Cooperatives: Principles and practices in the 21st century

Kimberly A. Zeuli and Robert Cropp
ABOUT THE COVER IMAGE: The “twin pines” is a familiar symbol for cooperatives in the United States. The Cooperative League of the USA, which eventually became the National Cooperative Business Association (NCBA), adopted it as their logo in 1922. The pine tree is an ancient symbol of endurance and immortality. The two pines represent mutual cooperation—people helping people.
Publication notes

This publication is the fourth and most extensive revision of the Marvin A. Schaars' text, *Cooperatives, Principles and Practices*, University of Wisconsin Extension—Madison, Publication A1457, July 1980. What has come to be known simply as “the Schaars book,” was originally written in 1936 by Chris L. Christensen, Asher Hobson, Henry Bakken, R.K. Froker, and Marvin Schaars, all faculty in the Department of Agricultural Economics, University of Wisconsin—Madison. Since its first publication, the Schaars book has served as a basic reference for cooperative members and leaders, cooperative instructors and development specialists, and students of cooperatives throughout the United States and world. It has been translated into several languages.

Although the Schaars book has been out of print for some time, the University of Wisconsin Center for Cooperatives (UWCC) continues to receive regular requests for copies. Its straightforward, basic information on the organization, structure, financing, and management of cooperatives is as needed and relevant today as ever. The revisions in this version, which reflect over two decades of learning about cooperative development as well as new cooperative laws and ways of doing business, will hopefully make it even more useful. Although we focus on cooperative businesses in the United States, and draw most of our references from the agricultural sector, most of the book’s content is pertinent to cooperatives anywhere, in any sector. Readers are encouraged to seek out other publications that deal more extensively with cooperative laws in their own states and countries, and provide more detailed information on consumer, service and worker-owned cooperatives and credit unions.

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Groups of individuals around the world and throughout time have worked together in pursuit of common goals. Examples of cooperation, or collective action, can be traced back to our prehistoric predecessors who recognized the advantages of hunting, gathering, and living in groups rather than on their own.

Although the word "cooperative" can be applied to many different types of group activities, in this publication the term is used to reference a formal business model, which has relatively recent origins. The earliest cooperative associations were created in Europe and North America during the 17th and 18th centuries. These associations were precursors to cooperatives. The pioneers of the Rochdale Society in 19th-century England are celebrated for launching the modern cooperative movement. The unique contribution of early cooperative organizers in England was codifying a guiding set of principles and instigating the creation of new laws that helped foster cooperative business development. Today, cooperatives are found in nearly all countries. Chapters 2 and 3 trace the remarkable history of cooperative development internationally and in the United States.

What is a cooperative?

The cooperative model has been adapted to numerous and varied businesses. In 1942 Ivan Emelianoff, a respected cooperative scholar, remarked that “the diversity of cooperatives is kaleidoscopic and their variability is literally infinite.” As a consequence of this diversity, no universally accepted definition of a cooperative exists. Two definitions, however, are commonly used.

According to the International Co-operative Alliance (ICA): *a cooperative 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.* Cooperative leaders around the world recognize the ICA, a non-governmental organization with over 230 member organizations from over 100 countries, as a leading authority on cooperative definition and values.

The ICA definition recognizes the essential element of cooperatives: membership is voluntary. Coercion is the antithesis of cooperation. Persons compelled to act contrary to their wishes are not truly cooperating. True cooperation with others arises from a belief in mutual help; it can't be dictated. In authentic cooperatives, persons join voluntarily and have the freedom to quit the cooperative at any time. The forced collectives prevalent in the former Soviet Union, for example, were not true cooperatives.

Another widely accepted cooperative definition is the one adopted by the United States Department of Agriculture (USDA) in 1987: *A cooperative is a user-owned, user-controlled business that distributes benefits on the basis of use.* This definition captures what are generally considered the three primary cooperative principles: user ownership, user control, and proportional distribution of benefits.

