Cooperative Conversions

Worker and Community Ownership for Business Sustainability and Transition

MONTANA COOPERATIVE DEVELOPMENT CENTER

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About

Cooperative Conversions: Worker and Community Ownership for Business Sustainability and Transition

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This publication was designed and published by the Montana Cooperative Development Center team in February of 2024.

The following information is meant to guide communities, individuals, and businesses in exploring employee-owned cooperatives; an innovative solution to business succession, retention, and development.

Acknowledgements and Thank Yous
Montana Cooperative Development Center is excited to bring an employee-owned cooperative program to Montana. This program and toolkit were made available through the continued support of the Montana Department of Agriculture, the United States Department of Commerce Economic Development Administration, and the hard-working team at MCDC.

A Note from MCDC
Montana Cooperative Development Center promotes the cooperative business model to address community and economic needs. The organization is celebrating its 25th year in 2024 and, as the only statewide cooperative development center, is excited to bring new resources to the communities we serve.

As you explore cooperatives for your community project or business, please contact the MCDC team through the website; www.mcdc.coop. Additional information on cooperative formation and management is available. The team at MCDC stands ready to assist new and existing cooperatives across Montana.

Disclaimer
The contents of this publiciation are intended for educational purposes only and do not constitute legal or accounting advice. For specific legal or accounting concerns, please contact a professional.

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Overview

Montana communities are losing essential businesses, making the conversion to worker or community owned cooperatives a vital solution.

Montana's business landscape is facing a significant challenge as many business owners in the state are approaching retirement age. Rural communities may be in danger of losing essential and anchor businesses that have operated in their communities for decades. The American Business Survey estimated that about 4,000 of Montana's business owners were 65 or over in 2020. These impending generational and economic shifts raise critical concerns regarding succession planning and the future of these businesses. Particularly in rural areas, where finding potential business buyers is notoriously challenging, alternative solutions such as converting traditional business structures to cooperatively owned businesses must be explored.

The cooperative business model is significantly important for rural communities, entrepreneurs, and existing business owners when addressing economic, community, business retention, and business succession concerns. Cooperatives provide a collaborative and sustainable approach to economic development. Cooperative businesses are owned and democratically controlled by their members, who are often employees, customers, or stakeholders with a vested interest in the enterprise's success.

Cooperative conversion emerges as a promising strategy to address these issues, offering a viable pathway to retain businesses, services, and employment opportunities within the community. By facilitating the transition of ownership to dedicated employees or community members, cooperative conversion ensures the continuity of local businesses and preserves the vital economic fabric of Montana's rural areas.

Establishing worker-owned cooperatives is an opportunity to bolster Montana's local economies by fostering both resilience and prosperity. By empowering workers to own and manage businesses collectively, worker-owned cooperatives not only create a pathway for the generation of well-paying jobs but also ensure economic stability within communities. In Montana, where community ties run deep, and self-reliance is valued, embracing the cooperative model can lead to a more equitable distribution of wealth and resources, ultimately strengthening the fabric of society and enhancing the overall quality of life for its residents.

The multi-stakeholder ownership cooperative model is yet another alternative offering a holistic business approach. It emphasizes employee and consumer engagement, shared decision-making, and a long-term perspective, which can lead to a more successful, resilient, and socially responsible enterprise.

This toolkit details the five phases of cooperative development used by the Montana Cooperative Development Center (MCDC). It offers a thorough overview of cooperative business models, focusing on worker-owned and multistakeholder cooperatives. It also highlights the value of cooperative conversion and provides a step-by-step outline of the conversion process. Additional resources are available in the appendices. Readers can also review additional resources, the toolkit sources, and access case studies and detailed information from MCDC's cooperative development partners via the QR code on the last page, enriching the toolkit with practical insights.

MCDC plans to continue expanding the conversion and multi-stakeholder cooperative program for Montana. Because of that, the QR code will remain a source of information that continued updates and relevant information will be shared on as further development occurs.

Cooperative Basics

Cooperatives are businesses that are organized to meet community needs and benefit the member-owners.

Cooperatives are a form of business collectively owned and democratically governed by their members. They focus on meeting the needs and interests of the membership first and foremost. The cooperative model is a powerful tool for fostering economic democracy, community development, and social empowerment.

Cooperatives are capitalized through the purchase of membership stock, also called common stock, which allows for ownership and an equal vote in decision-making. In certain cases, cooperatives may also offer preferred stock without ownership or voting rights, which serves purely as an investment opportunity. The modern cooperative business model has its roots in the early 19th century. Cooperatives were developed as a response to the social and economic challenges faced by workers and consumers by the Rochdale Society of Equitable Pioneers. The concept of cooperation and collective action has existed in various forms throughout history, but the formalization of seven cooperative guiding principles took shape during this period.

Today, cooperatives exist in various forms and sectors around the world. They are found in agriculture, finance, energy, telecommunications, retail, healthcare, and many other industries.

Though cooperatives are a global form of business, they are controlled on the state level or state-level equivalent. This means that each State in the US has different cooperative laws that need to be reviewed. This specific toolkit focuses on Montana State law. Though cooperatives, in concept, are interchangeable across state and country lines, they do require a strong understanding of local law to operate. Most Montana cooperatives are state-recognized businesses organized and operated as corporations under applicable state laws of Chapter 35 of the Montana Code Annotated.

Seven Cooperative Principles: Appendix A defines the seven principles that cooperatives worldwide follow. These principles are the cornerstones of all cooperatives and are introduced early into the cooperative development process.

In addition to the seven guiding principles, there are six values of cooperatives:

1) Self-help
2) Self-responsibility
3) Democracy
4) Equality
5) Equity
6) Solidarity

Overall, members of cooperatives believe in the ethical values of honesty, openness, social responsibility, and caring for others.

Cooperative Advantage

The cooperative business model offers a flexible and inclusive approach that aligns business objectives with community and social needs.

Understanding the advantages of cooperatives is an important step in determining if a cooperative business model is the right solution to your needs.

One should also review the pros and cons of cooperatives compared to other forms of businesses. A comparison of business models can be found in Appendix B. However, it is

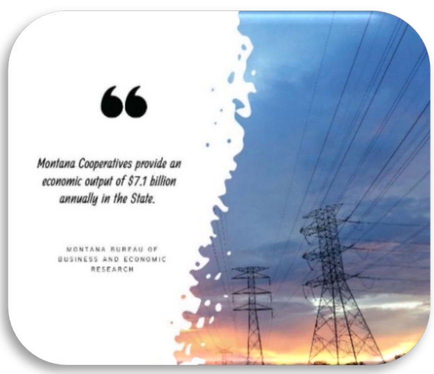
important to note that the Montana Cooperative Development Center can provide information to educate one about the differences it cannot, nor will it provide any legal or accounting advice. It is important that throughout the cooperative development process, one works either with the MCDC legal and accounting advisors or others with a firm understanding of cooperative law are consulted.

One clear cooperative advantage over other business structures is the ownership and decision-making process, for more information about the cooperative advantage, please reference the Cooperative Advantage document in Appendix C.

Cooperative Economy

Anyone exploring cooperatives as a solution to a community or economic need must understand that the cooperative community in Montana is rich and vast. With over 200 in-state and out-of-state cooperatives operating in Montana, the economic impact of cooperatives continues to grow.

As one explores cooperative solutions, one should remember that Cooperative Principle 6: Cooperation amongst Cooperatives is strong in Montana. With that, MCDC is the sister organization to the Montana Council of Cooperatives (www.montanacouncil.coop), which provides continuing services to all cooperatives regardless of sector/industry. Through this partnership, MCDC can often bring in additional resources, advisors, and partners through the cooperative community to support emerging cooperatives.



Introduction to Worker Cooperatives

Worker cooperatives enable workers to benefit directly from the business's success and provide a way for people to jointly own a small business.

A worker-owned cooperative, also known as an employee-owned cooperative, is a shared business model owned and operated by its workers. In a worker-owned cooperative, workers jointly own and manage the business, have a say in their working conditions, share in the profits, and contribute to the business governance. The shared ownership model fosters a collective commitment to the business's success***, making it more adaptable and resilient to market changes.***

Worker cooperatives are part of the growing cooperative movement across the United States and internationally. While worker-owned cooperatives can be established from the ground up, worker conversions have emerged as a significant trend. The conversion approach addresses both business succession and employee job retention while continuing to contribute to the tax base of local communities. The conversion process is later detailed in this document.

In a worker-owned cooperative, the employees themselves are the owners of the business, and they participate in the decision-making processes and share in the profits of the Cooperative. The cooperative democratic ownership structure allows each member (worker) to have an ***equal say*** in the cooperative's affairs through a one-member, one-vote system, regardless of their individual position within the cooperative.

