Bike Co-op Goes Flat

Difficulties faced by worker-owned bike co-op offer lessons for others of potential business pitfalls

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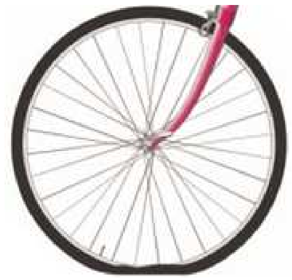

In the fitness-oriented town of Eugene, Ore., a different kind of cooperative struggled with many of the problems familiar to modern agricultural, value-added co-ops. In the end, the difficulties inherent in the worker-owned cooperative model forced Burley Design Cooperative, a manufacturer of much-sought-after premium bicycles and bike accessories for 28 years, to sell out to a private investor.

Burley built high-end bicycles, including tandems and recumbent bikes, on which the rider reclines as if in a chair. It originated the child-carrying bicycle trailer and produced a line of outdoor clothing and rain gear. The new owner has announced that the bicycles and clothing will be dropped; only the trailers, Burley's strongest product line, will continue in production.

The products had a reputation both in the United States and overseas for high quality, durability and affordability. The bike co-op competed in a market in which competition is fierce from China and other countries with much lower production costs. Burley child trailers, which can be converted to athletic strollers, retail from about $240 to more than $400. Its tandem bicycles ranged in price from about $1,000 to more than $5,000.

Burley had no problem selling its wares — in fact, its main dilemma was the opposite: it couldn't make enough product to meet demand. Further, as the new millennium began, inefficiencies ate away at its bottom line and it began having trouble meeting its delivery obligations. After more than two profitable decades, the cooperative began losing money in the early 2000s. By 2005, it was losing $1.5 million a year.

Production limitation hurt co-op

Cary Lieberman was the marketing manager for the coop, and has been retained by the new owner. He says the coop's inability to expand production was rooted in the cooperative structure itself.

Part of the problem is one with which many co-ops are familiar. When members can't provide enough capital on their own, the only alternative is to borrow. However, says Lieberman, "Raising capital is a nightmare. Banks don't understand the co-op model."

Another part of Burley's struggle was the tension between its tradition as an egalitarian worker cooperative, in which all members originally had equal authority, and the need for employees who specialize in management and have the knowledge, experience and authority to make decisions. Throughout its existence, the co-op's structure evolved as it attempted to be true to its roots and competitive at the same time.

The production problem was complicated by the fact that Burley products, while not cheap, were priced lower than competing products of the same quality. Lieberman names a competitor that sells "virtually identical bikes" for $2,000 more. The easy solution might seem to be to increase prices until demand and supply even out.

But Burley was wary about raising prices: "We don't want to alienate our loyal customer base, and we don't want to hurt our reputation for great quality at reasonable prices," Lieberman told *Rural Cooperatives.*

Reluctance to charge more when turning customers away might seem odd to some, but Burley was not a typical manufacturer. It was founded as a private business in 1969 by Alan Scholz, who owned a bicycle shop in Fargo, N.D., when he started selling bike bags sewn by his girlfriend, Beverly Anderson, to other bike shops. In 1974, Scholz and Anderson moved to the small Oregon town of Cottage Grove, and their product line expanded to include bike shorts, backpacks, rainwear and ski clothing. The sewing was done by a small group of people working in their homes and paid by the piece.

Employees form co-op

In 1978, Scholz and Anderson decided they didn't want to be bosses. They sold their business to their employees, after having cooperative bylaws drawn up by a local attorney, remaining on as co-op members.

In the beginning, all members received the same wages, a practice that was to continue until only a few years ago. Production of trailers began at about the same time. After a difficult period during the recession of 1982 — during which a number of members, including the founders, left the cooperative — business expanded dramatically as the fitness craze took hold of newly affluent baby boomers.


