperatives, it's a great time to examine democratic control, one of the seven principles that set co-ops apart from other businesses. Generally, co-op members vote for fellow members to serve as co-op directors. The board of directors establishes the vision for the co-op, directs its overall activities and hires a manager to run day-to-day business. We examine how members retain control as co-ops raise funds to grow, and how voting practices differ among co-ops.

THE POWER OF PREFERRED STOCK

Members retain control as co-ops raise funds to grow

The idea of co-ops issuing preferred or public stock used to make some members worry that they'd lose control over the co-op. But in recent years, the practice has gained ground in the food sector.

Equal Exchange, a Massachusetts-based worker-owned co-op that sells fair-trade coffee, raised \$10 million in preferred stock. Organic Valley, a farmer-owned wholesale dairy co-op headquartered in Wisconsin, raised \$42 million. Viroqua Food Co-op, a consumer-owned retail co-op Viroqua, Wis., raised \$800,000. Recently, a fledgling worker-owned restaurant in New York issued public stock.

Traditionally, cooperatives raise funds through the sale of member shares. With consumer-owned co-ops such as credit unions and electric co-ops, membership fees can run as low as \$5. Growing co-ops, and those looking at manufacturing and other capital-intensive ventures, find it difficult to raise the funds they need through amounts generated from member fees.

That's why some co-ops issue preferred stock or shares, a type of equity security used in all types of businesses—not just co-ops. The stock is “preferred” because the organization pays preferred shareholders first in case of liquidation. Usually, preferred stockholders don't vote on cooperative issues—co-op voting rights are reserved for members.

Equal Exchange Attracts Social Investors

Formed in 1986, Equal Exchange grew by 18 percent last year, rounding out the year with more than \$46 million in sales. Equal Exchange's 100-plus worker-owners hold \$300,000 in co-op membership stock. The co-op doesn't pay dividends to worker-owners, but they have the right to vote on co-op issues on a one-member, one-vote basis, and earn a percentage of profits.

“Most food companies these days are just a couple of people in an office park

who outsource their product and manage their brand,” says Daniel Fireside, capital coordinator. “At Equal Exchange, we buy directly from small-farmer cooperatives, and take possession of the product.”

To house inventory, eight years ago, Equal Exchange bought a 77,000-square-foot warehouse where it roasts more than 40,000 pounds of coffee in small batches every day. While 80 percent of Equal Exchange sales come from coffee, the co-op also markets chocolate, bananas and other products. Initial start-up funds came from friends, family and churches that supported the idea of offering a fair return to coffee farmers. As sales grew and the co-op needed to store and roast more coffee, the worker-owners turned to a new source of capital.

“We were able to finance this amazing growth almost entirely with what we call committed capital,” Fireside says. “We raised it from people who believe in what we do—who put as high a value on a social return as a financial return.”

In recent years, Equal Exchange raised \$10 million in equity by selling preferred stock to about 400 investors, including workers, loyal individual customers and food co-ops that sell the Equal Exchange brand. Twin Pines Cooperative Foundation jumped in as one of the biggest investors, along with a Mexican coffee cooperative. The largest investment from any one source totaled \$1 million—it came from an internal account where workers put aside half of their annual patronage to invest in preferred stock.

While dividends aren't guaranteed, Equal Exchange's board targets a return of 5 percent—not too shabby these days. Although the rate might fluctuate in any given year, the co-op hasn't skipped a dividend payment in more than 20 years.

“The crisis on Wall Street has been great for us,” Fireside says. “People are hungry to put their finances to use by a company with a deep social mission—and that's hard to find.”

Fireside fields a lot of inquiries from other worker co-ops, but many are intimidated by

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PROPORTIONAL VOTING VERSUS ONE-MEMBER, ONE VOTE...

Is there room for both under the co-op tent?

Most consumer co-ops, including food and rural electric co-ops, operate on a one-member, one-vote basis. Other types of co-ops, including Sunkist Growers Inc. of California and GROWMARK of Illinois, use proportional voting, where votes are weighted according to the amount of shares held or the volume done with the cooperative.

John Caragozian, secretary and senior counsel at Sunkist, explains that as a federated cooperative, Sunkist includes several district exchange co-ops that are comprised of the thousands of citrus growers who are members of Sunkist. The district exchanges nominate and elect directors to serve on Sunkist's board.

“The number of directors that a district exchange may nominate is based on the volume of fruit that goes through the exchange,” Caragozian says. “This system has been in place for generations.” Formed in 1893, Sunkist reports annual sales of more than \$1 billion.

While each exchange nominates its own director(s), all exchanges vote on the full roster of nominees. The complex voting system involves a lot of paperwork, but as Caragozian says, “It seems to work well. We try to operate by consensus.”

