Community Cooperatives

An Alternative Approach to the Mondragón Model and Why We Need It

INTRODUCTION

In the midst of the nation's worst recession since the Great Depression, little is coming out of Washington to address what the nation needs most — jobs.

New job creation is anemic and there is a troubling trend that could make the problem much worse — the accelerating retirement of baby boomers, especially those who own small businesses.

This is worrisome because the country's 15 million small businesses (those with 20 or fewer employees) account for half of all jobs, and baby boomers own approximately 60% of those businesses! Too many sellers and too few buyers could result in the closure of many businesses, with more jobs lost.

What is needed is a systemic solution that can address both job creation and job preservation.

This presents an opportunity for communities to effect a fundamental change to the very framework of their local economies.

THE MONDRAGÓN EXPERIMENT

In the cool green hills of northern Spain, five unemployed workers and their local priest founded a cooperative. The year was 1956, and the Mondragón Cooperative Corporation (MCC)[1] has since grown to be one of the most successful economic development programs in the world.

Named for the small town in the Basque country where it was founded, MCC is considered the model for worker-owned enterprises and its reach extends worldwide. It is a highly integrated network of cooperative businesses with at least 258 cooperatively owned subsidiaries and affiliated organizations that together employ more than 83,000 people. It competes successfully with conventional corporate competitors both locally and internationally.

Yet its enduring value lies not only in its financial success but in the changes it has brought to its worker-owners and their communities. Where MCC has a strong presence, we find extremely low unemployment (if any) and a markedly robust middle class with little signs of economic extremes in the form of impoverished areas or gated communities. Few regions in the world can rival the economic health and vitality of the regions dominated by Mondragón enterprises.

It took Mondragón decades to grow from five workers in a small Basque town to the global enterprise it is today, and communities wishing to emulate its success need a fast-track mechanism to help them leapfrog over that long growth cycle. To develop such a mechanism, we start by examining the Mondragón structure.

The enterprise is composed of a top-level coordinator (MCC, formed in 1991) that organized the disparate entities into three main business groups (Financial, Industrial and Retail). The Industrial Group has seven divisions, and within those groups nest the myriad of individual worker-owned cooperatives.

And even though the MCC now appears to be much like a conventional conglomerate (estimated to be the seventh largest company in Spain), key Mondragón principles are still in place. (The section titled Current Structure in *The Mondragón Cooperative Corporation (MCC): An Introduction*[2] provides a good overview.)

While we ultimately might want to emulate the full Mondragón model, we can commence with a more simplified version with two primary layers that can be quickly adapted to local economies throughout the United States and elsewhere:

- A central coordinating entity that organizes the effort in a particular region and provides the financing and business support that holds it all together.

- A network of existing businesses that voluntarily convert to partial or wholly owned worker enterprises and receive financing and other forms of support from the central entity.

The enterprise can grow by accreting additional existing businesses and by helping new businesses to launch and grow.

That brings us to our Community Cooperative model.

COMMUNITY COOPERATIVES

There is a steady and rapid increase in interest in worker-owned and other types of cooperatives, along with other forms of shared ownership and mutual benefit business models and systems. This movement is chronicled in the book "Owning Our Future – The Emerging Ownership Revolution"[3] by Marjorie Kelly, in which she explores experiments with new forms of ownership that she calls generative: aimed at creating sustainable economic conditions that can last for generations in contrast to the current exploitive, extractive model that maximizes short-term profits at the expense of long-term vitality.

Kelly's book reveals a quiet but pervasive movement toward more sustainable modes of ownership, commerce and economic development. However, with few exceptions, this movement is characterized by individual, one-off projects that lack the integrative, coordinated approach that is the hallmark of the Mondragón group.

But applying a few lessons from the MCC model could change that and ultimately lead to a substantial number of local businesses (big and small) being predominantly owned by a combination of employees, customers and the community, and run in a cooperative, mutually supportive manner that benefits all instead of the few. When a critical mass of local businesses are owned and run in this fashion, their local economies should begin to match the health and vitality of the Mondragón dominated locales in Spain.