USDA photos and graphic by Stephan Thompson

Burley moved to the larger town of Eugene to take advantage of a bigger labor force and better logistics. Eugene is an outdoorsman's delight, with mild weather year-round and easy access to the spectacular Oregon coast, year-round skiing and breathtaking rock-climbing, hiking and mountain-biking venues nearby. "Very few places in the country would compare," says Lieberman.

In the 1980s, it was also a good place to get a bike business off the ground. A Sony manufacturing plant provided good income to a relatively young and athletic population, a good local market for the co-op.

Eugene, a university town, is known for a strong sense of community, which fit well with the public-spirited nature of the co-op and also contributed to the firm's continuing commitment to quality. "If you're going to see the people you sell to on the street, you want to be sure that your products don't disappoint them," says Lieberman.

By December 1985, the cooperative had 15 members. They were paid an hourly wage that varied by the month, as determined by expected profits. The co-op restructured its bylaws and established a regular payroll. All the members were made employees and were paid consistent wages. A portion of the profits were set aside to fund capital improvements and meet other expenses.

While the changes improved the firm's efficiency, other ways of doing business left over from the early days of the coop remained. All members, regardless of their position, received the same wage. Governing the co-op remained simple in concept: all members were directors. Acquiring new skills and training was left up to individual members.

Business expertise needed

Elliot Gehr, the last president of the co-op, was with Burley for 18 years. "We'd always been amateurs," he says, "But we needed the expertise of business professionals." As the cooperative began a move to expand into the national marketplace, its egalitarian informality became more of a handicap.

Having all members on the board is democratic, but as a cooperative grows, decision-making becomes more cumbersome and conflicts can cause delays. The U.S. market for bicycles is subject to fads and rapidly changing styles and trends, making such a management model a serious liability.

In 1987, founder Alan Scholz, by then no longer a member, proposed a partnership to build tandem bicycles. At the time, the only high-performance tandems available were very expensive. Scholz saw an opportunity in a growing trend of couples engaging in fitness activities together.

In a joint venture with Scholz's company, Advanced Training Products, Burley began manufacturing tandems, further contributing to business growth. Burley and Scholz later ended the joint venture, and the co-op began producing bicycles entirely in-house.

By 1989, membership had grown to 39, and it was clear that things had to change. Management of the firm was still by consensus. The workforce was divided into teams, each with a leader. However, the team leaders were only first among equals; they were not given effective authority over their team members.

Management was becoming increasingly unwieldy, and decision-making was handicapped by the necessity to get a large number of people to agree on the smallest details. "People would waste time arguing where to put the hot plate," one member told me. "They'd waste $300 worth of time arguing over the color to paint a bike."

Restructuring improves productivity

The co-op appointed a committee to study restructuring. After much debate and controversy, it was decided to elect an eight-member board of directors and to give team leaders the status of managers with the ultimate responsibility for the performance of the people they supervised.

Gehr saw the elected board as a mixed blessing. While it streamlined decision-making, it also made many of the workers feel insulated from running of the co-op. "Some people choose not to participate in our outer democracy (government)," he says. "And now, some chose not to participate here."

The new structure made for muchimproved efficiency. Production and sales continued to grow. By 1992, it was clear that top-level management expertise had to come from outside. "We realized we had to import talent," says Gehr. For the first time, a new general manager was brought in from outside as an employee.

Also in 1992, the cooperative found itself caught short, swamped by a wave of unanticipated orders. In response, it hired about 20 seasonal non-member workers. After that, many more workers were hired as non-members. The quick expansion of employment resulted in some problems, including what Gehr says were some mistakes in hiring.

In 2003, membership in the cooperative was closed, with all further hires being employees only. In retrospect, Gehr thinks that was a bad idea. “We got bad advice,” he says. “Instead, we should have hired more members.” Gehr believes that membership encourages badly needed responsibility and creativity. By the time the co-op converted, only 55 percent of the workers were members.

Differential pay introduced

Another innovation made at the same time showed more promise. For the first time, differential pay was introduced. While pay levels were still lower than average in most areas, paying more for greater expertise or productivity allowed Burley much greater flexibility in hiring and retaining needed talent.

