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Collective reasoning

Going it alone isn't the best route for all business owners.

Cooperative corporations offer an alternative to franchising, with members working together to decide how their company should operate. With lower startup costs than most franchise systems and greater opportunity for owner input, the co-op model is gaining steam.

BY JASON DALEY

In 1999, Jerry Merrill was on a conference call with his franchisor, Baskin-Robbins, when he got the news every franchisee dreads. The company was not going to renew his franchise agreement, along with those of 600 other B-R franchisees across the country. Shreveport, La.-based Merrill, along with 34 other disowned franchisees, sued the company, mainly to give themselves time to figure out their next move.

Instead of just folding up shop, Merrill and his band of ice cream entrepreneurs decided to start their own chain. But KaleidoScoops isn't your average franchise. In fact, it's not a franchise at all—it's a cooperative corporation, an alternative model to franchising that has picked up steam over the last decade. As opposed to a franchise, where a corporate entity lays down the law to franchisees, co-op members own the company and elect a board of directors to collectively decide how the business is run.

"When you have a corporation that is publicly owned, it has to answer to stockholders," says Merrill, who serves as KaleidoScoops' chairman of the board. "We answer to our membership. A public corporation's focus is not always on its franchisees. But, believe it or not, in a cooperative model everybody wins. That can still happen in this country. The customer, the co-op members and the corporation can all profit."

To many, the word *co-op* brings to mind Depression-era dirt farmers and hippies running organic grocery stores. Liz Bailey, interim president and CEO of the Washington, D.C.-based National Cooperative Business Association (NCBA), admits that those stereotypes have been difficult to overcome, but says people are slowly beginning to realize the power of cooperatives and their potential as a viable business model. In addition to groceries and agriculture, there are co-ops for other types of retail, as well as banking and housing.

"By our best estimate there are 29,000 cooperatives generating 2 million jobs in the U.S.," Bailey says. "They hold $3 trillion in assets and add $650 billion [annually] to the economy. The recession has really driven interest in co-ops. They are affordable, and people are looking for deals. Lots of people have been moving into credit unions, which are a type of co-op, and that has had a big impact on perception."

In many ways, franchises and cooperatives are mirror images of one another. In franchising, a corporate entity with a strong concept and sense of purpose creates a system that can be replicated by franchisees. In a cooperative, independent business owners band together to reduce costs and in the process create a corporate entity to do their bidding, deciding together the details of their concept and what values they will pursue as a group. That type of cooperation can be hard to manage, and cooperatives often have a more difficult time expanding than centrally run franchises. At the same time, co-ops appeal to a different type of person, one who wants to own a business but doesn't want the rigidity of a franchise system.

"Cooperative members have a lot of free will," Bailey explains. "What you agree on and what you want to do is what the cooperative is then about. It's not like a franchise. It can be specifically tailored to what its members want it to be."

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Several high-profile chains operate as co-ops, though they are often mistaken for traditional franchises. Ace Hardware and True Value, for example, are co-ops; member/owners decide individually what products to carry in their independently owned stores, while standards and practices are determined through an elected board of directors.

Meanwhile, some franchises actually have a cooperative element to them. Supreme Court rulings in the 1980s opened the door for franchisees to form purchasing cooperatives in order to buy supplies from sources other than their franchisors, often at great savings. While many corporate offices resisted the cooperatives at first, the practice has become widespread—Subway and Burger King

Jerry Merrill of KaleidoScoops is sweet on the cooperative business model.

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are among the companies operating this way—and in many cases the purchasing co-op has become the primary source of products for franchise systems.

Like KaleidoScoops, Washington, Pa.-based Donut Connection is a cooperative that was born from the dissolution of a franchise. In 1990, Dunkin' Donuts acquired a mid-Atlantic concept called Mister Donut, deciding to cut loose about 375 of the chain's 550 stores. In 1995, James Morton, who had been Mister Donut's director of operations, joined with some 45 former dealers to create the Donut Connection Co-op Corporation, which has since grown to 185 stores. While members have the freedom to run stores their own way, Morton, now the co-op's COO and general manager, insists that the quality and standardization is just as robust as it would be within a franchise.