A Central Coordinator

One approach to achieve this is for local leaders to form their own centralized coordinating entity structured along cooperative lines. That entity would serve as the principal vehicle to help convert existing local businesses into worker-owned enterprises and to assist entrepreneurs who want to form new businesses using a cooperative framework. This entity would provide both financing and business coordination (training, supervision and guidance) and community-wide promotion (i.e., a "buy local campaign") and serve as the integrative mechanism for the entire effort within the community.

We define such a central coordinating entity a Community Cooperative (CC), typically organized as a corporation. Different from existing public, collective ownership models,[4] it would provide a common vehicle for local residents and nearby supporters to invest in local companies and provide them with support services and resources.

In traditional business terms, this entity can be thought of as a local public holding company. Holding companies own all or a portion of other, smaller companies. In this case, a CC would only own a portion of the local companies,[5] with the goal of helping the employees to ultimately own as much of the business as they want to, with the balance (if any) owned by the community at large.

A holding company can be a passive entity (merely owning other businesses) or it can also conduct some business on its own. CCs will most likely provide paid-for business services in addition to owning other companies.

HOW WOULD THIS WORK?

There is no single right way for a CC to be organized and run. Local conditions, preferences, participants and laws will shape each one. However, a group is being formed to assemble the generic tools needed by any community to establish and run a CC (tentatively called Community Cooperative Development Associates or CCDA) and help local groups to adapt those tools for local use.

CCDA will provide the elements of a basic CC model, along with the legal framework (including model legal agreements needed at all levels) and an Internet portal to conduct promotional aspects of the program, particularly fundraising. The following is one model that local parties can adapt to their own community.

FORMING THE COMMUNITY COOPERATIVE.

We begin with a central common legal entity that will most likely be a conventional C type corporation, set up to function legally as a cooperative, or perhaps a hybrid corporation formed under a state's cooperative laws (like those found in Ohio). This corporation is the CC and will serve as the holding company that will own all or a portion of the local companies that will be part of the enterprise. Those companies will be multi-stakeholder cooperatives themselves (partially owned by the workers and partially by the CC). The funding for both will come from a mix of local investors, including individuals and institutional investors.

In addition to money, the CC will provide a spectrum of other services and benefits, beginning with a community-wide marketing campaign to identify and engage local businesses where the owner is interested in selling to the employees. Normally the prospects of a company converting to a worker-owned enterprise is a hit-and-miss, one-off affair, where the current owner and employees find themselves contemplating that transition because of plans to shut down or relocate the business.

Less often are those conversions contemplated proactively, especially in a community wide, coordinated manner. That is one of the unique features of the CC concept — a campaign to actively seek out and find owners who are willing to sell their businesses to their employees and the community at large, resulting in a Mondragón-like region that has a large number of such enterprises.

Each community has a generous supply of candidate businesses that can be converted. And with baby boomer retirement, that supply could be far more than a community can absorb. Community Cooperatives presents a solution.

SALES OF SMALL BUSINESSES INCREASE

Pepperdine University's most recent quarterly Market Pulse Survey reveals that retiring baby boomers is for the first time the number one reason for selling a small business in the United States.

And the numbers are significant. According to Supply and Demand: The Baby Boomer Impact on M&A, "Approximately 40% of the family-owned businesses in the United States are expected to experience a leadership change in the next five years due to baby boomer retirements. . . . An estimated 9 million of America's 15 million business owners were born in or before 1964."

This means that at least 6 million small businesses will be facing the prospects of a sale in the next five years. With approximately 40,000 identifiable communities in the country, that averages 150 businesses per community!

The trend is already picking up steam: in the first three months of this year, the number of sales that closed jumped 56 percent from the same time in 2012, according to BizBuySell.com, an online marketplace for small businesses, reported in the Huffington Post article Retiring Boomers Driving Sales of Small Businesses.

Such a large number of businesses may create a glut, as explored in Baby Boomer Retirement and Businesses for Sale. Not only will this cause prices to drop for sellers, but many owners may resort to just shutting down their business rather than vainly looking for a buyer. That would result in an economic loss to the community and, more importantly, loss of jobs.

Thus the nation, local economies and in particular business owners will benefit from a system that actively facilitates the sale of their businesses, not to mention the employees who might otherwise lose their jobs with no replacement in sight. But this problem can be turned into a benefit that moves communities in the Mondragon direction and leverages the trends that Kelly describes.