GROWMARK, a regional grain marketing and farm supply cooperative based in Bloomington, Ill., has used proportional voting since its inception in 1927. “It allows member-owners with more equity a larger vote in matters requiring action by shareholders,” says Amy Bradford, manager of corporate communications. GROWMARK's annual sales total \$8.6 billion.

Like Sunkist, GROWMARK provides services to a network of local farmer-owned co-ops. FS co-ops in Illinois, Iowa, Wisconsin and Ontario, Canada, make up GROWMARK's core membership. More than 250,000 farmers own the local co-ops. Most of GROWMARK's member co-ops

also vote proportionally.

Bruce Reynolds, an economist with the US Department of Agriculture, studies co-op voting practices. “Many directors elections are not closely contested and voting by one-member, one-vote or proportionally often makes no difference—what matters is how you operate, and cooperatives govern by consensus,” he says. “It's the directors who work out a consensus on issues. When it comes to decision-making, cooperatives may move slower than other types of businesses, but their decisions may be better.”

Co-ops don't always move slowly. In February, Sunkist's board voted to sell its processing operations to a joint venture owned by Sunkist and another processor. “It was a complex deal,” Caragozian says, “but the Sunkist board dealt with it quickly—just as quickly as the other, for-profit company involved.”

Dave Swanson, an attorney with the Dorsey and Whitney firm in Minneapolis, specializes in co-op law. He also serves on the NCBA board of directors. Since 1983, Swanson has helped set up a number of New Generation cooperatives—most created to build plants that produce ethanol and biodiesel from corn and soybeans. In addition, he works with purchasing co-ops. Some co-ops in both sectors allow for proportional voting.

“When one guy does 20 times more business with the co-op than another, the one-member, one-vote method doesn't always fly,” Swanson says. “It has little to do with philosophy and everything to do with good relations with customer-owners.”

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the financial complexity involved in issuing preferred stock. In many states, issuers must register with the Securities and Exchange Commission and follow SEC rules.

Organic Valley Stock Proves a Smashing Success

Cooperative Regions of Organic Producers Pools (CROPP) was formed in 1988 by a group of Wisconsin dairy farmers. Today, CROPP owns the Organic Valley brand. With 1,687 farmer-owners in 33 states and four Canadian provinces, and annual sales of \$715 million, CROPP is the largest organic farming co-op in North America.

"Sales have grown more than 20 percent a year on average," reports Jerry McGeorge, director of cooperative affairs. "It's a universal challenge for co-ops—how to attract capital. We don't have access to the markets like traditional businesses. At Organic Valley, we want to spend our limited financial resources on getting product to customers, not on bricks and mortar."

The co-op outsources most of its processing to about 80 other organizations. But in 2004, Organic Valley built a new headquarters in La Farge, Wis., which accommodates 400 employees. In 2007, it opened a state-of-the-art distribution



Viroqua Food Co-op General Manager Jan Rasikas



Daniel Fireside of Equal Exchange visited coffee growers in Peru recently, along with a few co-op investors. Equal Exchange used funds raised through preferred stock to invest \$7 million in coffee roasting and packing equipment.

center nearby. "We see a need for significant capital expansion over the next five years," McGeorge adds.

Organic Valley raises capital three ways. First, each member contributes 5.5 percent of what he or she sells to the co-op each year. Second, Organic Valley plows a certain amount of profits back into its operation. Third, the co-op sells preferred stock.

"Each of our farmer-owners votes on a one-member, one-vote basis, regardless of the amount of production that we purchase," McGeorge says. "We educated our farmer-owners about how they would maintain control over decision-making."

Wisconsin and a few other co-op-friendly states allow cooperatives to raise preferred stock without registering with the SEC. Wisconsin law only allows preferred stockholders to vote on mergers or changes in dividend rates—not in director elections or other issues.

The preferred stock plan, debuted in 2004, proved a smashing success. Laws in 35 states limited the co-op's ability to advertise to the general public. McGeorge targeted socially responsible investors, including consumers and members of communities where Organic Valley operates. The co-op ran ads in newsletters printed by 10 of Organic Valley's largest food co-op customers—from Madison, Wis., to Minneapolis.

"We attracted two types of investors," McGeorge says. "Retired farmers who loved what we were doing, and consumers who loved what we were doing and loved our product."

In total, 1,838 parties invested, with the average purchasing \$25,000 to \$30,000. Stock earned a 6 percent return. In 2010, after raising \$42 million, the co-op cut off most sales. Today, only employees and members can purchase preferred stock. "Our stockholders are passionate about us," McGeorge says. "We have a waiting list!"

The National Cooperative Business Association (NCBA) took note of McGeorge, asking him to serve on an Equity Task Force. He made presentations at NCBA meetings, and now serves on the NCBA board. He also served on the board of his local food co-op in Viroqua, Wis., and helped Viroqua Food Co-op issue its own preferred stock.

