

# Journal of Cooperative Thought and Practice

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# Letter from the Editor

Welcome to the inaugural issue of the *Journal of Cooperative Thought and Practice*. Our intention is to be a creative learning community, bringing together the best of academic research and on-the-ground experience to promote the expansion and good practice of economic democracy.

Our first issue begins with one of my favorite pieces of academic research—far too little known in the cooperative community—from Dr. David Erdal in Scotland. For his Ph.D. dissertation at the University of St. Andrews, Dr. Erdal looked at the correlation between the concentration of worker cooperatives in a local economy and the community's standing on a wide variety of social measures, from health to crime to blood donation. He found what many of us have suspected all along: Cooperatives are good for everyone.

Our second piece is from noted cooperative scholar and practitioner Tom Webb, recently retired director of the Master of Management—Co-operatives and Credit Unions program at St. Mary's University in Halifax, Nova Scotia. In this paper, Webb and his colleagues highlight the important attributes of cooperative capital versus the capital at work in investor-owned markets.

Next is another piece of research that deserves to be far better known: the only longitudinal study we know of regarding the longterm effects of employee ownership on firms and their workers. This comes from the Ohio Center for Employee Ownership, whose staff members have tracked a cohort of companies with employee stock ownership plans (ESOPs) over the course of two and a half decades. Dr. Jacquelyn Yates, professor emeritus at Kent State University, kindly condensed and updated this paper for us after the untimely death of her co-author, Dr. John Logue.

Another timely piece of research, celebrating 25 years of

achievement, comes from David Thompson in California, who has patiently tracked and compared a groundbreaking limited-equity housing cooperative development in Davis, Calif., against comparable investor-owned properties—with very thought-provoking results.

We conclude with an engaging question-and-answer interview with evolutionary psychologist Dr. Robert Kurzban of the University of Pennsylvania, regarding his research on whether some of us are “born cooperators” and how these findings might inform future cooperative development efforts. A book review contribution from Don Kreis of the Vermont Law School rounds out this first issue.

Bringing together research and practice is not as easy a task as it should be, and many people have been helpful in this effort. William Nelson of the CHS Foundation supported the initial feasibility work for the journal. The Ohio Employee Ownership Center at Kent State University provided funding for this issue with the generous support from the U.S. Department of Agriculture. Keith Taylor of the University of Illinois–Champaign-Urbana has also assisted in a number of ways. This issue is dedicated to the fond memory of Dr. John Logue, exemplary scholar, dedicated practitioner, and one of the kindest people I have known.

Our hope is that this is the first of many issues uniting cooperative practice and thought in fruitful dialogue. For information or ideas about future issues, or to submit your comments on this one, please contact [mlund95@gmail.com](mailto:mlund95@gmail.com). Thanks for reading, researching, and practicing.

*Margaret Lund*  
*Editor*

# Employee Ownership Is Good for Your Health

*People thrive in a social environment  
characterised by employee ownership*

By Dr. David Erdal

My 1999 Ph.D. thesis at St. Andrews, titled “The psychology of sharing: An evolutionary approach,” includes a test of the prediction that people will flourish in more egalitarian communities, such as those with widespread worker co-operatives.

I had to find towns which were different in their levels of employee ownership, but were close enough and similar enough in all other ways to be comparable. Three towns in an area of northern Italy near Bologna met these criteria: one town, Imola, had 26% employed in co-ops (since this was Italy, employee ownership took the form of worker co-ops); one town (Sassuolo) had none; and one town (Faenza) was between the others, at 13%.

So, were the people happier living in the town with the most employee ownership? To test the thesis I compared them using a random-sample survey, covering health, education, crime, social participation and perception of the social environment. I also collected some whole-population statistics (e.g., on mortality, blood donation and voting).

The results were clearly consistent with the hypothesis—in other words, the answer was yes! If you want to be happy, live in a town with lots of employee ownership. Imola, with 26% employee

owners, was better on 17 out of 19 measures than the one without any employee ownership. It was better in all five areas (health, education, crime, social participation, and perception of the social environment). That is statistically significant: If these differences had happened by chance, you would have expected about half better, half worse. And the town with an intermediate level of co-ops was also in the middle on these measures of social health.

The most striking result was that the people in the town with high employee-ownership lived longer. Due to a huge difference in the rates of cardiovascular mortality, the people who live in Imola live significantly longer than those in the non-employee-ownership town. They just don't get so many heart attacks and strokes.

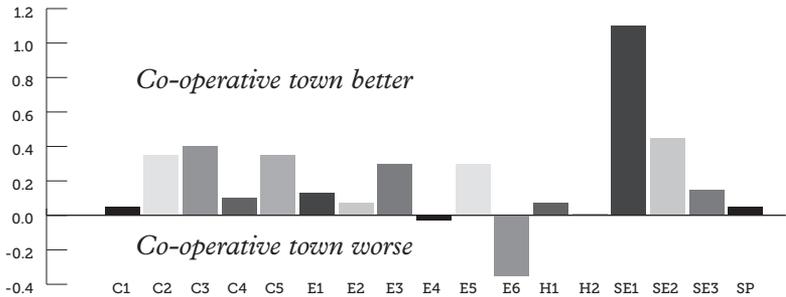
What does this mean? It means that one in four of the Imolese work in a company wholly owned by its employees, and the whole population in the town experiences:

1. Better mental and physical health, and longer lives, with much less cardiovascular disease.
2. Better education: staying longer at school after the legal leaving age, playing less truant, getting better training after leaving school, etc.
3. Less crime, including less domestic violence.
4. Higher social participation (joining clubs and charities; giving blood; voting)
5. And not surprisingly, they perceive their social environment as more attractive: when they need help their personal networks are more supportive; they see the political authorities as more on their side; and (hugely) they see less difference between rich and poor in their town.

The following graph shows the differences between Imola and the town without employee ownership on the measures in the survey. In addition to these measures, Imola was significantly better

on mortality, voting and blood donation.

This study does not prove anything—only establishes an association, and there may be unidentified other factors at work. But it places firmly on the table the hypothesis that a significant presence of employee ownership in a town helps to create a social environment where people thrive. Employee ownership really does make you healthier and happier, as well as wealthier.



*The graph shows the differences in the scores (after standardisation) between the top town and the town with no co-operatives. A column above the line indicates that the co-operative town was better. Mortality, blood donation and voting—not in the graph—were each similarly significantly better with co-ops.*

The following factors were measured:

**Crime:** victimisation (labelled in the chart below: “C1”), policing (C2), confidence (C3), feeling of security (C4), domestic violence (C5)

**Education:** level attained (E1), age leaving school (E2), truancy (E3), expected truancy (E4), post-school training (E5), perceived importance of education (E6)

**Health:** physical health (H1), emotional health (H2), mortality

**Social Environment:** perceived gap between rich and poor (SE1), helpfulness of authorities (SE2), supportiveness of social networks (SE3)

**Social Participation:** membership of clubs (SP), voting rates, blood donation

## Results

The results were in line with the prediction: the greater the proportion of people employed in co-operatives, the more positive were these measures. The town with the most co-operatives was very significantly better than the town with no co-operatives, and the town with an intermediate level of co-operatives was intermediate.

Surprisingly, Imola had the lowest score on two measures: the current expectation that children were attending school rather than playing truant (a very small difference in scores) and the view that education was important for happiness. The truancy result is unexpected, but very small. The difference in the feeling that education is important for happiness is more interesting, for while residents of the more cooperative towns were certainly happy, they felt less strongly that a good education was necessary to achieve this. This result is perhaps indicative of a greater degree of confidence in the community at large, and therefore a less strong conviction that individual educational achievement is necessary to ensure well-being.

## Replication

Since this is the first study of its kind, and since it was carried out with few resources, the result must be treated as “subject to replication.”

## Conclusion

With that general caveat, this study gives reason to treat seriously the hypothesis that egalitarian environments are better for people than non-egalitarian ones. The predictions were made on purely theoretical grounds, and the results show a strong pattern fitting the predictions. This hypothesis is worth investigating further.

*A version of this article originally appeared in Owners at Work 13:2 Winter 2002, pp. 1–3. Thanks to Jacquelyn Yates for her assistance with that article. A longer version of this article is available upon request to the editor of this journal.*

# Cooperative Capital: What It Is and Why Our World Needs It

By Alan J. Robb, James H. Smith, J. Tom Webb

*“We have so many beliefs we know are not true.”* (Steinbeck, 1954, p. 34)

A central challenge for anyone seeking to understand the dynamics of cooperative business is to understand both the context in which cooperators and cooperatives exist and the profound differences between cooperatives and other forms of business.

Cooperative businesses are islands in a sea of investor-owned firms. As islands they take on the language and concepts of the world around them even when they know they are not true for them and do not fit. Cooperatives are profoundly different from investor-owned firms, and that difference is the key to meaningful understanding of any aspect of cooperative business. Exploring the nature, role, and behavior of capital in a cooperative is no different.

## **The evolution and nature of cooperatives**

Cooperatives evolved in a number of countries in the mid-nineteenth century in response to the development of the Industrial Revolution and the upheavals this caused on society (Birchall, 1997). The rules adopted by the Rochdale Equitable Pioneers Society in 1844 have been very influential in the development of cooperative thinking and form the basis of the principles adopted by the International Co-operative Alliance.

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Industrialization and the development of the market economy tore society apart. This occurred in many countries, not just Britain as is sometimes implied (Birchall, 1997). In Britain, landowners used their absolute political power to enclose the common lands, forcing the landless to find their subsistence through wage labor.

In Birchall's (1997, p. 2) words:

One by one, all the customary rights that working people had had were stripped away: the right to gather firewood and to hunt game, the right to have their wages set by a magistrate, the right to 'poor relief' if they were unemployed or laid off from agricultural work in the winter, and so on. ... Now, for the first time, it was thought acceptable to allow people as individuals to take their chances within a volatile new market economy, that could not guarantee survival. As Polanyi puts it, whereas previously the market had been an adjunct to society, now society became an adjunct to the market.

The response from the affected members of society was the development of mutual organizations (trade unions, friendly societies, and cooperatives) whose common feature was to ameliorate the injustices of the market economy and its emphasis on the primacy of financial capital.

Mutuality was not a new concept; it lay at the heart of partnerships as a business form. Partnerships have existed as long as businesses have operated. Many of the features still found in partnerships were adopted by the founders of cooperatives; e.g., capital was contributed equitably (not necessarily equally), profits were shared in proportion to agreed-upon ratios (not necessarily in proportion to financial capital), members withdrawing from the partnership would be paid out their recorded capital.

Accountability was also an early value of cooperatives, as it was in sole traders and partnerships. The Rochdale Pioneers' rules of 1844 provided for quarterly general meetings at which members would receive audited financial reports (Birchall, 1994, p. 54).

From this brief summary of the development of cooperatives it can be concluded that:

1. Cooperatives exist to provide benefits to members through their active participation in the cooperative's activities.
2. Members of cooperatives benefit from the strength and solidarity that mutuality confers in markets.
3. Capital is contributed equitably by members, normally in proportion to the use that members make of the services of the cooperative.
4. Interest may be paid on capital contributions—but it should be limited and fixed.
5. Members' capital is repaid by the cooperative when the membership ceases.
6. As democratic organizations, cooperatives operate on the basis of equal voting rights rather than voting in proportion to the amount of share capital held.

### **The nature of an investor-owned business**

The development of the limited liability company in the mid-nineteenth century was designed to facilitate the investment of financial capital.

The United Kingdom Joint Stock Companies Act 1844 contained a number of provisions including the keeping of books of account, the regular preparation and publication of balance sheets and the appointment of auditors. These 'oppressive provisions' were subsequently removed in 1856 on the grounds that they were 'officious interference of the State' (Johnston & Edgar, 1963, p. 7).

Consequently company directors were left relatively free from legal obligations of accountability towards shareholders. Historically, directors have resisted any requirement to disclose detailed

financial information. The disclosure of profit and loss reports was not required until after the Royal Mail Steam Packet Company collapsed in 1929. By utilizing undisclosed secret reserves and transfers from off-balance-sheet entities, the directors were able to present the appearance that the company was profitable for more than seven years.

Although there has been a move in recent years towards triple bottom-line reporting, the overriding purpose of investor-owned companies remains the maximization of profits, often to the exclusion of any social or other considerations. This, not surprisingly, results in an amoral attitude to business. For example, when asked about the havoc his currency speculation caused to Far Eastern economies in the crash of 1997, George Soros replied, “As a market participant, I don’t need to be concerned with the consequences of my actions” (Clarke, 2003, p. 32).

To the extent that social responsibility is accepted in investor-owned companies, it is not simply the making of profits; it is to continually increase the profits that are made (Friedman, 1970). This may involve replacing employees by automation or by shifting production to lower-cost economies. When faced with a need or wish to exit the company, an investor must seek an external buyer for the shares held. That sale may be more or less than the equity originally invested and more or less than the net asset backing of the shares.

The key point to note is that the exiting shareholder exerts little direct influence on the company to perform. Indeed, more influence may be exerted by customers boycotting a company’s products—because of changes to traditional taste (opponents of the so-called New Coke forced the return of the traditional formulation after only a few months in 1985). In 2009 Cadbury’s decision to replace cocoa butter with palm oil sparked a similar protest and the decision was reversed within weeks (*Environmental Leader*, 2009).

Equally there is little, if any, direct incentive for the shareholder to transact with the company.

Because voting is normally related to the level of shareholding the organization is essentially undemocratic. Voting is based on the principle of one dollar one vote rather than one person one vote. The organization responds to the needs of capital rather than the needs of people and communities. An investor-owned business may meet human and community needs but that is not its purpose.