Tools, including expertise and money, will be needed to make it happen, community by community, a key benefit of the CC system.

Once in place, the system can address another universal problem, the nurture of startup businesses. By supporting new ventures as well as retention of existing businesesses, the CC systems not only preserves jobs in the community but helps to create new ones.

GAINING & SHARING EXPERTISE

Most businesses will need help to bring that about. Consultants known as exit planning advisors work with owners on ways to transfer ownership (succession or exit planning). There is even a Certified Exit Planning Advisor[6] designation and within that group, those who specialize in advising owners on how to transfer the ownership of their business to employees.

Ohio is one of the leading states for employee-owned businesses and the Ohio Employee Ownership Center (OEOC) at Kent State University has a number of certified experts and resources for both owners and employees that has been assembled over nearly three decades. Based on the experience of the OEOC experts, both sellers and employees normally need a good deal of hand-holding on how to put a deal together.

Each CC needs to obtain that expertise so that they in turn can provide it to the businesses within their community. The CC marketing team would include both sales people who locate the prospective sellers and the advisors who then can be brought in to structure the deal.

While each deal will be unique, there are certain common ways that the parties can reach an agreement, and the marketing team that reaches out to those businesses in the local community will be knowledgeable of those approaches, which can include various forms of cooperatives, ESOPs (employee stock ownership plans) and more.

FINANCING

A substantial portion of those employee groups will need to secure outside financing (rather than strictly seller financing). This could be a combination of debt and capital. If credit is sufficient to complete the sale, then the CC can help to bring that to the table.

However, many sales cannot be completed by pure debt financing, primarily because the net profit of the business (the money left over after all salaries and expenses have been covered) is insufficient to debt-service the entire acquisition. In this case, the CC also serves as an aggregator for capital from the community and helps to provide the parties to the transaction with sufficient capital.

The amount of capital needed for each deal will vary. In addition, it may be that in order to grow the business and allow it to create additional new jobs, the total amount of capital might need to include both purchase money and growth money.

Flexible Ownership Models

However, regardless of the amount, the community investors backing the deal are there only as long as the employees need and want them. Many employee groups will desire to ultimately own the business in its entirety and would want to buy out the CC's interest when in a position to do so.

Others will be happy to have the business permanently co-owned by the employees and the community. The goal of the CC is to accommodate the business conversion into whatever form of ownership the employees ultimately desire. It is dedicated to providing a support and nurturing role, not the dominating role that capital often provides in today's business environment.

Other Support Services

To that end, the CC will also assemble and organize other forms of support services and resources that will help the businesses survive and thrive, including basic business guidance and mentoring services that help ensure that the employee-owners learn best practices on how to run a business. The CC can also provide various group services such as group insurance and other commonly shared accounting, legal and other resources.

The goal is to have a healthy, well-run group of primarily employee-owned local enterprises that serve the needs of the local community and provide it with living-wage jobs that nurture and support the local economy in a sustainable manner.

LEGAL ISSUES

Complications related to federal and state securities laws will constitute a make-or-break set of conditions for a local CC effort. These issues are pivotal, as funding is the single most significant hurdle on the path to implementation.[7]

Public Funding

A local CC effort will be most successful when its funding comes from the general public rather than private investors. The system needs to accommodate both individual investors (i.e., local citizens) and the spectrum of institutional investors including pension funds, foundations, corporations, private equity funds, local governments (from their investment fund pools) and more.

However, raising funds from the general public invokes state and federal laws related to the sale of securities. This can be a minefield, but if organizers limit the investor pool to residents of the state where the CC will be located (a natural affinity group), then many federal laws and restrictions can be avoided.

Intrastate Offerings

Congress established a broad exemption in the federal securities laws for states that wish to establish their own rules for the sale of securities, known as intrastate offerings.[8] As long as all parties work within the guidelines, the federal government largely takes a hands-off approach to dealing with these offerings.

