



INVESTING IN WORKER OWNERSHIP

How Finance Institutions Can Create Deep Impact at Scale with Worker Cooperatives



Investing in Worker Ownership

For financial institutions looking to create deep and lasting impact, worker cooperatives are a powerful tool for economic and community development. They reduce inequality by allowing a greater segment of the population to build assets through business ownership. They combat poverty by providing access to employment for marginalized populations. And they strengthen local economies by rooting businesses in their communities.

Currently, there are an estimated 300-400 worker cooperatives in the United States that employ approximately 7,000 people. The potential for scale is vast, however, as more and more stakeholders recognize the transformative impact of the model.

In order to effect change that goes beyond these thousands of workers to hundreds of thousands or millions, we must develop a more robust ecosystem of capital sources. This ecosystem should include all types of institutions interested in more than just a financial return: private foundations, community development finance institutions, impact investors, and government actors in community and economic development. Together, these institutions can provide the financial resources necessary to create lasting economic change using the worker cooperative model.

The Worker Cooperative Difference

As values-driven companies, worker cooperatives live at the intersection of business and social impact. Within the social enterprise sector, their unique value is a focus on workers' shared benefit. Workers own and control the business democratically, adhering to the governance principle of one-worker-one-vote.

The model has proven to be an effective tool for creating and maintaining sustainable, dignified jobs; generating wealth; improving the quality of life of workers; and promoting community and local economic development, particularly for people who lack access to business ownership or even sustainable work options. According to United for a Fair Economy: "One of the main barriers to business ownership for people of color is access to start-up capital.... [Worker cooperatives make] business ownership more accessible."

- Worker cooperatives build local wealth. At a worker cooperative, profits do not go to distant investors, but instead go directly to the workers. As a result, the money stays grounded in the local economy, building community wealth. With ownership in the hands of workers, who are usually living and spending locally, these companies stay connected and accountable to their communities.
- Worker cooperatives create quality jobs. Workers have a meaningful role in the business, as they contribute to and benefit from the success of a company they co-own. Jobs at worker cooperatives tend to be longer term, offer extensive skills training, and provide better wages than similar jobs in conventional companies. Furthermore, worker cooperatives offer opportunities for greater participation in management and governance decisions that help the business succeed.



- Worker cooperatives create meaningful change for underserved populations. The New York Times concludes, “by placing workers’ needs ahead of profits, they address the root cause of economic disparity.” (3/23/14) More than half of worker cooperatives in the United States today were designed to improve low wage jobs and build wealth in communities most directly affected by inequality, helping vulnerable workers build skills and earning potential, household income and assets.

While it creates deep impact for workers and the communities, this unique shared ownership structure has, in the past, limited cooperatives’ access to outside capital. As worker cooperatives increasingly orient toward scale, outside financing is becoming more and more important, requiring a reexamination of how capital fits into a corporate form designed to maximize benefit to its worker-owners.

How are worker cooperatives structured?

Worker cooperatives in the United States are most commonly incorporated as cooperative corporations, a business entity available in approximately half of the states. The rules of cooperative corporation statutes vary from state-to-state, but all have fundamental principles in common. All cooperative corporations are membership organizations where members own and control the business on a one-member-one-vote basis. All cooperative corporations contain internal capital accounts for members, where their investment in the business accumulates over time. Some states have statutes specific to worker cooperatives, like in Massachusetts, while others have more general cooperative statutes, including producer cooperatives (like Organic Valley), consumer cooperatives (like REI), and other cooperative forms.

Although the cooperative corporation is the most common entity type for worker cooperatives, many cooperatives incorporate under more common business forms, such as a limited liability company (LLC) or C corporation. Many of the worker cooperatives started by nonprofits to serve disadvantaged populations, for example, use the LLC form because of its flexibility. Unlike cooperative corporations, these other entity types do not have cooperative principles woven into the fabric of the model. To ensure cooperative principles are followed, these businesses include them in their governing documents. The LLC form may also lack certain cooperative structures, such as internal capital accounts for members.

Worker cooperatives are not highly regulated at the federal level. However, worker cooperatives using any business entity type can follow certain IRS guidelines in order to avoid entity-level taxation on surplus distributed to its owners (similar to a subchapter S corporation). To elect this benefit under Subchapter T, companies must “operate on a cooperative basis,” which has two parts: (1) surplus in a worker cooperative is distributed to the employees based on hours worked, comparative salary, or another formula that reflects the employees’ contribution to the company through their labor and (2) return on capital is limited.