Worker cooperatives can exist in all industries and sectors, such as manufacturing, agriculture, services, and retail. They can be small-scale enterprises or larger corporations with numerous employees. The specific details of how a worker cooperative is structured and operated can vary depending on local laws, cultural context, and the preferences of the cooperative members.

A worker-owned cooperative is a value-driven business that prioritizes worker and community benefits. Cooperatives' objectives typically differ from those of traditional for-profit firms. Conventional businesses aim to maximize profits, while cooperatives have an explicit purpose of providing ***benefits for their members.***

- Worker-owners own the business and participate in its financial success.
- Worker-owners directly contribute to economic participation through their labor.
- Worker-owners participate in direct governance of the business.
- Worker-owners vote for their representation on the board of directors.
- Worker-owners may engage in day-to-day operations through participatory management structures.

Democracy at Work Institute (DAWI) is a key partner of MCDC's and provides excellent resources for those exploring the benefits of worker cooperatives. To access comprehensive materials on the Benefits of a Worker Cooperative, the DAWI report on Worker Cooperatives and Creating Better Jobs and a Fairer Economy with Worker Cooperatives, please scan the QR code at the end of this document.

Cooperatives are a global business model, but they are regulated at the state level (or its equivalent). In the U.S., each state has its own cooperative laws. While many resources are valuable, it's important to remember that in Montana, worker-owned cooperatives are considered for-profit corporations.

Always consult a local Cooperative Developer when considering a worker-owned cooperative.

How is a Worker-owned Cooperative different from an Employee-Owned Stock Plan (ESOP)?

Worker-owned co-ops and ESOPs are both models of employee ownership, but they differ in their structure, governance, and distribution of ownership and control within the organization.

Worker-owned cooperatives are based on direct ownership, democratic governance, and community impact. A worker cooperative is an employee-owned business where ***each member (worker) has one equal share of the business***. This means that every worker-member has one equal vote in the co-op—no matter their pay, how long they've been a part of the business, or what title within the business they hold. Worker-owned co-ops are democratic businesses in nature.

ESOPs focus on indirect ownership and more on retirement benefits. ESOP employees accrue share allocations while working and typically receive the value of their shares (usually in cash) at retirement or separation from service. ESOPs are not cooperatives, and there is no direct ownership by workers of company stock.

For more information on ESOPS, see the Worker Cooperatives and ESOP comparison document in Appendix D. Democracy at Work Institute (DAWI) also has an outstanding resource that showcases the differences regarding the business structure of a worker-owned cooperative and an ESOP: "A Brief Guide to Understanding Employee Ownership Structures," which can be accessed on our website using the QR code found at the end of this document.

Overall, and in the simplest terms, ***in worker-owned cooperatives, the employees/workers have full control of all aspects of the corporation.***

- The workers have equal ownership regardless of stature in the company,
- The workers receive the benefit of the profit-driven from the company,
- The workers have control of the governance through a democratically elected board of directors.
- The management is hired by the board of directors for day-to-day management services.
  - NOTE: it is important that during the development of the cooperative time is spent to develop strong policies and procedures.
- The workers make the decisions about the future of the cooperative and strategies for the next stages.

<u>Example of a Montana Worker-Owned Cooperative:</u>

Crucible is a workers' cooperative based in Bozeman, Montana. It was the first true worker-owned cooperative and values the people who are its member-owners. The cooperative encourages best efforts and brings mutual benefits through common goals. Its mission is to provide an equitable work environment that facilitates personal growth, quality of life, and community. https://www.crucible.coop/.

Introduction to Multi-Stakeholder Cooperatives

Multi-Stakeholder Cooperatives offer flexibility, sustainability, and increase opportunities.

As this toolkit explores cooperative business models, it's important to see worker cooperatives as just one part of a broader framework. While worker cooperatives empower employees through shared ownership, the multi-stakeholder model brings together various groups—such as workers, consumers, producers, and community members—under one structure. This inclusive model fosters diverse perspectives, creating a more resilient and collaborative enterprise. The next section delves deeper into the multi-stakeholder cooperative model and its unique benefits before discussing the process of converting traditional businesses into worker cooperatives.

Multi-stakeholder cooperatives, also known as hybrid or solidarity cooperatives, are democratically controlled enterprises that involve multiple stakeholder groups. These cooperatives are formed to meet economic and social goals by addressing the needs of all their owners, including employees, consumers, producers, or organizations like non-profits, businesses, government agencies, or even other cooperatives. The key is that all members, regardless of the type of entity, share a common goal that the cooperative addresses.

Each stakeholder group has a voice in the cooperative's decision-making process, with rights and responsibilities tailored to their specific role and contribution. In these cooperatives, classes of membership represent distinct categories of members, accommodating the diverse interests and roles of the various stakeholders involved. Stakeholders can be employees, consumers, producers, or organizations such as non-profits, businesses, government agencies, or even other cooperatives.

The multi-stakeholder ownership cooperative model with an employee/worker class membership offers a holistic approach to business, emphasizing employee engagement, shared decision-making, and a long-term perspective, which can lead to a more successful, resilient, and socially responsible enterprise.

Although the distinct member classes will undoubtedly share certain interests, these interests are unlikely to be exclusive. Under the multi-stakeholder business model, they are united by the mission of the cooperative, which should clearly articulate the advantages the cooperative aims to offer its members. Each class of members will contribute their distinct blend of expertise, viewpoints, and resources to the cooperative's endeavors. It is important to note that different membership classes have different requirements and rights in the cooperative. However, each member still follows a one-member-one-vote in matters of the cooperative. Membership classes may have differing levels of investment that influence the determination of the allocation of economic benefits and board structure.

Advantages of Employee Ownership for Multi-stakeholder Cooperative Model

The multistakeholder cooperative model is particularly well-suited to rural communities because it brings together diverse stakeholders, each with a vested interest in the cooperative's success. By including multiple classes of membership—such as workers, consumers, producers, and even local organizations—this model allows for a pooling of resources, expertise, and perspectives that can significantly enhance the cooperative's economic and social impact. In rural areas, where resources and opportunities can be limited, this collaborative approach helps address various community needs, from job creation and local services to social support and community development. By aligning the interests of different stakeholder groups, the multistakeholder cooperative model strengthens the business financially and fosters a more resilient and interconnected community.

The multi-stakeholder ownership cooperative model, especially with an employee class membership, offers several advantages for both the cooperative and its members. Some key advantages are:

- Diverse perspectives from each class of shareholders
- Shared ownership and control allowing for inclusive decision-making
- Consideration of stakeholders' interests
- Retention and attraction of talent
- Stability and resilience through diversified support
- Alignment of interests
- Increased employee engagement

- Positive organizational structure

The Challenges of Multi-stakeholder Model

Multi-stakeholder cooperatives can be a challenging process. The central organizing principle of cooperatives is rooted in a common mission and democratic governance. When there are multiple stakeholders, finding that common mission can be complicated and requires diligence to ensure equitable representation and decision-making power for all stakeholder groups. Actively prioritizing collective objectives and results over individual disparities and sole ownership is a task that doesn't come effortlessly.

While the multi-stakeholder cooperative ownership business model offers several advantages, there are also challenges that members need to be aware of as they form and operate the cooperative. Sometimes, challenges and benefits can overlap, like diverse interests and priorities. This speaks to the importance of a well-thought-out governance structure, policies, and procedures. Some of these challenges include:

- Complex Decision-Making Processes
- Governance Structure
- Capitalization and Financing
- Educational needs of each membership class
- Legal and Regulatory Considerations
- Sustainability of Participation in membership classes

Many Cooperative Development professionals will recommend having a strong consumer base for multi-stakeholder cooperatives. The concept is that the consumers' purchases generate the primary source of revenue for most businesses. Further components of incorporating consumers are:

> *A strong consumer base is essential for financial health, sustainability and overall success of most multi-stakeholder cooperative businesses. It enables the cooperative to fulfill its mission, support its various stakeholder groups, and contribute positively to its community and industry.*
>
> **Advice from John A. McNamara, Co Director at Northwest Cooperative Development Center**

- In a multi-stakeholder cooperative, a robust consumer base ensures a steady flow of income that can be used to cover operational costs, investments, and the cooperative's growth.
- A healthy consumer base supports the cooperative's ability to fulfill its commitments to other stakeholder groups, such as workers and producers.

