From #136, may - june 2008

Membership Is Ownership:

The Cooperative Advantage

BY MARILYN SCHOLL

Interest in food cooperatives is growing, due both to increased interest in local, natural, and organic foods and to increased awareness of our economic vulnerability. More and more communities want the stability and accountability that a cooperative can offer.

Cooperative ownership is an economic model that can create great benefits for our communities and member-owners. The cooperative model is powerful if we focus proper attention on the owner side of that compound word, "member-owners."

Typically, members pay fees or dues and get something, such as purchase discounts, in exchange. Owners invest and benefit if the business prospers. Cooperatives must create economic linkages with their member-owners by undertaking activities that make clear the close connection between the prosperity of the co-op and the prosperity of the member.

For cooperatives, owner equity and patronage refunds are tried and true tools that create and maintain a mutually beneficial relationship between the cooperative and its owners.

Owner equity fundamentals
Cooperative businesses require capital, and they generate capital in part through the share investments of member-owners. Debt and earnings are the other primary sources of capital.

A member share program has two essential goals: Member shares provide the co-op with an adequate capital base, and they create a sense of ownership. The co-op's purpose is to meet member needs, and members need to understand that fulfilling that purpose takes capital.

Members own and invest in their cooperative because they trust that doing so is in their best interest. Because our culture does not have many examples of democratic ownership, member share programs must include adequate education so that owners understand how co-op ownership works.

Advantages and disadvantages: All types of capital have advantages and disadvantages, and member shares are no exception. Member shares can be limiting and slow to accumulate, especially for co-ops that are looking to expand. In a few states, however, laws allow co-op investment options that help overcome this disadvantage in capital formation.

In meeting the co-op's needs, member shares have the advantage of being a low-cost way to build capital, since the co-op doesn't typically pay interest on member shares as it does on debt capital. And member investments are more dependable and less risky than relying on earnings as the primary source of capital.

Cooperatives demonstrate the advantage of being community-based businesses, where a relatively small amount of investment from a large number of people can create a sizable base of funds from which to leverage larger amounts of capital. The share investments demonstrate member-owner commitment to banks and other lenders.

Finally, member share investments are also advantageous because shares are not considered taxable income for the co-op.

Equity share investments, unlike fees or dues, are refundable if the member no longer wants to use the cooperative. If a member leaves, the co-op repurchases the share within pre-established limits and restrictions that protect the co-op. It also is important to have a plan for dealing with abandoned equity, so that it doesn′t have to be turned over to the state due to escheatment laws.

Determining share amount: In determining the amount of the share investment, co-op leaders should first consider the co-op′s long-term capital needs. Then, determine how much of that capital should come from member equity, and divide by the potential number of members. Reassess the co-op′s capital needs and member equity investment amounts as needed, and do so at least every five years.

Some co-ops implement an equity plan that requires an annual investment from each member. In this way, the capital base grows year by year and member by member. Whether your co-op uses a fixed fair share or requires an annual investment, note that determining the equity requirement does not begin with the question of what we assume the member-owners can afford. Affordability can be addressed by offering payment options that allow members to meet the investment requirement through smaller payments over a longer time period.

The co-op should offer a single class of membership with the same investment requirement and the same rights and benefits for each member. For co-ops that use patronage refunds, member courtesy cards can be issued to other people in the same household so that those purchases can be included in the patronage refund calculation. Multiple tiers and classes of membership can complicate communication and lead to perceptions of unfairness.

Annual fees or dues rather than share investments have some important disadvantages. First, fees and dues do not provide true ownership; you don′t own Sam′s Club or Costco just because you are a member. Second, fees and dues are taxable income for the business. Third, fees and dues are not refundable to the member. Administrative fees, if any, should be minimal, keeping the focus on equity and ownership.

Best words, best practices: Careless language can interfere with member-owners understanding the distinct advantages of cooperative ownership. Whatever words you use for owners and owner investment, choose and use your terms carefully and consistently. Communicate the true meaning of ownership with terms such as invest, investment, your share, refundable, and equity. Avoid inaccurate and potentially misleading terms such as cost, fee, pay, lifetime, one-time payment, and total. Member equity is not a fee, and it will likely change over time as the capital needs of the co-op change.

We carefully tell the story of ownership and cooperation so our members will understand and will be more likely to become active participants in that story.

