Equal Exchange:

Doing Well by Doing Good©[1]

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Equal Exchange:

Doing Well by Doing Good [2]

Introduction:

In 1983, Rink Dickinson, Jonathan Rosenthal, and Michael Rozyne were all recent college graduates and working for a food co-op warehouse in the Boston area. They began to question the system such as, "What if food could be traded in a way that is honest and fair, a way that empowers both farmers and consumers? What if trade supported family farms use of organic methods rather than methods that harm the environment?" Almost simultaneously they started to hear about groups in Europe who were doing *Fair Trade*. The advocates of Fair Trade wanted to ensure that the producers of products such as coffee, teas and chocolate would get a better price for their crops while supporting improvement in their environmental, social and political conditions. Rink, Jonathan and Michael liked the idea. According to Rink, they "...were basically food co-op people, interested in connecting small, local farmers with consumers to change the marketplace." It was not their intention to found a company at that time. They took the idea to the Board of Directors of the co-op warehouse. Half of the board supported the idea and half voted against it. It became apparent to them that if they were going to pursue their vision, they were going to have to develop an organization.

Over the next three years they met once a month to develop the plans and raise the capital for founding their own organization. During that time Rink said they used their jobs to learn about cooperatives, small farmers, entrepreneurship, marketing and "making mistakes, right and left." The food co-op gave them "a great environment to learn some skills". In 1986, Rink,

[2] The authors would like to thank the worker-owners of Equal Exchange who graciously shared their knowledge, experiences and perspectives about the company. Their viewpoints were invaluable in ensuring that this case provides a true representation of the culture and practices of the company.

Jonathan and Michael decided to launch Equal Exchange (EE). By that time, their ambition was "…to change the way food is grown, bought, and sold around the world."

Before the company could be launched, capital had to be raised. The three young entrepreneurs quickly learned that no institution, including organizations that specialize in high-impact social justice ventures, would lend them money. Thus, the fundraising focused on family, friends and their contacts. According to Rink, the general pitch was, "We want you to invest in this project and it is almost guaranteed to lose all of your money." On those terms they were able to raise $100,000.

Thereafter, no additional money was raised for several years. To stretch out the initial investment Rink described the founders as "living very low on the food chain."

EE embarked on its pioneering efforts to sell Fair Trade products in the United States with coffee from Nicaragua. From the beginning, EE paid the producers an above market price for their products out of a desire to help provide a better, more stable income and to more equitably distribute the proceeds of the final sales. The producers are typically small farmers indigenous to their region. On each product the company slogan -- "Small Farmers, Big Change" -- is prominently displayed.

Not content to just "…change the way food is grown, bought, and sold around the world," the founders of EE formally adopted a hybrid worker-owner co-op structure in 1990. They believed that such an ownership structure would make the employees feel valued and that they would in turn be willing to invest their whole being in the organization. Key to this new structure was shared employee ownership. Each worker-owner buys one share of Class A voting stock. No one did or can even today own more than one share of voting stock. Worker-owners can also buy unlimited shares of Class B, non-voting stock. Thus, power and potentially, leadership is distributed equally across all worker-owners on a democratic one-person/one-share/one-vote basis.

2012

Twenty–seven years later not only is EE doing good - it is doing well (See Appendix 1). Sales of EE have grown from zero in 1986 to $1,000,000 in 1991 to $42,887,000 in 2010.[3] In 2011, sales increased another 9% to $46,819,829. They are projected to exceed $50,000,000 in 2012. All EE products (coffee, tea, chocolate bars, cocoa, sugar, bananas, almonds and olive oil) are Fair Trade and most products are organic.

Co-Executive Directors Rink Dickinson and Rob Everts, and the worker-owners of EE are still interested in changing the world through socially responsible business. Its mission statement reveals the heart of EE:

> … to build long-term trade partnerships that are economically just and environmentally sound, to foster mutually beneficial relationships between farmers and consumers and to demonstrate, through our success, the contribution of worker co-operatives and Fair Trade to a more equitable, democratic and sustainable world.

In 2006, EE announced, "Our Vision in 20 Years... [To build] a vibrant, mutually cooperative community of two million committed participants trading fairly one billion dollars a year in a way that transforms the world."

Functional Areas at Equal Exchange

To fulfill its vision and mission, the founders for philosophical reasons developed a hybrid model that combined worker-ownership with a co-operative model to coordinate the functions. EE is a relatively small company, approximately 100 worker-owners, with geographically dispersed operations; worker-owners may fulfill multiple functions.

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[3] Sales figures for 2010, 2011, and 2012 were adjusted for acquisition of Oke USA, an importer and seller of organic bananas in 2010. The Statement of Operations and Retained Earnings in Appendix 9 is unadjusted.

Equal Exchange Governance Model

As portrayed in Appendix 2, EE has a Board of Directors that is elected by the worker-owners who in turn hire the Executive Director/s. Currently the position is called "The Office of Executive Directors" as it is shared by Rink and Rob. They are responsible for hiring the employees, who later may become worker-owners, but that does not happen without significant input from the other worker-owners. The worker-owners nominate candidates for the six *inside* board members and a joint, three-person worker-owner/board/management committee nominates candidates for the three *outside* seats. The worker-owners elect all nine seats, three each year. In turn, the Board of Directors hires the Executive Directors.

The Executive Directors are not board members. According to Lynsey Miller, Market Development Leader and a former board member, "They're at the board table, but they don't have votes. They are very active in that discussion and agenda setting." Thus, the worker-owners who elect the board and hold 2/3 of the seats are also responsible for hiring the Executive Directors.

All members of the board serve three-year terms. Instead of electing a new board every year, two inside directors and one outside director are elected to the board each year to promote continuity on the board.

This circular structure reinforces the following four concepts that are at the heart of the EE governance model:

1. the right to vote (one vote per worker-owner, not per share);
2. the right to serve as leader (*e.g*. board director, or other elected office);
3. the right to information;
4. the right to speak your mind.

EE provides the following elaboration on this model on its web site: www.equalexchange.coop

> A worker cooperative is an alternative for-profit structure based upon standard democratic principles. It is not designed to maximize profits, nor returns to investors, but rather to bring to the workplace many of the rights and responsibilities that we hold as citizens in our communities. These principles include one-person/one-vote equality; open access to information (i.e., open-book management); free speech; and the equitable distribution of resources (such as income.) …
>
> The delegation of responsibilities is very much like that of conventional firms - which allows for efficiency - except that at EE those at the "bottom" of the organizational chart are, as owners, also at the "top" of the same chart.[4]

Rob describes the genesis of this governance model as follows:

> From the beginning, it has been a culture in a context of participation and shared ownership of strong management. The founders were quite clear that ownership would be shared and that ultimately accountability for the highest level decisions would be shared and that we would attempt to build a strong cultural of internal participation and democracy. There was no interest in having it be a collective.

One important position in this governance model not shown on the diagram in Appendix 2 is the Worker-Owner Coordinator. This individual is elected by the worker-owners, but is not a board member. The Worker-Owner Coordinator has many duties, the most public and demanding of which is facilitating the meetings of the co-operative that are held at least quarterly. Overall the Coordinator is often akin to a police-officer directing traffic. He or she does not make the rules of the co-operative, but is empowered by the co-operative to keep their portion of the system moving smoothly, so that the necessary work may be completed. To do this the Coordinator directs the jostling interests, opinions and emotions of the members as best he or she can. One goal is to strike a balance between members' rights to ask questions, be heard and press for changes with maintaining an environment that is safe, respectful, and constructive.