Furthermore, as part of the larger cooperative community, worker co-ops also operate in accordance with the cooperative principles and values laid out by the International Cooperative Alliance. While these are not legal requirements, many cooperatives include a commitment to them in their governing documents or other policies.



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How does capital fit into the worker cooperative structure?

Like any business, a worker cooperative needs capital to start up and grow. While some startup capital can be raised through worker-owners pooling their initial capital contributions to the company, and growth capital may be sourced from member internal capital accounts over time, many worker cooperatives need outside financing to meet their business needs. However, the unique structure of worker cooperatives has historically brought with it unique challenges when raising outside capital.

For example, many senior lenders are unwilling to give loans without personal guarantees, and in a shared ownership form such as a worker cooperative, there may not be one individual able or willing to give such a guarantee. Worker cooperatives also have a complicated relationship with investment capital, because a fundamental feature of the form is that worker-owners own and control the business, and investors are often reluctant to risk capital without some form of control.

Understanding these difficulties, innovative worker-owned businesses and cooperative lenders have been working to come up with solutions that meet the needs of both parties.

The Current Capital Landscape for Worker Cooperatives

Currently, worker cooperatives have a huge range of capital needs. On the low end, smaller service companies need start-up loans for \$10,000 to \$30,000. On the high end, the Evergreen Cooperatives required a multimillion dollar investment to start a greenhouse, laundry business, and solar installation company in Cleveland. Startup financing needs generally include equipment costs, hiring, leases or real estate purchase, as well as training and workforce development. In addition to startup financing, needs for growth capital spans a similar range, from a few thousand for small expansions to several million for major growth, including real estate purchases.

In a 2013 survey of worker cooperatives, exactly half of the 54 respondents were currently or recently carrying debt of some sort. There was an average debt load of \$289,000 per workplace (excluding one multi-million dollar bond to purchase a building, which was a statistical outlier). Respondents also revealed that they were using a variety of creative financing methods, from community capital to friends-and-family loans, to access growth capital.

Recently there has been an increased need for capital to finance transitions in which retiring business owners sell the company to their employees. In these deals, the high-risk financing is typically provided by the selling owner or owners. In some cases, community-sourced financing such as a direct public offering is used to raise the high-risk capital. Finance institutions often supply the remaining capital, maintaining first position on any collateral.

To meet the diverse needs of worker cooperative businesses, there are a number of existing financing institutions that either specifically target cooperatives or provide capital to cooperatives as part of their general financing products and services.



Traditional Debt Lending

The lion's share of existing financing for worker cooperatives is traditional debt lending. Cooperative-specific lenders such as the Cooperative Fund of New England or the Northcountry Cooperative Development Fund understand the cooperative structure and, as a result, generally provide more efficient financing for worker cooperatives than traditional lenders. Community Development Finance Institutions (CDFIs) are another valuable resource, as they have a mission to serve the community. However, many are not well-versed with the worker ownership model and may have requirements that are burdensome for cooperatively owned enterprises.

Government programs serving small businesses can also be a valuable resource. For example, the Minneapolis business and real estate loan program has a history of lending to cooperatives. So far, \$3.5 million have gone to cooperative businesses, and another \$850,000 in lending to co-ops is currently pending. Some of these loans have personal guarantees or real estate as collateral, but others require underwriting that most finance institutions, including community lenders, are unwilling to do. Here are a few existing cooperative lenders and their attributes:

Finance Institution	Service Area	Loan Amounts	Underwriting Policy
Cooperative Fund of New England	New England and Eastern Upstate NY	\$1,000 to \$1M	Generally collateral is required. Personal guarantees are not required but helpful in lieu of collateral.
Common Wealth Revolving Loan Fund	Ohio & surrounding states	Up to \$250,000	Generally collateral is required. Personal guarantees are not required but helpful in lieu of collateral.
Local Enterprise Assistance Fund	National	\$50,000 - \$400,000	Generally collateral is required. Personal guarantees are not required but helpful in lieu of collateral.
National Cooperative Bank	National	\$500,000 to \$12MM	Collateral is always required. Personal guarantees are not required.
Northern California Community Loan Fund	Northern California	\$50,000 to \$2MM	Collateral is always required. Personal guarantees are not required.
Northcountry Cooperative Development Fund	National	\$5,000 to \$500,000	Generally collateral is required. Personal guarantees are not required except that it may be necessary with start-ups.
The Working World	National	\$1,000 - \$1MM	No collateral or personal guarantee required. Lien on all significant assets purchased with the loan.