At this point it may be helpful to summarize some key cooperative differences before we discuss aspects of cooperative capital.

### **Cooperative differences**

1. The very idea of cooperation rests on some assumptions about the nature of humanity. There must be an assumption that people are generally good and wish to do good. That does not include any naive notions about people being perfect but might be stated as a faith that, given an opportunity to make the world a better place, people will mostly choose to do so. If one did not hold this belief then cooperative activity would be foolish. A second key assumption is that people are both individual and social and that these two essential aspects of human nature need to be in some reasonable balance.

*Investor-owned businesses are based on a belief that the overriding motivation of people is economic rationalism. It is assumed that individuals act in their own best interests and seek to maximize the return on their financial resources. The best interests of humanity are reduced to financial interests. Consequently the owners of investor-owned companies must treat labor and materials as input costs to be minimized, if return on financial resources is to be maximized.*

2. Cooperatives are open to all persons “able to use their services and willing to accept the responsibilities of membership” (International Co-operative Alliance, 2007). Mutuality and participation are central to cooperation.

*Investor-owned businesses require no commitment to the activities of the*

*business.*

3. Cooperatives require members to

contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on the capital subscribed as a condition of membership. (International Co-operative Alliance, 2007)

*Investor-owned businesses invite the purchase of share capital as a speculation where the compensation may have no limit. Control of the capital is in proportion to the amount invested.*

4. Almost without exception cooperative businesses were established to respond to unfairness in dominant business arrangements. Often they were started as a direct result of exploitation of people by other types of business. The purpose for which people create cooperatives is to meet member and community need. Businesses exist for people, not the other way around.

Cooperatives are about justice and fairness. It is not an accident that cooperatives all over the world accept (even if they may fail to put them into perfect practice) a set of values and principles, predominantly those adopted by the ICA.

Cooperatives keep capital in the community where it was generated, while stock companies export capital elsewhere. Since they give surplus revenue back to their members, cooperatives keep wealth in their communities. Stock companies do the reverse. By distributing profits to shareholders, they take capital out of the community. (Gutknecht, 2008)

*Investor-owned businesses arose in an environment of laissez-faire where the concept of caveat emptor (let the buyer beware) was the accepted standard for behavior.*

*Writing at the time, Adam Smith warned of the dangers to society of*

*schemes proposed by the promoters of investor-owned companies:*

The interests of [those who live by profit] ... has not the connection with the general interest of society as that of ... [laborers and landlords]. The proposal of any new law or regulation of commerce which comes from this order [those who live by profit], ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but also with the most suspicious, attention. It comes from an order of men whose interest is never exactly the same with that of the publick, who have generally an interest to deceive and even oppress the publick, and who accordingly have, upon many occasions, both deceived and oppressed it. (Wealth of Nations, Part 1, Ch. xi, paras. 8–10)

Writing today, Cliff Mills offers the following assessment of the investor-owned firm:

A system designed to pursue one goal only is likely to achieve that goal; but it may do so at the expense of other potentially legitimate—maybe even more important goals. What economists call the ‘negative externalities’—the downstream costs of exploiting natural and human resources in the pursuit of profit—are becoming more recognised and better understood. (2009, p. 2)

While this ownership model provides a powerful driver, it also creates a problem. Being effective at delivering private benefit is all very well, but an economy based on the quest for the private benefit of some does not seek the common good of all. ...

This is even more significant when seen in the context of today’s global issues—diminishing natural resources, climate change, and global poverty. It makes little sense to attempt to solve these problems without acknowledging that the pursuit of growth and the maximisation of private gain might at best hinder these endeavours, and at

worst be a major part of the problem. There is now an urgent imperative to find a different and fairer basis for business—and for business ownership—that does not ignore today’s social and environmental concerns. (2009, p. 1)

This, of course, implies a need to create a better, fairer type of capital.

### **Cooperative Capital**

Cooperative scholars, managers, staff, board members and members—all of us are surrounded by currently dominant investor-owned business, and our thinking, even the language we use, is shaped by that environment. Mills puts his finger on a key obstacle for us to overcome:

Having become used to one way of trading and one way of living and thinking, it is difficult to put that to one side and accept the need to search for an alternative. Contemplating a different way of living and a changed basis for society requires a leap of imagination. (2009, p. 7)

That is the challenge for our thinking about capital. When we say cooperatives need capital we have in our heads the concept of investor capital whose only purpose is to maximize return. We want to suggest that cooperatives have to develop the concept of and co-operators and the public about another species of capital, cooperative capital.

Cooperative capital must behave in such a way as not to erode the cooperative business model comprised of its purpose, values and principles. None of these considerations are essential to other business models. In contrast, in the investor-owned business model any considerations such as these are essentially secondary and must be reconciled with and be subservient to maximizing the return to capital.

The purpose of capital in a cooperative and the purpose of the members or others providing the capital has as its primary focus

meeting member and community need. Members and others who invest in cooperatives expect, as long as the cooperative is successful, that they will be able to get their money back and that they will get a limited return of the investment. They also expect that member and community needs will be met in a fair and equitable manner consistent with cooperative purpose, values and principles.

Cooperative capital is equity, in the traditional accounting sense. It is the claim of the members of the entity to the net assets of the entity. The members of a cooperative are entitled to be paid back their equity when they leave the cooperative in exactly the same way that members of a partnership receive their equity (whether designated as “capital” or “current” account) when they leave the partnership. Cooperators should not find their capital “locked in” to a cooperative after they have left.

The obligation to pay a limited amount of interest on capital and the obligation to redeem cooperative capital are two important disciplines on the managers and directors of cooperatives. Capital is not free and must therefore be subject to a capital-rationing that aims at meeting members’ needs. The obligation to redeem capital puts managers under pressure to minimize capital expenditure and encourages the cooperative to attract new members and capital and satisfy the needs of existing members.

In summary, an investor in a cooperative business, based on the purpose, values and principles of cooperatives, should expect that his or her investment will be in an organization that:

- Makes possible meeting a human need in a fair and equitable manner.
- Conducts its operations in a manner that respects the cooperative values and principles, specifically: Equality, Equity, Mutual self-help, Self-responsibility, Democracy and Solidarity.
- Conducts its operations in a manner that respects the personal cooperative values: Openness, Honesty, Social responsibility and Caring for others.
- Operates in a manner that reflects the Cooperative Principles:

Open and Voluntary Membership; Democratic Member Control; Member Economic Participation; Autonomy and Independence; Education, Training and Information; Cooperation Among Cooperatives; and Concern for Community.

- Returns equity upon request unless it puts the cooperative in financial jeopardy.
- Pays a limited return or fair return and not expect a windfall at the expense of others.
- Allows the creation of a pool of capital that is owned collectively by the members and is the indivisible common property of the membership.
- Respects the co-operative values and principles, and does not act in such a way that it would inflict suffering on others through pollution or damaging the environment or community.
- Respects the co-operative values and principles, and acts in a manner that will respect the dignity of its workers and give them a meaningful way to contribute to society.

For example, the cooperatives in the Mondragon group in the Basque Country limit the gap between the highest and lowest paid to 9 to 1. As a result the per capita income in the valleys dominated by these cooperatives is the highest in Europe and the income gap the lowest. They have managed to combine a fair return on capital with a fair wage to the worker members who created the cooperatives to provide themselves with work. In the process they have had a major impact on stemming the outflow of people from the Basque Country. They have also managed to provide safe and secure work with excellent benefits. Capital in the Mondragon cooperatives has been used very efficiently not to maximize return to investors but to meet member and community need. It is an excellent example of robust financial health and robust cooperative purpose.

One hallmark of the Mondragon model is its use of capital. Rather than flowing into the pockets of executives

and outside investors, a company's profits are distributed in a precise, democratic way; set aside as seed money for new cooperatives; distributed to regional nonprofits; or pooled into shared institutions like the university and research center. In other words, each individual cooperative gains long-term benefits from the financial assets of the whole." (Schwartz, 2009)

This is a formidable list of benefits available to those who invest in a cooperative. An investor-owned business, by contrast, offers a very limited capacity to offer anything but to deliver a maximum return on invested capital. As the world learned in September 2008, as the value of investor-owned publicly traded shares dropped by 20–40%, the "unlimited return" may be negative as a result of the unregulated pursuit of narrow self-interest. Cooperative financial institutions did not create any of the "toxic paper" nor did the value of cooperative shares decline. The absence of cooperatives from this massive malfeasance and their stability in the face of market turmoil are additional benefits of deploying capital as cooperative capital. Those benefits accrue to both individuals using cooperatives to meet their needs and to the public generally. They are public policy benefits.

### **Cooperative financial institutions: the challenges**

Credit unions around the world have assets in excess of \$1.2 trillion dollars US (World Council of Credit Unions, 2010). Credit unions started small and started as consumer savings and loan societies. They were created because ordinary people, farmers, fishers, workers of all kinds often could not get credit to make large purchases, build a home or finance small family businesses. Many people found it obviously unfair that they had put their savings in banks but when they needed to borrow money they found they did not qualify for loans.

In addition mutual and cooperative insurance companies around the world were begun because insurance was not available

to many millions of ordinary people. Just the 400 distinct members of the International Co-operative and Mutual Insurance Federation have “assets approaching USD \$1 trillion” (International Co-operative and Mutual Insurance Federation, 2010). In addition there are a considerable number of other strong cooperative financial institutions such as the Rabobank Group, an international financial services provider that, in terms of Tier I capital, is among the world’s 25 largest financial institutions, CoBank and the National Cooperative Bank in the USA, a network of cooperative banks in Italy, the Caja Laborale Populaire in Spain’s Basque Country the Co-operative Bank in the United Kingdom (part of Co-operative Financial Services) and many others. It is safe to estimate that together cooperative financial institutions have assets well in excess of \$2.5 trillion USD.

For the most part the capital in these financial institutions is not available for cooperative development. Often when it is available it is available on the same terms as if it were available to an investor-owned firm—it is available, as investor-owned capital or more likely debt rather than equity. In large part this is a result of many credit unions doing limited commercial lending until recently and beginning commercial lending only after they had become large and their cooperative roots had become somewhat distant history. In part it is because regulators were leery of investments that were not “traditional.” In some cases it was because managers brought in from banks brought with them practices that worked well in investor-owned financial institutions.

The reasons also included some history of non-financial cooperatives believing they ought to get a loan just because they were a cooperative business regardless as to whether the purpose of the loan made good business sense. Finally, the early years of commercial lending by credit unions in Canada were not without some credit unions failing or being bailed out of bad commercial loans. We arrived at where we stand today, with over \$2.5 trillion USD in assets held by cooperative financial institutions, because a lot of

good people built strong, successful financial cooperatives.

The question now is, “where do we go from here?” Can our sophisticated cooperative financial institutions devise sound ways to invest in the further development of other types of cooperative business?

The challenge for financial cooperatives is that their members expect them to be responsible custodians of their savings and insurance premiums. At the same time an increasing number of their members want to invest their savings in ways that are consistent with their values and not destructive of the world they are leaving their children. Increasingly people are making the connection between how their savings are used and economic activity that is destructive of society, the environment and their children’s future.

A number of financial cooperatives have experimented with investment strategies that are profoundly cooperative and have met with considerable success. In the mid-1990s the Co-operative Bank in the United Kingdom began to vigorously position itself as an ethical lender. Most of the expectations listed above were met. The result was that it went from having a below average financial performance to a financial performance considerably above average. (See Figure 3.) Its ethical positioning served it well as the British banks suffered through the financial meltdown of 2008. In the first nine months of 2008 when British banks were looking for bailouts the one- to three-year-term deposits in the Co-operative Bank rose by 80%. There was hunger for cooperative capital investment opportunities then and since 2008 the opportunity has become significantly larger.

The Caja Laborale Populaire has had from its inception the goal of not just providing the workers in Mondragon’s cooperatives with a sound financial institution but to finance and make possible the growth and development of worker owned cooperatives in the Basque Country. The founders of the Mondragon cooperatives wanted to create workplaces that were participatory and to stop the drain of people from the region. Since launching its first coopera-

tive in 1956 the Mondragon group has grown to a workforce of 92,700 in 2008. The Caja has successfully participated in the growth of the Mondragon cooperatives while achieving solid success as a financial institution. In 1988 it administered €1.3 billion and by 2008 that had grown to €13.9 (Caja Laborale Populaire). It has also allowed people in the Basque Country to invest in their own future and that of their children.

In the United States, the National Cooperative Bank is a federally chartered organization with the mission to support and be an advocate for America's cooperatives and their members, especially in low-income communities, by providing innovative financial and related services. Toward that end it created NCB Capital Impact, an organization focusing on providing high-quality health care, housing, education and eldercare, using its depth of experience, cooperative approach, and diverse network of alliances to generate critical investments that create a high quality of life for low income people and communities.

In New Zealand the PSIS Ltd. is a financial services cooperative that uses the tag line in its logo "A cooperative way of banking." It has operated successfully since 1928. Because of its focus on mutuality, and its avoidance of speculative but profitable financial engineering practiced by investor-owned finance companies, the PSIS avoided losses in both the 1987 financial crisis and the 2008 meltdown.

### **Regulation of capital: implications for cooperatives**

Abuse of trust has been a fairly repetitive issue in the raising of capital for investor-owned business and it has led to a strict regulation of financial industries and stock markets. While there have been problems from time to time with cooperative financial institutions there have not been the equivalent of the savings and loan scandal of the 1990s, the Enron/Worldcom collapses, or the toxic paper fiasco of 2007–08. Cooperatives need, and for the most part see the need, to have some level of oversight and regulation but it

hardly seems reasonable to gear cooperative regulation, either in scope or form, to respond to the repetitive abuse of privately held investor-owned business.