The “user-owner” principle implies that the people who use the co-op (members) help finance the co-op and therefore, own the co-op. Members are responsible for providing at least some of the cooperative’s capital. The equity capital contribution of each member should be in equal proportion to that member’s use (patronage) of the co-op. This shared financing creates joint ownership (part of the ICA cooperative definition).

The “user-control” concept means that members of the co-op govern the business directly by voting on significant and long-term business decisions and indirectly through their representatives on the board of directors. Cooperative statutes and bylaws usually dictate that only active co-op members (those who use the co-op) can become voting directors, although non-members sometimes serve on boards in a non-voting, advisory role.
capacity. Advisory directors are becoming more common in large agricultural cooperatives in the United States, where complex financial and business operations require the expertise of financial and industry experts. Only co-op members can vote to elect their board of directors and on other cooperative actions.

Voting rights are generally tied to membership status—usually one-member, one-vote—and not to the level of investment in or patronage of the cooperative. Cooperative law in a number of states in the United States and in other countries, however, also permits proportional voting. Instead of one vote per member, voting rights are based on the volume of business the member transacted the previous year with the cooperative. Generally, however, there is also a maximum number of votes any member may cast to prevent control by a minority of members. For example, a grain cooperative might permit one vote to be cast for each 1,000 bushels of grain marketed the year before, but any single member would be limited to a maximum of ten votes. Democratic control is maintained by tying voting rights to patronage. Equitable voting rights, or democratic control (as written in the ICA definition), are a hallmark of cooperatives.

"Distribution of benefits on the basis of use," describes the principle of proportionality, another key foundation for cooperatives. Members should share the benefits, costs, and risks of doing business in equal proportion to their patronage. The proportional basis is fair, easily explained (transparent), and entirely feasible from an operational standpoint. To do otherwise distorts the individual contributions of members and diminishes their incentives to join and patronize the cooperative.

Co-op benefits may include better prices for goods and services, improved services, and dependable sources of inputs and markets for outputs. Most cooperatives also realize annual net profits, all or part of which are returned to members in proportion to their patronage (thus, they are aptly called patronage refunds). Cooperatives can also return a portion of their profits as dividends on investment. In the United States, however, federal and most state statutes set an 8 percent maximum on annual dividend payments. The purpose of these limits is to assure that the benefits of a cooperative accrue to those who use it most rather than to those who may have the most invested; the importance of capital is subordinated.

Today, some co-op leaders and scholars consider this dividend restriction arbitrary and harmful to cooperatives. From their perspective, the 8 percent maximum makes investing in cooperatives less attractive than investing in other forms of business. It makes cooperatives less competitive as well, especially in the agricultural processing sector, which requires a lot of capital for start-up and growth. An overview of the federal laws that govern cooperatives in the United States is included in chapter 3.

Why cooperate?

People who organize and belong to cooperatives do so for a variety of economic, social, and even political reasons. Cooperating with others has often proven to be a satisfactory way of achieving one’s own objectives while at the same time assisting others in achieving theirs.

Farmers create farm supply and marketing cooperatives to help them maximize their net profits. This requires both effective marketing of their products for better prices as well as keeping input costs as low as possible. The farmers recognize that they are usually more efficient and knowledgeable as producers than as marketers or purchasers. By selling and buying in larger volumes they can also usually achieve better prices.
Consumer cooperatives are established to sell the products a group of consumers want but cannot find elsewhere at affordable prices. The consumer members are primarily interested in improving their purchasing power—the quantity of goods and services they can buy with their income. They naturally wish to get as much as possible for their money in terms of quantity and quality. As owners, the members have a say in what products their stores carry.

Employees organize bargaining associations and labor unions to negotiate collectively with management and owners. In some cases, employees form worker-owned cooperatives. As the name suggests, a worker-owned cooperative is owned and controlled by its employees. Employees establish bargaining units and cooperatives in the hopes of increasing their wages and fringe benefits, improving their general working conditions, and ensuring job security.