The Coordinator is automatically the representative of the worker-owners on certain 'tripartite' committees and will serve next to representatives of the Board and Management. One example is the committee which nominates outside board members. The Coordinator also leads

[4] Source: http://www.equalexchange.coop/worker-owned/ July 25, 2012

the ten member worker-owner cabinet. The cabinet is a group of volunteers, accountable to the Coordinator. They carry out essential co-operative functions such as maintaining the internal education program and conducting the complex, multi-ballot, multi-site elections.

A secondary function for the Coordinator is to give the "State of the Co-operative" presentation at the annual meeting in May. It is an assessment of how well EE is functioning *as a co-operative*, not as a business per se. The worker-owners can call a meeting of the co-operative by presenting signatures of 10% of the worker-owners to the worker-owner coordinator. If a worker-owner wanted to bring something to an upcoming meeting, and had either the Coordinator's consent or the required number of signatures, the Coordinator would be responsible for putting the individual on the agenda and working with that person so that the idea is thought out and well presented.

As can be seen by this description of the governance model, the need for communication and coordination is complex for it to operate successfully. How the governance model works in practice is partially portrayed in the EE Governance Matrix (Appendix 3). The matrix was used from approximately 1998 – 2007, but no longer. It is reproduced in the appendices because it suggests who makes which decisions. The matrix was developed "… to identity decision-makers and illuminate the decision making process for key governance decisions at EE."[5] Thus, recruiting, selecting, hiring, developing, and retaining employees who can operate within this governance model and flex with the needs of the organization are critical.

Human Resource Management (HRM)

The worker-owners focus considerable attention on human resource management because of the need for a good fit of worker-owners with the ownership culture that exists on a daily basis. Recruitment is probably EE's HRM area of least worry. Whenever it does advertise an

[5] Source: Internal document entitled "Background to the Governance Matrix – October 2005 Version."

open position, it has multiple applicants. Because of its reputation, primarily spread by word-of-mouth, EE has no problem with obtaining a significant and qualified applicant pool. The hiring process, outlined in Appendix 4, is quite extensive and is considered critical to the success of EE. Two unusual aspects of the hiring process are that every potential new worker-owner goes through a three-stage interview process and the hiring process is not considered complete until after the review process and the new hire has been on the job for three months.

Once hired the employee is matched with a mentor and is on probation for one year. There is approximately a 5-10% new employee turnover during the first year. After the first year, all worker-owners vote on whether to offer the employee worker-ownership status (i.e. the chance to join the co-operative). Before the vote, the mentor and the employee's supervisor circulate written statements on behalf of the candidate. With rare exceptions only those new employees who have fared well reach this point. New hires that have been poor employees, or seem ill-suited for the co-op, are generally weeded out by this time. Almost all worker-owner candidacy votes are taken online, but current worker-owners may also request an in-person meeting for a discussion and vote. In such a case all worker-owners are free to discuss the individual's fit for EE before the vote is taken. Worker-owners can vote "yes," "no," or abstain. Unless 20% or more worker-owners vote "no" the candidate is welcomed into the co-op. Over 95% of employees who make it to the one-year point are accepted as worker-owners. When one is not accepted it can be a traumatic event for all.

During the probation period the employee is expected to participate in a curriculum to learn about the mission of EE, how it works, and to be prepared for the responsibilities of worker-ownership and governance. The worker-owners feel that it is very important to develop and strengthen a worker-ownership culture. To support the development of the culture, EE has developed an **Owners' Manual** that is over two hundred pages in length. To both support this effort for new employees and to reinforce the worker-ownership culture for all, every Thursday morning is "Exchange Time" for 1½ hours. Exchange Time lectures and discussions cover topics such as Fair Trade, co-op history or issues affecting their farmer partners. New employees are practically required while all other employees are encouraged to participate. The discussions are recorded and shared via EE's intranet with remote employees and regional offices. Cody Squire, who joined EE right out of college a few years ago, enthusiastically described Exchange Time as:

> It's one structured thing that you can depend on having every week just to learn about something new, to look deeper into something you already know about, or to hear from somebody who has just returned from working with farmer co-ops in Peru.

In addition to Exchange Time, EE has "ten percent time". Employees can use ten percent of their work time for purposes unrelated to their core functions. This time can be used to cross-train, work on governance committees, or learn more about the product. For example, Lynsey used her ten percent time to serve on the Board of Directors, where she helped create the twenty-year vision for EE. Mike and his colleague, Danielle, in Quality Control led a program called "The Brew Crew." It is a year-long curriculum on coffee. People from other departments participate in coffee quality trainings every two weeks for a year.

To develop future leaders, EE uses an unusual 360 degree peer evaluation process. As is normal, peer, subordinate, superior and self-evaluations are performed. The unusual aspect of EE's process is that all those who provide feedback must sign their forms. In other words, the feedback is not anonymous. Alison Booth, Manager of EE's Espresso bar in Seattle, WA, described how it worked for her:

> If I'm being evaluated, my supervisor and I will have access to them… Sometimes they are just nice to hear, but not terribly helpful; sometimes they're a little hard to hear. Most of the time, people are really careful to give constructive criticism, to give specific examples of things we could do better or things we did well.
>
> Then I do a self-evaluation, and my boss does a supervisor's evaluation. He combines his thoughts with my evaluation and the peer evaluations and pulls them all together. We talk about what's working, areas for improvement and what to focus on in the next year.

To further increase intellectual capital, EE maintains a library to which all employees have access. Mike described the library as, "Awesome … it's full of DVD's and books on anything from economics to feminism to Fair Trade to …" The worker-owners also have responsibility for the education committee, originally, a board committee. At EE, education was identified as a "… vital function. In shifting accountability for this committee, Worker-Owners became more accountable for their own education and the orientation of new employees to our co-operative."[6]

The worker-owners staff many roles in this model, and share in both profits and losses. Because EE operates as a worker co-operative, profit sharing is referred to as "patronage." "Patronage" is a common term used in co-operatives where co-op members receive a share of the profits, or bear a portion of losses, based on the extent they have participated in the co-op. At EE all worker-owners who worked a full year receive the same amount without regard to rank or seniority as all contributed the same amount of labor time. The total potential patronage distribution consists of 40% of net income after state taxes and preferred dividends are paid. Half of this distribution is reinvested in EE, and half is paid in cash. In years of losses the Patronage Rebates are charges against the retained distributions.

In area of benefits, EE "is generous" according to Brian Albert, Chief Financial Officer, who had approximately thirty years with some well-known international firms before joining EE.

[6] Source: Internal document entitled, "Evolution of EE Governance: Worker-Owner Oversight of Education Committee."

For example, it offers all employees twelve sick days. A worker-owner can use them for him/herself, to take care of a sick child, to attend a doctor appointment, or to spend time with a sick parent. All worker-owners receive two weeks of vacation for the first two years. After that, they receive four weeks. After their eighth year they receive five weeks. In addition, employees receive the standard holidays plus the Friday after Thanksgiving.

EE is also generous in the area of pay, whereby it pays above average at the novice level jobs, but pays below average for senior level management positions. It maintains a top-to-bottom pay ratio of four-to-one. It clearly states on the web site that this ratio was adopted to reflect the Fair Trade ethic inside the corporation.

Production

EE has not been content to be a single-product company. Its four major products and their percentage of sales are coffee (80.1%), chocolate (16.1%), tea (2.7%), and snacks (1.1%). Snacks include products such as Organic Tamari Roasted Almonds. In 2010, EE increased its stake in Oke USA, an importer and seller of organic bananas, to 90%. Oke USA sales were $4,400,000 in 2010. In 2011, EE introduced organic olive oil. In 2010, EE sold $38,487,000 of its products other than bananas. Ninety percent of its coffees are certified organic and 100% of its tea, cocoa, chocolate, sugar, and bananas are certified organic.