- Strong revenue streams enable the cooperative to provide fair compensation to employees and competitive prices to producers.
- A loyal customer base demonstrates that the cooperative is fulfilling its purpose and meeting consumers' expectations. Repeat business and positive customer relationships contribute to stable revenue over time. This engagement can lead to positive word-of-mouth marketing, brand advocacy, and a deeper connection between the cooperative and its customers.

Challenges of Adding Employee Membership Class to a Cooperative

A cooperative can successfully integrate employee membership, creating a more inclusive and participatory cooperative model. Doing so requires open communication, shared commitment, and well-defined governance structures that reflect the interests of all stakeholder groups. Members must engage in thoughtful planning and ongoing dialogue to build a cooperative that effectively balances the benefits and challenges of the multi-stakeholder cooperative ownership model.

One key aspect of developing a cooperative is strong facilitation, especially in a multi-stakeholder cooperative. Utilizing facilitators (a cooperative developer or others) will ensure that a cooperative project includes all aspects and priorities in the business structure.

Understanding the financial impacts of adding an employee membership class to the cooperative is particularly important. A few important considerations:

- Power Imbalance: Existing members might have established power dynamics within the cooperative. Introducing employee membership can lead to a power shift, which could create tension or resistance among the stakeholders.
- Decision-making Processes: Different stakeholder groups may have varying interests and priorities. Incorporating employee members into the decision-making process may require adapting governance structures to ensure equitable representation and effective stakeholder collaboration.
- Financial Considerations: Employee membership could impact the cooperative's financial structure, as the allocation of profits and capital contributions might need to be revised to accommodate the new members. This may require addressing potential concerns about sharing profits with the workforce.
- Training and Education: Existing stakeholder groups may not fully understand the implications and benefits of adding employee membership. Adequate training and education programs will be necessary to promote understanding, cooperation, and buy-in from all stakeholders.

For further reading on an example of a successful addition of employee membership to an existing multi-stake cooperative. Central Coop of Washington can be found by following the QR link at the end of this document to MCDC’s online resources.

Essentials of Cooperative Conversion

Business owners can transition to cooperative ownership with employees or community members, keeping vital businesses in Montana communities.

Converting a traditional business structure to a cooperative business model involves transitioning ownership and control from a traditional business structure, such as sole proprietorship or LLC, to a cooperative business structure. The democratic structure of cooperatives helps ensure that profits and decision-making remain within the community, strengthening economic vitality and fostering growth. Converting from a traditional business to a cooperative business model preserves local businesses and jobs and reinvests in the local economy, creating jobs, building resilience, and enhancing community well-being.

Entrepreneurs and small business owners are at the heart of Montana's economy. According to a recent SBA 2021 Small Business Profile, 99.3% of all Montana businesses are small businesses. The percentage of Montana employees working at small businesses in 2018 was the highest of any state, with small businesses accounting for 67.2 percent of employment.

In rural Montana, local businesses thrive on building and nurturing local relationships, which foster trust and active civic engagement. Locally owned businesses excel at reinvesting money into the local economy, as they are more likely to donate and support community causes, fundraisers, and events and hire within the community. ***Small businesses' dollars circulate three times more funds throughout the communities they are in than absentee-owned firms or corporate chains.***

Converting to a cooperative from traditional ownership may be an exit strategy for the owner, whether because the owner is retiring or wants to leave the business for other reasons. In Montana, it is expected that few business owners have an ownership succession plan and will close due to attrition, resulting in the loss of vital community anchor businesses, jobs, essential services, and a critical source of tax revenue for local governments.

National studies from MassMutual and PwC have highlighted the significant lack of succession planning among small business owners, particularly those from the baby boomer generation. According to the 2022 MassMutual Business Owner Perspectives Study, only 35% of small business owners have started creating a succession plan, even though 46% plan to retire within the next decade. Additionally, only 33% have identified successors for their businesses.

The PricewaterhouseCoopers (PwC) 2021 Family Business Survey found that less than half of small business owners have a documented succession plan in place. This lack of planning poses a significant risk, as many businesses may face closure due to the absence of a clear transition strategy, leading to job losses and reduced local economic stability.

The cooperative conversion option can be an excellent option for rural small business owners, where the impact of closures can be even more profound. An excellent example of a worker conversion is found in Jay, New York, with the Ward Lumber. The company was a multi-generational-owned business that had no apparent heirs. The owner, Jay Ward became a champion of the worker-owned cooperative and facilitated the company's transfer to his employees – staying on to be their CEO as approved by the newly instated Board of Directors. Their story is within the Resources that are included through the QR code on the last page of this toolkit.

> *Every business is going to go through a transition, whether that is by design or default. Rather than choose liquidation or selling to some other business that would change the culture, I wanted to look at employee ownership. Employee ownership vests the control of the company in the hands of the people that work it every day, who live in the communities that we serve, and have that vested interest in ownership. I really wanted to empower the employee team to make decisions on their behalf and for their benefit.*
>
> **Jay Ward, CEO Ward Lumber**

Rural businesses are often key providers of essential services and employment within their communities. Encouraging small business owners to start succession planning ***now*** is imperative, as it can take considerable time to develop and implement an effective plan. ***Early planning can help navigate the complexities of transitioning ownership, secure the future of the business, and maintain the economic vitality of rural areas.*** Outreach and education about the conversion option and process are an important part of this process.

This toolkit covers three types of cooperative conversions: worker, community, and multi-stakeholder. A worker-cooperative conversion occurs when ownership transitions to employees. A community cooperative conversion occurs when ownership transfers to community members. A multi-stakeholder cooperative occurs when ownership transfers to multiple stakeholders, including workers, community members, or businesses.

Worker Cooperative Conversions

In the context of cooperative businesses, ***"worker conversion" refers to the process of transitioning a conventional business into an employee-owned cooperative***. It involves transforming a traditional business structure into a democratic organization where the employees collectively own and control the enterprise.

Transitioning a small business to employee ownership can positively impact employee engagement, productivity, and retention. It allows the business owner to establish a legacy for her/his efforts in building the business. Additionally, it offers a financially rewarding exit path that can be supported by professional assistance from MCDC and other business development organizations such as the Small Business Development Center and other technical providers.

The goal of a worker conversion is not to dimmish the value of the company for an easy sale to the workers but to build out a transition process where the workers pay a fair market value of the business and take over the ownership while the previous owner(s) move out of the operation. Small business owners throughout the United States increasingly see employees as highly desirable buyers because their expertise in operating business offers continuity, which can boost company value, and their commitment to the Main Street social fabric that could be jeopardized by outside buyers.

Employees may consider worker conversion for many compelling reasons. The employees may consider work preservation, sustainability, the ability to own and control the direction of the business as well as community and social impacts as a reason to consider creating a worker-owned cooperative. Particularly in rural areas, employees often share a profound sense of responsibility for the business's prosperity. They recognize the pivotal role that rural enterprises play in supporting community initiatives, educational programs, and fundraising activities, and they are motivated to uphold and further these contributions in their local town.

Worker-owned cooperatives offer a compelling solution to Montana’s economic challenges, particularly in creating robust, well-paying jobs and fostering successful enterprises. By creating workers as owners and fostering a culture of collaboration and shared prosperity, cooperatives hold the potential to drive local economic development, promote resilience, and contribute to a more equitable and sustainable future for the state.

Please scan the QR code at the end of this document for additional reading from DAWI on determining whether a worker conversion is a good move for you as an employee or a business owner.

<u>Considerations For the Employees/Workers</u>

Forming a worker cooperative is a significant undertaking that requires careful planning, collaboration, and a deep understanding of cooperative principles. Seeking advice from experts and learning from successful cooperative ventures can greatly assist in navigating the exploration and formation of a worker-owned cooperative.

For workers considering purchasing their business and converting it into a worker-owned cooperative, several key considerations must be addressed to ensure a successful transition. These considerations span the business's financial, legal, organizational, and cultural aspects. The following are some of the critical points of these considerations.

- **Financial Considerations:** Workers need to determine the business's fair market value. This may require hiring a professional appraiser to assess the business's assets, liabilities, and overall financial health. Workers must explore various financing options to fund the purchase. This may include securing loans or seeking grants and financial assistance programs designed to support cooperative transitions. A feasibility study for market analysis, financial projects, and assessing the business's capacity to operate profitably under worker ownership may be necessary.
- **Legal Considerations:** Workers must decide on the cooperative's legal structure. This includes drafting and adopting bylaws, articles of incorporation, and other necessary legal documents to establish the cooperative as a legal entity.
- **Organizational Considerations:** Establishing a clear governance model is vital. This involves defining the roles and responsibilities of worker-owners, setting up a democratic decision-making process, and creating policies for day-to-day operations. Developing robust internal communication channels to ensure transparency and effective collaboration among worker-owners is necessary. Regular meetings and clear communication protocols can help maintain cohesion and address any issues promptly. Training and education for worker-owners on cooperative principles, financial management, and operational skills is essential for the cooperative's success. Ongoing education helps ensure that all members are equipped to contribute effectively. Adhering to the cooperative principles, such as voluntary and open membership, democratic member control, and concern for the community, helps guide the worker-owned cooperative conversion towards long-term success and sustainability

The process of collaboratively developing a worker conversion business model mirrors the steps required for establishing any cooperative enterprise. This journey encompasses five distinct phases, each essential for effectively gauging worker interest, assessing the viability of conversion, crafting financial plans and bylaws, addressing legal prerequisites, and smoothly transitioning from the operational phase of a conventional business to a worker-owned cooperative.

