Forget Venture Capitalists—This Scrappy Composting Co-Op Found Another Way to Get Startup Money

The banking system makes it tough for local businesses to get their hands on startup money. But creative entrepreneurs are finding solutions.

CERO worker-owner Josefina Luna (second from right) after a training session with employees at a local supermarket. Photo courtesy of CERO Cooperative Inc.

Laura Flanders posted Jan 29, 2015

At age 60, when many of her friends are considering retirement, Josefina Luna is chair of the board of CERO Cooperative Inc. CERO is a five-member worker-owned cooperative on a mission to encourage composting and create jobs in the hard-up Boston neighborhoods of Roxbury, Dorchester, and East Boston. It's a small but unusually diverse team: Of the five worker-owners, two are African-American, two are Latinas, and one is white. They communicate in English and Spanish. To kick-start their business, they've also had to learn the language of stocks and shares, but they just may have hit on a new way of raising capital for businesses owned by poor people.

"How do we finance a sustainable society in a capitalist economy?"

"I didn't know anything about investments, stocks, or shares when we started," says Dominican-born Luna, who is a former teacher, but she knew nothing good was happening in Roxbury, the Boston neighborhood where she lives. "In the 22 years I've been here, nothing's changed. We see the same few stores; the same few jobs that don't pay workers well."

When Luna got involved in setting up CERO Cooperative Inc. in 2011, the unemployment crisis in her area was dire. Luna had experience working with people struggling with drug and alcohol abuse. She has been involved in community organizing campaigns that aimed to get better services. But what her neighborhood really needed wasn't more services; it was more good jobs.

The city of Boston doesn't collect commercial waste, only residential, but at the time it was considering a plan that would require businesses to reprocess their food scraps. In those scraps, Luna and her colleagues saw an opportunity. What if CERO could offer local businesses a service they were about to need, gathering their organic waste and keeping it out of the local landfill, while also taking it away to a composting site, where all those potato peelings, eggshells, and apple cores could decompose back into nutritious soil or green energy?

Good for jobs, the planet, and the local economy, CERO had an attractive triple bottom line and excellent timing. The challenge for Luna and her colleagues was finding the funding to buy the specialized collecting and compacting trucks they needed to start safely and efficiently operating and signing up clients. Heavy and wet, organic waste can't easily be hauled in the same sort of vehicles that gather regular trash or recyclables. The CERO worker-owners calculated they'd need about $100,000 for a single custom-made compactor.

"We can't go to a bank; we're working-class people, not people who have credit history," explains Luna. "We don't have lots of business with the bank."

"What we had was our sweat," says her fellow worker-owner Steven Evans, a Roxbury native with an entrepreneurial spirit (he's co-owner of a bike shop and a landscaping company) but no capital and no formal credentials. "Just waiting around for a job to come to us is never going to work."

Thanks to a relatively unknown financial instrument, that sweat may finally be paying off. After three years of filing applications to state securities regulators and working for free, in October CERO launched what's called a "Direct Public Offering," or DPO—a means by which a business offers stock directly to the public**.** Setting the minimum investment at just $2,500, open to any resident of Massachusetts, by the end of the year CERO had raised the $100,000 they needed to go into a bank for a loan, and in January they did just that, receiving a $100,000 line of credit from the Cooperative Fund of New England.

"People who are sincere about wanting to work with us ... can now put their money where their mouth is."

"People who are sincere about wanting to work with us and have a little cash can now put their money where their mouth is," says Evans,

Boston's composting law went into effect on October 1. CERO is currently picking up four tons of trash a week. For now, Evans and his fellow drivers are still using box trucks rented for the day from Ryder, but they hope to buy their own trucks soon. Evans, who still works part time as a taxi driver, says it's the "best thing that ever happened to me." He's cleaning up and collecting trash in the streets where he once hung out and looked for work.

"Investment apartheid"

Many people would like to make their neighborhoods healthier and less subject to the whims of global capitalists. But starting businesses requires capital and, as the old saying goes, the more you have the more you can make. For everyone else, it can be almost impossible to get investments or loans or credit.

At the core of the problem is the way that financial systems operate in the United States. Although tools exist to fund nonprofit organizations on the one hand and profit-maximizing corporations on the other, small local businesses slip through the cracks.

First there's the question of expertise. Aaron Tanaka is a 2014 fellow with the Business Alliance for Local Living Economies (BALLE) and managing director at Boston Impact, an "impact investment" fund that uses loan financing, grants, and equity investments to incubate new worker-owned community businesses, including CERO. The idea of CERO grew out of a couple of failed vegetable oil collection efforts of which Tanaka, Luna, and Evans had been a part a few years back, at a time when Tanaka headed up the Boston Workers Alliance. Those projects were undercapitalized, but they were also ill-prepared, Tanaka says.

“We were great at grassroots organizing, movement building, and getting grants, but that’s about where our expertise stopped**.**” Until recently, writing business plans had not been part of the typical activist’s experience.