To produce organic coffee, chocolate, tea, and its other products for sale to others, EE must first secure the raw materials. The producers of these products are spread around the world. EE buys raw product from four continents – North and South America, Africa, and Asia – and almost exclusively from developing countries (see map in Appendix 5).

For example, coffee is grown largely in developing countries and is often the second most valuable commodity after oil exported by them, according to John M. Talbot, a sociology professor at the University of the West Indies in Jamaica. Cacao, the key ingredient for chocolate, also is only exported by developing countries. The large multinationals typically buy their raw materials from either large plantations or large sellers of coffee. The large sellers depend on middlemen, often referred to as "coyotes," to buy the coffee from small growers. According to an article in the April 25, 2011 issue of **Time** magazine, Ugandan coffee farmers get 0.66% of the retail value of their product. In contrast, the U. S. Department of Agriculture estimated that U.S. farmers receive 12% of the retail value.

EE buys directly from co-operatives that represent small producers and thereby helps these co-ops to internalize the activity, and profits, formerly captured by the middlemen (see comparison of supply chains in Appendix 6). It buys raw materials from over forty small farmer cooperatives in twenty-five countries at higher prices than typical. In its 2009 annual report, EE defined it sourcing standards as:

- **Quality** Find the best beans.
- **Flavor** Select sweet beans with unique flavor characteristics.
- **Farmer Partners** Trade with small farmer co-operatives that share our vision of community empowerment.
- **Direct Relationships** Import directly from farmer co-operatives.
- **Fair Price** Pay above the market price, often above Fair Trade prices.
- **Environment** Support sustainable agriculture, the preservation of sensitive areas, and reforestation of degraded land.
- **Commitment** Source all our coffee according to the quality of the beans and the quality of the source.

EE supports the co-operatives with both financial and technical assistance. In its 2008 Disclosure Document to Sell Class B Preferred Stock, the relationship with small farmers was described as follows, "Our Commitment: we pay a fair price to the farmer, trade directly with democratic co-ops; supply advanced credit and support sustainable agriculture." In other words, EE goes beyond just paying a fair price; it pre-pays on its contracts with the cooperatives. It also provides assistance to the cooperatives to ensure that they can provide a high quality product.

Mike Mowry, a quality control specialist, described what he did on a trip to Nicaragua as follows:

> We do a lot of work going down and actually training about quality. Even with their quality departments, we do extensive training on how to roast samples and how to cup coffee.[7] The whole idea is collaborating with their tasters and our tasters.

EE maintains that "great" coffee can be obtained from many sources. What sets it apart is that it buys "great" coffee from "great" sources.

Based on their initiatives, EE also provides assistance to the small farmer co-ops beyond food products. For example, it has provided assistance for training programs for women in Guatemala, an ecotourism project in Nicaragua, and new classrooms in El Salvador.

When all of the sourcing standards work well, quality product is shipped to EE for further processing. However, sometimes EE has to break off a relationship with a co-op for either quality-control reasons or compromised governance of the co-operative such as not living up to expectations of accountability, transparency, and democratic governance.

Another difficulty with attempting to reach EE's production standards is illustrated with its history of bringing tea to market. In the l980's, when EE consisted of a small staff of five or six, tea was typically grown on large plantations; obtaining the product from small farmers was difficult. When EE first imported tea during the late '80's, the tea came from Sri Lanka and was a generic tea that may not have been from small farmers nor Fair Trade. At that time there were no "fair trade" standards for tea. That would only come later. However, EE did know the exporter, an exemplary grass-roots non-profit/self-help organization called the "Sarvodaya movement." It still operates today. In fact, it was one of the key players in relief and reconstruction after the 2004 Indian Ocean tsunami. At that time, working in solidarity with a locally rooted, progressive, self-empowerment organization--who would also receive a sizable

[7] "Cup Coffee" is an expression used to describe the industry standard process to test the quality of coffee.

portion of the tea profits--was the moral equivalent of "Fair Trade." That trade link was lost after approximately three years due to interruptions caused by the bloody Sri Lankan civil war.

Around 1997, EE made a second attempt at procuring tea from a region of India famous for tea, Darjeeling. By then the formal Fair Trade standards had been created for tea. To EE's dismay, it was focused on plantations, and yet EE plowed ahead. A hurdle was that there was no tea available that was Fair Trade certified *and* organic *and* high enough quality for EE's market *and* from small farmers. The market demanded the first three criteria, but not the fourth (which was most important to EE). EE with the help of key, even ironic, allies in Darjeeling and Germany began to create a path that EE thought gave it the best chance to eventually deliver a tea with all four characteristics. Rodney North, Spokesperson for EE, characterized its most important ally as "ironic" because it was a big tea plantation called TPI. In fact, it had been one of the model plantations for Fair Trade tea certification. The owners of TPI, the Mohan family, shared EE's aspirations to bring small farmers into the Fair trades system. Thus, in the early years, 50% or more of the tea EE imported was from the TPI estates, and TPI gathered tea leaf from co-ops of small farmers around them for the rest. TPI also assisted these co-ops with organic certification, Fair Trade certification, rehabilitating their tea bushes, and improving quality. Over time it shifted the tea blends to have more and more sourced from small farmers.

There were many more evolutionary steps thereafter so that today EE has a line of twelve teas. Ten are 100% small-farmer tea leaf. And two are "other" (neither small-farmer sourced nor traditional estate – that is because one, the mint, is sourced from a US farm, and the other, chamomile, is from an exemplary philanthropic Egyptian NGO "Non-Governmental Organization" farm entity called SEKEM. "BUT it is only a temporary source until we locate a suitable Fair Trade certified co-op of organic, small-scale chamomile growers" asserts Rodney.

When EE quality products are received in the United States, additional processing may have to be performed. Coffee has to be roasted, tea packaged, bananas ripened, and chocolate processed. Then the product has to be marketed and distributed.

Marketing & Distribution

EE markets and distributes its products through multi-channels: (1) retail outlets, (2) an interfaith network, (3) schools, (4) the Internet, and (5) EE cafes. Approximately 72% of its products are sold through retail outlets, including health food stores, food co-ops, by-the-cup shops (i.e. cafés and restaurants), universities, and chain stores. The consumer-owned food co-ops were EE's first sales channel and remain the largest sales segment. In contrast, selling to the larger grocery store chains is particularly difficult because as the former Director of Marketing explained:

> It is tougher to succeed in that channel, because we don't have the marketing dollars that major food companies have, and that's been something that's been a struggle to try to figure out how to succeed because you need to have a national brand awareness, which is really tough to do on a small budget.

Thus, EE has developed some unconventional promotional strategies. In fact, Lynsey referred to them as "guerilla marketing." In the early days, she described some of the marketing:

> We would go out on the streets of Boston handing out coffee samples and when the police would come over to ask if we had a permit, we'd try to get them to have a coffee sample because we didn't get permits; kind of have to think on your feet and talk your way through challenges.

Another guerilla marketing tactic it uses is grass roots events. Beside traditional in-store product demonstrations, EE staffs do many public speaking events, organize consumer letter writing campaigns to ask supermarkets to carry its products, and even go door to door to get its message across. Another example of EE's use of guerilla marketing is the type of coupon shown in Appendix 7.

The interfaith channel is EE's second largest distribution channel with approximately 20% of sales. It includes a dozen formal partners: American Friends Service Committee, American Jewish World Service, Catholic Relief Services, Baptist Peace Fellowship of North America, Church of the Brethren, Disciples of Christ, Lutheran World Relief, Mennonite Central Committee U.S., Presbyterian Church USA, United Church of Christ, United Methodist Committee on Relief, and Unitarian Universalist Service Committee. The Fair Trade products distributed through these Interfaith partnerships affords faith-based organizations another opportunity to live in accord with their values and to discuss their connections and fellowship with those who grow and harvest food around the world. EE also provides materials to educate consumers on issues of economic justice, sustainable farming, and the effects of an increasingly industrialized food industry dominated by a small number of firms.