The cooperative business world has a powerful vested interest in ensuring that it behaves in a responsible manner since a cooperative business or ethical failure reflects on the business model. Cooperatives, with their community base and local, regional and national organizations, also tend to know each other and are sensitive to ethical issues around financial matters. That said no significant effort has been made by either cooperatives or governments to devise a regulatory system for cooperatives that was appropriate to their significantly lower level of risk.

Regulators often do not have an understanding of the cooperative business alternative. This is not surprising since few educational institutions include the cooperative model in their curriculum. (Chamard, 2003). The inclusion is even more rare in university business schools. Even in countries where cooperatives are a significant part of the economy they are virtually invisible in university business schools. In this context it is not surprising that regulators too often see cooperatives as some kind of aberration or a defective business model. Not is it surprising that they should use the same regulatory approach that they see as necessary for investor-owned business. New approaches are needed.

### **The evolving need for capital in cooperatives**

Cooperatives are not the exception to the rule that any enterprise must have ownership capital to conduct day-to-day operations, to provide the necessary infrastructure, and to create a base for obtaining external financing—often bank debt. In the cooperative form of enterprise, such capital is provided by members through initial capital investments, retained margins, member deposits or subordinated member loans. The importance of capital furnished by members cannot be overlooked or understated. Lenders view the amount of member sourced capital as a measure

of the member's commitment to the venture. The more capital provided by members' equity, the less that needs to be obtained from other sources. Consequently, a greater percentage of equity included in the capital structure results in not only the need for less debt but also the debt will likely carry a lower price (i.e., interest rate).

The first cooperatives and credit unions began with a few members and many started in an era when their business was not capital intensive. As they progressed and grew and often merged, and as their businesses became more capital intensive their need for capital grew. This is a pattern not markedly dissimilar to many investor-centered businesses. The nature of cooperative capital however often left them with significant capital drains when an age class of members reached an age where their use of the cooperative ceased or sharply declined. For worker, fishery and agricultural cooperatives this often presents a serious problem sometimes leading to failure or demutualization. In their study of the demutualization of Lilydale, Hailu and Goddard concluded:

In conclusion, cooperatives that wish to remain so must operate in a manner that generates enough capital to meet their equity redemption needs and debt associated with asset acquisition. This study's findings provide evidence that financial leverage is one of the crucial factors in the growth of cooperatives. Over-reliance on debt necessitated a change in business structure for Lilydale. (2009, pp. 116–129, p. 128)

The National Cooperative Grocers Association reports that at least 50 percent of food co-ops in the U.S. are undergoing some form of expansion. The capital needed for buildings, equipment, and inventory is far beyond these co-ops' ability to finance growth through retained earnings. To finance this immense natural growth, food co-ops need to look at acquiring substantially higher levels of capital. (Thompson, 2009, p. 22)

For differing types of cooperatives the sector specifics differ. The rise in industrial agriculture in North America led Fulton and Hueth to make the following observation in an overview of conversions and failures:

The pattern described above suggests that a structural shift may have indeed taken place in agriculture, one with which it is increasingly difficult for cooperatives to deal. As agriculture becomes more industrialized, the need for capital at the processing and marketing levels increases. (2009, pp. i–xi)

### **Cooperative structure and capital**

For consumer cooperatives the level of member investment often does not keep pace with the increasing capital intensiveness of the business. In most cooperatives around the world there is only one class of member. In consumer co-ops you must be a consumer to be a member, in a worker or producer co-op a worker or a fisher or a farmer to belong. But people in their lives are interdependent. Farmers are also consumers and consumers are workers. Consumers depend on farmers; farmers on workers and all depend on having access to capital to meet their needs. Consumers, farmers and fishers and workers also need to save money for their retirement, children's education, major purchases, etc. We each play many roles in our lives and, while we are each uniquely individual, we are at the same time completely interdependent.

In the same way it is possible to see providers of cooperative capital, as opposed to investor capital, are users of the business. They are people who wish to use their savings to meet human need, respect cooperative business purpose, values and principles and provide a clearly limited financial return. Investors of cooperative capital are interdependent with farmers, fishers, consumers and workers. Seen another way, they are workers, fishers, consumers, and farmers. The purpose of their investment is multifaceted.

The single class of member cooperative does not reflect this

interdependence. It also means that a single class of member must be the sole source of capital for the cooperative. Cooperative structures that have been evolving in such diverse places as the Basque Country of Spain, northern Italy, Canada, and the United States offer a cooperative model that better reflects our interdependence and offers cooperatives a broader range of sources of capital. These are the so-called “solidarity cooperatives.” The very name resonates with an important cooperative value. Some examples:

- The Caja Laborale Populaire, Mondragon’s powerful and enormously successful financial institution has cooperatives which are members, as well as worker members; and Eroski, Mondragon’s retail system, has a board elected by both consumer and worker members.
- The Weaver Street Market in North Carolina has both worker members and consumer members. (Cooperatives owned by both producers and consumers are not unusual in the United States).
- Italian social cooperatives often have workers and consumers of their services as members—for example, social workers and former prison inmates.
- Canada has numerous solidarity cooperatives, especially in Quebec, and the federal cooperative act allows for multiple classes of members, including investor members.

A paper by Co-operative Action in the United Kingdom devotes an entire chapter to a very similar concept it calls “stakeholder” cooperatives.

### **Impact of capitalist capital on cooperative businesses**

All sources of capital including debt exert an influence on the businesses that hold them, and cooperatives are no exception. A cooperative unable to meet its payments on a bank loan will find itself under pressure to act differently and potentially to act in ways not consistent with its cooperative business model.

What happens to a cooperative business when it employs non cooperative capital especially forms of equity capital, which does not behave in a manner consistent with cooperative purpose, values, and principles? The greatest potential source of tension relates to investor expectations of return. If the cooperative cannot offer benefits that are attractive enough to compensate for the lack of high or maximum return it may feel that an excessive or unlimited return is the only option. If the member benefits are not sufficient to compensate for the lack of unlimited return or if members are not likely to have available capital resources to meet the amount needed a cooperative may, especially if the need is urgent, be in a position where it has no alternative but to seek purely investor driven capital.

Once launched on this path the cooperative is on a slippery slope. When members realize the cooperative now must maximize the return to a group of investors or provide them with a higher return than members are receiving for their cooperative capital the perceptions of member benefits are more likely to decrease than increase. Any further need for capital is more likely than before to have to be met from outside the membership. The cost of capital is not likely to decline.

If the outside capital is tradable on traditional stock exchanges, then the ability of the cooperative to offer competitive returns compared to capital owned business will be reflected in the share prices. It is likely that only in a weak market will cooperative shares have much chance to increase in value and if the market is very weak the cooperative's shares are likely to follow the market down. It is difficult to imagine a scenario where the logic of the market will favour the price of cooperative traded shares as long as the cooperative does not make return to investors its overriding goal.

These considerations suggest that there will be an inevitable pressure on any cooperative that seeks investor driven capital to seek to maximize the return to capital as the overriding goal of the business in place of cooperative business purpose, values and prin-

principles. That of course means ceasing to be a cooperative.

Further pressure would come from asset strippers seeking to “unlock value” by demutualising the cooperative as has happened with building societies in the United Kingdom and credit unions in Australia and the United States.

### **Issues in attracting capital**

**Narrow limited return vs. multiple returns.** Cooperatives have generally made offers for capital that really focus just on the financial return and are in direct competition with investment offers and opportunities in investor-owned companies. In that competition they see themselves as hobbled by the cooperative limited rate of financial return, which they see simply not competitive, if rate is all that is on offer. Cooperatives need to learn to frame their investment offers offering a “multiple return” outlined above. The limited return needs to be contrasted with the ‘casino’ type returns that have characterized publicly traded shares over the past decade with the possibility of more instability ahead.

**Risk: lessons from September 2008.** Part of the multiple return means cooperatives need to eschew “playing with the big guys” and offer their members and the public investments that are significantly more solid and real. For the most part an examination of the 2008 debacle shows that they did, with only very minimal exposure, indeed eschew the “toxic paper.” Investments in cooperatives did not collapse in September 2008. They may not have grown as fast over the previous decade but they did not lose 25–35% of their value overnight. Cooperatives offer a patient capital alternative. They are, in the words of the Co-operative Banks in the United Kingdom, “good with money” in both the sense of using it carefully and using it to do good.

In looking forward, the global investor driven economy’s stability is very difficult to predict. The toxic paper/housing credit failure in the United States brought the global economy to the brink of a depression. There are current concerns about a long line of issues

that have the potential to result in significant global ripple effects: European economic stability issues related to the weakness of several countries; the very high rate of credit card debt in several rich world economies; the energy crisis as markets seem incapable of ensuring a smooth transition from fossil fuels; the food crisis; the ability to manage rapid and sustained urbanization; etc. The crisis of 2008 has been narrowly averted by massive government spending.

This level of government spending, and resulting debt, has in itself been cited as a possible cause of future instability. At the very least, the current debt levels raise significant doubts about the capacity of governments to respond to a future crisis. The stabilizing calm of the cooperative part of the economy looks more and more like a large quiet blessing and source of hope.

### **Future directions**

**The provision of cooperative capital.** Cooperative financial institutions need to educate and inform their regulators about the social and economic benefits of, cooperative capital as described above.

Regulators should be open to the possibility that there are very significant positive public policy benefits from an increase in cooperative capital related to meeting basic human needs, promotion of democracy, stimulation of rural economies, etc. Regulators and financial cooperatives should also take into account the stable performance of cooperative capital. There are significant public policy benefits for governments that encourage the growth of cooperative capital as a percentage of the global economy.

In this it must be remembered that the funds under the direction of cooperative financial institutions are the funds of members or users who expect not to lose those funds. Cooperative financial businesses have enormous expertise to examine the potential risks and benefits associated with significant shifts toward becoming more energetic suppliers of cooperative capital. They also have the level of sophistication to explore risk sharing at a global

level as a natural extension of cooperation among cooperatives.

**The need for a cooperative capital fund.** One possibility for expanding the availability of cooperative capital could be the creation of cooperative capital funds. Cooperative financial institutions on a regional or national basis could create such funds where a percentage of the funds under their direction could be invested. The resulting pool of funds could be made available for investments consistent with cooperative purpose, values and principles. Possibilities that could be considered could include shares and loans to cooperative business, home mortgages, loans to not-for-profit businesses and social economy businesses.

It is essential that the risk level of such funds be along the same cautious lines that credit unions and other cooperative financial institutions have traditionally used. These funds are not meant to be charitable foundations but custodians of member savings who ensure those members that the funds are used for 'good' purpose and receive a fair return that quantifies not only the financial return but also the "social" return. A selection of funds with varying levels of risk and varying (but not excessive) levels of return or varied purpose may be a reasonable option. It is also reasonable that the deposit of such funds receive favourable tax treatment in light of the public policy benefits.

**Meeting member savings needs and social responsibility.** Members of cooperatives have investment needs around education for their children and especially around retirement. For the most part they have no option but to invest in investor-owned business. Even when they use cooperative businesses like credit unions or insurance or cooperative banks for their retirement funds, their savings are mainly channeled into investor-owned companies and banks. Visits to the website of the Canadian Credit Union Ethical Funds and that of the Cooperative Financial Services confirmed significant investments in the fund portfolios of investment offerings of banks in Canada and the United Kingdom. These funds, while better than funds with no social responsibility screens, are not sufficient.

The 2004 paper by Co-operative Action provides an excellent examination of the growing number of people who wish to find socially responsible outlets for their savings. (Co-operative Action 2004, Chapter 4) This growing interest is not confined to the UK. Ethical funds have appeared more and more frequently from modest beginnings in the mid 1970s. The Co-operative Bank in the United Kingdom made its debut as an ethical financial business in the mid 1990s.

Canada's credit union ethical funds began in the 1980s. There is growing interest among people in ideas like local investment, fair as opposed to windfall returns, investing in not-for-profit businesses, investing in cooperatives and investing in socially responsible business (excluding weapons, tobacco, heavy polluters, environmentally and socially irresponsible business).

The crash of September 2008 also increased the appeal of "slow capital" and movements of people wishing to find a less exploitive and more stable place for their investments. Financial cooperatives need to become creative and innovative in providing people with cooperative capital investment opportunities and to educate their members and the general public of the many positive benefits to be obtained from using savings as cooperative capital.

Subsequent to September 2008, millions found their retirement savings decimated and their faith in capital centered investments eroded. Cooperative financial institutions experienced significant growth as people looked for ethical and more responsible investment opportunities. There was also an increase of interest in ideas like "slow capital" that both fosters stable development and does not seek rapid windfall gains. All of this presents an opportunity for the cooperative business model.

Cooperatives need to explore options for funds that do not invest in banks and investor-owned business but rather are designed to invest in meeting human need. One or several funds might be created: a Cooperative Business Capital Fund; a Social Enterprise Fund; a Green Investment Fund, a Local/Regional/Community

Fund. Each would have some or all of the following characteristics:

- Stable limited growth—this could vary depending on risk but there would be no ‘windfall’ or unlimited returns.
- Rates that are fair to the investor, the user of capital and the community. This allows people with retirement or other savings to obtain a reasonable return for the use of their savings without windfall gains that are exploitative. It also assumes a higher cost of capital in situations of higher risk and provision of sharing gains with the community when returns on an economic activity are very high.
- Cooperative capital investments in various types of cooperative businesses with requirements for reporting on adherence to cooperative purpose, values and principles or on social responsibility.
- Exclusion of investments in economic activity that is destructive of community, society and the environment. (Some cooperatives such as the Co-operative Bank in the UK exclude investments in weapons, tobacco, heavy polluters and environmentally and socially irresponsible business.)
- Positive investment strategies for environmentally and socially responsible products that meet human and community needs. (There is significant need for ‘green investment’ funds and funds for social economy businesses.)

