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THE EVOLUTION OF THE CO-OP LAUNDRY

The cooperative laundry has been said to be one of the most successful ventures that encourages competing healthcare providers to collaborate in reducing their mutual costs of producing patient care. This article will discuss the history of laundry cooperatives and their impact on healthcare with an eye on their future direction.

Mankind has been cooperating in order to survive throughout history. Whether the desired outcome was to bring down large game animals or market agricultural products, the cooperative model has allowed smaller firms to access larger markets and provide greater purchasing power. A brief history of the cooperative and several derivations is available courtesy of the University of Manitoba.

Exactly what defines the cooperative model and how does it differ from other business models?

Cooperative: (also co-operative; often referred to as a co-op) is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.[i]

The differences between a cooperative and a corporation are as follows:

- A cooperative is organized and operated for the purpose of providing its members with goods and services.
- Regardless of the number of shares a member has, no member has more than one vote.
- The return on capital investment to the members is limited by legislation.
- Any surplus is usually returned to the members in the form of patronage dividends. Each member receives a share of that surplus in proportion to the amount of business done by the member with or through the cooperative.

A Bit of History

The laundry co-op is a derivative of the hospital co-op, which traces its roots in this country to various communities' early efforts at healthcare. An example of an early hospital cooperative was the Fetterman Hospital Association, an example of the forerunners of the health maintenance organization (HMO). The Fetterman Hospital Association formed in April of 1885 to provide healthcare for the cattle workers employed in the surrounding east Wyoming plains. Poor weather and declining cattle prices forced job losses and the decline of the subscriber base. The Fetterman Hospital Association cooperative soon closed, making its last journal entry on May 11, 1889.

President Lyndon B. Johnson signed the Social Security Act of 1965 (establishing Medicare/Medicaid) on July 30, 1965, as a part of his "Great Society" movement. Former President Harry S. Truman, who first entertained the idea of a national health insurance plan in 1945, became the first person enrolled in the Medicare program. Beginning in 1968, Medicaid spending, combined with the growth of employer-based systems of health insurance, resulted in rapid growth in healthcare spending and created supply shortages. These supply shortages, combined with the political will to moderate the supply problem, led to several federal initiatives. One such initiative was an IRS code change which would affect many hospitals' futures.

The early laundry cooperatives were prompted into creation in 1968 by Internal Revenue Code Title 26 §501(e). This code was designed to allow two or more non-profit hospitals (IRS code 501(c)(3)) to increase their efficiency by combining specific administrative support functions within a tax-exempt cooperative service organization.

The largest healthcare central laundry organization in the world is The International Association for Healthcare Textile Management (IAHTM). This organization is comprised of both U.S. and Canadian healthcare co-ops, and was founded in 1969 to create an environment where ideas and information can be shared for the mutual benefit of members and the organizations they serve. IAHTM members provide service to approximately 3,000 healthcare facilities and process 700 million pounds of clean linen each year.

A Closer Look at the Cooperative Laundry

Let's look at some of the advantages to utilizing the cooperative laundry model. First, outsourcing to a cooperative laundry provides the advantage of increasing return of scale or economies of scale. This expression means that if a production input (an hour of labor or a dollar of capital) is added to two laundries, often the larger laundry can produce more output (clean linen) than a smaller laundry. Until a critical mass (often theoretical) is reached, the financial goal of a cooperative laundry is to produce more units to further spread out the fixed costs of building and equipment, Additionally, it can be said that more volume (therefore income) allows for the purchase of more efficiency-producing technology and the skilled technicians to maintain such technology.

> *"Economies of scale permit more efficient use of equipment, utilities, textiles, and labor. Specifically, it is not unusual to find an OPL operating at 50-60 lbs per operator hour, while a well-run cooperative can easily reach three times this number or more."*
>
> *Lynn Dunning, President and General Manager, North Texas Healthcare Laundry*

Second, hospitals are increasingly concerned with core competency. Core competencies are the factors that give firms their competitive advantage (especially factors which are difficult to imitate). Few hospitals would claim laundry or linen management as a core competency.

A third important factor, which may compel a hospital to utilize a cooperative model for laundry processing, is the adage (borrowed from retail) that the highest revenue activity per square foot will always prevail in a space utilization decision. So, the space occupied by textile services could return more revenue if utilized by an outpatient clinic or a central services facility that supports even more departments. A hospital invests great sums of money to provide aesthetics, parking, security, and transportation options to its facility. The return on these investments is never maximized by a textile care operation.

Finally, a vertical integration between ownership, management, and consumers is rare in modern business. The cooperative, by virtue of its structure, helps create an incentive for those with expertise in linen management to train customers in the value of decreasing consumption. There are few examples of suppliers of goods and services encouraging the monitoring of consumption of products and thereby reducing the firm's income. The cooperative helps "correct" those incentives. Certain cooperative precepts must be in place to accomplish this goal.

Lynn Dunning outlines the agreements contained in the North Texas Healthcare Laundry Cooperative Association, which aid in this regard:

- Leadership shared by owners.
- Ownership according to the demand for the laundry and linen services.
- Control of the process, which established the quality and price of services.