Viroqua Rocks Retail Food Co-ops

Viroqua Food Co-op started up 16 years ago, and it's been growing at double-digit rates ever since. Jan Rasikas, general manager for the past 14 years, says the co-op serves one of the most active organic farming areas in the United States, fueled by the success of Organic Valley.

"The town of Viroqua has a population of about 4,500, yet our co-op has 2,800 members," Rasikas says. Membership fees of \$75 for singles and \$150 for families weren't building enough equity to attract credit.

Annual sales reached \$1.3 million seven years ago, but the co-op felt squeezed in its 920-square-foot retail space. This year, Viroqua Food Co-op expects to take in \$5.5 million in sales, all generated from its new 7,300 square-foot building, which includes 4,400 square feet of retail space.

"Even though co-ops are common here, banks often need convincing when it comes to lending to co-ops," says Rasikas. She found a local bank that would provide financing with the help of a US Department of Agriculture Rural Development Loan Guarantee. But to qualify for the guarantee, the co-op still needed to raise 25 percent of the loan amount in the form of equity. Preferred shares are viewed as equity. Unlike debt, equity strengthens the balance sheet.

Viroqua Food Co-op's board offered an



With the help of Jerry McGeorge, Organic Valley began offering preferred stock in 2004. Now, they have a waiting list.

annual 5.5 percent return on preferred stock the first year, selling it in \$500 minimum increments. The co-op raised a total of \$800,000 in six years, and dedicated \$400,000 of it to the building project, which totaled \$1.6 million. The \$400,000 in equity satisfied the USDA loan guarantee requirement, and the local bank provided most of the funds for the building. North Country Cooperative Development Fund also kicked in. After raising the needed equity, Viroqua Food Co-op closed the offering.

"We were one of the first food co-ops to offer preferred stock in the U.S.," Rasikas says. "More co-ops began to understand the power of preferred shares, and others followed in our footsteps."

"The retail food co-op world stood up and took notice," confirms Organic Valley's McGeorge. "At least a half a dozen other food co-ops have raised equity the same way."

Fledgling Worker Co-op Issues Public Stock

While Equal Exchange, Organic Valley and Viroqua Food Co-op offered preferred stock to a limited investor group, Workers Development began raising equity for a worker-owned restaurant through a public stock offering in April.

"The opportunity for job creation in restaurants is huge," says Chris Michael, one of the founders of Workers Development. According to Plunkett Research Ltd., almost 13 million people are employed in nearly a million U.S. restaurants. "It's not cutting edge, it's not rocket science, and that's why we've targeted the restaurant industry."

Michael and other founders think the time is right to create worker-owned businesses. "We're making a connection with disapproval of the current economic system," he says.

The partners plan to open Workers Diner in a mixed-income Brooklyn neighborhood. The diner will feature an old-school diner menu, with fresh sodas, bar stools and booths. It's expensive to start a restaurant in New York City. Workers Development hopes to raise \$500,000 in stock equity within a year—enough to fund start-up. Workers will retain voting control.

Michael claims this is the first time in 100 years that a worker-owned co-op has issued public stock. Workers Development is attracting investors through Facebook ads, Twitter blasts and email. Residents of New York and Connecticut can purchase a minimum of \$100 in shares through workersdiner.com.

For more information, visit equalexchange.coop, organicvalley.coop and viroquafood.coop.

CREDIT UNIONS SEEK NEW WAYS TO RAISE CAPITAL

Food-sector co-ops aren't the only member-owned businesses seeking capital. Rod Staatz, chief executive of State Employees Credit Union (SECU) of Lithicum, Md., was quoted in a March 25 *Washington Post* article as supporting federal legislation to allow credit unions to raise capital in new ways.

With \$2.2 billion in assets, SECU is well capitalized today. But Staatz fears that as SECU and other credit unions increase in size, restrictions on raising capital could "throttle growth."

Staatz joined representatives of 4,000 credit unions who came to Washington, D.C., for the Credit Union National Association (CUNA) Governmental Affairs Conference, asking that financial cooperatives be allowed to issue added forms of capital to supplement retained earnings generated from member deposits.

In February, Rep. Peter King (R-N.Y.) and Brad Sherman (D-Calif.)

introduced legislation authorizing the National Credit Union Administration to allow credit unions in good standing to accept supplemental capital.

"The legislation doesn't prescribe a specific solution," says Mark Wolff, CUNA senior vice president of communications. "It allows the regulator to define what constitutes supplemental capital. It could be a type of subordinate debt or uninsured shares. These options would only be available to members of the credit union, not to outside investors, and they would not affect member ownership or one-member, one-vote governance."

Wolff doesn't expect the proposal to pass this year, but says the bill's introduction has "started the conversation" and predicts that large, growing credit unions will continue pushing for it. The banking lobby opposes the move, "as they do any new authority for credit unions," Wolff says.