Benefits fundamentals

Equity is one side of the ownership coin, and member benefits are the other side. The owners provide tangible support for the business with their equity investments, and in return the cooperative provides benefits to member-owners. The most important benefit for the member is the existence of the co-op itself. People invest in a co-op because they want to use its services. In addition, members receive benefit from being a part of the community, supporting the mission of the co-op as well as the community it serves.

Members should also receive some individual, tangible benefit because of their ownership investment in the cooperative. Any benefits program should be sustainable even if 100 percent of sales are to members—benefits should not be so costly to the cooperative that they become a disincentive to promoting membership. Member benefits also should be simple and easy to explain.

Discounts or patronage refunds? While both discounts and patronage refunds are tangible member benefits, and both generally benefit the owner in proportion to how much they spend, patronage refunds are a best practice for providing benefits, superior to a discount system in a number of important ways. First and foremost, patronage refunds are directly tied to the health and profitability of the business and to the essential dual role of the consumer-owner. The cooperative′s board decides to allocate earnings to the members only after ensuring that the business has actually made money. And since the business is more likely to show a profit if the members use the business, patronage refunds support a mutually beneficial relationship.

With discounts, the ‟earnings″ are given away whether or not there are any actual earnings, because the decision about how much discount is offered is made before the sales are known. If the discount amount was set too high, then the co-op can lose money; if set too low, members may not receive as much benefit as they should. Members often have a hard time seeing how much benefit they accumulate through discounts, and shelf prices are often artificially inflated to make the discounts affordable, thereby weakening the co-op's price image. Everyday discounts can be costly and unsustainable, while discount days are not equitable for all members.

Even with all these disadvantages, the worst thing about register discounts is that they create a sense of entitlement, which makes it harder to create a sense of ownership. Surcharges to nonmembers, on the other hand, can be powerful incentives to join, but they are also off-putting to first-time customers or those who prefer not to join.

Too often discounts provide an unrealistic return on investment. If a member were to invest the same amount of money in a savings account or the stock market, they might expect a return of 2 to 10 percent a year. A $200 investment might provide an acceptable return of $5 to $20 a year. These returns should be kept in mind when considering the amount of return co-op owners should receive annually through discounts.

Patronage refunds, on the other hand, create a mutually beneficial relationship, one that encourages and rewards member investment. Members can trust that the co-op is not unduly profiting from their purchases, because surpluses are returned in proportion to those purchases. The co-op can trust that the members support the business and will wait for their benefit until after all sales and costs for the year are accounted for.

Members pay attention to patronage refunds: there is nothing like a check in the mail to remind one of the meaning of ownership! Some cooperatives time patronage refunds so that members receive their checks before Thanksgiving, near the end of the year, or right before April 15, as one way to enhance the value of the refund.

The management and board of the cooperative pay attention to patronage refunds because such refunds can create appropriate pressure for the co-op to generate net income, one sign of a healthy business. Patronage refunds, whether distributed or retained, reduce the co-op's tax obligations and keep more money circulating in the local economy. Since the IRS allows the co-op to retain up to 80 percent of the allocation, the retained portion provides a tax-free and interest-free way to capitalize the business.
(For more information, see *C.G.* #134 January-February 2008, "Planning Patronage Refunds," by Bruce Mayer.)

While patronage refunds provide the primary economic return on owner investment, food co-ops use an array of other member-owner benefits and incentives to attract new owners, show the value of membership, and thank owners for their patronage. Member appreciation events, special prices on selected products, coupons, special orders, free or reduced class fees, discounts from community businesses, and case discounts all can provide incentives to join and economic benefits for members. These benefits are usually determined by the co-op's management and should be structured and communicated carefully so they are sustainable and flexible over time.

Time to make a change?
If your co-op has not been emphasizing ownership and equity or has created a sense of entitlement with discounts, it will be a challenge to create an ownership culture. But this problem will not get easier with time. Begin by building understanding of the issues among the co-op's leaders. Plan how to educate and engage owners in the conversation.

Overcoming resistance to change must include a clear vision of the value the co-op brings to its members and the community. When making structural and difficult change, it is preferable to make all the changes at the same time. Dragging it out with incremental changes makes communication more challenging, increases the cost, and adds to resistance. (See other Cooperative Grocer articles for stories of co-ops that have made membership system changes.)

Summary

In our society, we are programmed to look out for number one; we are not taught how to create, maintain and share the ownership of community assets and common wealth. The cooperative structure offers us an economic means to meet our common needs through democratically owned businesses. When many of today's food co-ops were established, we wanted to create an alternative to the capitalist society, but many of us threw out the baby with the bath water. Rejecting concepts equated with capitalism—profit, equity, ownership, and management—too many food co-ops went out of business clinging to their idealism.

