THE EDITOR NOTES

BY DAVE GUTKNECHT

Building Blocks: A = L + C

I remember learning balance sheet basics at some of my earliest co-op meetings. "A = L + C" was written for all to see, then explained again and again: Assets = Liabilities + Capital. When we understood it, we encountered this question: How do we finance the assets that make our cooperative business possible?

The need for these questions never ends—not if co-op managers and boards of directors are to understand what it is they are leading. One current teaching technique, in Cooperative Board Leadership Development training, uses colored Lego blocks to convey the varying components of balance sheets.

Again, how will the cooperative be capitalized? The question is old and essential, yet the answers have often been short-lived and inadequate. Being undercapitalized can mean the co-op is unable to make needed improvements, unable to take advantage of market opportunities, or even to meet its obligations and remain in business. Although founded in the name of shared ownership, consumer co-ops frequently have shared the benefits while undervaluing the investment side of sustaining the business. Historically, co-op members and leaders often have shorted member investment in order to offer low barriers along with the immediate return of earnings, either through purchase discounts or cash patronage dividends.

Given the past and current strong performance of many food co-ops, these statements may seem inaccurate. After all, years of food co-op success and expansion have been built on good business leadership, on growing interest in cleaner food and local food, and on the public trust that has been earned by food co-ops. However, many co-ops remain small for decades, unable to strongly expand membership and services. Even the more successful co-ops, usually of larger scale although with a neighborhood identity, are slow to grow into additional stores—yet when they do so, the expansion is almost always successful.

In sum, the challenges of startups as well as the slow growth in co-op stores both testify to the centrality of capital and the limited leveraging of cooperative capital. Ironically, a pattern of operational success may reinforce a weak assumption that earnings will provide the owner capital needed for future growth in sales and services. Member equity requirements have meanwhile been kept at low, inflation-resistant levels in most food co-ops. A $75 member equity requirement established 20 years ago is worth much less than that in today's economy. Granted, costs for everything else have gone up for both consumers and the co-op, but the member's investment quite often has not been increased.

The inadequacy of member-owner investments can become more evident when the co-op's leadership recognizes an opportunity to expand ownership and services. The co-op's balance sheet may not be strong enough—meaning, typically, that it shows too little owner equity and too much reliance on future earnings to repay the added debt.

Despite these issues, most food co-op balance sheets have grown stronger and show much potential. When expansion is decided upon, co-op member equity and (subordinated) member loans are increased, then leveraged to great benefit. Co-op members and co-op institutional lenders help supply the financing, while improved training and development resources also support expanding food co-op outreach and services. But that capital gap often remains. The cooperative's service orientation and restrictions on investments leave few alternatives to reliance on debt financing and its costs and obligations.

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These are perennial challenges in cooperatives. Illustrating this, all of the capital sources mentioned here are part of St. Peter Food Co-op's financing strategy. See the report in this issue's cover section, which discusses new co-op laws that address co-ops' capital needs by allowing a significantly expanded role for nonmember investors—thereby extending or contravening historic cooperative rules and principles.

The ongoing economic decline is making capital harder to secure from conventional sources. Inflation continues, although much disguised in official figures, reinforcing the desire to achieve some return that drives much of where people invest. But the worsening recession also makes investing in local cooperatives increasingly attractive, in part because these are local businesses characterized by transparency and democratic governance.

The home-grown economy and its investments are of growing importance. We'll need greater local resilience to withstand volatile national and global economies. Well-capitalized co-ops can be leaders in this economic rebuilding. ■

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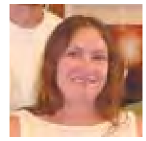

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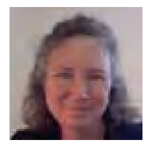

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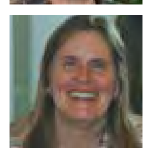

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