Lieberman says that the shift to differential pay “shook things up.” As with any innovation, it had its bad effects as well as good. “Some people lost enthusiasm because they felt it was a betrayal of cooperative principles.”

Gehr maintains that other bad advice hampered the co-op’s efforts to grow. “The trouble is, most accountants just aren’t familiar with the cooperative model,” he says. “As a result, we didn’t take advantage of opportunities to plow profits back into the business, as we should have.”

Gehr is especially troubled by the co-op’s past ignorance of the use of non-qualified dividends. “If you’re growing, qualified dividends are the easy answer. But in a less profitable year, if you give out all of your profits as dividend payments to members, you have to borrow. The use of non-qualified dividends allows you to build up a financial cushion.”

Lieberman says that in the past, the cooperative was “property-focused” at the expense of investing in machinery. It moved into its present facility in 1996, a spacious, modern “green” building constructed with the help of the members. But while the facility had ample room, the use of the space available was not as efficient as it could be.

After taking advantage of a state grant for training in manufacturing efficiency, co-op managers and board members realized that the various stages of production were scattered haphazardly. Machines and work stations had remained where they were originally put, and new elements were stuck wherever they would fit.

Using what they had learned, they were able to rationalize the set-up so that each workstation required the same amount of time. The trailer shop showed an 18-percent improvement in productivity, Gehr says, and nobody had to work any harder.

The changes ran into resistance from some members, however. Once the machines were put into their new, more efficient positions, workers returning after the weekend found everything moved back to its original place.

Parts standardized

Other measures were put into the works to improve efficiency. The co-op began working to standardize the parts that make up its various bicycle trailer models, which are now the largest selling brand in Germany (they meet stringent German safety codes) and continue to expand sales in North America.

> *“Some people lost enthusiasm because they felt it was a betrayal of cooperative principles.”*

Burley saved not only time and money, but cut back on greenhouse-gas emissions through the use of powder coating for bike finishes. Powder coating is more environmentally friendly than “wet spray” paint, because it doesn’t use volatile solvents. It also takes less skill and less time to apply. Wet spraying demands care and skill to apply the coat properly — applying it too wet results in runs and sags; not wet enough results in a dull or “orange-peeled” finish.

Powder coating works by spraying a dry, electrically charged polymer powder onto the metal surface. The bike frame is then placed in a large oven and heated. The powder melts and forms a hard, glossy protective finish. Besides being more efficient to apply, powder also gives a much tougher and more durable coat. The disadvantage of powder coating is the sizeable capital expenditure required for the large oven to heat the painted items.

Other upgrades included automation of various tasks, including wheel building and truing and the production of small parts. According to Gehr, the automation reduced risk in comparison to using outside suppliers: “By producing parts in-house, we’re not beholden to others for delivery.”

In any case, the bike shop worked, as Gehr put it, like a “cottage industry,” with a huge number of different parts for the various models and a great deal of hand work. This doubtless contributed to a decision by the new owner to close down production of all bicycles.

When interviewed last summer (prior to the conversion), Lieberman and Gehr both said that the Burley board and management were well aware of these and other stumbling blocks to greater efficiency. “We’re making investments now that we should have made 5 years ago,” said Lieberman.

Need for credit heralds change

The need for credit for upgrades led to the cooperative's conversion. The firm's CEO, Char Ellingsworth, had been brought in from outside as the chief financial officer. She was promoted when her predecessor left to use experience he gained at the cooperative to engage in "lean manufacturing" training.

One of Ellingsworth's recommendations was a change in status to a worker- owned corporation. At the time, the move was seen as solution to remaining true to the cooperative spirit. The intent was not to issue stock to raise money, but to make the firm more attractive to lenders.

Cooperative shares were to be converted proportionately to stock shares. Current workers were to be issued common stock, and former workers who still held membership were given preferred stock. There was to be no controlling interest.