The development of the interfaith channel is a great example of entrepreneurship in action among the worker-owners at EE. Prior to the mid-1990's, EE worked with congregations on an ad hoc one-by-one basis. Then Timothy Bernard, a Lutheran Minister, and Erbin Crowell, an EE salesperson, hit upon the idea of establishing formal relationships with faith-based communities. As related by Rodney, "Erbin had to sell this idea internally to Rink and others, and Timothy had to do likewise within the Lutheran community's leadership. Eventually, they created a pilot project which grew to be very successful."

Another example of entrepreneurship within EE was led by Virginia Berman. She began with focusing fund-raising opportunities with elementary, middle and high schools. Instead of selling items such as magazine subscriptions and popcorn, the schools would sell Fair Trade products from EE. Then she heard from the teachers who wanted to help the students to grasp the significance of Fair Trade. In response she requested and received funding to create educational materials. Currently, there is a flexible and engaging free-to-download curriculum targeted for grades 4-9 at http://www.equalexchange.coop/educationaltools.

To reach the technologically savvy, EE has embraced social media such as Twitter, YouTube, and Facebook to communicate its message to current and potential consumers. Additionally, EE takes advantage of the electronic media to offer an unusually active, in-depth and out-spoken blog and to provide e-newsletters to which anyone can subscribe. All of these efforts are as Lynsey said, “To try to connect with the public and consumers.” The use of social media also reinforces its marketing efforts through retail stores, and the interfaith network. Moreover, it leads to its fourth marketing channel, the Internet. In 2011, Internet sales to individual shoppers accounted for approximately 2% of sales. EE expects these internet sales to hit one million in 2012. Currently, EE is looking at how to expand its internet sales. Over ½ of Interfaith sales previously discussed are also executed via online stores. Thus, in total approximately 12% of EE’s sales come through the Internet.

EE’s two cafés are its fifth form of marketing and distribution. It started selling its products through cafés prior to the 2008 recession. One of them is in Boston and the other in Seattle. Due to high capital costs and the challenge of winning new customers it takes even popular cafés like these two, eighteen to twenty-four months to reach the breakeven point. For now EE has placed on hold the further addition of cafes. Instead, it is trying a different way to reach customers.

In keeping with the EE tradition of thinking outside the box, it has developed cafés on wheels. They are described by Brian as follows:

> We have two custom built tricycles very close to completion. They’ll be in the Boston market probably within the next 30 to 60 days. They are stand alone. They have marine batteries and they carry all the supplies they need. They can brew coffee right there onsite. If you park it here in the morning and not much action, you can park it over there

> in the afternoon, yeah, that seems to be a better spot. It's kind of a brand building, and they have kind of a wow factor.[8]

In addition, some of the independent cafes have also adopted mobile approaches to reach the customers. For example, Common Grounds: A Fair Trade Café in Salisbury, MD uses a converted trailer to reach customers at community events such as West Wicomico Heritage Bike Tour and Salisbury University's Freshman Move-In Day (See Appendix 8).

As with all Fair Trade products, which tend to occupy the premium or gourmet segment of their categories, the pricing is above that charged by mass-marketers such as Maxwell and Kraft. This reflects the higher quality, the higher unit costs of a small firm, but it also supports the higher prices paid to the producers. Yet, the prices for EE products are still on par with much larger competitors, such as Starbucks, Peet's, and Green Mountain, who offer comparable quality coffee. To persuade customers to buy its product, without the aid of expensive marketing campaigns, EE uses a significant amount of informational marketing. For example, as stated earlier, on the packaging of every chocolate bar, tea bag or box, and every bag of coffee is the slogan, "Small Farmers, Big Change." In addition, information on how the product is grown, who grows it, where it was grown, and why it is different often appears on the packaging material. Sometimes pictures of growers also appear. To further differentiate the products, Fair Trade and USDA Organic seals are on the packaging materials, as well. EE tries to use every opportunity to get its message across and connect with the public and consumers.

Finance[9]

EE issues two forms of stock – Class A Common Stock and Class B Preferred Stock. Every worker-owner must own one share of Class A stock, and no more. No one else may

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[8] The trikes were introduced after this interview was conducted. To see a Boston Globe article about them go to http://www.boston.com/ae/food/restaurants/articles/2010/09/22/thanks_to_equal_exchange_trikes_its_one_whole_cafe_with_cream_and_sugar_to_go/.

[9] Financial Statements can be found in Appendix 9.

purchase it. This ensures equal voting rights, one person-one vote, and to a larger degree, equal power among all worker-owners. Worker-owners purchase a share when they are elected into the company after completing their probationary first year. When originally issued in 1990, each share was worth $2000. In January 2011, each Class A share was worth $3,170. To prevent the cost of stock ownership from being an obstacle to joining the co-operative, new worker-owners, once elected, are provided with an interest free loan to purchase their share. They have four years to repay the loan and it can be repaid with the cash portion of the patronage distribution.

Both worker-owners and outsiders can own Class B Preferred Stock. Shares sell for $27.50. Dividends are declared annually by the Board usually in January and are targeted at 5%. Originally, individual shares could be purchased. As Rob related, "Someone could buy a share for their grandchild for $27. We loved that type of thing, but we are operating under limits of 500 maximum outside shareholders. If you exceed that limit, then it is considered to be publicly traded." In 2011, preferred shares must be purchased in lots equal to or greater than $10,000.[10] When EE offers its preferred shares, it does so in the following manner according to Rob:

> We do have to be diligent and deliberate about talking to people and sharing. We have a very extensive disclosure document that everyone has to look at before they invest in us. There's got to be some connection to EE to get them here in the first place, whether it's a personal connection or whether they represent an account of ours; maybe they actually are a worker-owner and they want to be an investor, too. It has to be people who fundamentally know us and have direct access to the books and can see quite closely.

To assure direct access to financial information, EE practices an extreme form of open-book management. Privately or closely held firms such as EE are not required to make available to the public an annual report, but the company publishes each year's annual report on the web. The financial statements for 2006-2011 were extracted from those reports and are contained in Appendices 5 and 6. EE goes further by putting all of their annual reports dating back to 1986

[10] The JOBS Act of 2012 act raised the limit from 500 to 2,000 investors before a company is to be publicly traded. This change is expected to be helpful to EE as well as other ESOP companies over the next 10 years.

online including a Spanish language version for their many suppliers in Latin America that represent 90% of EE's imports.[11]

Preferred shares are sold as a long-term investment. Preferred stockholders can redeem them for their full price only after five years. Shares cannot be redeemed until after two years and then for only 70% of their value, 80% after three, and 90% after four. In addition, there is provision in the disclosure statement that the Board of Directors "… may postpone or delay a request for redemption" if the total debt to total equity ratio exceeds 2:1 or the redemption would cause it to exceed that ratio.

Class A Common Stock and Class B Preferred Stock have the following unusual restriction and explanation for that restriction on them in the disclosure document:

> On the sale of all the assets, liquidation or dissolution of the corporation, any residual assets left after the payment of all debts shall be distributed first to the Class B shareholders in the amount equal to the balances in their internal accounts and then to the current members or, if said residual assets are insufficient, then on a pro rata basis in proportion to the relative balances in their internal accounts. Any assets remaining after said distribution shall be distributed to an alternative trading organization as so determined by the Board of Directors of the corporation

Basically the capital gain due to the Company's growth, if it is ever realized through a sale, stays within the Fair Trade community, rather being distributed to stockholders. According to Rodney:

> The mission purpose of this treatment is to remove the temptation that the Company would ever be sold for personal financial gain, and reflects that EE was created to do something quite specific, to carry out Fair Trade and to model a new approach to business, and not as vehicle to generate wealth for any one stakeholder. Therefore, the likelihood is that the company will remain independent, despite a steady stream of buy-out offers, and its mission remains intact. As the mission and the dividends, not the capital gain, are the basis for investment, this protects the stockholder's interest.