States may have one or more categories of offerings that would fit. For example, Ohio allows Ohio companies to register an offering[9] that permits a company to sell to any state resident (with no other investor qualification) and it may use any means to reach out to those investors, including general solicitations via print, broadcast media and the Internet. In essence, this means that such a company can use intrastate crowdfunding[10] to raise the capital they need, provided they do it only in their state.

WRINKLES

Even though states are allowed to define their own intrastate offering rules, the federal government still retains jurisdiction over illegal activities, in particular those related to fraud. Other activities that can trigger federal purview include:

- **Shareholder limits and total assets**: The total assets of the CC and its number of shareholders exceed federal limits that trigger the requirement for registering with the SEC and becoming a reporting company.[11] Currently that is triggered if the company has more than $10 million in total assets and a class of equity securities, like common stock, that is held of record by either 2,000 or more persons or 500 or more persons who are not accredited investors. The CCs could easily exceed those limits.

- **Timing of offerings:** The company issues two or more offerings back to back that are not separated by enough time (typically at least six months) or terms (e.g. ,same price for same kind of shares) to make them distinct offerings, resulting in what the SEC calls integration of securities offerings wherein the Commission views them as one offering. The SEC would then usually apply the rules that would have applied to the most restrictive of those offerings. And even if the offerings were identical in nature (same restrictions) they still could be treated as one and impact such things as the "coming to rest" requirement of an intrastate offering by substantially elongating the time everyone has to wait for the holding period for resale of their securities.

- **Investment companies:** Finally, organizations that are set up to pool investments in order to invest those fund in other business entities are generally referred to as investment companies. Most investment companies are subject to federal SEC laws under the Investment Companies Act of 1940. The Investment Company Act applies to all investment companies, but exempts several types from the act's coverage. The most common exemptions are found in Sections 3(c)(1) and 3(c)(7) of the act and include hedge funds.

National Commonwealth Group has devised solutions for these and other problems.

CONCLUSION

Not only does the nation need a system for creating new local jobs, but for preserving jobs that might be lost with the closure of existing small businesses. National Commonwealth Group has devised a solution that addresses both problems, one that communities can do on their own, and brings a long-term, sustainable economic benefit.

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ENDNOTES

1. http://en.wikipedia.org/wiki/Mondragon_Cooperative_Corporation

2. http://www.ownershipassociates.com/mcc-intro.shtm

3. See also her previous book "The Divine Right of Capital"

4. A CC would resemble a business development company or BDC (a publicly traded company that invests in private equity companies i.e., non-public companies, often early stage startups). Essentially it is a venture capital (VC) company that is open to the public not just just deep pocket investors. It is also similar to a VC in that it invests in a number of smaller companies with the goal of "harvesting" those investments when the companies are re-sold or go public. A BDC would normally be listed on a national stock exchange and have nationwide appeal. In contrast, our CCs would be a publicly traded company only in a specificl geographic area, and not on a stock exchange. The CC or its agent would manage its own stock sales, and would appeal only to local investors. A CC would normally issue shares of stock using state-based securities laws, which only permit the CC to sell its securities to residents of the state where it is located. Thus it is a public company inside just one state, usually one region of that state.

5. There may be circumstances where the CC is the sole owner of a local enterprise, but the majority would only be partially owned

6. Exit Planning Institute https://www.exit-planning-institute.org/

7. Given the complexities of this issues we will only touch on highlights in this document and encourage those needing more details to contact us.

8. The article "Intrastate Offering Exemption" http://tenonline.org/art/sl/9210.html by a Michigan securities attorney explains in plain language the SEC requirements for such an offering.

9. See Ohio Revised Code Sec. 1707.09 Registration by Qualification http://codes.ohio.gov/orc/1707.09

10. The concept of crowdfunding has become a hot topic lately and many are looking to the 2012 Jumpstart Our Business Startups or JOBS Act. However, implementation of federal crowdfunding has been stalled at the SEC, which was mandated to come up with implementation rules to allow companies to use it, but has gone well past the time allocated for it to do so. However, many states' intrastate offerings regulations already provide for crowdfunding-like offerings, provided they are done strictly within that state. And in some cases, like Ohio, the state's rules are more open and flexible than the federal ones anyway.

11. See Exchange Act registration requirements at http://www.sec.gov/info/smallbus/qasbsec.htm.