Considerations for the Business Owner

All business owners, particularly those in rural areas, often find themselves overwhelmingly immersed in the day-to-day operations. The constant demands of running a business can leave minimal time for planning for business succession and retirement. These matters become even more pronounced in rural settings where clear successors might be scarce, and resources to either transition or sell the business are unknown.

Transitioning a small business into a cooperative entity presents a pragmatic answer to address ownership succession, job stability, and employee retention concerns. Achieving success and long-term advantages in this endeavor demands a devoted allocation of resources and professional guidance.

Converting a traditionally owned business to a worker-owned cooperative business model offers numerous benefits and can be an attractive option for current business owners considering succession planning. Below are some common reasons why business owners consider converting from a conventional-owned business to a worker-owned cooperative.

- Business Succession/exit: strategy whether for retirement or other reasons:
- Knowledge Transfer: recognizing employees' knowledge and contribution to business
- Job Creation and Retention
- Community Empowerment/ownership/legacy
- Significant Tax Break - 1042 rollover.

The resources on MCDC's website (see the QR code on the last page) include further information for business owners. Additionally, succession planning is becoming a trending topic amongst economic developers. Organizations like the Smalls Business Development Center and the Montana Manufacturing Extension Services are building out further resources to address this growing concern for Montana. In other states, similar counterparts are doing the same.

Taking Advantage of the 1042 Rollover Tax Benefit

By considering these benefits and the substantial tax advantages offered by the 1042 rollover, business owners can make a strategic and impactful decision to transition to a worker-owned cooperative

The 1042 rollover allows business owners to defer capital gains taxes on business sales to a worker cooperative, provided they reinvest the proceeds in qualified replacement property (QRP). This can result in substantial tax savings. By deferring capital gains taxes, business owners can maximize the financial returns from the sale, providing more funds to reinvest in other ventures or for personal use in retirement.

The tax incentive can make it financially easier for employees to purchase the business, facilitating a smoother transition to worker ownership. This helps ensure the business remains operational and successful post-transition.

Community Cooperative Conversions

Many businesses in Montana communities are more than just places of commerce—they are vibrant gathering spots where people connect, socialize, and support one another. For example, grocery stores, cafés, and breweries often serve as central hubs where community members can buy goods, share meals, enjoy live music, or participate in local events. These types of businesses are ideal candidates for community conversion, especially when an owner is ready to retire or sell. Converting these spaces into community-owned cooperatives not only preserves these vital social hubs but also strengthens the local bonds essential to the neighborhood's social and economic fabric.

A traditionally owned grocery store can be transformed into a community-owned cooperative, where the customers become the owners through a cooperative conversion process. This approach particularly benefits rural communities, where grocery stores often serve as vital anchor businesses. Converting an existing store into a consumer-owned cooperative is usually quicker and more streamlined than starting a new one. This process helps ensure that jobs stay within the community, the business remains local, and access to fresh food is preserved. By becoming a cooperative, the community (consumers) gains direct ownership and control over an essential local resource, strengthening the area's economy and social fabric.

MCDC plays a crucial role in guiding communities through the cooperative conversion process. The organization provides expert assistance and resources to help transform traditionally owned businesses, like grocery stores, into community-owned cooperatives. Partnering with organizations such as the Food Co-op Initiative (FCI) and other supportive networks, MCDC ensures that the conversion process is smooth and effective. The work being done together keeps local goods accessible, sustains jobs, and empowers communities to take ownership of vital local businesses, reinforcing their economic and social well-being.

The online resource page following the QR code at the end of this document provides more information about the grocery store conversion process from MCDC's partner, Food Cooperative Initiative (FCI).

Multi-Stakeholder Cooperative Conversions

Various stakeholders who want to preserve a business in their community might consider creating a multistakeholder cooperative to convert an existing traditional business. This allows them to own and control the business collectively, ensuring its long-term viability and alignment with community values. Converting a traditionally owned business or grocery store into a multistakeholder cooperative—where ownership is shared among consumers, producers, and workers—can be a powerful and efficient model for rural communities. This governance model emphasizes partnership, shared responsibility, and mutual benefit, recognizing the interdependence of different actors in achieving collective outcomes. This approach recognizes that a business is sustained by the collective contributions of various stakeholders, each with a vested interest in its success. By including multiple stakeholders in ownership, the cooperative can better align its operations with the needs and goals of the entire community.

A multistakeholder model can enhance resilience and sustainability for rural communities, where resources are often limited, and the interdependence among local businesses, workers, and consumers is strong. Producers, such as local farmers, gain a stable market for their goods; workers benefit from improved job security and a voice in decision-making; and consumers ensure continued access to locally sourced products. This collaborative ownership structure fosters a more inclusive and balanced approach to business, where the economic and social benefits are widely shared. In essence, a multistakeholder cooperative preserves a vital local resource and strengthens the community’s overall economic and social fabric.

Cooperative Development Process

Strong cooperatives start with strong foundations. While development can be complex, MCDC has identified a five-phase process to assist.

Forming a cooperative can be a complex process as it requires multiple people to join and collectively make decisions. A cooperative is a business run, operated, and owned by its members. By purchasing a membership share in a cooperative, each member not only becomes an owner but also directly contributes to capital and participates in the collective effort to generate returns and create value for all members.

Montana has four types of legal cooperatives. For this toolkit's purposes, the following process refers to a for-profit Cooperative Association in Montana Code Annotated Title 35 Chapter 15. For any reader outside of Montana, it is imperative to understand that cooperatives are interchangeable conceptually, but as stated in the earlier sections, different state laws will affect formation. Understanding state laws and connecting with regional cooperative development centers is essential when forming successful cooperatives.

It is also important to understand that cooperatives are built to address a need. They are not charitable organizations and should be developed with strong financial health in mind. However, cooperatives are not about profit; the return to membership is the service the cooperative provides, not cash. Cooperatives' unique structure allows the business to be driven for the well-being of the members, not by the profit needed to meet stockholder demands.

Phases of Cooperative Development

MCDC has identified five distinct phases of cooperative development. Each phase comprises multiple steps and actions that should be completed before advancing to the next phase. In many cases, some steps can be carried out concurrently. Each cooperative project determines which steps are appropriate and necessary for building a successful cooperative.

Below is an outline of each phase. MCDC will assist steering committees throughout these phases, but the steering committee must execute the necessary steps to establish a successful cooperative. For more information, please see Appendix E's Phases of Cooperative Development.

It is important to note that the following phases are interchangeable for any cooperative forming in Montana. The following emphasis is on worker conversions for the purpose of this toolkit.

Introductory Phase

The introductory phase is the first step in developing a cooperative initiated by a group interested in solving a community problem or increasing opportunities. This phase aims to understand the cooperative model, identify community partners to form a steering committee, and understand MCDC's supportive technical and educational role in the development process.

This phase begins with an initial meeting to understand the cooperative business structure and development process. Cooperatives emerge from the efforts of individuals seeking to collaboratively address matters of significance to them using a democratic approach. This phase may involve multiple meetings and informational sessions to gather enough collaborators to formalize a steering committee. If there is enough interest and a steering committee is forming the project will transition into the Exploratory Phase.

- *The Cooperative Steering Committee*

Forming a cooperative is a collaborative and democratic effort. No one person can form a cooperative alone. A typical committee is comprised of five to seven members.
The composition of a steering committee for exploring a worker conversion cooperative can vary based on the specific needs and circumstances of the business. The steering committee's effectiveness relies on diverse skills, experiences, and perspectives. Each member should contribute to the committee's objectives, whether assessing the feasibility of the conversion, planning the transition process, or ensuring ongoing success as a cooperative. Regular communication, collaboration, and shared commitment to the Cooperative's values are crucial for the steering committee's success. All decisions are jointly made, and every member actively participates throughout every stage of development. The following section contains more information on the steering committee's role as does the Appendices.