A single cooperative capital umbrella fund might look at investing in all these differing enterprises or a set of different financial cooperatives might each wish to spread the initial risk by developing a specialized fund each and promoting each other’s funds. The risk for the funds could be shared nationally or even internationally. Would such funds be viable? Could cooperative financial institutions cooperate to create these investment options? Would the administration costs be higher than in investor-owned mutual funds? Could risk-sharing mechanisms at national or international levels reduce risk? How close could these funds come to a promise of full stability? Could these attributes be effectively explained and

conveyed under existing securities laws? These are all questions requiring much further exploration but the creation of a cooperative capital fund would appear to be meritorious.

Finally, these cooperative capital funds should be, when reasonable, members of the cooperatives in which they invest. As members of these cooperatives their role would be to ensure that the cooperatives in which their capital is invested are not just operating in a financially responsible manner but in a manner that reflects cooperative purpose, values and principles.

### **Tradable cooperative capital?**

The 2004 paper by Co-operative Action also raised the possibility of creating a separate exchange for some types of cooperative shares. The ethical exchange concept that they put forward for discussion, would offer those wishing to invest in cooperative shares, presumably including cooperative capital funds, the possibility to increase the liquidity of their investments. That said, exchanges for trading shares have two functions for maximum-return, focused capital. The first is to provide liquidity, although it must be noted that if an investor-owned firm is in financial difficulty the shares may be of little or no value. The second function is to allow speculation as to the value and make possible speculative gains to the investor.

It is of value to cooperators who wish to invest in cooperatives that their investments are as liquid as possible. Member shares are liquid but only as long as the cooperative is in sound financial condition. Introducing a speculative component to investment in cooperatives, to conjure up the possibility of evading limited return, does not seem possible without subjecting the cooperative to pressure to act in ways that will maximize tradable share values. The effect is to convert the cooperative into a business form where maximization of shareholder value increasingly becomes the prime driver of the business. This is an assault on the very fundamentals of what it means to be a cooperative. The purpose of the business

has begun to change.

Is it possible to design an ethical exchange system that would not erode the cooperative nature of the business? It may be but it is an endeavor that is fraught with great risk. If the gain in attracting investment to cooperatives results in an increased likelihood of the cooperative demutualizing or acting like an investor-owned business in response to that capital then the gain is not worth the cost. If people wish to invest in investor-owned business with its particular risks and narrow range of benefits they will do so. If cooperatives structure themselves to attract capital that is structured and behaves like investor-owned capital it will begin to limit the ability of the cooperative to function as a cooperative.

## **Conclusion**

If cooperative business is no different from investor-owned business it is difficult to develop a rationale for its existence. The greater the difference based on cooperative purpose, values, and principles, the stronger the rationale and the greater the contribution to meeting human need and making the world a better place. The financial collapse of 2008; the growing income disparity between and within countries; and our growing environmental crises underline the need for constructive alternatives. We need capital that is socially constructive rather than destructive and more stabilizing rather than destabilizing. We need capital that is restrained, limited, and controlled and directed to meeting human need rather than human greed. Cooperative capital is constructive, stabilizing and restrained. The world needs more cooperative capital and ways of diverting savings from becoming investor to becoming cooperative capital.

Just as cooperatives have agreed on a shared purpose, values and principles they need to apply the purpose, values and principles to the expectations for the behavior and characteristics of the capital they use. This paper suggests a starting point for developing a

shared understanding of the distinct nature of cooperative capital and a set of expectations of cooperative capital that their members and the public could share. In a world with a shaken faith in its business system and an increasing hunger for values driven business, the emergence of cooperative capital as an alternative is a significant business opportunity.

Cooperative financial institutions need to develop more and better strategies to provide cooperative business with the capital it needs and to provide cooperative members with expanding opportunities to have their savings used in a manner consistent with cooperative purpose, values and principles.

There is need for a growing number of cooperatively inspired cooperative capital funds, green investment funds and social economy investment funds. The risks associated with such new investment vehicles can be mitigated by risk sharing among such funds at the national and even international level.

The creation of some form of tradable cooperative capital may be possible but represents enormous risks for undermining what makes the cooperative business model a valuable alternative in our increasingly fragile global economy.

Finally, as businesses that are based in communities, and where governance is democratic, cooperatives are much better suited to provide the capital needed to meet local and community needs. As cooperatives and cooperators become more familiar with the idea of cooperative capital their ability to meet local needs will improve as will their ability to assist members to use their savings to provide capital for local and regional needs. Cooperators, rather than being forced to invest their savings in obscure financial instruments that offend their values and finance investor capital endeavours in distant places, will be able to see their savings used to meet real economic needs closer to home.

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# Continuity and Change Over 25 Years of Ohio ESOP Companies

By John Logue and Jacquelyn Yates

In the last 30 years, employee stock ownership plans (ESOPs) have become the most common form of employee ownership and a significant factor in the American economy (Kruse, Freeman, and Blasi 2010, p. 13). The National Center for Employee Ownership (NCEO) estimates that in early 2011 there were about 10,900 companies partially or wholly owned by their employees through ESOPs, stock bonus plans, and profit-sharing plans, investing primarily in employer securities, with 10.3 million employee-owners who held about \$869 billion in equity in their companies (NCEO, 2012). We estimate that 90% to 95% of the plans were ESOPs, based on information from IRS Form 5500 reports filed mostly in 2007 and obtained via Larkspur Data Resources' Form 5500 data, version 12.1.

ESOPs, a concept developed and promoted by economist Louis Kelso, were rare in the United States prior to legal changes recognizing them as qualified pension plans in 1974. The intent of Congress in establishing ESOPs was to create financial assets for company employees, not to promote employee involvement or participation in corporate governance. U.S. Senator Russell Long, the author of every major piece of ESOP legislation from 1973 until he retired in 1987, put it succinctly: "Our capitalistic system should have a great many more capitalists. From where are they to come?"

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Logically, from the ranks of employees” (Long 1989, p. vii). Consummated politician that he was, Long may have well understood that once employees became owners in their companies, they would take a different view of their employer, its operations, and the whole world of business; and given the slightest opportunity, they would begin to think and act like owners, focusing their thoughts on growing the business and helping it to succeed (McIntyre, 2003).

### **ESOPs and public policy**

The number of ESOPs grew rapidly in the years immediately after 1974 through the 1980s. This growth was aided by public policy. Friendly laws that existed between 1976 and 1986 created two special types of ESOP plans: TRASOPs (Tax Reduction Act Stock Ownership Plans) and PAYSOPs (Payroll Stock Ownership Plans), which provided dollar-for-dollar tax credits for corporate contributions of very limited amounts of equity to employees, and encouraged many large corporations to set up plans. The “1042 rollover,” enacted in 1984, enabled owners of closely held companies to sell at least 30% of the stock in their companies to employees through an ESOP and defer taxes on the capital gains by “rolling” them “over” into a stock account, making employee ownership a retirement planning strategy. A Delaware court decision permitted ESOPs to be used as a takeover defense (*Shamrock Holdings, Inc. v. Polaroid Corp.*, 559 A.2d 257 (Del. Ch. 1989)). From 1989–96, banks were allowed to deduct part of the interest on loans to ESOPs from their taxable income, which encouraged lending to leveraged ESOPs that needed to borrow money to buy out a retiring owner. Since 1998, ESOP companies can be S corporations under federal tax law, allowing the portion of the company owned by the ESOP to be exempt from corporate income tax. The income is taxed when employee-owners receive payouts from their stock accounts.

In addition to tax policy, ESOP growth was encouraged by several state ESOP centers established to educate business owners

and managers and to facilitate the sale of companies and company stock—largely in closely held companies—to the employees. The complexity and initial cost of establishing an ESOP necessitates education of the selling owners, and the centers offered basic information at no more than the cost of a phone call for owners thinking of selling to their employees. Often the centers provided a list of accountants and attorneys known to be knowledgeable about ESOPs. State centers also educated the employee-buyers.

After an initial surge of ESOP creation between 1974 and 1990, the growth rate of ESOP company numbers slowed in the decade between 1990 and 2000, and the size of the ESOP sector has been roughly stable in the last 10 years. Yet clearly the continued existence of an employee-owned sector, including some firms that have been employee owned for 30 years or more, indicates that employee ownership with employee involvement is an ownership structure that is as viable, durable, and economically sound as conventional firms. And if employee involvement and participation is encouraged, ESOP firms beat conventional firms in their industries (Kruse, Freeman & Blasi, 2011, p. 22).

### **ESOP company performance**

Early studies comparing the performance of employee-owned companies with their conventionally owned competitors found that ESOPs enhanced corporate performance in productivity, sales, and profitability. But closer scrutiny by the General Accounting Office of the U.S. Congress in 1986–87 overturned the notion of a universal ESOP effect. The GAO found no impact of ownership on performance *except in companies that combined employee involvement with employee ownership* (GAO, 1987). This finding has since been replicated in several dozen studies (Freeman, 2007; Logue & Yates 2005, pp. 7–34; Kruse & Blasi 1997, pp. 134–6).

### **Ohio's ESOP data**

This paper reports on the longitudinal development of ESOP

companies (i.e., change in the same companies over time) in Ohio over 20 years.

We believe that Ohio's experience with ESOPs is fairly reflective of United States ESOPs as a whole. While not a perfect mirror of the nation, Ohio is a state that is close to the national averages on many statistics. Its economy is diversified, and, as in the rest of the United States, most ESOPs were established by small business owners who found selling to their employees a more attractive choice than the alternatives, even while a small number of buyouts of distressed companies grabbed most of the headlines. Ohio is a little more unionized than the United States as a whole (BLS, 2010b), and companies in our 2005 study are probably a little more unionized than the state generally. In the 2005 study, 20% of the ESOP firms had unions. In one respect, however, Ohio is different. Drawing on IRS Form 5500 data, we found that Ohio's ESOPs resemble the nation's in terms of median numbers of participants in the plan and median ESOP plan value per participant, but the median Ohio plan was about twice as large as the national median, with about twice as many participants.

To provide insight into the longitudinal development of ESOPs, this chapter draws on a unique dataset: three total population surveys of Ohio ESOPs conducted by the Ohio Employee Ownership Center (OEOC) in 1985–86, 1992–93, and 2004–06. We will refer to the surveys, respectively, as the 1986 survey, the 1993 survey, and the 2005 survey, as these were the years when the majority of the reports were made. It is likely that about 10% more ESOPs in fact exist than we were able to locate at the time of the survey, an estimate based on comparing a known subset of existing Ohio ESOPs with their listings on the Form 5500 reports.

The estimated population of ESOPs in Ohio was 168 when the 1986 survey was conducted, 275 at the time of the 1993 survey, and 330 at the time of the 2005 survey. All were surveyed, but of course, not all responded. Response rates were 38%, 61%, and 36% respectively. The longitudinal data collected in the three surveys

provide the opportunity to investigate the key question of the characteristics of organizational change in long-lived ESOP firms. We are especially interested in their potential to succeed as long-term wealth generators for their employee owners.

## **Methodology**

The database for this study combined the three Ohio surveys with IRS Form 5500 pension and benefit plan filings 1993–1994 and 2004–2006, matching records by Employer Identification Number and plan number. Unfortunately, earlier Form 5500 data from 1974 to 1993 has proved to be unusable, and even later data contained some errors, which we corrected where we noted them. The data were self-reported by company executives, mostly CEOs and CFOs, who had some role in ESOP administration. The disadvantages of such self-reporting are well known, but there is no other way to investigate the internal organizational structure of closely-held employee-owned companies. For a credibility check, we compared self-reports to government-collected data, and found the figures to be identical or very similar.

The methodologies of our 1986 and 1993 surveys are discussed at some length in Logue and Rogers (1989, pp. 9–12) and in Appendix 1 of Logue and Yates (2001, pp. 181–89), respectively. Similar information for the 2005 study can be found in Logue and Yates (2011, pp. 277–280).

A known source of bias in the study is a preponderance of respondents that were or had been members of Ohio's Employee-Owned Network, a support organization that offers low-cost training and education for employees of member companies. Of the 2005 respondents, 40% had been Network members, while current or former members of the Network amounted to only about 20% of all ESOPs surveyed. Network companies tend to be more interested in participative management. In addition, the respondents were more likely to be small companies and less likely to be publicly traded companies with ESOPs, of which the largest in Ohio is Procter and Gamble.

### **Profile of cohorts and comparison groups**

The surveys yielded longitudinal data for up to 20 years for 37 Ohio ESOP companies, which in 2005 were about 20% of Ohio's still-viable ESOP plans established earlier than 1992. These were companies where the ESOP had "matured," in the sense that any initial acquisition debt had been paid, a substantial fraction of the workforce were likely to be "founding participants" nearing retirement age, and the company had weathered at least one economic cycle, meaning that it had survived at least one downturn of economic activity, one peak, and the transitions in between. Nine companies had data for both 1986 and 2005, and seven of those provided data for all three surveys. These nine are the older cohort. Twenty-eight companies provided data for 1993 and 2005. These are the younger cohort. Companies in the two cohorts resemble each other in many ways, being almost entirely closely held, established by a retiring owner, mostly in manufacturing or construction, with a small labor force, and a little more likely than companies not in the cohorts to embrace the philosophy that "employees deserve to be owners, and we would have a plan even if there were no tax incentives to share ownership." However, with respect to other characteristics, they seem to be at different points in their development, especially in terms of the percentage of the company owned by the ESOP and S corporation status.