This version of a "poison pill" to prevent takeover by outsiders is not commonly encountered. Some at EE call it the "No Exit Strategy." Brian related the following regarding this provision:

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[11] Source http://www.equalexchange.coop/annual-reports/index.php. Accessed July 25, 2012.

> Anecdotally, I bumped into an attorney, she specializes in ESOP's and employee owned accounts … she said that our by-laws are maybe a little over the top, but in the next breath said, she's used them more than once as the model for others.

To raise additional working capital EE uses an unusual method for debt financing. Anyone can buy an EE Certificate of Deposit (CD) through Eastern Bank of Massachusetts. The minimum for these CD's is at $500. By 2012, EE had raised over $1,000,000 via CD's. It also has received loans from the Calvert Foundation, Everance, religious institutions and individual supporters. These organizations and individuals are referred to as mission lenders. How the sources of capital have changed between 2005 and 2010 can be seen in Appendix 9. Although atypical, the financial policies collectively support EE's unusual governance model for a for-profit corporation.

The Industry

The industry consists of large multinationals that sell coffee, chocolate (i.e., Hershey, Nestle, and M&M/Mars), tea (i.e., Lipton) and other competitive products and small competitors. With the addition of bananas, Dole and Chiquita became competitors. Rob says that EE is a victim of its own success. Since 1986, a number of Fair Trade firms have sprung up. Rob estimates that 700 or 800 other coffee roasters - large and small – are doing some amount of Fair Trade. For example, Starbucks now sells more Fair Trade coffee than EE, but it is a small percentage of Starbuck's total sales. The same is true of Dunkin' Donuts. In contrast, the U.S. companies deeply engaged in Fair Trade tend to be small. According to a 2009 study by Fair Trade Federation, the average number of full-time employees in a Fair Trade company is fewer than ten.

In addition to other companies getting into Fair Trade, there are competing organizations to certify what is a Fair Trade product. Starting in 2012, Fair Trade USA (aka Transfair), will certify coffee, cocoa, and sugar grown on large-scale plantations and private estates as Fair Trade. Other terms such as “shade grown” applied in the industry to products sold by EE and others do not have a common definition.

Fair Trade is growing rapidly. According to a 2012 report published by Fair Trade International global sales of Fair Trade certified goods were $6.6 billion in 2011, a 12% increase from 2010 and 44% over 2009 sales.[12] Fair Trade Federation (FTF) estimated in 2008 the total market for Fair Trade products bought in the United States was $1.18 billion. Rodney estimates that at retail, Fair Trade in the United States in 2011 was over $2 billion. In the same FTF report, increases in sales by product varied even for the same country. For example, Fair Trade coffee, the largest Fair Trade product, grew approximately 32% between 2010 and 2011 in the U.S. In contrast, tea grew by 21% and cocoa grew by 67% in the same time period in the U.S. Obviously, Fair Trade is growing more rapidly than non-fair-traded products. This growth is occurring in part because natural and Fair Trade products have gone main stream.

In 2006 the Hartman Group reported, “Almost three-quarters (73%) of the U.S. population consume organic foods or beverages at least occasionally. Clearly, the conventional belief that all organic users are highly educated, high-income, Caucasian females should be put to rest.” “LOHAS” is an industry term standing for Lifestyles of Health and Sustainability and may better serve as a moniker for those consumers who frequent outlets such as Whole Foods and food co-ops. According to Rodney, “They are interested enough in being healthier, and supporting environmental sustainability that they spend more time researching their purchases, they’ll go out of their way, and they’ll pay more (but not just any price). Some of them are also interested in matters of fairness and social justice – and will shape their purchases accordingly.”

[12] Source: See: http://www.fairtrade.net/single_view1+M528a593be0f.html. Accessed July 26, 2012.

In a 2008 study by Alter Eco USA, 71.4% of US consumers reported that they had heard the term "Fair Trade." However, less than 10% surveyed reported that they had recently purchased a Fair Trade item. This pattern may be changing. Researchers from the Massachusetts Institute of Technology, Harvard University, and the London School of Economics found "substantial consumer support for Fair Trade, although a segment of price-sensitive shoppers will not pay a large premium for the Fair Trade label."[13] The consumers who were already purchasing premium coffee were willing to pay an additional 8% for Fair Trade labeled premium coffee. The Fair Trade Federation expects the market to continue to grow if distribution widens and consumers can more easily identify Fair Trade products.

Challenges

Although EE is the largest company in the U.S. that sells Fair Trade products exclusively and has continued to grow, Rob sees challenges ahead. One is the trend towards locally grown or prepared food. Obviously, coffee cannot be locally grown in the continental United States, but it is increasingly locally *roasted*, a very popular selling point.

The significant challenge that Rob sees is "how does EE remain entrepreneurial?" As he said:

> One challenge ahead is being prepared to take more risks, being prepared to reinvest in ourselves structurally, or whether it's to spin off cooperatives. We're contemplating this with the retail café sector. Being prepared to take risks and also how do we look at this thing, a big company succeeding in many local markets where we aren't necessarily based there, that's a challenge.

Given EE's leadership, worker-owners, culture and history, changes do seem inevitable. The question is "what changes will they make?"

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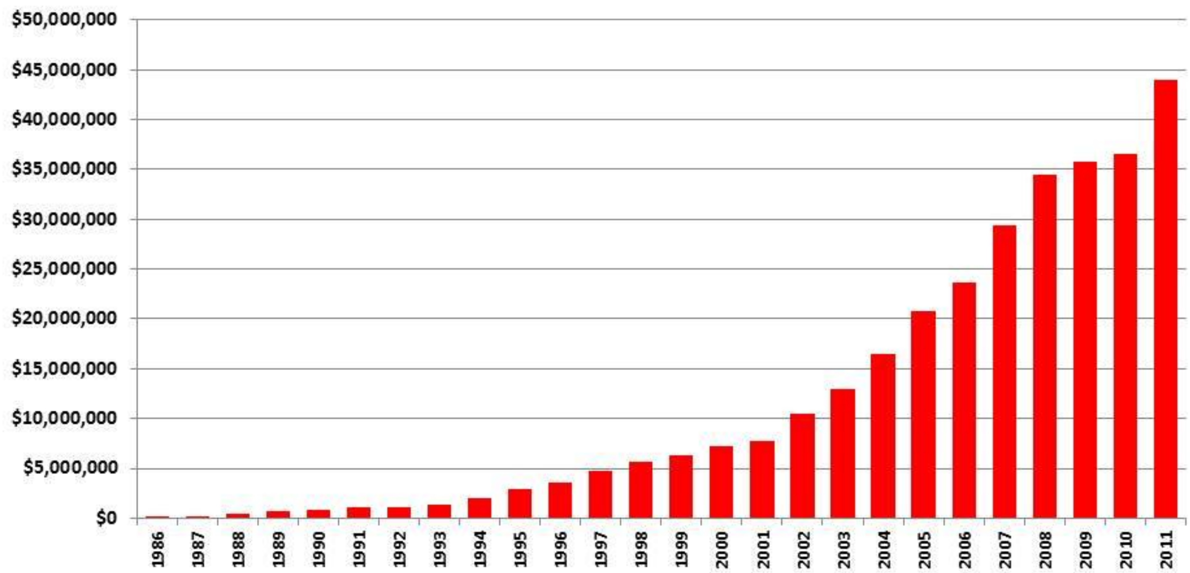
[13] Hainmueller, J, Hiscox M, Sequeira S. 2009. Consumer Demand for the Fair Trade Label: Evidence from a Field Experiment, Working Paper.