The board voted unanimously in favor of the move. When the vote was put to the membership, a significant minority opposed it, seeing it as a betrayal of the cooperative tradition. "There were definitely a lot of unhappy people," says Lieberman. Nevertheless, on June 23, 2006, the co-op voted to convert.

The change apparently came too late to save worker ownership of the firm. By September, Burley had a huge backlog of orders — including more than 3,000 trailer orders — which it was unable to fill because of a lack of cash to pay suppliers. A search for emergency funding resulted in an offer by a local businessman, Michael Coughlin, to purchase the company's assets and liabilities. The purchase went through on Sept. 8.

Coughlin says he wants to keep Burley production in Eugene, unlike other producers in the market that have switched production overseas. However, while 53 jobs were retained, the rest of Burley's 109 workers were laid off. Production will concentrate on the coop's core business: trailers, which account for 80 percent of revenues. Despite setbacks, Burley trailers still command 50 percent of the market.

Production of the fabric covers of the trailers will be contracted out. The other lines have been discontinued. According to Lieberman, when the product line is expanded again, it will be with products "more closely aligned with the trailers."

Members will be paid off through the sale of real estate owned by the coop that has been deeded to them. Shares of the sale will be assigned based on length of membership.

Growth accelerated problems

In retrospect, Burley's fortunes were shaped by its growth. As a small, worker- run cooperative in a growing market, it did well. Expansion, however, changed its internal dynamic. "At the point where membership broke 40, size became a problem," Lieberman says. The co-op was no longer as close-knit.

It also appears that expanding into different lines, which seemed logical at the time, contributed to an operation that was too diversified to be properly managed or capitalized under the coop's management culture. Instead of rationalizing the manufacture of existing products, the co-op added new ones, in part because the membership wanted to do so.

"We build the things we'd like to ride," is the way one member put it. Tardiness in bringing in outside management expertise contributed to this problem. An expanding market masked problems that might otherwise have been noticed sooner by management and membership.

Both Lieberman and Gehr agree that, although the change to an elected board was necessary for effective management, it also changed the atmosphere of participation that members had enjoyed. "At some point, for a lot of people, it became just a paycheck," says Lieberman. Gehr says electing the board "gave people permission to go to sleep."

Lieberman says that founding members moved on or died, taking with them the passion that had motivated the firm in its earlier years. Meanwhile, says Gehr, quick expansion resulted in the hiring of people who did not share the "cooperative spirit," or in some cases were just bad workers.

In addition, the fitness and mountain- biking crazes of the 1980s and early 90s have died down as baby boomers get older. That, coupled with increasing pressure from low-wage overseas producers, has resulted in much more difficult markets for Burley's products.

"In a worker-owned co-op, the owners need to be cognizant not only of their jobs, but business management issues as well," says Paul Hazen, president and CEO of the National Cooperative Business Association. "It's a complex business model, because in times of change, the situation can become "personal" for employee-owners, when objective decision-making is needed to grow the business and see to its survival and continued success. The business model is also empowering, because it gives "employees" the same rights and responsibilities as "owners." Hence more pride, better product, fairer wage scale."

"Due diligence must be a constant. A strong management team is critical, a capital reserve is a must, even if it means no dividends to the owners during lean times, open communications of business issues and continual co-op education can prevent complacency," Hazen continues. He also notes that seeking expertise from outside the coop can be invaluable.

Gehr also believes that the co-op suffered from inherent conservatism and resistance to change, coupled with a sense of being shielded from the problems of private businesses. Another member puts it this way: "People thought, hey, we're Burley. Things will work themselves out."

Lieberman believes that the loss of the cooperative was not inevitable. "Unfortunately, what was needed was just more than members were willing to give," he says. He's philosophical about the loss, however. "Most companies don't stay under the same ownership for 30 years."

Lots of hand labor, such as proper alignment of bike frames (as seen here in the Burley plant), is required in production of high-quality bicycles.

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