Cooperatives do not, as is sometimes assumed, contradict the goals of capitalism. If that were the case, cooperatives would not play such an important role in the American economy. About 48,000 cooperatives, operating in nearly every business sector imaginable, serve 120 million members, or roughly 4 out of 10 Americans. The top 100 cooperatives in the United States, ranked by revenue, individually generated at least $346 million in revenue during 2002 and in the aggregate, $119 billion. They represent agriculture, finance, grocery, hardware, healthcare, recreation, and energy industries (figure 1.1).

Cooperatives are especially important to agriculture. In 2002, 3,140 agricultural cooperatives provided roughly 3.1 million farmers (many farmers are members of more than one cooperative) with agricultural marketing, farm supplies, and other farm-related services. They captured 28 percent of the market share.

Figure 1.1. Top 100 revenue generating cooperatives in the U.S. by sector, 2002

![Bar chart showing top 100 revenue generating cooperatives by sector, 2002](image)

In terms of non-agricultural cooperatives, 84 million Americans are members of 9,569 credit unions, 865 electric co-ops serve 37 million people in 47 states, over 1.5 million families live in housing cooperatives, and over 3 million people are members of 5,000 food cooperatives.8

The involvement of so many people in cooperatives in such a highly competitive economy reflects the general satisfaction of members toward their companies and the apparent efficiency and solid financial performance of these businesses. Chapter 4 provides a more comprehensive discussion of the various types of cooperatives and the extent of their economic success in the United States.

In short, cooperatives are organized to serve member needs and are focused on generating member benefits rather than returns to investors. This member-driven orientation makes them fundamentally different from other corporations. Additional cooperative structural characteristics and guiding principles further distinguish them from other business models. In most countries, the cooperative model represents only one of several different ways a business can choose to legally organize. Chapter 5 presents a comparison of the six major alternative business models in the United States.

Cooperative management and development

To prosper, cooperatives must be well organized, well financed, well managed, and governed well by a committed membership. They must be progressive, adapting to changing business climates, and responsive to their members’ changing needs. Members, the board of directors, and management each have responsibilities within the cooperative. Strong, viable cooperatives require all three groups to do their share. Chapter 6 describes each group’s unique and important role.

Although capital, employees, business volume, and good management practices are all very important for successful operations, a co-op’s members are its most important asset.

Cooperative success also hinges on effective member education and communication. Indeed, providing education, training, and information to members is one of the seven cooperative principles adopted by the ICA. The unique education needs of cooperatives and the essential elements for a successful education and communication program are also discussed in chapter 6.

Cooperative financing is also critical and in today’s complex cooperative organizations it can be quite complicated. Adequate capital is one of the fundamental principles of sound business operation and at the same time one of the biggest challenges facing cooperatives today. Financing options must be consistent with principles of cooperation as well as with federal and state laws. Chapter 7 lays out the main concepts behind cooperative financing, including alternative sources of capital and equity redemption plans.

As with other business forms, cooperatives should be established only to meet a well-defined need in the market. Before cooperatives are created, advance research should be done by a steering committee to ensure sufficient support by other potential members in the community. Chapter 8 discusses in greater detail the procedure for organizing cooperatives. A good feasibility study, strong membership drives, and a comprehensive business plan are essential ingredients.

A final analysis of the cooperative model’s benefits and limitations, to members and the broader community, is presented in chapter 9.
The historical development of cooperative businesses cannot be disconnected from the social and economic forces that shaped them. Co-ops then, as now, were created in times and places of economic stress and social upheaval.\textsuperscript{9} Ancient records and archeological discoveries point to the existence of cooperative organizations created by early civilizations in diverse parts of the world (China, Greece, Egypt, etc.). But it is the founders of the Rochdale Society in 19th century England who are celebrated for launching the modern cooperative movement. The Rochdale pioneers, and the early European cooperative thinkers and organizers who laid the foundation for their success, are responsible for codifying a guiding set of principles that helped guide the development of cooperatives across the world.