Appendix 1

Graphs of Equal Exchange's Growth in Sales and Profits

Equal Exchange's Growth in Sales: 1986 to 2011



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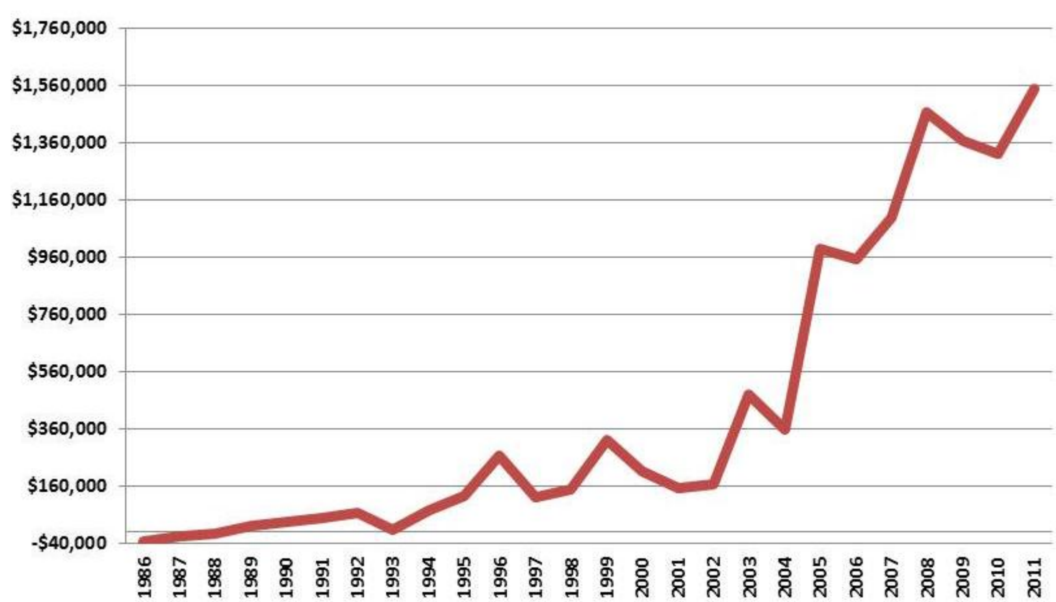
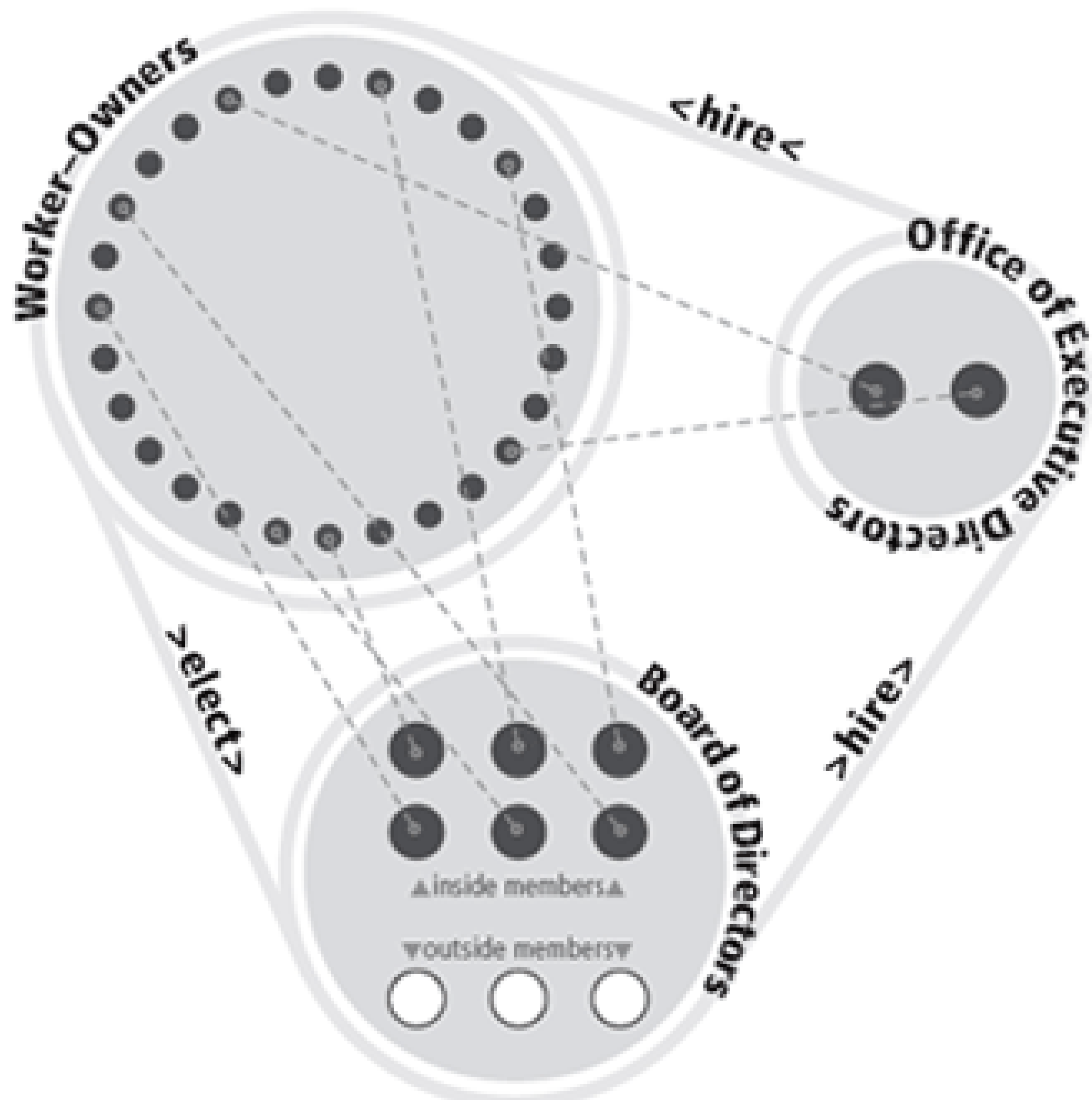
Equal Exchange's Growth in Pre-tax Profits/Losses: 1986 to 2011



Appendix 2

Governance Model for Equal Exchange



Equal Exchange Governance Matrix

(*approved by the Board of Directors, October 12, 2005*)

While Equal Exchange encourages participation on many issues at all levels of the company, this matrix describes the required roles in governance decisions.
The matrix is maintained by the Governance Committee; material changes are ratified by the Board

Key:

D	**Decision Maker,** also responsible for decision making process
R	**Ratifier,** must formally approve or reject the decision
I	**Required Input,** decision maker must seek their input and counsel

Decision	Executive Director(s)	Board of Directors	Worker Owners	Mgmt Council	Recommend places / people where you can provide input.
FINANCIAL					
Create Annual Budget	D	R		I	Department Head
Change Budget > 7%	D	R		I	Department Head
Out of Budget Borrowing > $15% of Equity	D	R			OED, Board Member
Allocate Annual Class A Patronage Rebate	I	D	I		W/O Coordinator, Board Member
Allocate Annual Class B Dividend	I	D			Investor Coord., OED, Board Member
PERSONNEL					
Set/Amend Personnel Policy	I	D			Personnel Committee, OED
Change Salary Max:Min Ratio	I	D	I		W/O Coordinator, Board Rep
Define Compensation Structure	D	R			Department Head, Board Member
Define Compensation Philosophy	I	D	I		
CORPORATE ORGANIZATION					
Amend Articles of Incorporation*		D	D		W/O meeting, Board Member
Amend By-Laws*		D	D		W/O meeting, Board Member
Elect Directors to the Board			D		W/O meeting
Elect Chair of the Board of Directors		D			Board Member
Hire Executive Director(s)		D	I		Board Member
Elect Company Officers		D			Board Member
Appoint Education Committee Chair			D		
Appoint Personnel Committee Chair		D			
Appoint Governance Committee Chair		D			
Approve Sale of Class A Stock (Membership)			D		W/O Meeting
Approve Sale of Class B Stock	I	D			
OPERATIONS					
Change Organization Location	D	I	R		W/O Meeting
Add New Service or Operation	D	I	R		W/O Meeting
Add/Remove Producer Groups	D				
Add Product Line	D	R		I	Product Mgmt Comm.