Far more familiar to most activists is grant writing. Philanthropy is big business in the U.S., a multitrillion dollar industry on which nonprofits tend to depend. Federal tax law requires foundations to give to charities, not to for-profit businesses.

Of course, foundations don’t just provide grants; they also make choices about where to invest their endowments, and those investments are way bigger. Under federal law, foundations are only required to give away 5 percent of their net investment assets. The rest of their money is usually invested in high-yield stocks and not in projects like CERO. The money-making and money-giving arms of a foundation are often in conflict.

“If a foundation invests 5 percent of its assets in its mission to support local food business and better nutrition and the other 95 in Monsanto, what’s it really accomplishing?” asks Deborah Frieze, co-founder of Boston Impact, where Tanaka works.

CERO worker-owners Tom Hall and Steven Evans on their route. Photo by Josefina Luna.

There is a way in which foundations can invest in businesses. They can make “Program Related Investments,” or PRIs, related to their charitable giving. But most do not. It’s risky, and traditional trustees and asset managers don’t feel comfortable, says Jeff Rosen, chief financial officer of the Solidago Foundation, based in Northampton, Massachusetts. Asset managers are used to maximizing returns on investments, and grant makers are used to making grants.

“It’s the question we’re always struggling with: How do we finance a sustainable society in a capitalist economy?” Rosen says.

Exclusion from the foundation system is just the beginning of the problem for companies like CERO. The Americans who are most likely to want to invest in local businesses are essentially banned from doing so.

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Under securities laws passed in the 1930s to protect people from fraudulent stock offers, Americans are divided into accredited and “unaccredited” investors. Accredited investors are required to have more than $1 million in assets, not including their homes, or more than $200,000 in annual income.

“If you’re in the top 1 percent of income or wealth earners, you are allowed to invest in anything, no questions asked,” explains Michael Shuman, author of *Local Dollars, Local Sense*, who calls the system “investment apartheid.”

“If you’re in the other 99 percent, you can’t put a penny in a local small business without that business doing massive legal work,” he says.

Most mom and pop businesses can’t afford the legal fees involved in drawing up a thick stock-offering document. Because of that, even if they have means to invest, the majority of Americans invest in professionally managed mutual funds, which results in roughly 95 percent of the population investing in only half the economy—the large multinationals listed on Wall Street, says Shuman.

Threading the needle

CERO found a way to thread this tricky financial needle, but it took a lot of assistance. If raising a child requires a village, raising startup capital for a locally owned poor people’s business currently seems to take a planet. In CERO’s case, even with a lot of good will, getting off the ground required grants, loans, legal expertise, specialized training, investment dollars, and, of course, contracts.

Add to that list some timely changes in federal and state law—and all that sweat. And they’re not out of the woods yet.

In 2011, Luna, Evans, and the other members of CERO raised grant funds to hire a business manager named Lor Holmes, who came to the job with a master’s degree in community business development and years of experience setting up micro-businesses for women survivors of domestic violence. She got into it, she says, when the women turned to her and said, “Surviving’s not enough.”

Holmes applied that same logic to CERO and aimed to make the project thrive. With Holmes’ help, CERO drew up a business plan, conducted a crowdfunding drive, and raised $17,000 in donations from more than 300 donors. The group used that money to hire Jenny Kassan of Cutting Edge Capital, an expert in the field of community capital development, who helped CERO submit their application to the state securities regulators in Massachusetts and prepare their public offering.

The Commonwealth of Massachusetts securities forms had space for only one owner's signature, Holmes recalls, but all five co-owners signed anyway. "Here, we said, put your corporate seal on that."

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Direct public offerings have been around for years, but most investors and entrepreneurs don't know about them. Professional fund managers don't tend to inform their clients about this option, Kassan explains, because not doing so leaves them with so much power.

"I don't think there's a conspiracy, but there are some very wealthy investors who benefit from small businesses having the belief that there are no other places to go," she says.

Efforts to make change at the federal level have been slow. In 2012, a coalition of odd bedfellows that Shuman describes as "Tea Party Republicans, locavore progressives, and high-tech young people who wanted to sell apps on their iPhones" pushed Congress to pass the Jumpstart Our Business Start Ups or JOBS Act, which made it cheaper for small businesses to "crowdfund" their operations and loosened the restrictions on which Americans could invest in securities or stocks.

"The Securities and Exchange Commission was supposed to implement regulations for this, but for two years they've sat on it," says Shuman.

Funders found ways to get money to CERO anyway. Protecting them against loss through a deal drawn up between the Cooperative Fund of New England and the Solidago Foundation, Frieze at Boston Impact was able to persuade her board to give CERO a $10,000 no-interest loan. (If the business fails, the Solidago deal will enable the donor-advised fund of Boston Impact to write their loan off as a grant.)

An ad for CERO's direct public offering. Image courtesy of CERO Cooperative Inc.