### **Older and younger cohorts compared**

All of the older cohort were closely held, as were 96% of the younger cohort. The median year for establishing the ESOP in the older cohort was 1980; for the younger cohort, it was 1986.

The public often associates employee ownership with failed efforts to rescue floundering firms, but just one of the older cohort and one of the younger cohort reported in 2005 that the ESOP was established to avert shutdown or job loss. However, employees in many cohort companies had made sacrifices to create their ESOP. A little more than half of the older cohort (56%) and about a third

(32%) of the younger cohort gave up wages or benefits, or converted another retirement plan to establish the ESOP.

About half of each cohort was in manufacturing: 55% of the older and 46% of the younger. About a quarter of the older cohort (22%) was in wholesaling, compared to 7% of the younger, and about a tenth of the older cohort (11%) and a sixth (18%) of the younger were in construction. Other cohort companies were distributed over a variety of industries, including arboriculture, banking, business or professional services, insurance, retail, and transportation.

The older cohort reported a median of 125 employees in 1986; the younger, a median of 140 in 1993. By 2005, the older cohort median increased to 220 employees, while the younger cohort rose to 210. In all, the older cohort employed 2,564 in 1986 and 2,717 in 2005. The younger cohort employed 10,112 in 1993 and 12,176 in 2005. A third of the older cohort was unionized, compared to 29% of the younger, but just 11% of each cohort included union members in the ESOP.

The cohort companies saw steady growth in the percentage of their company that was owned by the ESOP. Five of nine in the older cohort were 100% employee owned by 2005, compared to two in 1985. Three more were majority owners, and just one owned a minority of the company. In the younger cohort, just one of 27 was 100% employee-owned in 1993, compared to eight in 2005, with nine more being majority owners. Among 81 other companies surveyed in 2005, just 17% were 100% employee-owned.

### **Cohort companies compared to others surveyed**

Were the cohort companies fundamentally different from other companies surveyed? The most obvious way in which they were different is that all companies in the cohorts still had ESOPs and were still in business at the time of the 2005 survey, compared to 24% of 55 other companies surveyed in 1986 and 29% of 132 other companies surveyed in 1993. Despite their exceptionally long

survival, in the early years of their ESOPs, the companies in each cohort looked very much like other companies surveyed at the same time, with a few interesting exceptions. In terms of number of employees, median annual sales, rate of unionization, economic sector, and vesting schedules, they resembled other ESOP companies. However, from earliest survey in 1986, the cohort companies were more likely to be majority owned than other companies in each survey, a trait that becomes more common as time passes. They were also more debt averse. Although their rate of leveraging was about the same as other companies in the 1986 (older cohort) and 1993 (younger cohort) surveys, by 2005, just 13% of the older cohort were leveraged, compared to about a quarter of the younger cohort and nearly three-quarters of other companies surveyed. In the older cohort, the median percentage of employees who were in the ESOP was slightly higher than the younger cohort or the other companies surveyed.

The cohorts were companies competing in traditional economic sectors. How did they survive and succeed as mostly “Rust Belt,” “old economy,” or “sunset” manufacturing and construction companies, with many blue collar workers with little or no college education?

### **How they survived and prospered: participative management and fiscal prudence**

In most cases, ESOPs are a “get rich slow” plan where employees build value in retirement accounts by building their companies. If the ESOP does not remain in place for over a decade, employees are unlikely to see much benefit, even if they make exceptional sacrifices and efforts to improve their companies. We inquired informally among Network members with long-established ESOPs as to what they thought helped them to survive and prosper. Along with many specifics, their replies pointed in two general directions: the first, participative management; the second, business caution and fiscal prudence, particularly in borrowing, acquisition, and expansion.

## **Participative management**

From the mid-1980s to the present, the fruitful combination of participative management and employee ownership has been documented and studied (GAO, 1987; Blasi,

Freeman, Mackin, & Kruse, 2010). There are three essential elements that a participative management strategy must include if it is to improve ESOP firm operations and financial returns. These elements are training, communication, and participation. Training helps employees develop the skills and knowledge to understand their jobs and the ESOP, how they contribute to the profits of the company and the value of the ESOP, and the business context in which the company operates. Communication provides specific information about the company's performance and passes timely information to the employees so they can react promptly and effectively. Participation establishes practices and structures that enable employees to act on their knowledge in their work units and in the governance of their company.

Benefits for the improvement of operations can be gained from introducing limited aspects of communication, training, or participation, but the benefit is maximized when many specific techniques are used together (Logue & Yates 2001, pp. 138–42). Finding the right mix of techniques is an art rather than a science. At OEOC annual conferences, managers often observe that there seems to be no particular practice that always works to maximize the potential of employee ownership. Effective management tailors training, communication, and participation to the specific conditions of the firm. Those who succeed often say that they “just kept trying things” until they found out what worked. When participative management succeeds, the result is a widespread sense of ownership and a shared culture that leads employees to contribute to success in hundreds of small and large actions. Sometimes these are one-time events such as a warehouse reorganization to reduce labor costs and speed up deliveries or an inspired employee-owner committee that suggests a profitable new product line. Sometimes

they are systemic changes. In addition, respondents reported a beneficial impact of the ESOP in areas where only changes in employee behavior could account for the improvement, such as lower turnover or better labor–management relations (Logue & Yates, 2001, p. 37). More practically, Simecek (2001, 2008, 2010) offers a brief practical and philosophical roadmap to developing a healthy culture of ownership by discovering and rewarding employee behavior that builds trust and cooperation.

Because it is not entirely clear that some techniques reliably work better than others, we measured training, communication, and participation with simple indices that count how many different techniques a company has used over time. At a minimum, this measure suggests how actively a company is trying to develop its culture of ownership, since the introduction of any new practice is an investment of employees' paid time and often capital costs for the firm.

### **Communication**

Expectations for more and better communication are almost universal in this digital age, so it is not surprising to find a general increase in methods of communication used among all firms in the survey. Companies in the older and younger cohorts looked very much like other companies surveyed. Where the cohorts stood out was in being more likely to provide financial communication about the performance of the company; to hold annual, quarterly, or monthly meetings with employees; and to sponsor ESOP communication committees to educate employees about the ESOP.

### **Training**

Ever since Japanese companies began to claim a noticeable share of American automobile and consumer electronics markets, consultants have commanded lucrative fees by promising to train United States workers to be more like Japanese workers. For a while, books and consultants were flooding into the market, prom-

ising to enhance profits through greater productivity, higher-quality products, and improved cooperation within work units and between rank-and-file workers and management. All the activity left behind some improvements in productivity, but at root it seems to have been more of a fad (Miller, Hartwick, & Le Breton-Miller, 2004). This is largely, we believe, because the training was not tied to compensation, as it would be in an ESOP company. Interestingly, many Japanese companies have ESOPs, so workplace training and participation occur within a context of long term ownership (Kato, 2003).

Training employees to perform their jobs effectively, see how their efforts fit into the work of others in the enterprise, and exercise effective cooperation and supervisory skills is essential to the success of any firm. Also helpful in employee-owned companies are two kinds of training not usually found in conventional firms: financial training that helps employee-owners to read the company's financial reports, and ownership training to understand the basics of running a business and how profits are connected to ESOP stock values (Thomas & Maxwell, 2001, pp. 62–63). With financial and ownership training, employees are better able to see their firm through the eyes of management and to think like owners.

Companies in the two cohorts used training a little more than did other companies surveyed. The cohort companies were considerably more likely to provide financial and ownership training. In 2005, two thirds of the older cohort and 54% of the younger offered financial training, compared to 42% of other companies surveyed; and three quarters of the older cohort and 64% of the younger offered ownership training, compared to 45% of the other ESOP companies.

### **Participation**

Analysis of the 1993 data made it clear that employees regarded participation in everyday decisions in the work unit in a dif-

ferent light from participation in governance. Although participation in work-unit decisions had a statistically significant association with improved operations, it was governance, specifically having non-managerial employees on the board of directors, which had the strongest tie to operational performance (Logue & Yates, 2001, pp. 150–151). The typical employee probably can make more meaningful and informed contributions, more often, in work-unit committees, department meetings, and cross-functional teams, but non-management representation on the board was more strongly associated with greater employee interest in participation in decision making, which appeared to be an important intervening variable linking participative management with improved operations (Yates, 2000).

To simplify the idea, shop-floor or work-unit participation practices promote information sharing, consultation, and consensus building among employees and supervisory management to reduce waste and improve efficiency, without necessarily seeking approval from higher authority. In the 1993 survey, we queried respondents about some of these techniques, including quality circles, quality of worklife program, problem-solving groups, labor-management participation teams, self-managing work groups, and total quality management.

By 2005, respondents' choices of employee involvement techniques were expanded. The eleven choices included the original six techniques and five new techniques. Just a handful of companies used any of the involvement techniques before establishing the ESOP. After the ESOP was established, the cohorts' use of the original six techniques increased sharply in 1993 but declined by 2005.

The decline in use was consistent with the argument that the techniques listed in the six-variable list were fads rather than lasting methods. However, scores on the eleven-variable index in the 2005 survey suggested that the cohorts were using work-unit/shop-floor participation as much or more than before, but they were using different techniques, including suggestion systems, employee

attitude surveys, coaching or mentoring, and the use of a joint management or joint steering committee. Respondents reported an increase in all except for the joint steering committee. In terms of overall work-unit participation, older and younger cohorts had increased their use of employee involvement (a median of four techniques for the older cohort, and three for the younger), while other firms surveyed in 2005 reported low use of employee involvement before the ESOP (a median of zero), and a median of two after the ESOP.

Participation in governance includes the pass-through of stock voting rights to the employees, representation of non-managerial employees on the board of directors, and the use of employee elections to select representatives of non-managerial employees. Because of the impact it has on the firm's performance, we expected that participation in governance would have spread extensively among the older companies in our latest survey. And yet, for all the power of governance participation to improve operations, most ESOP firms do not routinely establish it, and where the ESOP was established with little or no governance participation, it rarely developed later.

Pass-through voting gives full rights to vote shares to ESOP participants in closely held companies (rather than curtailing those rights as the law specifically permits). One might reasonably expect all 100%-employee-owned firms to pass through full stock voting rights to their employee-owners, but only about 40% do so. What is more, the longitudinal data do not suggest a tendency for the practice to spread over the years. In the older cohort, none used pass-through voting in 1986. Since 1993, the same three companies have been using it. Eleven companies in the younger cohort passed through voting rights in both 1993 and 2005. Two firms added pass-through rights between 1993 and 2005, but one took them away in the same interval, and now its plan allows only the legally required minimum.

Three companies in the older cohort reported having non-

managerial directors on the board in the five years prior to the 1993 and 2005 surveys, even though all but one of the companies were at or close to being 100% employee-owned. In 2005, about two-fifths of each cohort had non-managerial board members. Among the cohort companies with majority ownership in 2005, half of them had non-managerial employees on the board. Less than a quarter of other majority-owned companies did so.

In addition, there has been a modest trend toward greater use of employee elections for non-managerial board members among the younger cohort. Companies that already had such directors were more frequently selecting them through election or other means of employee participation, an increase in use from less than 20% in 1993 to about 40% in 2005. In addition, the total number of non-managerial employees serving on the board between 1993 and 2005 increased from three to nine among the older cohort and from 14 to 20 among the younger cohort. Growth in non-managerial board seats among the older cohort was due to increasing numbers of non-managerial board members among the same firms. In the younger cohort, it arose from increasing numbers of companies using the practice.

### **Fiscal prudence: debt aversion, investment, wages and benefits, willingness to sacrifice**

**Debt aversion.** In all, the cohort companies seem averse to debt. In IRS Form 5500 reports from 1993, the total liabilities of the older cohort's ESOP plans were \$2.7 million, and the median liability was zero. In 2005, the total liabilities of the older cohort were \$28 million, but median liability was still at zero. In the younger cohort in 1993, 19 companies reported plan liabilities totaling \$11.1 million with median liability of \$150,000. By 2005, 14 companies reported plan liabilities totaling \$4.4 million, and none had debt over \$1 million. The median was \$1,200.

A way to see fiscal prudence in action in the cohort companies is to visit their facilities, as most OEOC staff members have done

over nearly 25 years of the center's existence. There are no grand corporate headquarters. Facilities tend to be clean, functional, and plain, often with signs of wear. Employees care for their equipment meticulously and make do with existing tools and machines if they can. When new equipment is needed, employees often build it themselves. One Ohio company is legendary for operating machines that are beyond ancient—a few are a century old. Fiscal prudence, however, is more than resourceful maintenance of capital goods.

Unfortunately, only our latest Ohio survey examined investment, wage, and benefit strategies compared to the companies' industries, so we do not have longitudinal data for these variables. However, we summarize our findings from the 2005 data below.

**Investment.** Half of the older cohort companies reported higher investment than their industry, as did 37% of the younger cohort, compared to 26% of others surveyed in 2005. About a sixth of each group—17-18%—reported investing less than their industry.