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Preferred stock, direct public offerings, and other equity financing

In addition to traditional debt, worker cooperatives are increasingly seeking equity capital that is structured to be consistent with cooperative principles. Although there are only a handful of current examples of their use, these equity instruments are garnering interest throughout the worker cooperative community, and could become much more common in the years to come.

- **Preferred stock**

Worker cooperatives adhere to the principles of one-worker-one-vote and a limited return on capital, which generally limits their ability to raise money by selling shares to investors. However, Equal Exchange—a national distributor and retailer of fair trade, organic goods based in West Bridgewater, Massachusetts—used preferred, non-voting shares to raise millions of dollars from what they called “committed capital”: people who put as high a value on social return as on financial return. The average investment was \$25,000 and the company targeted a 5% annual dividend. Namaste Solar, a Boulder, CO-based residential and commercial solar service company, structured a similar private offering of preferred shares, with an annual target dividend of 6.5%. The shares do not appreciate or depreciate.

- **Direct public offerings (DPOs)**

For start-ups or other worker cooperatives that need high-risk capital, loans are often difficult to secure. In cases where the mission of the cooperative appeals to the community, a direct public offering has served as a viable alternative to a loan, which spreads the risk among local residents who care about the company’s success. Jenny Kassan, founder of Cutting Edge Capital, a firm that helps social ventures raise funds for their business, has worked with multiple worker cooperatives to structure their offerings.

For example, CERO Cooperative in Massachusetts is offering up to \$350,000 in preferred stock to finance equipment and other capital expenditures, and working capital relating to the operation of a zero waste collection, composting and recycling business. The public can directly invest in CERO with a minimum buy-in of \$2500. The stock has a 4% targeted annual dividend.

DPOs have also been used by companies transitioning from a conventionally owned business to a worker cooperative. For example, in the case of Real Pickles, the goal was to sell \$500,000 in stock in Massachusetts and Vermont, with a minimum investment of \$2,500. The co-op was able to attract 80 investors eight weeks. The stock purchases ranged from the minimum \$2,500 to a \$25,000 investment from a local food cooperative and a \$50,000 investment from a local foundation.

- **Profit sharing returns**

The Working World, a non-profit organization that provides investment capital and technical support for worker cooperatives, has developed another model for financing cooperatives. According to The Working World, they “help design, fund, and carry out productive projects, only requiring that cooperatives pay us back with the revenues the investments generate.”



That is, the investment capital, which may be used for equipment, raw materials, facility improvements, and working capital among other things, is paid back only when the company is making a profit, in what is sometimes called a “royalty model” of repayment. The Working World provides technical assistance and plays an active role in the development of the business, a key part of the model that allows them to target investments in underserved communities. When the funds are repaid, they are “reintegrated to our locally-based revolving loan fund to be overseen by the cooperatives and the community it serves.”

The Role of Worker Cooperative Development Organizations

At least a third of the worker cooperatives in existence today were built by worker cooperative development organizations or other community-based organizations to provide their constituents with access to dignified, meaningful work. These organizations often provide capital access to worker cooperatives by:

- Paying for start-up costs such as equipment, legal costs, and training through their operating budget
- Guaranteeing loans to the cooperative
- Providing loan-readiness training and technical assistance to worker-owners

For example, the Beneficial State Bank—a CDFI that serves California, Oregon, and Washington—provided a large loan to a start-up worker cooperative being developed by the Arizmendi Association in the Bay Area, but only with the Association’s guarantee.

There is a wide range of roles that a cooperative development organization can play, from an intensive incubation role in which the developer is providing or guaranteeing the capital, to a lower-touch coaching role in which the developer may build working relationships with lenders and provide technical assistance and business advisory services to cooperatives. The existence and support of a cooperative developer or technical assistance provider is a key risk-mitigating factor for lenders.

How Can Finance Institutions Create Deep Impact with Worker Cooperatives?

A more worker cooperative-friendly capital landscape means building an ecosystem that supports more and larger deals, while respecting the principles and practices that make worker cooperatives such a powerful and effective tool. New capital tools and relationships have the potential to not only meet demand in a responsible way, but also seed it, encouraging future cooperative start-ups or conversions.

