

Vermont Coop Summit October 14 2010

When John Cote called me a few months ago and asked me to give this talk, I thought about it for a while before accepting. Usually, when I give talks it's about something I already know about the Vermont economy—the jobs situation, the outlook for the future, issues concerning the state's tax policy, and the like.

As I thought about the subject of coops in Vermont, I realized I didn't have any government statistics I could fall back on to give you some flashy powerpoints. Or even boring powerpoints. I figured it would be a good opportunity to learn about a part of the state's economy that I knew nothing about. So I accepted John's invitation.

As I started thinking about it, I realized I did know something about coops, at least on a personal level.

I've been a member of Recreational Equipment Inc, REI, a national outdoor equipment coop, for more than 40 years.

When I first moved to Vermont in 1980, I became a member of the Onion River Coop. For those of you who don't know, and I assume most of you here do, that's now City Market in Burlington.

About a decade ago I became a member of New England Federal Credit Union, another type of cooperative.

I frequently buy products from another major Vermont cooperative—Cabot.

And, living in rural Westford, I buy my electricity from Vermont Electric Cooperative.

So that's five cooperative institutions that I choose to belong to, or to buy products and services from. Well, I don't have much choice about electricity. With apologies to Vermont Electric Coop, the state forces me to buy my electricity from VEC. But wait a minute. Why am I apologizing, and to whom? After all, I am part of the Vermont Electric Coop. So can I apologize to myself?

More seriously, I probably represent the situation of a lot of people in Vermont. We have a lot more connections to cooperative institutions than we realize. And that's borne out by statistics—at least at the national level, as I'll discuss.

What I'd like to do this morning is to talk about three things. First, what are coops and their cousins (employee owned firms and the like)? Second, why do they exist? And third, how important are they in the Vermont economy?

I. What are coops?

You all probably know what cooperatives and their family friends are, but as someone who has only recently begun thinking about the bigger picture, I'd like you to look at them from an economic perspective

We differentiate coops from other forms of firm organization by their ownership structure. Firms earn profits for its owners and the owners are, in standard economic theory, interested in maximizing profits. That's a very loose term, because maximizing profits may mean driving your employees like slaves (read Karl Marx or better yet, Frederic Engels for this), or it could mean allowing them huge amounts of freedom and providing lots of benefits. (See Silicon Valley firms for a good example of this.)

Owners of for profit firms—we usually call them corporations—are the shareholders, and they choose managers who are supposed to do their bidding for them, maximizing profits. The modern version of the corporation was invented in the early 1800s, although its roots go back to the 17th century when individual corporations had to be chartered by the British Crown, which meant they were essentially monopolies.

Beginning in the early 1800s, corporate charters became easy to obtain as governments lifted their restrictions on them as they proved to be a powerful tool to organize large amounts of capital. Since then, corporations have played a key role in delivering newer and cheaper goods and providing all of us with a high and rising standard of living. And both the level and the two percent annual growth rate of our standard of living would astound anyone living before the modern corporation was invented.

Other firms have a different ownership structure. In recent analysis of these types of firms by the National Bureau of Economic Research—the same organization that decides when recessions start and end--the authors term this ownership structure 'shared capitalism', a term I like. It includes employee owned firms, like full ESOPs, firms where employees own a share of the firm, perhaps through 401k plans, and firms where part of employees' compensation package comes from either a profit sharing plan or stock options.

In profit-maximizing, traditional corporations, managers maximize profits for the stockholders, and one of their main tasks is to motivate their employees to maximize their productivity. How do employee owned firms compare? Are employees motivated by a different view of their role?

Our first problem is to ask what exactly is an employee owned firm. I can visualize an organization where all of the employees own the firm—an employee owned firm. Employees may be motivated differently.

But what about an organization where the employees own only some portion of the firm? Is that any different than a firm where they own all of it? How much do employees have to own before the firm, or the employees, behave differently than in a standard profit-maximizing corporation?

And what about the case where the firm's suppliers own an organization—a cooperative, like Cabot—or one where the firm's customers own the organization, like electric cooperatives. Does that make a difference? And what kind of difference might it make? Are employees of these firms more productive, which means they can supply the product at a lower cost? Are the firm's employees paid more if they're more productive? Or do these types of organizations exist because they can do a better job at marketing by pooling together, rather than trying to do it individually?