**Pay.** About two-fifths (43%) of the older cohort and a quarter (29%) of the younger cohort reported that they paid wages better than their industry. About a quarter (26%) of the other companies in 2005 did the same. A survey of employees found that paying wages at or above market levels complemented the positive impact of high-performance policies and shared capitalism (Blasi, Freeman, Mackin, & Kruse, 2010, p. 161).

**Benefits.** Almost all of the companies reported offering better benefits than the industry. Part of this is a simple ESOP effect: ESOPs were generally added to other existing benefit plans, thereby increasing benefits. Fully 89% of Ohio ESOP companies responding to the 2005 survey maintained another retirement plan in addition to the ESOP. The younger cohort was the most likely to say that benefits were better than the industry average (69% compared to 43% of the older cohort).

**Contributions to the ESOP.** Long-lived ESOP companies have had more than usual experience with financial sacrifice. Older cohort companies consistently contributed a higher percentage of

payroll to the ESOP (median at least 10% of payroll from 1986 to 2005) than the younger cohorts (median at least 4.4% of payroll from 1993 to 2005), and considerably more than the other surveyed companies (median at least .75% in 1986, and 1.1% in 2005).

**Other sacrifices and concessions.** In addition, many in the two cohorts began life as employee-owned firms with weaker pension plans, arising from sacrifices made to initiate the ESOP. In 1986, five of the nine (56%) in the older cohort gave up a pension or profit-sharing plan or made other concessions to establish the ESOP. In 1993, 13 of 28 in the younger cohort (46%) did the same. Less than a third (29%) of other companies surveyed in 2005 reported making a sacrifice to acquire their company.

### **Impact of the ESOP on employees' interest in participation, on company operations, and on financial performance**

Participatory management and fiscal prudence cannot make a substantial impression if the employees do not become interested in implementing them. In analysis of the 1993 data, interest in participating in decision making emerged as an important intervening variable between efforts to improve the company and the impact of those efforts on operations and profits (Logue & Yates 2001, pp.150–1; Yates, 2000). The variable may be a surrogate for what Pierce, Kostova, and Dirks (2003, p. 86) call “psychological ownership,” “...that state where an individual feels as though the target of ownership or a piece of that target is ‘theirs.’” Certainly there are other powerful factors, especially economic factors, that influence performance and profits, but many of them are beyond the control of the employee-owners. The question for them must be, “What can we do?” The will to ask that question and act on the answer begins with a change in interest.

**Interest in participation in decision making.** In 1986, employees at the companies in more than one-third of the older co-

hort were already expressing greater interest in decision making than those in other companies surveyed. By 2005, that percentage had increased to nearly two-thirds. In the younger cohort, expression of greater interest was very high in 1993 (82% of companies) and declined to about the same level as the older cohort (62%) by 2005. For other companies, expression of interest in greater participation was always lower than among cohort companies. In both 1993 and 2005, it was reported by just over half of the companies.

ESOP managers speak of an arc of interest among employee-owners—little interest at first because of little knowledge, then inflated expectations, followed by disillusion with low account balances. Then, as employees' account values grow, enthusiasm and interest revives (Seymour, 2010). In the cohort companies, however, reports of increased interest did not fall back to pre-ESOP numbers or even as low as the other companies in each survey. What made the difference? We suspect that it was earlier efforts made toward developing the company with participative management. Our 1993 study showed strong correlations between participative management and interest in participating in decision making (Logue & Yates, 2001, p. 151).

**Company operations.** Respondents were queried on the impact of the ESOP in 15 specific areas: absenteeism, manager-worker communication, job performance, worker job satisfaction, product quality, turnover, motivation, productivity, working conditions, customer service, employee participation, profitability, labor-management relations, production costs, and employee attitudes in general. Between the 1986 survey and the 1993 survey, judgments about the impact of the ESOP became more positive and remained so into the 2005 survey. Favorable impacts did not march forward in unison across all variables, but there were increases over time in both cohorts. Overall, the cohorts reported a more favorable impact of the ESOP than did the other companies in the two surveys.

**Employment.** As noted above, employment in the cohorts grew overall in a general context of decline in manufacturing jobs.

Employment growth roughly matched Ohio's employment growth in the older cohort and was about twice the rate of the state's growth among the younger cohort. Among the manufacturers in the cohorts, employment grew slightly among the older cohort and declined slightly among the younger cohort, so that, overall, between 1993 and 2005, there was a net loss of 3.5% of manufacturing jobs in the cohort companies, while in Ohio as a whole during the same period, manufacturing employment declined by 17% (BLS, 2010a). What is more, ESOP companies generally reported that they outsource less than their competitors in the industry, which helps employment within the state and the nation.

**Number of participants.** One of the more remarkable findings of our analysis is growth in the number of ESOP participants. Participants in the older cohort grew by 90%, almost doubling between 1986 and 2005, while the younger cohorts' participants increased by 58% between 1993 and 2005. The growth was not in just one or two companies but generally spread across the board and appears to be the result of increasing employment, acquisitions that brought more participants into the ESOP, increases in retirees or their beneficiaries with active accounts in the ESOP, and, in the case of one company, a surge of retirements apparently driven by declining employment. Regardless of the causes, the increase in participants made more people eligible to receive wealth. What is more, the increase in participants took place while the median company's per-participant account value was growing. The pattern of growth in participants was mirrored in IRS Form 5500 data for all Ohio ESOPs, although much of the increase there can be attributed to six large firms.

**Profits.** In the three surveys, 63% to 72% of the cohort companies reported a favorable impact of the ESOP on profitability, compared to less than half of the other companies surveyed. All companies in the older cohort were at or above their industry in profitability, and none were below it. The younger cohort was approaching that pattern in 2005.

**Stock value.** Since most of Ohio's ESOP companies are closely held, their stock value is set by professional valuers rather than by stock market trades. The valuers take into consideration a number of variables, including profits, the value of comparable companies, the health of the industry, debt and asset levels, and the value of likely future earnings. The annual valuation is monetized at diversification, retirement, or other separation from the company. For employee-owners in publicly traded companies, the stock market sets the value of their shares. The median growth in share value in the cohort companies was not notably better than the comparison companies, but the cohorts were less likely to report large losses.

Most companies were upbeat about the performance of their stock value in the 2005 study. Of companies in the 1986–2004 cohort, 78% said stock value had increased somewhat or substantially, as did 82% of the 1993–2005 cohort. Of others from 2005, 58% said their stock increased somewhat or substantially.

### **Wealth creation**

One of the most remarkable developments revealed by the longitudinal survey was the growth of employees' account values. Within each cohort, the average value per participant of ESOP accounts grew more rapidly than inflation, stock market index investments, or the value per participant in other ESOP companies. Most companies base ESOP allocations on W2 wages, so that the benefits are not equally distributed among ESOP participants (Carberry 2010). For 1986, we used information the companies reported on the survey. For 1993 and 2005, we used IRS Form 5500 because it included more companies. The total of net assets in the older cohorts' ESOPs was \$21 million in 1986 and \$266 million by 2005. Wealth of the younger cohort, which had their ESOPs for a shorter time, was \$103 million in 1993 and \$272 million in 2005. The median of average value per participant among the older cohort was \$12,039 in 1985, and \$64,837 in 2005. Among the younger cohort, the median grew from \$18,147 in 1993 to \$53,362.

While the average values are perhaps not impressive compared to retirement needs that may extend over decades, they are usually in addition to another pension plan. And they are exceptional compared to the norm: when the average American worker retires, his or her wealth is typically little more than the value of a home (Mishel, Bernstein, & Allegretto, 2007, pp. 265–6).

The growth of wealth in fact understates the total wealth created through the ESOPs, since almost every firm that existed over time made distributions from the ESOP trust to retirees, survivors, and employees who separated from the firm prior to retirement age.

To check the record of wealth generation in the cohorts more carefully, we examined only those firms with IRS data on account value in both 1993 and 2005. The medians are very close to the median for each cohort as a whole, suggesting that missing data did not substantially distort the results.

### **Summing up the impact of ESOPs**

What, then, is the overall impact of the ESOP in the judgment of our respondents? It is quite favorable, and more favorable among those companies that have had an ESOP for more than 15 years. However, the ESOP companies that participated in the survey were probably among the more satisfied and successful. Many ESOPs failed to “take” for a variety of reasons and terminated their ESOPs, even though their companies continued in business, showing that, while ESOPs do not cause business failures, not all ESOPs succeed.

### **The fate of ESOP companies**

In examining what works and what does not in ESOP companies, and how they change over time, one question always hovers in the background: What happened to the companies that did not respond to our surveys and to those that did respond once but never reappeared? We examined this question by researching the

fate of the ESOP in every company that indicated on the 1993 IRS Form 5500 that it had an ESOP or stock bonus plan with some number of participants, even if they entered 0 for the number of participants, along with every company that had participated in the 1986 survey.

At a minimum, the companies not surveyed provided a background for the survey results. At best, their data would complete some parts of our picture (which, by this point, was becoming a family album) of Ohio ESOPs. Outcomes for ESOPs established prior to 1985 were compared to companies surveyed in 1986, including the older cohort. Outcomes for ESOPs established prior to 1992 (including those prior to 1985) were compared to those surveyed in 1993 and 1986, including both cohorts.

We researched several data sources to discover the fates of ESOPs, sometimes resorting to “preponderance of evidence” criteria to draw conclusions. There were few selloffs or bankruptcies. More than three-quarters of ESOP companies surveyed in 1986 were still in business, and a little less than half of those still had an ESOP. More than 85% of companies surveyed in 1993 were still in business, and about half of them still had an ESOP. Surveyed companies were just a little more likely to keep their ESOPs than those not surveyed. The relatively high termination rate for ESOP plans, compared to other retirement plans, is not new (GAO, 1991).

The survival rates of ESOP companies can be compared to those of conventional startup companies where the annual turnover is 10% per year for new companies with employees (SBA, 2012). In 2007, the annual closure rate for all companies smaller than 50 employees was 2–3% per year. For publicly held companies and companies with owners not classifiable by gender, ethnicity or veteran status, the closure rate was 7.8% in 2007 (U.S. Census, 2012). Survival rates among ESOP companies in Ohio are higher than that.

## **Conclusion**

In general, the restricted number of cases limits what we can

say from the longitudinal study. Nonetheless, it is the only longitudinal data that looks inside the closely held ESOP companies.

When coupled with the research on fate, which examines every Ohio ESOP in existence in 1993, we can look beyond the small cohorts in the study to address some of the concerns that have been raised about the viability of employee ownership via ESOPs as a business form. First of all, we can affirm that employee owners can and do “act like owners” and that their firms have an excellent survival rate, even if their ESOP is eventually terminated or converted into some other form.

They do not undercapitalize their companies, an old criticism based on the reality that co-operatives have had difficulty with capitalization when they had only the members’ own capital to draw upon. With the power to borrow, ESOPs offer an alternate route to outside capital. More than 80% of ESOP companies in this study reported that they invested the same or more than other companies in their industry. And companies in the older cohort had a steady track record of high contributions to the ESOP—more than 10% of payroll. ESOP funds could be used to buy out retiring employees, to invest in recapitalization or acquisition, or to acquire tranches of stock from the original sellers.

However, like most owners of successful closely held firms, employee-owned companies surveyed here say they pay themselves the same or somewhat better than the average worker in their industry. But, judging by their longevity, they do not destroy their firms by taking unsustainable wages and benefits. And they reap wealth at retirement. They could not enjoy the material benefits if they did not maintain, as they have reported for this study, stable, profitable businesses that do better than their competitors over time spans that cover a working career. In the hard-pressed manufacturing sector, ESOP companies have survived far more successfully than conventional ones.

Like owners generally, they wish for full control of the business and its profits. If they are partial owners, they seek to become 100%

owners. Like small business owners everywhere, they are interested in participating in the management and governance of the firm. Firms with the longest ESOP life spans reported a remarkable record of efforts to inform and train employees, but also to include them meaningfully in management and governance decisions. When they do so, the impact on firm operations and performance is positive.

However, long-established ESOP companies that did not introduce participation early in their organizational life seem very sluggish in later extending participation in management and governance, even in companies that are now 100% owned by the ESOP. The greatest hurdle of all seems to be including non-managerial employees in governance.

And they do endure. We know that slightly more than a third of the firms studied in 1986 were still in business and still had their ESOP in 2007.

In employment, they have generally kept even with Ohio's statewide pattern, and in a declining sector (manufacturing), they were able to stabilize employment. This greatly benefits their local communities, as do pay and benefits that equal or exceed their industry.

What is also quite interesting in the Ohio results is that the ESOPs that survived moved along a maturation curve toward majority or 100% ownership, and, more slowly, toward greater acceptance of participatory employee ownership, with better understanding of how to activate its potential. The findings suggest that, over the years, some employee-owned firms do take gradual measures toward implementing participative management. Perhaps there is a tipping point that consists of some combination of participative management and percentage of ownership. If firms do not reach it, they are unlikely to benefit from the ownership advantage, and that increases the likelihood of early termination of the ESOP. There is a suggestive contrast between the cohort companies that slowly but steadily progress in development of their business organizations and the other companies in each survey that lag behind the cohorts.

Because employee ownership is still an unfamiliar concept in the U.S. business community, education and information are needed to extend the approach and to teach modifications of business practices that maximize the economic performance that employee ownership can inspire. A center recognized by attorneys, economic development professionals, and accountants can help owners who want to sell get started by providing basic information, a roadmap to the process, and referrals to competent professionals who will guide the sellers and buyers through the deal. Additionally, state centers would help to preserve small businesses in a variety of forms, not all employee owned, by educating owners on succession planning. The politics of state governments have operated to the detriment of employee ownership centers. A modest federal investment in state employee ownership centers could provide the outreach, support, and service tailored to local values and needs. Education of potential sellers and financial professionals would spread awareness of the evidence that employee participation enhances ESOP company performance. The existing evidence is, in fact, so strong that one could make an argument that ESOP fiduciaries who do not encourage it are failing the fiduciary obligation to plan participants because they are failing to enhance stock value in obvious and known ways.

