What is an Employee Cooperative?

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An employee cooperative is a membership organization set up to market the labor and skills of its members through owning a business. It is owned by the members. Each member has one voting share. Its profits are allocated among the members on the basis of how much labor they put into the co-op. In co-ops, financial ownership is separated from share ownership, and each member has an internal account which holds his/her financial interest in the co-op.

Employee cooperatives are part of a broad family of cooperative businesses, which include agricultural co-ops like Land of Lakes or Agland, which are owned by their farmer members; credit cooperatives like credit unions, which are owned by their depositor members; mutual insurance companies like Nationwide and State Farm, which are owned by their policy holder members; and consumer co-ops like some natural food stores, which are owned by their customer members.

Employees will work for a period – which we need to determine – before becoming voting members and owners. Future employees will also have the opportunity to become members and owners after a probationary period.

Members elect a board and the board hires the management.

Co-ops typically divide their profits (“net margins”) between two accounts: (1) a “collective account” which absorbs losses if the business loses money and (2) members’ accounts. The board decides how retained earnings are divided between the collective account and the members’ accounts.

Once the collective account reaches an adequate level to absorb eventual losses, most or all of the additional retained earnings are allocated to members’ accounts.

In tax terms, co-op allocations to members are not taxable at the corporate level (so there’s no “double taxation”) but are taxable to the members as personal income. Therefore, typically in new cooperatives, 75% or 80% is retained in the members’ accounts and 20% or 25% is allocated in cash to members to pay their taxes.

On the other hand, when you take your account out of the co-op, you don’t pay income tax because you paid the tax when your money went into your account originally.

While you pay down the debt the co-op took on to buy the business from the owner by redeeming their stock, the co-op will be putting all its profits into paying down the loan. When the debt is paid off, the board of directors will determine what portion of the profits need to be kept in the business and what part can be paid out in cash to members.

Your financial interest in the co-op includes your membership fee and your annual allocations. If the co-op makes money your account will grow every year, and the longer you work in the co-op, the bigger it will be.

Initially, members’ accounts stay in the co-op, capitalizing the co-op by buying tools, paying off borrowed money, building working capital to buy supplies, pay wages, etc. Once the co-op has adequate capital between the collective account and the members’ accounts, it will begin to pay out part of its profits (assuming there are profits) to members in cash dividends each year.

There will be a mechanism through which members who leave the co-op will receive the value of their accounts.

Additionally, after the co-op has paid off its debt to buy out the owner and has adequate cash for business needs, the board can choose to “revolve” members’ accounts. That means that the board can decide to pay out to members money that was -- for example -- allocated to their accounts ten years ago. That rewards folks for their seniority in the co-op.

The basic procedures for the co-op are laid down in the company's articles of incorporation and bylaws.

Key decisions to be made on co-op structure

1. Qualifications for membership:

   * probationary period of employment before admission as member (I suggest at least 6 months, but you can certainly count past employment against the probationary period)
   * amount of membership fee
   * options for paying membership fee (cents per hour worked vs. cash up front)

2. “Patronage dividends”: How will each year’s profits be allocated to members?

The formula for allocation has to be based on labor input into the co-op, but labor input can be measured by (1) hours worked, (2) W-2 earnings, or (3) other measures of labor input, including seniority.

You can “mix and match” these. You can, for example, distribute a quarter of profits on the basis of hours worked during the year, a quarter on seniority with the company up to some cap (such as five years), and half on W-2 earnings.

3. Board structure
   * how many members
   * a majority of the board have to be elected by the members
   * how to provide veto rights for the owner while they still have their capital in the business

4. Annual meeting(s)
   * when
   * procedures
   * how members can call additional meetings

5. How will members be paid out & when?

   * members who leave
   * do you want a provision that permits “revolving accounts” of members who stay

You want to give basic guidance and leave the details to the discretion of the board which needs to evaluate the financial position of the business.