Exploratory Phase

In this phase, the group will clarify the purpose and goals and determine the worker cooperative's feasibility. The steering committee members will also develop a vision and mission statement and determine the cooperative's decision-making and governance.

In some worker conversion cases, the current owner(s) of the business might approach the employees to see if the workers are interested in ownership. In other instances, the employees might convene a steering committee independently and will then approach the owner with their desire to convert the business to a cooperative. In either case, MCDC will bring resources to the table and can facilitate and support the steering committee as they explore the feasibility of forming a worker/conversion cooperative.

- *Exploring if Worker Conversion Will Work*

Transitioning to a worker-owned cooperative is a significant decision that requires careful consideration from both the steering committee and agreement from the existing owner(s). A key step in the exploration is a facilitated vision planning session, during which the committee can further develop the Cooperative's goals, expectations, and timeline. MCDC can provide this service to start-up cooperatives in Montana or other great facilitators such as the Montana State Extension Service agents.

When a steering committee is in the initial exploration phase of forming a worker-owned cooperative, they typically engage in a series of activities and discussions to assess the feasibility and viability of the cooperative concept. Here are some initial steps that may occur:

1. Awareness building: The committee introduces the idea of a worker-owned cooperative to employees and other stakeholders, fostering awareness about the cooperative model and its potential benefits.
2. Identify champions: Identify key individuals among the employees who are enthusiastic about the cooperative idea and who may take on leadership roles or become advocates for the concept.
3. Initial communication strategy: Develop an initial communication strategy to maintain transparency and keep all stakeholders informed about the exploration phase's progress.
4. Community engagement: If the Cooperative's success is intertwined with the local community, the committee may engage with community members to gather support and address community-related concerns.
5. Build relationships: The committee may begin building relationships with potential partners, such as cooperative development centers, financial institutions, or legal advisors, who can provide support in later stages of the process.

These initial exploration activities lay the groundwork for a more in-depth feasibility study and planning in the subsequent phases of cooperative development.

Planning Phase

The planning phase is the most important and often longest phase of cooperative development. In this phase, the steering committee may need to conduct a full financial feasibility study for a worker conversion. The steering committee will work with experts to collect data, gather financial information, create a business plan, and draft legal documents.

- *Assessment of Business Viability*

Valuing a business accurately is crucial to ensuring a fair and successful transition to a cooperative model. The business planning process will assess the value of the business and the project viability and establish a framework for all aspects of business operations for the converted business. This phase is an assessment of the business where the steering committee will engage with professionals to affirm if a transition to a worker cooperative is legally and financially sound. MCDC may recommend connecting to a regional Small Business Development Center (SBDC) or Montana Manufacturing Extension Center (MMEC) to assess the business.

When a steering committee is in the assessment stage of determining the value of a business for a worker conversion cooperative, they will need to consult with experts, such as accountants, attorneys, economic developers, and financial advisors, to conduct an initial assessment of the business's financial and operational feasibility as a cooperative, considering factors like profitability, market demand, and competition. Here are several important factors to consider.

1. Financial Statements and Performance
2. Assets and Liabilities
3. Market Analysis
4. Earnings and Cash Flow
5. Market Demand
6. Location and Real Estate
7. Customer Relations

Valuing a business involves financial analysis, industry insights, and specific business context. Collaborative decision-making within the steering committee and input from relevant experts can help ensure a well-informed and fair valuation process.

Transitioning to a worker-owned cooperative is a significant decision that requires careful consideration from both the workers and the current owners. To ensure a successful transition, both workers and current owners should approach this process with honesty, open communication, and a willingness to collaborate.

- *Assemble a Transition Team*

A transition team may vary based on the business's specific needs and the expertise required. The team's primary goal is to guide the conversion process, ensuring that it is well-planned, legally compliant, and successful in establishing a worker-owned cooperative. The expertise required may include financial advisors, legal counsel, marketing, and communications—each situation will be unique.

The purpose of a transition team when forming a worker cooperative from an existing traditional business is to facilitate a smooth and successful transition from the old business model to the cooperative model. The transition team plays a crucial role in managing the various aspects of the conversion process and ensuring that the interests of both the workers and the business owner are met.

A transition team would be like an advisory team in other types of cooperatives. It consists of people who provide a specific skill set to help guide the formation of the cooperative but who will not be future members or owners of the cooperative.

- *Finance and Business Planning*

The steering committee is responsible for developing a business plan based on the information received from the business assessment and overall planning efforts, including vision and purpose. A business plan is recommended for any form of start-up cooperatives. The business plan can include:

1. Executive Summary
2. Cooperative Description
3. Market Analysis/Business Assessment
4. Cooperative Management and Governance
5. Description of service/product
6. Marketing and Sales
7. Funding/Capital Stack
8. Financial Projections
9. Supporting documentation

When collecting financial data for the project, it's advantageous to maintain a connection with MCDC and other partners, such as financial institutions, accountants, or legal advisors who can provide support in this stage of the process. Partnerships serve as a valuable resource, offering guidance on the necessary financial information, insights into forthcoming expenses, and assistance addressing capitalization challenges.

A good working relationship with the current owner is helpful when developing cooperative financial projects. Past financial statements, taxes, and other information are essential to fully understanding how the cooperative can perform and the realistic financial success that it can achieve.

MCDC, SBDC, and MMEC can provide financial and technical assistance during this phase. For MCDC clients, the steering committee can have access to a business plan software tool to help formulate strong financial projections. This platform serves as a resource for constructing the cooperative's business plan and generates financial materials that substantiate the project's feasibility for potential investors and traditional lending institutions.

- *Bylaws*

One of the steering committee's important tasks is creating preliminary bylaws for the Cooperative. Bylaws are standing rules that specify the cooperative's operational practices and must meet the requirements of Montana State Law. When the steering committee is ready to draft bylaws, MCDC can provide templates for consideration. The draft bylaws will be voted on and adopted by the membership during the first membership meeting which is part of the following organizational phase.

Organizational Phase

In this phase, the steering committee will complete and send incorporation documents to the proper state agencies, begin membership recruitment, and hold the first membership meeting. This step is usually seamless after the previous stages are completed. The committee will transition into Commissioners of the Cooperative, with the powers to obtain subscription agreements and finalize incorporation. The Montana Code Annotated Section 35, Chapter 15, details how to incorporate a cooperative in Montana legally.

- *Subscription Agreement*

A subscription agreement is a legal contract used in cooperative business formations to document prospective members' commitment to purchase membership shares or equity in the Cooperative. This agreement outlines the membership cost, the membership's voting rights, and how many shares of common and preferred stock will be offered. Once those factors are determined, MCDC can provide the committee with subscription agreement templates.

- *Incorporation Documents*

Incorporation documents, commonly known as articles of incorporation and written securities exemption, constitute the fundamental legal records that formally establish the corporation as a distinct legal entity. The draft bylaws and subscription agreements provide most of the information needed for the incorporation documents. All documents should undergo a final legal review before being submitted to state agencies.

- *Final Steps to Incorporation*

Once all documents have been reviewed, the steering committee members sign and file the intent to incorporate documents with the Secretary of State and the Written Exemption with the Securities Office. They then officially become Commissioners who can collect subscription agreements for the cooperative. It is important to note that within the Chapter 15 laws, the Commissioners cannot collect subscription payments until full incorporation.

If enough subscriptions are collected to finance the cooperative as outlined in the business plan, the Commissioners can proceed with steps to finalize the incorporation. If not, it is recommended that the business plan and/or marketing approach for membership attraction is revisited. A steering committee that has dedicated enough time to creating the business plan and staying in contact with potential members should not have any issues meeting membership expectations—this is why a strong business plan and community outreach are so important.

Before the cooperative is fully incorporated and can collect money from subscription agreements, it must hold an initial membership meeting and report it to the Secretary of State per Montana law. At the first membership meeting, the members will vote to adopt the draft bylaws and elect a board of directors. Montana law requires the Commissioners to give written notice to all members ten days before the first meeting. It is common for the Commissioners to become the cooperative’s temporary board of directors for the first year of operations.

After the first meeting, the cooperative is legally required to make a full report of the first meeting to the Secretary of State. Once the report is completed and approved by the SOS, and the cooperative obtains an EIN from the IRS, it is considered fully organized and may engage in business.

Operational Phase

Once the cooperative is incorporated, the board of directors holds its first meeting, collects member subscription fees, and begins to plan for business operations. This includes voting for the board officers, arranging start-up and operational capital, setting board policies, and determining hiring and personnel practices.