### **Acknowledgements**

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# A Tale of Two Communities

## *The longitudinal effect of limited-equity housing cooperatives*

By David J. Thompson and Margaret Lund

It's not often that social scientists get a "separated at birth" scenario with which to test the effects of two very different sets of circumstances on two otherwise virtually identical entities.

Interestingly for the affordable housing community, we have such a situation in Davis, California. Twenty-seven years ago, two very similar multi-family complexes—one an investor owned rental apartment complex and the other structured as a limited-equity housing cooperative—were put on the market within a year of each other.

While the limited-equity housing co-op offered residents a reasonably affordable home-ownership opportunity at the time it was built—and a cost comparable to the apartment building across the street—what is really telling is the effect that the limited-equity housing cooperative (LEHC) structure has had over time. As the cost of market-rate, single-family homes and apartment rental rates have continued to climb in Davis, living expenses at the co-op increased at a much lower rate. The result is that the housing co-op has not only maintained affordability, but has actually grown more affordable every year. Such a result should give policymakers pause for thought when they contemplate the most efficient use of scarce

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public dollars for affordable housing.

In 1985, the Dos Pinos Housing Cooperative, a 60-unit, limited-equity housing co-op, was built on the prosaically titled Sycamore Lane in Davis. The year before, the Sequoia Apartments, a 50-unit, market-rate apartment complex had been constructed across the street (Thompson, 2004). The Sequoia development was comparable to Dos Pinos in quality and appearance, with about the same density per acre and a similar mix of one-, two-, and three-bedroom units. Though they looked the same, one was a rental apartment complex, owned by an out of town investor and the other was a limited-equity housing cooperative, owned and controlled by its residents.

Limited-equity housing cooperatives are an affordable housing strategy designed to make home ownership accessible to low and moderate income households, particularly in markets where the median price of housing tends to rise faster than median income. In a housing cooperative, each resident household purchases a share or membership certificate in a cooperative corporation, which then holds title to the property. Members occupy their individual units in accordance to the terms of a proprietary lease commonly known as an occupancy agreement. In Dos Pinos, the units are individually metered so that members pay all their own utilities directly. Common expenses (reserves, management, insurance, etc.) are assessed to each unit in proportion to the size of the unit, and the entire property is governed by a board of directors elected by the members of the co-op on a one-unit, one-vote basis.

In market rate housing cooperatives, individual members may sell their shares in the co-ops (and along with the shares, the right to occupy their particular unit) for whatever a buyer will pay, much like a condominium. A limited-equity housing cooperative, on the other hand, requires of members that the member share can only increase at a pre-determined rate (set by the corporation bylaws and, in California, by state law) in order to preserve affordability for future households. LEHCs thus occupy a middle ground be-

tween rental housing, which offers no opportunity for equity accumulation at all, and market rate home ownership, which has no ceiling (or floor) on fluctuating property values. With LEHCs, homeowners retain the control rights and tax advantages of ownership housing coupled with some amount of home equity growth, but usually much more limited than what is available in the speculative market.

At the time it was first occupied in 1985, a two-bedroom unit at Dos Pinos (the most common type of unit in Dos Pinos and the most common in the City of Davis) cost \$598 per month. A comparable unit at Sequoia Apartments cost only \$535, a difference of 11%. Dos Pinos was built without any subsidy from city, county, state, or federal governments so its development costs were all market rate. Residents were willing to pay slightly more than they would at Sequoia, the market rate apartments across the street, to gain the advantages of home ownership: namely, stable housing costs, a tax deduction for mortgage interest and membership in a cooperative community. An annual survey conducted by the University of California at Davis Housing office covering more than 160 market rate apartments (8,720 units) found that on average, without the tax deduction, monthly expenses at the housing co-op were actually 19–27% higher (depending on the size of the unit) than the average comparably sized rental unit in Davis. At the time it was occupied (1985), Dos Pinos offered many advantages to residents as a home ownership co-op over a comparable rental apartment. But at the beginning, lower price was not one of them.

Twenty-five years later, however, the story was quite a different one. Area median household income increased during that time period by 152%, but at the same time, the cost of the average two-bedroom apartment in Davis had gone up almost 200%. By comparison, monthly carrying charges (the co-op equivalent to rent) at Dos Pinos' two-bedroom units had risen just 44% in twenty-five years. Initially, Dos Pinos units had been somewhat more expensive than comparably sized units at either the apartment complex across

the street or in Davis generally. However, by 2004 Dos Pinos units were priced, depending on unit size, between 37% and 57% less than very similar units at the Sequoia across the street. Compared to Davis at large, Dos Pinos three-bedroom units, the most popular size for families, cost an astounding 67% less than comparably sized market rate units in the rest of the city. Five years later, at the 25th anniversary of the co-op, this figure had increased to 69%. Thus, over time, it is clear that the LEHC structure offered an incomparable value to the members. Without the need for any ongoing subsidy from local, state or federal sources, but based simply upon the limitations set by California law and prudent controls by the board and resident-owners, Dos Pinos delivered that most elusive of all housing policy objectives, a high quality affordable housing option that only got more affordable over time.

Nor was it necessary to wait 25 years for the benefit of LEHCs to become apparent. Based upon the standard supposition that a household should spend no more than 30% of income on housing, even before the tax deduction, two-bedroom units at Dos Pinos at initial occupancy were affordable for households at 92% or more of Yolo County median income for three person households and at 111% of median for a four-person, three-bedroom household (Cooperatives & Non-profits in Davis and Yolo County). This essentially meant that, from the first day it opened, a household of median income could afford an appropriately-sized home at Dos Pinos without unduly stressing their household budget. While this may seem like a basic sort of accomplishment, in the California real estate market it is often very difficult to achieve. An attractive college town with a well-regarded school system and an intentional slow growth philosophy, affordable housing is very hard to find in Davis. Rental vacancy rates there are typically very low (averaging about 2% over the last decade), and median home prices quite high (UCD Housing Study Tables, 1985–2009). The average single family home sold in Davis was \$531,745 in 2009 for example, far out of reach for the typical Yolo county family of four with a median in-

come of only \$72,600 (Eichorn, 2009; Cooperatives & Non-profits in Davis and Yolo County, 1985–2009). As a result, many households in Davis are forced to pay more than 30% of annual income toward housing costs. The City of Davis has estimated that more than 40% of all Davis households are in that position (City of Davis, 2000). Disparities like this are common in California, giving it one of the lowest rates of home ownership in the country (U.S. Census, 2010). In this context, Dos Pinos offered a highly affordable and accessible home ownership option right from the start.

The two-bedroom Dos Pinos unit that had been affordable to a household at 92% of median income in 1985, by 2009 was affordable to a household who earned just 53% of median income, a significant achievement in the affordable housing arena. And far from paying a premium for home ownership and control as Dos Pinos residents did when the co-op first opened in 1985, by 2009 co-op residents were paying a third less in housing expenses than their peers at Sequoia across the street. This represents a significant savings in household expenses for low and moderate income residents, even before the modest equity accumulation allowed at Dos Pinos is factored into the equation.

Limited-equity cooperatives deserve a closer examination. Most affordable housing studies of ownership programs focus only on measuring the amount of equity gained through ownership as the measure of success. By this methodology, Dos Pinos never measures well against other ownership programs. However, if you instead look at the wealth generation created by the LEHC model, a very different story emerges.

In 2009, the share price to buy into a three-bedroom apartment at Dos Pinos was \$26,312. A household living in the average three-bedroom apartment in Davis was paying \$1,818. However by investing in a share at Dos Pinos this same family could bring their monthly housing expense in terms of rent/carrying charge down to \$1,076 to gain a monthly savings of \$742. In addition, at Dos Pinos they would earn annual interest of \$1,300 added to their share and,

if they itemized their taxes, they would also gain net tax deductions of \$1,007 (yielded from a deduction of \$4,195 at a 24% tax rate: 15% federal and 9% state tax rate). The grant total would be \$11,211 in economic gain in one year as a result of an investment of \$26,312 in a share in Dos Pinos. So, the return on investment at Dos Pinos is about 40% per annum and that rate of return has increased every year.

Another comparison worth mentioning is that in the more than 25 years since Dos Pinos was built there have been two substantial multi-year downturns in property values. During those periods, all the owners of both unrestricted, market-rate homes and appreciation-capped condos or single family homes lost sizable equity. Neither in the earlier downturn nor in this downturn has any Dos Pinos member lost any of their equity upon sale. The LEHC model keeps chugging along strongly, effectively and securely.

Indeed, in contrast to other affordable housing techniques which require repeated injections of subsidy to maintain affordability over time, limited-equity housing cooperatives are the only source of affordable housing that actually grows more affordable over time rather than less. If properly structured and legally enforced, the affordability component continues in perpetuity. In addition, this superior result is delivered for less government funding per unit than any other home ownership model. LEHC residents are also spared the additional expense of a real estate transaction every time a unit changes hands. Because there is no change in the underlying mortgage (only a change in ownership of a share of stock) there are no associated real estate transaction expenses for joining or leaving a housing co-op. This saves residents significant costs when compared with other home ownership options.

For the residents of Dos Pinos, the difference made by the LEHC structure was substantial and measurable. A study by Neighborhood Partners, LLC, an affordable housing consulting firm (*note*: co-owned by one of the authors), put the combined net savings and wealth building gain for the 60 households at Dos Pinos

relative to the market cost of rental housing at close to half a million dollars during 2009, a not insignificant sum (Cooperative Housing Bulletin, 2011). This is money that residents then typically turn around and spend in their local community, or, as is sometimes the case at Dos Pinos, save for a down payment on a market rate home. Without the LEHC structure in place, as is so clearly demonstrated by the comparable property across the street, residents would certainly be the poorer for it, and likely the community would as well. The experience of Dos Pinos certainly demonstrates the ongoing returns of the cooperative model of home ownership.

**Table 1**

	<b>1 BR Sq. Ft.</b>	<b>2 BR Sq. Ft.</b>	<b>3 BR Sq. Ft.</b>
<b>1986</b>			
Dos Pinos	\$420 652	\$598 928	\$798 1238
Sequoia	\$345 705	\$535 955	\$735 1250
UCD Survey	\$342	\$434	\$621
DP vs Sequoia	18%	11%	8%
DP vs UCD	19%	27%	22%
<b>2004</b>			
Dos Pinos	\$537	\$754	\$954
Sequoia	\$805	\$1,035	\$1,495
UCD Survey	\$819	\$1,069	\$1,591
DP vs Sequoia	-50%	-37%	-57%
DP vs UCD	-53%	-42%	-67%
<b>2009</b>			
Dos Pinos	\$615	\$863	\$1,076
Sequoia	\$954	\$1,280	\$1,780
UCD Survey	\$947	\$1,226	\$1,818
DP vs Sequoia	-55%	-48%	-65%
DP vs UCD	-54%	-42%	-69%

**Table 2**

	<b>1 BR</b>	<b>2 BR</b>	<b>3 BR</b>
Dos Pinos Incr '86-'04	28%	26%	20%
Sequoia increase '86-'04	133%	93%	103%
UCD increase '86-'04	139%	146%	156%
Dos Pinos incr '86-'09	46%	44%	35%
Sequoia increase '86-'09	155%	120%	122%
UCD increase '86-'09	177%	182%	193%
Dos Pinos as a % of UCD in 2009	65%	70%	59%

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# "If some people are born cooperators, what about the rest of us?"

*An interview with Professor Robert Kurzban, University of Pennsylvania*

By Margaret Lund

Several years ago, a colleague introduced me to the fascinating research of evolutionary psychologist Robert Kurzban of the University of Pennsylvania. Using college students as subjects, Kurzban and his colleagues (Kurzban & Houser, 2005) used a series of games whereby players were asked to allocate tokens between a group account and an individual stash for differing rewards. The point was to study the degree to which ordinary people will contribute for the common good of a group. The results showed a remarkably consistent pattern whereby some individuals reliably contributed to achieve group benefits; a somewhat larger cohort of players consistently declined to bear any cost for the benefit of the group; and the largest number of players responded conditionally based upon their knowledge of other people's behavior. That is, most people would only act for the benefit of the group to the degree that they believed that everyone else was doing so too, making reciprocity an important motivator in group contexts. This seemed to me a particularly important finding for those of us involved trying to organize successful group endeavors and so we caught up

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with Professor Kurzban to get his thoughts on the application of this research to cooperative development.

*ML: I am intrigued with this idea that your research shows that some of us (13%) are more or less “born cooperators” while somewhat more of us (20%) will rarely cooperate if given the choice. I understand from your research that the idea is that these proportions are more or less stable or set within the population. Is that correct?*

RK: While it is always good to be cautious about generalizing, these same fractions pop up in the game again and again. The mix might be different in different contexts, however, if people were punished in some way for example. But the frequencies with respect to the central incentive structure suggest some kind of relatively reliable pattern.

*ML: I am also intrigued by the idea that the large majority of us (two-thirds of people) fall somewhere in the middle—is it fair to say, then, these “reciprocators” in the middle are subject to influence by either of the other groups? Can you talk a bit more about the conditions of influence?*

RK: It is all extremely subject to context. The perception of this middle group regarding what other people are doing and how other people are being rewarded is key—it is all about perception.