Remove Barriers to Access

In the 2013 survey of worker cooperative workplaces, nearly 25% of respondents report being turned down for a loan or other form of credit. The top three reasons listed were: (1) financials did not support the loan application, (2) there was insufficient collateral, and (3) personal guarantees were required. To bridge this gap, all the players in the ecosystem can play a role in



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making debt capital more available to worker cooperatives.

Strong cooperative community bonds, experience with informal lending arrangements among cooperatives, and deep customer loyalty are all assets that can be leveraged creatively to secure credit to worker cooperatives.

For Lenders. What's the role of banks and other finance institutions interested in lending to worker cooperatives? Lenders that want to add worker cooperatives to their portfolio can:

- Work with existing technical assistance providers or provide technical assistance to support borrowers in getting loan-ready, even building these costs into the financing structure
- Understand the cooperative business model and offer underwriting of high-potential cooperative businesses, and be open to creative collateral or other arrangements for securing the loan
- Work with cooperative lenders, foundations, or government programs that offer loan guarantees to mitigate your risks

For Cooperative Finance Institutions. For finance institutions interested in developing the worker cooperative ecosystem, it is critical to proactively build the pipeline of cooperative deals and educate lending partners about the value of worker cooperative businesses.

- Partially or fully guarantee loans made by CDFIs and other lenders interested in worker cooperatives
- Offer underwriting of loans to high-potential cooperative businesses, and/or be open to creative collateral or other arrangements for securing the loan
- Offer worker cooperatives junior debt at an affordable interest rate
- Educate CDFI's and other lenders interested in worker cooperatives about the cooperative model
- Highlight successful deals through case studies to raise awareness
- Work with existing technical assistance providers or provide technical assistance to support borrowers in getting loan-ready
- Work with cooperative developers and other partners to actively seek out healthy cooperative businesses that need capital for growth

For Local Government. Worker cooperatives have great potential to build wealth and create jobs in local communities. Local government can create greater access to capital for worker cooperatives through existing programs:

- If the city has a loan program, learn about the cooperative business model and offer underwriting of high-potential cooperative businesses, and be open to creative collateral or other arrangements for securing the loan
- Educate CDFI's and other lenders in your network about the cooperative model
- Partially or fully guarantee loans made to worker cooperatives by CDFIs and other lenders in your network
- Provide information and assistance to worker cooperatives looking for capital



For Philanthropy. Philanthropy has a critical role to play in building the cooperative ecosystem, especially as it relates to low-income communities and populations with barriers to employment. To create better access to capital for worker cooperatives, foundations and other philanthropic institutions can:

- Convene and educate lenders interested in community impact about the worker cooperative model
- Fund organizations that provide technical assistance, leadership development, and capacity building services to worker cooperatives
- Fund the development of metrics for worker cooperatives so that the field can better understand the impact of the model on the companies, workers, and communities
- Invest Program Related Investment (PRI) funds in finance institutions that support the worker cooperative ecosystem

Use Investment Capital to Create More Worker Cooperatives

Beyond removing barriers to capital access, finance institutions can play a transformative role by creating more worker cooperatives. Two primary ways to achieve this are to:

Put conditions on capital investment. Lenders and investors can require portfolio companies to implement some worker cooperative practices and principles as a condition of investment using a side letter or other mechanism. This can include profit sharing, greater employee participation in management or governance, greater information sharing/open book management, implementing an actual employee ownership plan, etc.

Exit shares to worker-owners. Private equity firms can exit their shares to a democratically governed employee stock ownership plan (ESOP) or worker cooperative. By exiting shares of social enterprises or even traditional businesses to employee ownership, investors ensure that the businesses they invest in continue to be local and serve their communities for the long-term



Democracy at Work Institute

US FEDERATION OF
WORKER COOPERATIVES

The Democracy at Work Institute advances the worker cooperative field in order to create a fairer economy and better jobs, build local wealth, and create meaningful change for underserved populations. Created by the US Federation of Worker Cooperatives, the Institute is the only national organization dedicated to building the field of worker cooperative development., and brings both a birds-eye view of the national stage and an experiential on-the-ground understanding of cooperative business. Through research, education and relationship-building, we are working to bring the worker cooperative movement to scale to effect transformative change for individuals and communities throughout the country.