The new board should complete board training, including strategic planning, policy development, and defining governance versus management. The US has a vigorous cooperative education system for new board and cooperative members to take advantage of. MCDC does provide board, governance, management, and strategic planning services for clients. There are also excellent resources which provide additional support within National partner organizations such as:

- US Federation of Worker Cooperatives
- National Cooperative Business Association
- St. Mary's College
- National Farmers Union

Within this phase, the board and the cooperative should also begin to interact with the overall robust Montana Cooperative Community. The Montana Council of Cooperatives is the trade association for all cooperatives regardless of industry. The Council's primary role is to unite, promote, and sustain cooperatives. An annual meeting occurs every year in January, and activities happen in regions yearly. Cooperatives formed under MCDC receive an introductory membership to the Council for the first three years after incorporation.

The final phase focuses on ensuring the cooperative's long-term sustainability and growth. The board of directors will work on evaluating the cooperative's performance, continuing member engagement, and planning for future growth and development.

Role of the Steering Committee

As outlined in the cooperative development phases, the steering committee is the foundation of the cooperative before, during, and after. The steering committee guides the cooperative through five phases: introductory, exploratory, planning, legal, and operational. MCDC supports the committee through these steps, but each cooperative is unique and requires active decisions from its members. At each phase, the committee must evaluate if the cooperative model fits their project.

Depending on the committee's activity level, incorporation typically takes 6 to 24 months. MCDC can facilitate some meetings, but the committee must handle pre- and post-meeting tasks like research, emails, and drafting plans. MCDC and any other technical assistance provider engaged will provide support but are not members of the steering committee, leaving decision-making to the committee members.

A committed steering committee is crucial. Members should understand their roles and be ready to dedicate time and energy for a smooth process. A steering committee typically has 5-7 members to ensure efficient decision-making. If needed, an advisory committee or, in the case of the worker conversion, a transition team, can provide additional expertise. At no time should the steering committee allow for one person or one entity to control the narrative and decisions. Remember, cooperatives are democratic with open and voluntary membership and are always membership benefitted, membership controlled, and membership owned.

No single member should dominate even in the steering committee phases; decisions are democratic, with each member's voice equally important. Specific roles, like notetaker and scheduler, should be assigned to leverage members' strengths and capacity. The steering committee manages the project, setting deadlines, assigning tasks, and tracking progress.

The Appendices include a fact sheet on the roles and responsibilities of steering committees.

Conclusion

Cooperative conversions can be a vital tool for Montana businesses and communities.

Through strategic partnerships and alliances, MCDC brings a dynamic blend of knowledge, funding, and technical know-how to the cooperative landscape in Montana. MCDC empowers cooperatives to thrive, innovate, and contribute to the economic well-being of their communities and the state. By leveraging diverse networks and resources, MCDC is dedicated to building a resilient and cooperative-driven future for Montana's businesses and communities.

As workers, business owners, communities, and other stakeholders consider converting a traditional business structure to a cooperative business model, keep in mind that the cooperative model is not just about business; it's about building a future where economic power is shared, communities are strengthened, and everyone has a stake in the success.

Professionals who share common trades and skills can explore worker ownership like Crucibles did to pave their own path of business ownership. The worker cooperative business model is vast, and though new to Montana, there is a significant network at the US Federation of Cooperative Workers. It is highly recommended that anyone who has an interest in a worker-owned, multi-stakeholder-owned, or cooperative conversion explore the resources and source materials linked through the QR code at the end of this document.

Together, with the support of the Montana Cooperative Development Center and partners, communities can create a vibrant, cooperative-driven economy that benefits all Montanans.

Appendices

Appendix A: Cooperative Overview

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The Seven Cooperative Principles

1. Voluntary and Open Membership

Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership without gender, social, racial, political, or religious discrimination.

2. Democratic Member Control

Co-ops are democratically controlled by their members, who set policy and make decisions for the cooperatives. Members have equal voting rights—one member, one vote. Members can never have more than one vote in a cooperative, regardless of longevity or investment.

3. Member Economic Participation

Members equally contribute to and democratically control the capital of the co-op. Members can receive a limited distribution of capital through patronage or dividends in proportion to the amount of business conducted through the coop rather than capital invested.

4. Autonomy and Independence

Cooperatives are autonomous organizations democratically controlled by their members. If they enter into agreements with other organizations or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. Education, Training, and Information

Cooperatives provide education and training for members, board members, managers, and employees to contribute effectively to their cooperatives' development. They inform the general public about the nature and benefits of cooperation.

6. Cooperation Among Cooperatives

Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, regional, national, and international structures.

7. Concern for Community

Cooperatives work for the sustainable development of their communities through policies approved by their members. Cooperatives exist to benefit members and the communities they serve.

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What is a Cooperative?

A cooperative is a business owned and democratically controlled by those who use its products, supplies, or services. Cooperatives are formed to meet members' specific objectives and are structured to adapt to members' changing needs.

"A cooperative is an autonomous association of persons united to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise." *– International Cooperative Alliance*

The primary objective of a cooperative is to serve its members rather than maximizing profits for external shareholders. Cooperatives are owned and operated by a group of individuals or businesses who come together voluntarily to meet their common economic, social, and cultural needs and aspirations.

A cooperative is a state-recognized business organized and operates as a corporation under applicable state laws of Chapter 35 of the Montana Code Annotated.

Types of Cooperatives

Cooperatives exist in all business sectors, such as utilities, agriculture, telecommunications, financial, retail, professional services, housing, and childcare. Cooperatives can take various forms of membership—a few examples are consumer, worker, producer, and multi-stakeholder cooperatives. Each type has its unique characteristics, but they all share the fundamental principles of cooperation and democratic control.

Montana has over 170 cooperatives ranging from rural electric cooperatives to agriculture cooperatives to consumer cooperatives to credit unions. Here is a list of the most common cooperatives formed in Montana:

Consumer cooperatives are owned and governed by the customers of the cooperative who benefit from the products or services offered by the cooperative. Examples of consumer cooperatives include food cooperatives, credit unions, and housing cooperatives.

Worker cooperatives are owned and managed by their employees. Workers have an equal say in the decision-making process, and profits are typically shared among the members based on their contributions to the cooperative.

Producer cooperatives are formed by agricultural producers who join forces to collectively market their products or obtain better access to inputs and resources. Individual producers work together to buy supplies and services and sell, market, and distribute their products. Producers save costs and acquire access to goods that would otherwise be unavailable or too costly alone. This type of cooperative allows small-scale producers to compete more effectively in the market.

Community development cooperatives or investment cooperatives are community impact funds made up of local community members and investors who identify businesses, projects, or causes into which they choose to invest together.

Multi-stakeholder cooperatives involve multiple groups, such as consumers, producers, employees, and community members, who collaborate to meet their shared needs and goals. This model allows diverse perspectives and interests to be represented within the cooperative.

Shared service cooperatives provide shared services and resources to their member organizations. They are formed when multiple organizations or individuals, typically from the same industry or sector, collaborate to establish and operate a cooperative entity to meet their common needs. The member organizations of a shared service cooperative typically benefit from economies of scale, reduced costs, increased efficiency, and improved quality of services.

Cooperative Structure

By pooling resources, sharing risks and rewards, and promoting democratic decision-making, cooperatives create sustainable and equitable enterprises that prioritize the well-being of their members and the communities they serve.

- **Control:** Management is controlled by a board of directors who are elected members. Each member has only one vote regardless of the amount of equity a member has in the cooperative.
- **Capital:** Equity comes from membership rather than outside investors. The member's liability is limited to the amount they have invested.
- **Earnings:** Earnings and losses are allocated to the members based on the use of the cooperative during the year, not equity held. The allocation may be distributed in cash or retained as additional equity.
- **Taxes:** Earnings are taxed once, either as the cooperative's income when earned or as income of the members when allocated to them.
- **Life:** A cooperative is designed to have perpetual existence. Members can routinely join or resign without disrupting ongoing operations.

Guiding Values and Principles

Cooperatives are based on the values of self-help, self-responsibility, democracy, equality, equity, and solidarity.

Members of cooperatives believe in the ethical values of honesty, openness, social responsibility, and caring for others.

Cooperatives must follow their country and region's laws; however, communities worldwide use the same **Seven Principles** to guide their cooperatives. Adopted from the Rochdale Principles, these principles encompass cooperative values. The Seven Principles serve as a framework for all cooperative organizations to operate in a democratic, transparent, and socially responsible manner.

weight. While decisions are democratic, steering committees need to identify roles and responsibilities for each steering committee member, such as notetaker, scheduler, and point of contact. It can be useful to assess the steering committee strengths and assets before starting to plan the cooperative.