And what about a firm where a single employee is the owner? Should we consider that to be an example of this "shared capitalism"? After all, if ten people work at a firm and all ten own the company, is that any different than if one person is the firm?

In Vermont, the Census Bureau reports that 60,000 Vermonters own businesses that have no employees other than the owner. And these businesses have a total of \$2.4 billion in revenues. In a state with an employment level of nearly 300,000, that's one person for every five payroll employees.

That may stretch the idea of employee-owned firm beyond where most of us want to go with it. Nonetheless, it's worth remembering that one reason people start their own business is for the personal satisfaction that comes with ownership. And that, it turns out, is one important reason for the success of coops and employee owned firms.

Finally, how are we to consider firms that are owned by the government itself? Compare, for example, Vermont Electric Coop, a cooperative firm owned by its customers, with the Burlington Electric Department. If we are trying to measure the extent of employee owned firms in Vermont, or of cooperatively owned firms, where does something like Burlington Electric fit? It's certainly not like shareholder-owned Green Mountain Power or CVPS, and it's certainly not employee owned. But is it a cooperative? Burlington Electric is "owned" by the taxpayers of Burlington. So if you do consider it a similar to a cooperative—owned by its members--then should we consider our local schools to be cooperatives, owned by the townspeople? I don't think I would agree with that statement, but you can see that definitions of what we mean by cooperatives is critical.

II. The second question was why do cooperative type organizations—including employee owned firms-- exist?

Firms combine labor and other resources to produce products or services for sale to buyers. Those that provide the best combination of price and quality survive. Those that don't fail. Do cooperative types of firms do a better job than traditional firms? That's really asking the question of how do firms make decisions on what to produce and insure that workers are working effectively and efficiently.

There are two ways to motivate a worker. Workers always have a tendency not to work hard if they don't directly benefit from the fruits of their effort. In a single person, or single family, firm, this is not a problem. But once firms start getting large and complex products, it is.

One way to motivate workers is to supervise him or her closely. But this is costly. You could have one supervisor overseeing each worker, but that's not a path to prosperity. The other way is to motivate the worker. Cash works well, but does a manager know a worker is working well just because she pays him a lot? No.

Another way to motivate workers is to have other workers make sure that their colleagues are working well. That's one benefit of the shared capitalism model. In a large survey, researchers found that shared ownership—having the employees benefit from the success of the firm—promotes what is called “co-monitoring”. That is, employees push other employees to perform better and therefore perform the role of monitoring employees to insure they work hard and don't shirk.

Moreover, it appears that firms that give employees a stake in the decision-making process within a firm are more efficient, have higher productivity, and

There are other ways to do this. One of my favorite stories that I like to tell my students when we are talking about this issue is of the Chinese canal boat teams. In China, canal boats were pulled by teams of men who split the revenues they received for pulling a barge. Mules or oxen were too expensive, so humanpower was used. How did these teams of barge pullers make sure that everyone was pulling their own weight, so to speak. The team members got together and hired an overseer to whip anyone they saw shirking. That's one way to do it.

The idea that shared capitalism might be something worth pursuing is not something recent. Most of you are probably aware of Louis Kelso, the investment banker who put the idea of ESOPs into reality in the 1970s.

But, surprisingly, John D. Rockefeller and other corporate leaders encouraged profit sharing and employee ownership as early as 1919 to encourage the spread of capitalism into the working

class. Agricultural cooperatives had already been around for a while, and in Vermont, the St. Albans Creamery and Cabot coops both started around that era.

Even earlier, back in the late 1890s, mutual burial societies, mutual insurance companies and other similar organizations began to become popular. Even before that, Albert Gallatin, Thomas Jefferson's Secretary of the Treasury, wrote that "The democratic principle upon which this Nation was founded should not be restricted to the political processes but should be applied to the industrial operation" and used that principle as he established a profit sharing plan when he organized the Philadelphia Glass Works in 1795.