The loans and the crowdfunder enabled CERO to pay their bills long enough to release their DPO and begin operating. Almost at once, they started signing up clients. Among those so far are five America's Food Basket grocery stores, Northeastern University, and Crop Circle Kitchen, a food service incubator that helps local truck vendors.

The first contract from Northeastern is small, valued at $6,760 for the year, but a renewal could be worth 10 times that, says Holmes. Other local institutions, like the public school system, the public hospital, and the county jail, could all provide CERO steady business.

As of mid-January, CERO's DPO had raised $143,000 of a $350,000 goal. Holmes says the money came from 40 investors, including the Local Enterprise Assistance Fund (LEAF) and Equal Exchange Coffee, which each kicked in $5,000. “Investments range from $2,500 to $25,000 each,” she said, “with $2,500 being the average investment size coming in from individuals.”

With another $20,000 donated in an end-of-year fund drive and a line of credit from The Cooperative Fund of New England, which specializes in working with co-ops, CERO will soon be buying their own truck, Holmes says. It’ll bear the names of all those who contributed to their crowdfunder.

At last, Evans is getting paid for the day he spends collecting waste. He's still driving a cab part time, but it's a start. (All CERO worker-owners are paid the same: $20/hour.) The company’s hiring a sales person to work alongside Holmes to build up clients.

“It’s amazing to go from austerity to finally having money to spend,” says Holmes.

“Still, to spend a couple of years working without getting paid is not a model I support replicating,” she adds.

The rise of “community foundations”

The larger challenge may be to shift consciousness.

“My retirement money’s in mutual funds,” Kassan admits. “Even though I know damn well the stock market is based on a big lie that we can grow forever burning fossil fuels—but we’re brainwashed that this is the only safe way to invest our money.”

We need new analysis of what’s “safe,” what’s an acceptable risk, a moderate return, and collateral. Is “capital” only buildings and property, asks Shuman, or also community support and social impact? Do mom and pop stores have social impact?

Many of CERO’s investors believe they do. Among the first was Glynn Lloyd, founder of City Fresh Foods, based in Roxbury, which provides economical meals to local schools, child care centers, and homebound elders. “I share their philosophy. It’s good for my business. If I’m not going to reach into my pocket, who will?” says Lloyd.

Shuman and Rosen are part of an initiative to create a revolving fund of community-controlled investment dollars for food businesses in western Massachusetts. The number of investors and fund managers willing to invest in “good” enterprises with high risk and low returns will always be small, Shuman points out, especially in a media culture that celebrates the high-rolling gambler who scores the big stock market win.

Another source of local capital may be community foundations. A report last fall from the Democracy Collaborative profiled 30 “community funds” that are experimenting with “whole portfolio integration”—putting more of their investments, like their grant making, into their mission.

Currently there are about 760 place-based community funds in the United States, with combined endowments totaling $65 billion and annual grant making roughly $5 billion. Accountable to boards that are usually comprised of local residents, leaders, and activists, their grant making is local. As the idea catches on that local universities and hospitals (“eds and meds”) can act as “anchor institutions” for jobs and healthy development, some of those community funds are asking whether local foundations could be “anchor institutions” too, not just through their grant giving but through contracting with and investing in local businesses.

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Thirty out of some 760 funds doesn’t make a trend, says report author Marjorie Kelly, but more and more community funds are taking up the mission of building up community wealth.

Given the options, Scot Sklar, adjunct professor at George Washington University and president of The Stella Group, an investment group targeting green energy projects, believes DPOs are going to take off.

“There’s no non-pain-in-the-butt way to get money,” Sklar says. “DPOs are a way for the local community to play ball in the economy.”

Main Street businesses using Wall Street tools is no simple matter, as the worker-owners of CERO discovered. It’s certainly not for the faint of heart. State regulators vary in their attitudes to DPOs, says Kassan. Offering in more than one state requires complying with each state’s requirements. Once they receive approval from the state to offer stock, companies generally have one year to raise funds before they have to resubmit their financial information and reapply.

Like any share offering, a DPO can be vulnerable to outside investors gaining undue influence. To keep control local, an offering needs to be structured in a way that explicitly favors local investors and offers them a return that keeps decision making in local hands. In CERO’s case, investor shares are nonvoting shares. Control over the business rests with the cooperative’s worker-owners. The offer's open only to Massachusetts residents.

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We can’t crowdsource our way to a new democratic economy, says Stacy Mitchell, director of the Institute for Local Self-Reliance. “The state level approach means a closer, more democratic relationship between the investor, the producer, and the consumer—and that’s good in that it’s capital that’s rooted in relationship,” she says. But we should not imagine that we’re going to create a robust financing system for local businesses through DPOs alone, she warns. “What we need is a robust community banking system that works for all.”

In the meantime, investment dollars are still coming into CERO, and its worker-owners are out there collecting waste. “We’re just getting started,” says Evans. “What have I got to lose?”

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