3. Project manager

The steering committee guides the project and keeps it on track—determining the cooperative's purpose, decision-making, creating and following deadlines, assigning responsibilities to each member of the team, tracking progress, etc. The overall success of the cooperative and the timeline is up to the steering committee. MCDC will not act as a project manager for any cooperative project.

4. Become incorporators, commissioners, and board members

In the legal phase, the steering committee members select incorporators to sign and file the cooperative's intent to incorporate (or articles of incorporation if filing as an agricultural marketing cooperative) and written securities exemption with the Secretary of State and State Auditor. The minimum number of incorporators for a Chapter 15 cooperative is three, and a Chapter 17 cooperative needs at least five. After filing, the incorporators become commissioners. They can collect subscription agreements and legally sell shares to the cooperative. Generally, commissioners become interim Board of Directors members for at least the first year of the cooperative's operations—this provision is written into the cooperative's bylaws.

In most instances, the steering committee will become your incorporators, act as commissioners, and serve as the first board members.

Responsibilities

1. Determine feasibility

The first responsibility of the steering committee is to determine feasibility, whether through a formal feasibility study conducted by a third party or through community feedback. MCDC can help prepare survey questions, facilitate community meetings, and provide references to groups that perform feasibility studies. MCDC can also help identify funding sources, review applications, and administer grants if necessary. MCDC does not write feasibility studies or grants for feasibility studies.

2. Create a business and financial plan

The steering committee creates a business plan to determine how the business will run. MCDC provides assistance for business planning through worksheets, business planning software, and reviews. There are certain expenses, revenues, and considerations to include that are specific to the cooperative model. The business plan

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History of Cooperatives

The concept of cooperation can be traced back to various ancient civilizations, where people collaborated to achieve common goals, such as agricultural tasks or building projects.

The modern cooperative movement is often attributed to the Rochdale Pioneers, a group of tradesmen in Rochdale, England. In 1844, they established the Rochdale Society of Equitable Pioneers, an early consumer cooperative store to buy and sell basic goods at affordable prices.

The Rochdale Pioneers introduced key principles such as democratic control, open membership, and the distribution of surplus among members. They established the Rochdale Principles, now known as the seven cooperative principles, that are still in use today.

The electrification of America by electric cooperatives played a significant role in the cooperative movement in the United States. This effort, known as the Rural Electrification Administration (REA) program, had a transformative impact on rural communities and contributed to the growth and relevance of the cooperative movement in the country. The cooperative movement expanded to include various sectors, such as agriculture, credit, housing, and worker cooperatives.

The cooperative movement remains active and diverse in the modern era, with cooperatives operating in a wide range of sectors, including agriculture, finance, healthcare, education, housing, childcare, community impact, and more.

Throughout its history, the cooperative movement has demonstrated its ability to empower individuals and communities, promote economic democracy, and provide sustainable solutions to various societal challenges. Cooperatives have been instrumental in fostering a sense of community, promoting social responsibility, offering alternatives to traditional business models, and contributing to the economic development and resiliency of communities.

Appendix B: Business Model Comparison

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Business Model Comparison

MODEL	OWNERSHIP AND CONTROL	BENEFITS	CONSIDERATIONS
Cooperative Create wealth and benefit members	**Members:** Ownership based on holding a share of common stock. Financed by the sale of shares to members. Members democratically elect a board of directors. One member, one vote. The board sets policy.	Social business founded to provide services for members and community. Legally considered a corporation. Earnings from business are taxed once. Limited Legal Liability	Profits are allocated to members based on level of use (patronage). Each member has equal voting power.
Sole Proprietorship Generate wealth for the owner	**Individual Owner:** Financed by owner. Full legal liability. The owner sets policy and manages the business.	Simple and inexpensive to start. Owner reports on personal tax returns.	Owner personally liable for business debts.
General Partnership Generate wealth for partners	**Partner Owners:** Financed by partners. Full legal liability. Partners vote in proportion to investment. Partners set policy and manage business.	Partners report on personal tax returns.	Partners are personally liable for business debts. Profits are distributed in proportion to investment.
Corporation Generate wealth for shareholders	**Stockholder Ownership:** Ownership is determined by the number of shares held. Policy set by Board of Directors elected by majority stockholders.	Owners have limited personal liability for business debts. Owners can split corporate profit among owners and corporation, paying lower overall tax rate.	Most expensive to start. Sperate taxable entity. Taxed twice, once at the corporate level and then at the individual level.
Nonprofit Corporation Benefit the public	**Board of Directors:** Elected or appointed Board of Directors. The board sets policy based on set bylaws and articles of incorporation documents.	Founded around societal interests or causes. Can be tax-exempt.. Contributions to charitable corporations are tax-deductible.	Cannot return any profit to their members. Membership does not grant ownership. The full tax advantage is available only to certain nonprofits types
Limited Liability Company Generate wealth for partners	**Partner Ownership:** Financed by two or more partners. Limited legal liability. Partners vote in proportion to investment. Partners set policy and manage the business.	Owners have limited personal liability for business debts.	Profit and loss can be allocated differently based on ownership interests.

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Appendix C: Cooperative Advantage

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The Cooperative Advantage

The cooperative business model offers a flexible and inclusive approach that aligns business objectives with community and social needs.

1. Member Ownership and Control

Cooperatives are owned and governed by their members, who are also the primary beneficiaries of the cooperative's activities. Each member has an equal say in decision-making, regardless of their financial contribution, allowing for inclusive and participatory governance. This democratic structure ensures that the interests and needs of the members are prioritized, fostering a sense of ownership and empowerment.

2. Shared Risks and Rewards

As members, individuals pool their resources and share both the risks and rewards of the cooperative enterprise. This collective approach helps mitigate individual financial burdens and spreads risk across the cooperative, making it more advantageous for starting or operating a business.

3. Economic Benefits

Cooperatives distribute profits to their members based on their participation, rather than on capital invested. This ensures that benefits generated by the cooperative are shared equitably among its members. Cooperatives often focus on providing goods or services to their members at reasonable prices. This economic advantage helps improve the financial well-being of the members and can contribute to the local economy.

4. Stability and Longevity

Cooperatives tend to have a long-term perspective, prioritizing sustainability and the well-being of their members over short-term profits. This stability allows cooperatives to weather economic downturns and adapt to changing market conditions more effectively. As member-focused organizations, cooperatives have a vested interest in maintaining their operations and serving their communities over the long run. The cooperative business model is typically more resilient to economic fluctuations or industry challenges.

5. Shared Services and Access

Through collective action, cooperatives can access supplies, services, resources, and expertise that might be challenging for individual members to acquire on their own. This can include securing bulk purchasing power, accessing shared facilities or infrastructure, or benefiting from joint marketing efforts. The cooperative structure facilitates collaboration and the pooling of resources for the benefit of all members.

Co-op Advantage | 10.13.23

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6. Social and Community Impact

Cooperatives often prioritize social and community objectives alongside economic goals. They aim to address the needs of their members and contribute positively to their communities. The cooperative business model promotes cooperation, inclusivity, and equitable distribution of benefits, which fosters social cohesion, promotes local development and job creation, and supports sustainable practices.

7. Member Engagement and Education

Cooperatives emphasize member education, providing training and resources to enhance their members' knowledge and skills. This focus on education helps empower individuals to actively participate in decision-making, understand the cooperative's operations, and contribute to its success. This democratic learning process can have long-lasting personal and professional benefits for members.

8. Collaboration and Networking

Cooperatives foster collaboration and cooperation among members and with other cooperative businesses, by pooling resources, knowledge, and expertise. Members and the business benefit from shared learning, support, and effective political action. The principle of cooperation among cooperatives allows for networking opportunities where members connect with other cooperatives, organizations, and stakeholders with similar objectives, which can lead to increased market access, innovation, and mutual support.

It's important to note that the advantages of the cooperative business model can vary in each state, industry, region, and individual cooperative. However, the seven fundamental principles of cooperation, shared ownership, and member focus remain consistent, underpinning differences between other business models and the advantages of the cooperative business model.

Appendix D: Worker Cooperative and ESOP Comparison

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Comparing Worker-Owned Cooperatives & Employee Stock Ownership Plan

Worker Owned Coops and Employee Stock Ownership Plans (ESOP) are both models of employee ownership, but they differ in their structure, governance, and how they distribute ownership and control within the organization.

Worker-Owned Cooperatives

Worker-owned cooperatives are based on direct ownership, democratic governance, and community impact. In a worker cooperative, each employee, or member, owns an equal share of the business. This means every worker-member has one vote in the cooperative, regardless of their pay or tenure. Worker-owned co-ops are inherently democratic, with each member having an equal say in major decisions affecting the business.