III. How important are firms like these—coops, employee owned firms, and the like--in Vermont?

Our knowledge of the extent of employee ownership or “shared capitalism” as the NBER study termed it, is limited because there are almost no surveys, official government or less formal private surveys that ask questions about them.

Based on a limited survey, the NBER shared capitalism study found that nearly half of all workers are involved in some form of shared capitalism and the share has grown dramatically since the 1980s. How does that break down? Nationally, somewhere between 25% and 33% of workers are eligible for profit sharing. About 20% own stock in their own companies, and around 10% of all employees are eligible for, or hold, stock options in their companies.

One of the myths of the Vermont economy—and there are many—is that Vermont’s economy is different from the national economy. It’s not. The share of employees in Vermont by sector—manufacturing, retail, education, health—are similar to national shares. The size distribution of Vermont firms is similar to national norms. Therefore, there’s no reason to assume that these national statistics don’t apply to Vermont. That would mean that somewhere between 75,000 and 100,000 Vermont employees have some sort of profit sharing plan, another 60,000 own stock in the companies they work for, and about 30,000 have stock options. That’s a total of between 165,000 and 190,000 workers out of a total of 240,000 private sector employees in the state.

Based on information, well, a conversation with Jon Crystal at the Vermont Employee Ownership Center (which is the only source of data we have on employee owned firms in Vermont), there are about 35 ESOPs in Vermont, with a varying amount of employee ownership shares. These firms have around 4,000 to 5,000 employees. But based on the NBER study, that’s only a small portion of the total number of employees who have some ownership stake in the firms at which they work.

And those numbers do not count the number of workers employed in different types of cooperatives or of people who have some direct relationship to the products produced by those firms.

What do I mean by that? Take, for example, electric cooperatives. Although the employment level of the two electric coops (Vermont Electric and Washington Electric Coops) are small, they account for 15% of all the electric customers in Vermont—and municipally owned electric companies—primarily Burlington Electric-- account for another 15%. Those are sizable numbers of people who directly interact with a coop for a major budget item.

Financial coops—generally known as credit unions—have an even larger impact. Credit Unions began in the U.S. in 1909 and the first was established in large part through the working of a man named Edward Filene (no, he didn’t organize it in his basement, but it is the same Filene).

Our neighbor to the east, New Hampshire, passed legislation establishing credit unions in 1921, and by 1939 the Granite state had nine state-chartered credit unions and five federally chartered credit unions, with about 7,000 members.

As late as 1939 Vermont had no state credit union law, although there were five federal credit unions. Five of them. The three that reported data had a total of 206 members. Vermont was a laggard state back then—34 states had already passed laws enabling the charter of state credit unions.

Today there are 30 credit unions with about \$2.2 billion in assets, which, based on data from the state's banking regulators, is about 20% of the total assets of all financial institutions doing business in the state. That's not insignificant, but it's not huge. However, credit unions have about 300,000 members. Some of that total may represent people who are members of more than one credit union, but given the state's population is 620,000, and the adult population over the age of 21 is about 500,000 that is a huge share of the state's population who are members of, and buying services from, one type of cooperative.

Finally, there are the state's agricultural cooperatives. The largest are the dairy coops, Cabot and the St. Albans Creamery. These two coops, which were founded 100 years ago, have a membership of 1,700 farms—although not all of them are in Vermont. Still, given that the U.S. Department of Agriculture counted 1,200 dairy farms in Vermont in 2007, probably every dairy farm in Vermont is a member of a cooperative. And there are a number of smaller coops that provide seasonal and other food products to their members. While small, they are visible, especially in their local communities and

Conclusions:

I know many of you would like me to say that the number of cooperatives and alternatively owned firms in Vermont is a large part of the state's economy. I can't and won't say that. I will say, though, that every player in the Vermont economy—from manufacturing to health care to education to agriculture to the arts to small business—wants to believe that each of them accounts for at least 50% of the Vermont economy, and they have the numbers to prove it. They don't.

Employee owned firms, cooperatives, and other firms that are part of Vermont's "shared capitalism" economy, do play an important role in the economy qualitatively if not quantitatively. They remind us of the importance of motivating employees by having them share in the fruits of their effort and by showing that quality and satisfaction in the workplace and in the marketplace have a positive payoff to firms, their employees and their customers.