By intent, either the Board, or the Worker-Owners may amend the Articles of Incorporation and By-laws.

Five Elements of Decision Making
When trying to understand a decision to be made, these are five questions you should ask.

1. What is decision to be made?
2. When will be made?
3. What are the forums for input and debate?
4. Who makes the decision?
5. What body, if any, ratifies the decision?

Appendix 3

Notes: W/O stands for Worker-Owner, OED for Office of Executive Directors

Appendix 4

Outline of Equal Exchange's Hiring Process

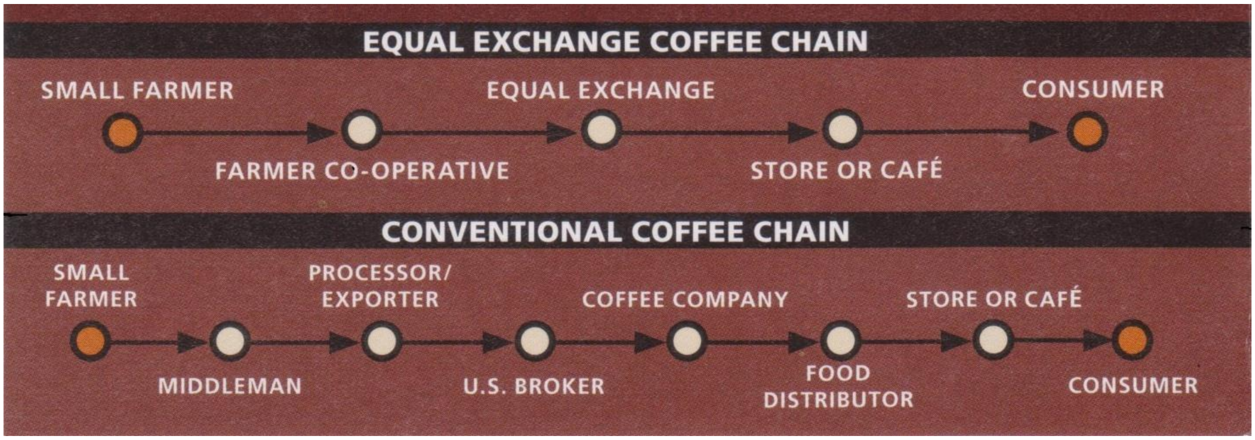
1. Executive Director Determines Need for Position
2. Executive Director and Chair of Hiring Committee Agree on Process
3. Hiring Committee Develops Tactics
4. 100 Point Rating System (20 points for each category)
   - Fit (mandatory)
   - Team (mandatory)
   - Communication (mandatory)
   - Option 1 (e.g. skills, aptitudes)
   - Option 2
5. Recruiting
   a. Defining Target Applicants
   b. Internal Posting
   c. Networks
   d. Previous Applicants
   e. External Advertising
6. Essay Questions
7. First Round Interviews -- Conference Calls with Committee
8. Second Round Interview -- In person, or by phone
9. Third Round Interview -- In-person Interview
10. Reference Checks
11. Offer Letter -- Delivered by Mail for Signature
12. Three Month Review

Appendix 5

Where Equal Exchange Buys from Small Farmers by Country, 2010

Appendix 6

Equal Exchange vs. Conventional Supply Chain



Source: Equal Exchange Pamphlet

Appendix 7

EXCLUSIVE ONLINE COUPON
FOR THE EQUAL EXCHANGE CASE STUDY

Sample Equal Exchange's organic, Fair Trade products for yourself and save 10% off your order at our retail web store http://shop.equalexchange.com

Coupon code: **dwdg10**

Coupon expires December 31, 2015

Appendix 8

Common Grounds Mobile Café at Freshman Move-In Day at Salisbury University

Appendix 9 [14]

Equal Exchange, INC.: Statements of Operations and Retained Earnings

	Years Ended December 31					
	2006	2007	2008	2009	2010	2011
SALES	$ 23,639,000	$ 29,370,480	$ 34,440,241	$ 35,832,510	$ 36,525,856	$ 46,819,829
COST OF SALES	$ 14,165,000	$ 18,866,940	$ 22,446,593	$ 23,075,260	$ 23,659,316	$ 33,617,786
GROSS PROFIT	$ 9,474,000	$ 10,503,540	$ 11,993,648	$ 12,757,250	$ 12,866,540	$ 13,202,043
OPERATING EXPENSES	$ 7,946,000	$ 8,646,241	$ 9,535,120	$ 10,771,023	$ 11,234,758	$ 11,350,116
INCOME FROM OPERATIONS	$ 1,528,000	$ 1,857,299	$ 2,458,528	$ 1,986,227	$ 1,631,782	$ 1,851,927
OTHER (EXPENSE) INCOME:						
Interest Expense	$ (576,000)	$ (737,131)	$ (720,437)	$ (622,848)	$ (323,662)	$ (387,182)
Reduction of Investment to Market Value			$ (80,000)			
Bad Debt Expense - Loans		$ (38,759)	$ (80,000)			
Charitable Contributions Expense		$ (5,296)	$ (105,000)			
Interest Income		$ 22,118	$ 9,314	$ 3,754	$ 14,832	$ 7,346
Bad Debt (expense) Recovery, Net - Trade			$ (14,265)			
		$ (759,068)	$ (990,388)			
INCOME BEFORE INCOME TAXES	$ 952,000	$ 1,098,231	$ 1,468,140	$ 1,367,133	$ 1,322,952	$ 1,472,091
PROVISIONS FOR INCOME TAXES:						
Current		$ 325,000	$ 435,000	$ 430,000	$ 484,000	$ 689,000
Deferred		$ 110,000	$ 165,000	$ 163,000	$ 94,000	$ (40,000)
	$ 415,000	$ 435,000	$ 600,000	$ 593,000	$ 578,000	$ 649,000
NET INCOME	$ 537,000	$ 663,231	$ 868,140	$ 774,133	$ 744,952	$ 821,042
RETAINED EARNINGS, Beginning of Year	$ 1,255,725	$ 1,619,725	$ 2,069,068	$ 2,654,249	$ 3,174,783	$ 3,595,014
Less: Preferred Stock Dividends Paid	$ (173,000)	$ (213,888)	$ (282,959)	$ (253,599)	$ (324,721)	$ 428,917
RETAINED EARNINGS, End of Year	$ 1,619,725	$ 2,069,068	$ 2,654,249	$ 3,174,783	$ 3,595,014	$ 3,987,139