Fortunately, we can look to the cooperative principle, along with the generations of businesses that existed before us throughout the worldwide cooperative movement, to establish effective and sustainable structures that balance the needs of individuals and of business, so both can prosper. If co-op members only look at personal gain, they miss the power of cooperation. The opposite is also true: if cooperatives don't offer meaningful benefits to its owners, cooperative leaders have missed the point. Cooperatives must balance the needs of the owners and the needs of the business they own. Owner equity investment and patronage refunds are effective tools to create the right balance.

Cooperatives do offer an alternative—a business model in which no one benefits at the expense of others, that builds a community rather than drains its resources. The owners of any type of business provide capital, and in return expect some control and some return on their investment. In investor-owned businesses, those with the most money to invest have the most control and get the greatest share of the benefits. In a cooperative, owners provide capital equitably, have only one vote regardless of amount of investment, and receive their benefit or return based on how much they use the co-op. Ultimately a co-op's success is dependent on its understanding and effectively implementing the economics of ownership within the principles of democracy.

The notions of ownership and patronage refunds are embedded in the third cooperative principle: "Member Economic Participation." Rising from the successful innovations first realized by the Rochdale Pioneers some 160 years ago, this principle outlines the way cooperators contribute to, control, and share the wealth created by their business. This distinctly cooperative advantage has proved itself for generations, and it is even codified in our current tax laws and IRS rules.

Cooperative membership is cooperative ownership. Our owners and directors, staff and management, should all understand that this economic model offers us many advantages, including the ability to serve members, build equity, and share in the common wealth.

Building Blocks for an Owner Investment Plan

Following are critical considerations for a cooperative owner investment plan:

Ownership: a mutually beneficial relationship exists between the member-owners and the co-op.

Investment: the money belongs to the member and is invested to help the co-op better meet the member's needs.

Fair Share: the co-op's overall capital needs are divided equitably among all members; the equity requirement is based on a member's "fair share."

Flexibility: because the equity requirement is based on the co-op's capital needs, this requirement may change as the needs of the business change.

Values: member equity investment helps to accomplish the co-op's mission and create a cooperative economy.

Developing Best Practices

The best practices discussed in this article are a result of a three-year project to analyze and learn from what has worked and what hasn't. In 2001, a small group of experienced cooperators from successful food cooperatives met in Northampton, Mass., to help our friends at newly organized River Valley Market Co-op set up their member-owner policies and practices. Rosemary Fifield from Hanover, Elizabeth Archerd from the Wedge, Lisa Malmarowski from Outpost, Peg Nolan of National Cooperative Grocers Association, and Marilyn Scholl of Cooperative Development Services set about to create an ideal membership program. A year later, over 200 people attended the "Let's SOAR" conference in the Twin Cites to share experience, knowledge and insights. Together we developed a set of best practices for member programs that any food co-op can implement and gain from. **For more information, go to** www.cdsfood.coop/bestpractices

Administration of Membership Programs

For co-ops and members to properly benefit from the decisions concerning profits and patronage refunds, the operational practices must keep pace with the desired outcomes. Membership records are the official record of corporate ownership.

To maintain and use these records requires adequate resources: labor, computer hardware and software, backup systems and support, even desk space.

Both the computerized database and the individual entry forms (paper or electronic) should have fields for: member name and number; all communication avenues (e.g., address, phone numbers, email).

In addition, the database itself should include: a record of equity payments, including the amount and dates paid, as well as the next payment due; the ability to import and update members' purchase data daily from your POS system; a record of each member's purchase amounts for the current and past fiscal years; a record of patronage refund distributions (both paid out and retained) for each member; notes of communications made to the member about membership-related issues.

As with all operational systems, the collection of members' equity and patronage data should be as seamless and simple as possible. Talented and professional staff, using appropriate technology and software, make it possible for our cooperatively owned businesses to take advantage of the patronage refund method and provide excellent member-owner services.

back to current issue contents

Home | **Current Issue** | **Index of Topics** | **Index of Issues** | **To Subscribe** | **To Advertise** | **Contact Us** | **Special Publications** | **Food Co-op Directory** | **About Co-ops** | **Links and Resources**

Editor: Dave Gutknecht dave@cooperativegrocer.coop
Managing Publisher: Dan Nordley dan@triangleparkcreative.com
Webmaster: webmaster@cooperativegrocer.coop