The cooperative typically maintains cost advantages over other models. However, to be fair, we need to address the challenges or disadvantages of the cooperative laundry. Many have outsourced management or sold entirely to capital venture firms.

Chuck Rossmiller, CEO of HLS of Chicago, responding to a query regarding the Blue Wolf purchase of HLS, stated, "private equity money is taking an interest in our industry because it represents stability, growth, and high integrity clients in a market where all three of these elements are lacking." In theory, any group of owners could sell its cooperative laundry for a profit. This could result in the laundry's customers paying the price for the leverage in higher linen processing costs. Most companies willing to purchase a capital-intensive firm, like a laundry cooperative, would require a return significant enough to reflect both the cost of money and an acceptable risk premium.

The IRS initiative of the late 60s, which drove the vast majority of the larger cooperative into being, all formed in this time period. The boom ended in 1981 when HCSC Laundry v. United States, [450 U.S.1] found HCSC ultimately losing the right to qualify for exemption from federal income tax as a charitable organization. However, HCSC was not alone in legal battles with the IRS, as no fewer than six cases of laundries and central service firms were fielded by federal district courts, with the HCSC case seeing Supreme Court action as the deciding factor in whether or not "co-ops" have federal tax burdens. Ultimately, the IRS decision was based upon the purposes that IRS code 501(e) had specifically identified as endorsed business activities. Interestingly, of the original purposes listed by the code, most have not been sustainable in the co-operative form, while the laundry co-op still maintains some success. Although the IRS changed the federal ruling concerning the corporate income tax, most states and municipalities continue to honor the original interpretation of the IRS code. States vary, but most allow the exemption of cooperative for business (franchise) tax, sales taxes on purchase, taxation of linen rental, property taxes, etc.

Despite the change in federal IRS code, the efficiencies gained and other positive externalities of the cooperative maintain it as a viable option in the outsource realm. Whereas, the cooperative laundry movement did experience a definite cooling effect following the 1981 tax decision, cooperative laundries do continue to form. The cooperative development can be difficult. There are hard and soft consolidation costs, including equipment liquidation and human resource reallocation. Political relationships between competing systems do not always come naturally, nor does the "psychic cost" of all the switching process.

The board of a cooperative does need to function as a unit and compromise is necessary to keep the organization healthy. One or more of the members may feel their needs are not being met. Sharing an operation is different from owning it oneself and decisions may be a more involved process.

More than one cooperative has been formed with a loan based on long-term contracts with the health system or the facilities. Thus, a cooperative could represent an expansion of the healthcare's credit and capital, previously untapped by the system. Cooperative directors are often supply chain vice presidents and mid- and first-line hospital managers often serve on operations and linen teams.

Innovative Cooperative Models

Another noteworthy variation of the cooperative is the Employee Stock Options Plans (ESOP). The ESOP is a model made popular in the dotcom boom of the 1990s as a low-cost benefit providing tax advantages to the firm as well. "The laundry is the flagship of a wider network of Evergreen Cooperative business, part of an effort to transform the quality of life for Cleveland's (Ohio) low- and moderate-income residents."[ii] The planners, including the Cleveland Foundation, the Ohio Employee Ownership Center at Kent State University, ShoreBank Enterprise, and others, embark on a first attempt to bring together business enterprises of this nature vs. solicitations to outside corporations. The goal was to develop a local worker-owned enterprise that can provide services to its anchor institutions.

The Evergreen Laundry venture "represents the first significant effort to create green jobs that not only pay a decent wage, but also build assets and wealth for employees, since they are not only workers, but also owners."[iii] The concept is based on each worker owning shares in both the laundry and its profits; intended to keep the money within the community and providing employee-owners with the ability to purchase a home and improve their quality of life. The model calls for employees to begin as temporaries for the first six months followed by a $2.50 per hour wage increase with 50 cents-per-hour set aside for three years. This design buys them a $3,000 share in the laundry operation, eventually sharing in company profits.

"The cooperative works with Towards Employment, an agency that builds the job skills of low-income residents, including those with criminal convictions."[iv]

The unifying principle behind cooperatives, despite their business purpose or exact structure, is adaptation to business evolution. Since the advent of the internet, consumers have increasingly demanded more input in the consumption process. Whether the driver is healthcare reform or simply global competitiveness, new firms must emerge as alternatives to less responsive, more traditional institutions. How much longer will consumers accept the products, service, and prices that are dictated to them? As customers increase their engagement in the consumption process, new models will be emerging. Whether by the cooperative or another unforeseen firm type, these needs will be met. The role of the engaged manager is to meet consumer's needs rather than being driven by economic change.

[i] *The International Cooperative Alliance website www.ica.coop accessed 5/24/2010*

[ii] *Alperovits G, Howard T, Dubb S Cleveland's Worker-Owned Boom Yes Magazine. 2009 Jun 05; Available at www.yesmagazine.org/issues/the-new-economy/clevelands-worker-owned-boom accessed 05/04/2010*

[iii] *ibid*

[iv] *ibid*

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