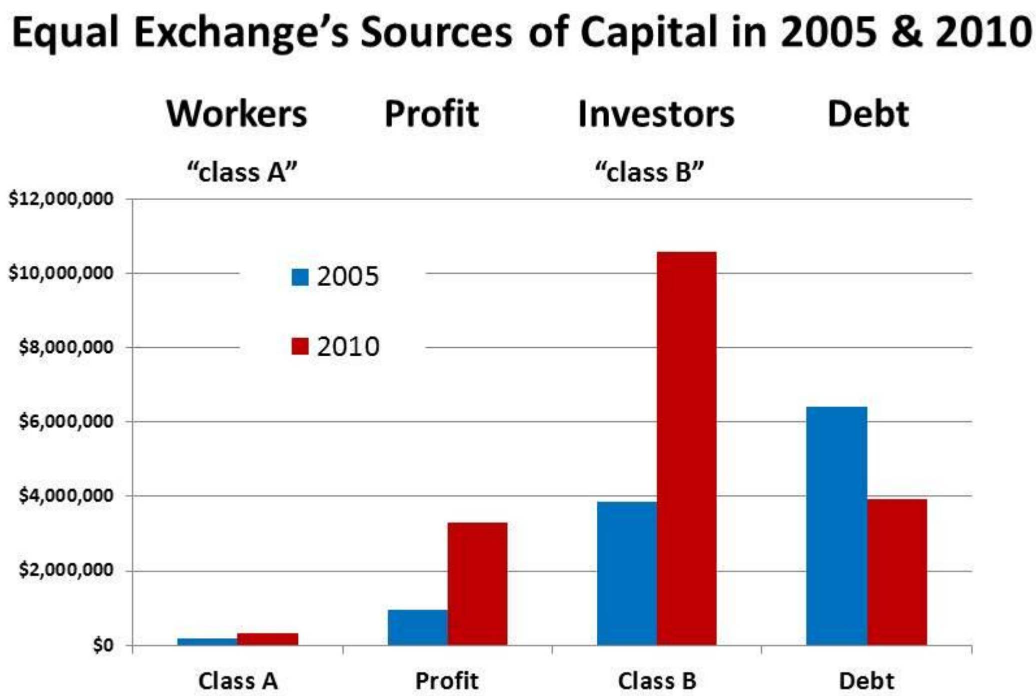
[14] These 6-year consolidated financial statements were constructed from financial data published by EE on the web at http://www.equalexchange.coop/investing.

Equal Exchange, INC.: Balance Sheet

	December-31					
	2006	2007	2008	2009	2010	2011
ASSETS						
CURRENT ASSETS:						
Cash and Equivalents	$ 480,150	$ 381,497	$ 212,717	$ 376,667	$ 823,699	$ 757,429
Accounts Receivable - Trade, Net of Reserve for Possible Uncollectible Accounts of $50,000 in 2009 and 2008	$ 1,569,117	$ 1,973,098	$ 2,227,843	$ 2,185,768	$ 2,655,707	$ 2,849,063
Notes Receivable - Other	$ 10,500	$ 34,174	$ 88,628	$ 324,996	$ 17,538	$ 34,800
Inventories	$ 6,983,311	$ 8,193,630	$ 10,839,429	$ 8,293,729	$ 8,290,646	$ 15,117,041
Prepaid Expenses, Advances in Inventory, and Other Current Assets	$ 381,538	$ 766,611	$ 928,227	$ 415,139	$ 535,330	$ 800,338
Deferred Income Tax Asset	$ 75,000	$ 77,000	$ 145,000	$ 115,000	$ 377,496	$ 367,496
TOTAL CURRENT ASSETS	$ 9,499,616	$ 11,426,010	$ 14,441,844	$ 11,711,299	$ 12,700,386	$ 19,926,167
PROPERTY AND EQUIPMENT, NET	$ 6,497,284	$ 7,311,901	$ 7,473,243	$ 7,017,564	$ 6,653,683	$ 5,979,771
OTHER ASSETS:						
Intangible Assets, Net	$ 64,154	$ 49,794	$ 35,434	$ 28,994	$ 211,153	$ 182,212
Investments	$ 100,000	$ 151,326	$ 190,870	$ 381,861	$ 68,513	$ 43,360
Notes Receivable, Net of Current Portion	$ 128,233	$ 281,188	$ 234,473	$ 6,039	$ 38,501	$ 39,249
TOTAL ASSETS	$ 16,289,287	$ 19,220,219	$ 22,375,864	$ 19,145,457	$ 19,672,236	$ 26,170,759

	December-31					
	2006	2007	2008	2009	2010	2011
LIABILITIES AND STOCKHOLDERS' EQUITY						
CURRENT LIABILITIES:						
Notes Payable - Lines-of-Credit	$ 3,006,846	$ 4,022,153	$ 5,164,438	$ 624,928	$ 567,952	$ 3,463,192
Capitalized Lease Obligations, Current Portion	$ 250,328	$ 420,470	$ 447,679	$ 432,124		
Mortgages and Other Notes Payable, Current Portion	$ 200,001	$ 319,677	$ 1,639,829	$ 550,639	$ 121,793	$ 1,253,534
Accounts Payable and Accrued Expenses	$ 1,219,767	$ 1,079,240	$ 940,158	$ 1,089,703	$ 1,539,374	$ 2,198,802
Accrued Expenses and Other Current Liabilities	$ 661,840	$ 660,063	$ 769,526			
Corporate Income Taxes Payable						$ 271,632
Patronage Rebates Payable	$ 228,036	$ 418,205	$ 255,255	$ 421,875	$ 147,000	$ 376,382
TOTAL CURRENT LIABILITIES	$ 5,566,818	$ 6,919,808	$ 9,216,885	$ 3,119,269	$ 2,376,119	$ 7,563,542
LONG-TERM LIABILITIES						
Capitalized Lease Obligatiosn, Non-Current Portion	$ 866,058	$ 1,572,897	$ 1,125,216	$ 693,092	$ -	
Mortages and Other Notes Payable, Non-Current Portion	$ 3,238,671	$ 3,259,969	$ 2,875,097	$ 3,190,008	$ 3,228,784	$ 2,616,521
Deferred Income Taxes	$ 292,000	$ 404,000	$ 637,000	$ 770,000	$ 900,000	$ 850,000
COMMITMENTS AND CONTINGENCIES						
TOTAL LIABILITIES	$ 9,963,547	$ 12,156,674	$ 13,854,198	$ 7,772,369	$ 4,128,784	$ 3,466,521
STOCKHOLDERS' EQUITY:						
Preferred Stock; Authorized 299,800 Shares; Issued and Outstanding, 390,116 Shares in 2011, 333,262 Sahres in 2010, 290,429 Shares in 2009 and 206,864 Shares in 2008	$ 4,564,605	$ 4,829,986	$ 5,680,390	$ 7,978,429	$ 9,156,382	$ 10,728,960
Common Stock; Authorized 200 Shares; Issued and Outstanding, 108 Shares in 2011 107 Shares in 2010, 99 Shares in 2009, and 93 Shares in 2008, 85 Sahres in 2007, 81 Shares in 2006	$ 222,165	$ 232,555	$ 260,903	$ 282,683	$ 313,343	$ 318,753
Less: Common Stock Subscriptions Receivable	$ (80,755)	$ (68,064)	$ (73,876)	$ (62,807)	$ (60,682)	$ (59,480)
Retained Earnings	$ 1,619,725	$ 2,069,068	$ 2,654,249	$ 3,174,783	$ 3,595,014	$ 3,987,139
TOTAL STOCKHOLDERS' EQUITY	$ 6,325,740	$ 7,063,545	$ 8,521,666	$ 11,373,088	$ 13,004,057	$ 14,975,372
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$16,289,287	$ 19,220,219	$ 22,375,864	$ 19,145,457	$ 19,355,278	$ 26,170,759

Appendix 10


Equal Exchange's Sources of Capital in 2005 & 2010
Workers
"class A"
Profit
Investors
"class B"
Debt
$12,000,000
$10,000,000
$8,000,000
$6,000,000
$4,000,000
$2,000,000
$0
2005
2010
Class A
Profit
Class B
Debt