"People who want to open a donut shop want to manage it as their own business," Morton says. "If they want to sell water, ice or pizza, too, that's their choice. They still benefit from a powerful national brand and purchasing power.

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> —Howard Brodsky, CCA Global Partners

"We have stores from Minneapolis to Miami right now. Our quality is the same as you'd find at a franchise. Our coffee is brewed to spec. Our cups, bags, boxes and donuts are all uniform. It's a very attractive model for someone who wants to get into business without paying a 10 or 20 percent royalty."

Still, it's not a free-for-all. Members can't tamper with the brand, stock discount donuts or run dirty stores. "We do maintain tight control over the core brand, and we will cite them and take legal action if we have to, though that's something we haven't had to do yet," Morton says. "Our members have a lot of freedom in how they want to do things because they know their market better than someone else."

Merrill at KaleidoScoops agrees that the most appealing aspects of co-ops are the freedom and low overhead costs. There is no upfront franchising fee, nor are there royalties to pay (though there is a charge of about $5,000 in licensing and training fees, and a nominal membership fee). "Our cost of getting into business is now under $100,000," Merrill says. "Yogurt and ice cream franchises usually run $275,000 to $500,000. We cost about 30 percent of what it costs to get into those businesses."

KaleidoScoops offers members assistance in finding locations, signage, access to proprietary flavors and many other services similar to those that a good franchisor would provide. What's more, co-op members receive patronage dividends, since the corporate side of the cooperative does not hoard its surplus profits but redistributes them to members.

But cooperatives do have shortcomings. Many, like KaleidoScoops, don't have the resources to engage in national advertising. And because they often have a bare-bones staff, new members don't get the same level of hand-holding new franchisees usually receive. Morton at Donut Connection says he tries to help members as much as possible but admits that as the only person running the "corporate" side of the business, he has difficulty addressing all the questions and problems that crop up.

Howard Brodsky has thrived with the co-op model. When he co-founded carpet retailer CCA Global Partners 27 years ago, he wanted his locations to run as cooperatives, not franchises. His goal was to even the playing field for independent business owners, not to command and control a chain of stores. Now his empire encompasses 12 co-ops—including Carpet One Floor & Home, Lighting One, The Bike Cooperative and Flooring America—which see more than $10 billion in sales per year. CCA says it has returned more than $1 billion in dividends to its members, and that the extra boost helps them grow and reinvest in their businesses. While 25 percent of independent flooring shops bit the dust during the recent recession, CCA flooring cooperatives had a failure rate between 1 and 2 percent, Brodsky says.

Successes like his are one reason talk about cooperatives seems to be in the air right now. "There's been a tremendous interest in co-ops in the last two or three years. There's an enormous awakening of what's being done in this sector," Brodsky says. "Most co-ops started in the Great Depression, when people were frustrated and felt they didn't have any control over their lives. People have that same attitude today. They don't want to be part of a larger company that can control them, but they often don't have the scale to make their business profitable. That's where co-ops fit in."

The NCBA's Bailey thinks business owners and investors should start looking more seriously at co-ops. "Cooperative development is a form of entrepreneurism," she says. "Entrepreneurs take risks, and a cooperative development does, too—it's just a collective form of risk. Co-ops are a tool for entrepreneurs who really want to own their own businesses, but who also want access to products and economies of scale that will make them a better business."

Brodsky agrees. "It is a hidden gem of a model," he says. "When someone understands what a cooperative is, they love it. It's the lack of understanding that has been the big barrier, not a lack of success in the cooperative world. I think the future of co-ops is a tremendous horizon, with the world as its playing field." Ⓔ

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