*ML: You talk about the fear of being “free ridden”—do you see that this middle group is primarily motivated by avoidance of negative consequences like being free ridden, or might they also be influenced by a positive vision put forth by one of the cooperators?*

RK: Is it fear or is it greed? It is hard to tease these two things apart. The bulk of players respond negatively to the idea that “I am contributing more than others.” It’s not quite fear, it’s more like inequity aversion. In this context it was easy for people to detect when other people were benefitting too much, it was fairly transparent. With big groups it gets hard and very complicated to see the same connections.

*ML: When you mention that what participants know about others’ rates of cooperation is critical—in a cooperative development situation, would you say that means that it’s vital to make known what the lead-*

*ers of the co-op are willing to invest? Or is it more important that this middle group knows that “everyone” is putting in a certain amount of money or effort—not just the diehard cooperators?*

RK: There is only a little data about the effect of leaders on a group. What is clear from this research is that people are very concerned about what the least cooperative members are doing. It doesn't take too many bad people to trip up a whole group. For a cooperative developer, it might mean paying particular attention to the people who seem the least cooperative. It is really irritating to people when others don't do their part.

Not that leadership is unimportant, but the individuals with the largest multiplier affect are the most negative ones.

*ML: What can be done with these free riders, the people who take from the group without contributing?*

RK: You can keep them out by exclusion or try to modify their behavior by public sanction, publicly displaying their lack of cooperation for example. Elinor Ostrom in her research has some data about the use of sanctions in successfully self-managed groups (see Design Principles 4 and 5 below).

*ML: You mention in the paper that when participants were allowed to discuss the game, more cooperation ensued—would you generalize this finding to other situations? Professor Ostrom, for example, in her research concludes that face-to-face interaction increases cooperation—would you agree?*

RK: Much of the literature supports the idea that face-to-face interaction increases the level of cooperation, and this is literature going back 40 years. I don't know if it is because of better monitoring through in-person interaction or better information or what, but the results are fairly solid that people act more cooperatively when they regularly interact in person.

*ML: Two other points from a presentation of yours that I found intriguing are the assertions that “good institutions can elicit cooperation” and “public sanctioning can be cheap and effective”—would you elaborate?*

RK: Regarding “good institutions,” if you look to Ostrom

again, you will find that in very different contexts and with very different institutions she has found common elements in well-functioning, self-managed systems, and that the peer monitoring and the sanctions we spoke of are very important to this. A lot depends on the public good context—the history of a group and their past dependencies, etc., will influence how well a group of people will manage a common resource. But some institutional features clearly induce more cooperative behavior.

As for public sanctioning, the sanctioning mechanism has been explored in a laboratory setting and the conclusion has been that people cooperate more reliably in a public group where the behavior of others is known.

*ML: In the paper you cite another piece of research suggesting that groups that contain free riders and conditional cooperators "might expect to experience cooperative decay and convergence to a non-cooperative equilibrium" over time with speed of conversion depending upon the composition of the group. Will this always happen, or can you suggest strategies for our cooperative institutions that would allow them to remain vibrant over generations rather than decay?*

**RK:** In laboratory experiments cooperation does diminish over time. If you let the groups go on long enough, the group will degenerate and becomes less cooperative. However, experiments involving the real world application of this are very limited and there are not too many claims.

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## **Elinor Ostrom**

Nobel prize laureate Elinor Ostrom was widely recognized for her work concerning the successful self-management of common resources. While her research primarily focused on the management of natural resources (fishing grounds, water systems etc.) many have found her work broadly applicable to the management of any kind of shared resource endeavor, including cooperatives. The following summary of the eight design principles exhibited by successfully self-managed resource systems was taken from *Grassroots Economic Organizing (GEO) Newsletter*, Vol. 2, Issue 9, and can be retrieved from: <http://geo.coop/node/678>.

### **The eight design principles**

The full name is Design Principles for Sustainable Management of Common-Pool Resources. They are perhaps better described as good practices: characteristics of common-pool resource management systems that have been observed to be regularly associated with the long-term sustainability of that system. Not all principles need to be realized in all circumstances, but the prospects for sustainable governance tend to increase when more of these principles are in place. The design principles are still an area of research, but they are maturing.

**1A User boundaries:** Clear boundaries between legitimate users and nonusers must be clearly defined.

**1B Resource boundaries:** Clear boundaries are present that define a resource system and separate it from the larger biophysical environment.

**2A Congruence with local conditions:** Appropriation and provision rules are congruent with local social and environmental conditions.

**2B Appropriation and provision:** The benefits obtained by users from a common-pool resource (CPR), as determined by appropriation rules, are proportional to the amount of inputs required in the form of labor, material, or money, as determined by provision rules.

**3 Collective-choice arrangements:** Most individuals affected by the operational rules can participate in modifying the operational rules.

**4A Monitoring users:** Monitors who are accountable to the users monitor the appropriation and provision levels of the users.

**4B Monitoring the resource:** Monitors who are accountable to the users monitor the condition of the resource.

**5 Graduated sanctions:** Appropriators who violate operational rules are likely to be assessed graduated sanctions (depending on the seriousness and the context of the offense) by other appropriators, by officials accountable to the appropriators, or by both.

**6 Conflict-resolution mechanisms:** Appropriators and their officials have rapid access to low-cost local arenas to resolve conflicts among appropriators or between appropriators and officials.

**7 Minimal recognition of rights to organize:** The rights of appropriators to devise their own institutions are not challenged by external governmental authorities.

**8 Nested enterprises:** Appropriation, provision, monitoring, enforcement, conflict resolution, and governance activities are organized in multiple layers of nested enterprises.

# Cooperatizing Corporate Personhood

*A review of Humanizing the Economy  
by John Restakis*

By Donald M. Kreis

How's this for an inconvenient truth in this, the International Year of Cooperatives? Cooperatives are corporations.

The point is relevant not because the United Nations has formally recognized all that cooperatives have achieved since the modern era of this business model began in 1844, and all that cooperatives can achieve. Rather, the question arises in light of the persistent national conversation about the 2010 *Citizens United* decision of the U.S. Supreme Court (*Citizens United v. Federal Election Commission*, 130 S.Ct. 876, 2010), which determined in the context of campaign-finance law that the free speech rights secured by the First Amendment to the U.S. Constitution apply to corporations. Those of enlightened sensibilities who object to *Citizens United* have tended to rail against the notion of “corporate personhood,” although the phrase appears nowhere in the opinion of the court and the concept itself is but a metaphor from the nineteenth century.

Among those who have succumbed to this temptation is John Restakis, in *Harmonizing the Economy: Co-operatives in the Age of Capital*. Condemning the “anti-human and sociopathic attributes of the most powerful institution of our time,” Restakis discerns a bitter irony in the reality that “the very rights and freedoms to human

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liberty and democracy that were won at such cost by opposing the divine rights of kings and property have in our age been eclipsed by the extension of these same human rights to property in the guise of the corporation." This is unhelpful—particularly at the end of an informative and inspiring 261-page disquisition on the transformative effect cooperation has had in Italy, Japan, Sri Lanka, Argentina, and even the sex trade in Calcutta.

Human beings form clubs—Cub Scout troops, bowling leagues, nonprofit charitable organizations, cooperatives, and, yes, greed-oriented investor-owned, multinational stock corporations. All are empty vessels into which people may pour their proclivities for virtue and/or expediency. To incorporate is merely to take advantage of two gifts offered by government—here in the United States by state governments—to those who would create such entities. The first is perpetual existence; an incorporated entity does not die with its founders. The second, and most valuable, is limited liability—what I, as a member of my food co-op have in common with my neighbor who owns a share of Exxon Mobil is that neither of us can be held personally liable for any misdeeds committed by these organizations. The most we can lose is the sums we have already invested by becoming members and/or shareholders.

Thus, what separates my food co-op from Exxon Mobil is not a decision to eschew a spurious claim of corporate personhood, nor even (as Restakis implies throughout his book) any inherent virtue gap between those who would cooperate and those who would join a club whose singular purpose is individual wealth maximization. The real question—indeed, the critical case to be made in the International Year of Cooperatives—is: What specific legal attributes do cooperatives have that offer the opportunity for economic enterprise conducted so as to build social capital and preserve the planet as a habitable place for future generations?

The question is admittedly a somewhat prosaic one and, thus, less of an interesting and inspiring read than the accounts Restakis gives of people with disabilities in the Emiglia-Romagna region of

Italy, young women sold into a form of sexual slavery in the fetid slums of Calcutta, victims of nuclear warfare in Japan, and oppressed factory workers in authoritarian Argentina, all of whom have successfully used some form of cooperation to empower themselves in the face of great obstacles. But making the case for cooperatives requires something more than righteous indignation, even in the face of what Restakis correctly identifies as nearly unchecked avarice on the part of the wealth-maximizing class worldwide.

Alas, Restakis not only avoids this case—he arguably obscures it. The enterprises he describes are all cooperatives in a very loose and inchoate sense, but his book ultimately reveals little of what they have in common beyond a commitment to collective and democratic action in the name of social justice. He offers a rich history of the Rochdale Pioneers, and it is this account that offers the most persuasive evidence that the successful case for a new burst of cooperative development must arise out of practical advice about what sets co-ops apart and why all people, regardless of what political label they bear, should consider forming co-ops to optimize their connection to the economy around them. As Restakis points out, the weavers in Rochdale “helped transform economics by *formalizing* reciprocity as an economic principle.” As others have long since noted, the Rochdalian insight was that, however appealing were the ideas of cooperative philosophers like Robert Owen, William Thompson, and William King, what made the difference was a focus on business fundamentals and, in particular, on apportioning surplus in a fair and equitable way—i.e., according to patronage (Kagawa, 1936, p. 102).

A cooperative’s most essential attribute is the lack of outside investors who neither use nor even need the enterprise but take on ownership interests purely as wealth-extracting rentiers. The absence of such potentially parasitical participants, combined with the limited liability and perpetual existence provided under U.S. law to all corporate entities, as embellished by the First Amendment liberties reinforced in *Citizens United*, is truly the so-called

“cooperative difference.”

With its potential at a historic apex, the cooperative difference is nevertheless under assault. The siege comes several forms. In ascending order of malignity, there are (1) superficially benign efforts to authorize hybrid entities such as limited cooperative associations (businesses that are nominally cooperatives but which have outside investors who can exert significant control at the governance level), (2) obstacles such as uncongenial securities laws, a hostile Small Business Administration, and antediluvian economic development policies that thwart cooperatives' ability to raise capital, and (3) hostile calls for demutualization, such as public arguments made by Representative Jim Cooper (R-Tennessee) and even some environmentalists in favor of cashing out electric cooperatives and turning them over to investor-owned utilities (Cooper, 2008).

Thwarting demutualization—which, obviously, turns the clock backward for cooperators—and making the case to non-cooperators for even more of these truly democratic business enterprises, requires attention to fundamentals. As Brett Fairbairn of the University of Saskatchewan has cogently warned, a “black box” cooperative that has no real active relationship with its members risks economic failure and oblivion. Conversely, as Fairbairn notes, a cooperative

whose practices and policies are transparent to [members], and that thinks, as an organization, about its future, has distinct advantages over conventional business models. Instead of being seen as a marginal kind of business that has less access to capital and more onerous obligations than its competitors—dare we say this is the standard view of many economists?—a co-operative has powerful advantages because of its integrated, flexible, and dynamic relationship with its members. In the best of all worlds, co-ops can integrate members' economic activity, their purchases, or their production, in ways of which other businesses can only dream, to obtain efficiencies or quality premiums no other form of business can match. (2003, p. 26)

This rhetoric is ultimately more compelling and persuasive, across the political spectrum, than railing against corporate personhood.

A nugget that lies somewhat buried is Restakis's discussion of cooperatives in the Emilia-Romagna region of Italy (where co-ops account for 40 percent of the region's Gross Domestic Product). Unlike in the United States, a cooperative's retained earnings are exempt from taxation; the *quid pro quo* is that co-ops must retain 80% of their surplus in an "undivided reserve" fund that bolsters balance sheets and can only be distributed to other cooperatives (or escheated to the state) in the event of dissolution. Restakis calls this a "lifeboat" for co-ops as the global economy roils onward. He is correct.

Restakis nevertheless concludes his narrative on a gloomy note, suggesting that cooperatives need not be triumphant but must only continue to exist somewhere, just as medieval monasteries kept the ideals of classical antiquity alive during the Dark Ages. Interestingly, Toyohiko Kagawa of Japan, the twentieth-century theologian who saw cooperatives as the embodiment of the Christian love principle, drew an explicit link between cooperatives and medieval institutions some 75 years ago (Kagawa, pp. 44, 85-87, 99). Kagawa published his *Brotherhood Economics* in 1936, positing the cooperative movement not simply as the answer (in contemporary parlance) to the question of "what would Jesus do?" but also as the most compelling antidote to the ascendant "isms" (fascism, totalitarian communism, unrestrained capitalism) of his day. Our immediate future may indeed prove to be as dark an era as the time of global war that immediately followed Kagawa's call for world cooperatization, a persuasive appeal with unacknowledged echoes in the Restakis book. But triumph is not foreclosed, provided that we set aside *Citizens United* and instead dedicate ourselves to the hard work of building cooperatives as citizens, united.

*Donald M. Kreis is associate director and assistant professor of law at the Institute for Energy and the Environment of Vermont Law School, president of the Cooperative Fund of New England and treasurer of the Hanover Consumer Cooperative Society.*

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