Employee Stock Ownership Plans (ESOP)

ESOPs focus on indirect ownership and are often used as a retirement benefit. Employees in an ESOP accrue share allocations while working and typically receive the value of their shares, usually in cash, upon retirement or separation from service. Unlike co-ops, ESOPs do not involve direct ownership of company stock by employees.

Ownership Structure

Worker Owned Co-ops
In a worker-owned cooperative, employees collectively own the business. Each worker-member typically owns one share of the cooperative and has equal voting rights in its governance, irrespective of their position or length of service.

ESOP
In an ESOP, employees do not directly own shares in the company. Instead, an ESOP trust owns the shares on behalf of the employees. The company contributes shares to the ESOP, often as a retirement benefit, and employees receive these shares over time, usually when they retire or leave the company.

Governance and Decision Making

Worker Owned Co-ops
Worker co-ops operate on a democratic basis, where each member has an equal vote in major decisions affecting the cooperative. This includes decisions on management appointments, strategic direction, and distribution of profits.

ESOP
ESOPs are structured as traditional corporations or LLCs, with a board of directors and management team making decisions. Employees might have some influence through their voting rights on major issues, but day-to-day decisions are often made by management.

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Purpose and Focus

Worker Owned Co-ops
Worker co-ops are designed to empower workers both economically and socially by giving them control over their workplace. They emphasize worker self-management, job security, and community development.

ESOP
ESOPs are primarily used as a retirement benefit and a tool for incentivizing employees by linking their financial success to the company's performance. The main focus is on providing a retirement fund through ownership.

Legal and Regulatory Framework

Worker Owned Co-ops
The legal framework for worker co-ops varies by state but often includes specific laws or regulations that recognize and support cooperative businesses.

ESOP
ESOPs are regulated under the Employee Retirement Income Security Act (ERISA) in the United States, a federal law that sets minimum standards for investment plans in private industry. They also come with specific tax benefits.

Risks and Rewards

Worker Owned Co-ops
In worker co-ops, employees share both the risks and rewards of the business. They directly participate in profit-sharing and are involved in decision-making processes that can significantly impact their work environment and community.

ESOP
Employees in ESOPs benefit from the company's growth through the appreciation of their shares over time. However, their ownership stake and influence over company decisions may be more limited compared to those in worker co-ops.

Appendix E: Phases of Cooperative Development

MONTANA Cooperative DEVELOPMENT CENTER

Phases of Cooperative Development

The Montana Cooperative Development Center (MCDC) offers low-cost and free technical services for new cooperative development. MCDC has identified five distinct phases of cooperative development. Each phase comprises multiple steps and actions that should be completed before advancing to the next phase. In many cases, some steps can be carried out concurrently. It is the responsibility of each cooperative project to determine which steps are appropriate and necessary for building a successful cooperative.

Below is a concise outline of each phase and its associated steps. MCDC will assist cooperative groups throughout these phases, but it is ultimately the duty of the steering committee to execute the necessary steps to establish a successful cooperative.

Phase 1: Introductory

The introductory phase marks the first step in your cooperative journey. This phase offers an opportunity to gain a foundational understanding of cooperatives and the role of MCDC in the development process.

Steps in this phase include:

1) *Complete a Technical Assistance Request form with MCDC.*
2) *Review materials about cooperatives.*
3) *Hold initial meetings with MCDC.*
4) *Identify potential steering committee members.*

Questions to answer before moving to the next phase:

1) *Are three or more individuals interested in serving on the steering committee?*
2) *Is a cooperative the most suitable business structure for this concept?*

Phase 2: Exploratory

The Exploratory Phase is the most critical phase in cooperative development. This phase determines whether the project is feasible, viable, and sustainable as a cooperative.

Steps in this phase include:

1) *Provide cooperative education to ensure all steering committee members comprehend the cooperative business model.*
2) *Form the official steering committee responsible for building the cooperative.*
3) *Create a shared cooperative vision through group meetings, communications, and conversations.*
4) *Conduct feasibility studies, market analyses, community interest surveys, and community meetings as necessary.*

2) *Fully incorporate the cooperative by submitting proof of notice of membership meeting, Names and ranks of board members, and adopted bylaws.*
3) *Obtain EIN from the IRS once the Secretary of State has granted the business license.*

Phase 5: Operational

The Operational Phase is the final phase during which the cooperative commences operations, and the newly elected board can begin implementing the business plan.

Steps in this phase include:

1) *Set up accounts.*
2) *Collect membership fees.*
3) *Draft policies.*
4) *Apply for funding.*
5) *Acquire facilities.*
6) *Hire a general manager.*
7) *Procure goods and materials.*
8) *Continue to recruit new members.*

The cooperative development process is unique for each cooperative. Montana Cooperative Development Center has outlined the phases and steps in the process to help each project move smoothly through the development process and create a sustainable cooperative. MCDC does not guarantee that every cooperative project will be successful, that is up to the steering committee and the future members of the cooperative!

MONTANA Cooperative DEVELOPMENT CENTER

Steering Committee Roles, Responsibilities, and Requirements

The steering committee moves the cooperative through the five phases of incorporation—introductory, exploratory, planning, legal, and operational. MCDC (Montana Cooperative Development Center) has identified five phases of cooperative development and will help the steering committee through the various steps of the development process. Each cooperative is unique and will require steering committee members to make active decisions throughout the process on what is necessary for their business. At the end of each phase, the steering committee must evaluate whether the cooperative model best fits their project.

Depending on how active the steering committee is, incorporation can take between six and 24 months. For a shorter timeline, this could mean meeting weekly or biweekly. MCDC will facilitate at least seven steering committee meetings, but the steering committee will need to do pre- and post-meeting work which can include meetings, emails, research, and drafting business plans and bylaws. MCDC strictly provides technical assistance—we do not become members of the steering committee. We provide as much assistance as possible, but it is ultimately up to the steering committee to make decisions about the business and meet regularly to keep the project moving forward.

Participating in a steering committee is a big commitment. Selecting members who understand what is being asked of them and are willing to dedicate their time and energy is the best way to ensure a smooth and collaborative process.

Roles

1. Number

While there is no magic number, we typically recommend that a steering committee have between five and seven members—a small number helps the group find time to meet more easily and make decisions in a timely manner. If you need extra members or experience on the steering committee, consider setting up an advisory committee to help you with specific topics or for a specific time during development.

2. Democratic Decision Maker

No one member should lead the committee or make most of the decisions. Building a cooperative should be a truly collaborative effort; each member's voice carries the same should also include a strong membership recruitment plan, a marketing plan, and at least 3 years of financial projections. The steering committee will ultimately be responsible for creating a business plan and financial projections that prove the financial feasibility of the cooperative.

3. Draft bylaws, subscription agreements, and articles of incorporation

The committee drafts bylaws detailing how the cooperative is governed, subscription agreements detailing membership eligibility and benefits, and articles of incorporation to file with the Secretary of State. MCDC has templates of these documents and will help the steering committee work through each to create strong guiding documents for the cooperative.

4. Create marketing materials and recruit members

After the steering committee plans the cooperative, it needs to engage potential members through marketing materials. For example, these can include social media ads or community presentations.

When the selected incorporators become commissioners, they can begin collecting subscription agreements to create the cooperative's membership and raise capital for its operations. A good rule of thumb is that revenue generated from subscription agreements should finance the cooperative's first year of operations.

Requirements

1. Eligible for membership to the cooperative

All members of the steering committee should become members of the cooperative after incorporation, so the membership requirements of the cooperative should reflect that. Interested parties who do not meet membership requirements or do not want the responsibility of serving on the steering committee can become part of an advisory committee. They can be community partners, offer technical assistance, or provide other feedback the steering committee can use.

2. Reflect the diversity of the cooperative

To incorporate all points of view, the steering committee members must reflect the diversity of the cooperative. If the cooperative has multiple ownership classes, there should be at least one member for each class—producers, consumers, business owners, etc. If the cooperative serves a large region, the steering committee should have representation of the entire area.

3. Experience in business planning

While not exactly a requirement, it is a good idea to include members with experience or expertise in business planning or the cooperative industry.

4. Willing to equally share the burden of the cooperative

All steering committee members must be willing to take an active role throughout the process. Building a cooperative is a collaborative effort and will not succeed if all steering committee members do not commit to equally sharing in the work.

5. Represent future members

Steering committee members must remember they are acting as a representative of future members when building their cooperative. It is essential to continue to check in with your community as you build the cooperative and take feedback and considerations seriously during the planning process.

Sources and Resources

Additional materials for worker-owned cooperatives, multi-stakeholder cooperatives, and cooperative conversions.

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