Revolutionary roots in England
The first cooperative businesses created in Europe arose during periods of great social upheaval and distress caused by dramatic shifts in agricultural and industrial production practices. Prior to the Industrial Revolution (about 1750-1850), most families in England and other parts of Europe were largely self-sufficient, creating enough food and goods for their subsistence and small amounts for trading. The Industrial Revolution introduced the factory system of production and was marked by a rapid succession of remarkable inventions that accelerated the industrialization of business. Examples of inventions during this period include smelting iron with coal instead of charcoal, the cotton gin and power loom, and the steam engine. The writings of Adam Smith at the time, especially his advocacy of the laissez faire principle (no government intervention in the economy), further spurred the revolution.

The industrial system gradually replaced cottage industries and home-based production. Workers were required to move into cities to find work. Away from land, their families were increasingly integrated into a market economy; instead of producing most of their household requirements, especially food, they had no other choice but to purchase them. Advances in production were not, unfortunately, accompanied by fair labor standards. Workers were typically paid very low wages and were subjected to harsh working conditions.\textsuperscript{10} People remaining in rural areas were not much better off. An agricultural revolution was already well underway in the 18th century. The introduction of new cultivation methods and crop varieties supported a dramatic change in land tenure patterns. Scattered, small plots of farmland were aggregated into large, enclosed estates, primarily for the purpose of grazing sheep and other livestock. Between 1760 and 1843, nearly seven million acres of agricultural land in England were enclosed in estates. As a result, large numbers of small farmers were driven from their land into neighboring towns and villages with few remaining jobs.

A movement towards greater freedom of expression was another hallmark of this revolutionary period. The citizens of England began to publicly dissent with government policies, taking issue with the status quo and demanding more personal rights. Therefore, the widespread poverty, unemployment, and general social deterioration that were left in the wake of the industrial and agricultural revolutions were met with a public outcry to the government for improved working and living conditions.
Early cooperative societies

In the absence of public assistance, the people of Europe established various types of self-help organizations. Mutual fire insurance companies existed in London and Paris as early as 1530, although the first highly successful and well-known example was organized in England in 1696, the Amicable Contributionship. The people of England also created Mutual Aid Societies (they eventually became known as Friendly Societies) that offered financial payments and assistance to members in times of sickness, unemployment, or death. By the mid-18th century many well-established societies were already in operation. They were legalized with the passing of the first Friendly Society Act (also called the Rose Act) in 1793. A number of bills were introduced in the 19th century to encourage Friendly Societies since they lessened the public burden. Workers organized labor unions to bargain with employers for more favorable working conditions and to lobby the government for improved labor legislation.

Cooperative or quasi-cooperative industrial businesses were in operation in England by 1760. Most were consumer-controlled organizations focused on flour milling and baking industries. Cooperative corn mills for grinding flour appeared in a number of cities shortly after the turn of the 19th century to cut the cost of flour and prevent tampering by greedy millers. Purchasing cooperatives already existed in most Western European countries by the 18th century. The Weaver’s Society in Fenwick, Scotland (often referred to as “penny capitalists”) began to purchase supplies as a group in 1769.

The precursors to mutuals and unions were guilds, the associations of merchants, artisans, and craftsmen that date back to Medieval times. Guilds had binding rules for production and business practices. Although guilds were created partially in an attempt to establish local trade monopolies, they incorporated socialist practices: member control, equitable treatment of all members, and financial support of members who were ill or faced family crises.

Robert Owen and Charles Fourier—Cooperative visionaries

“Often men wish to escape the realities of life, and when they do, they dream of Utopias.”


The first cooperative movement, that is, the establishment of a coherent argument for the cooperative form of organization, gained momentum in the early 19th century with the writings and advocacy efforts of Robert Owen and William King in England and Charles Fourier in France. Robert Owen and Charles Fourier were both well-known Utopian Socialists; not only did they envision ideal societies, they tried to create them in Europe and the United States.

Robert Owen (1771-1858) was a prominent industrialist who began to advocate the establishment of a new type of community to alleviate the poverty and suffering caused by the Industrial Revolution. Charles Fourier (1772-1837) was a bourgeois, famous French social philosopher whose plans for self-reliant communities were motivated by the French Revolution and his view that the working class was being dehumanized and repressed.

They both envisioned rural villages composed of farms and small-scale industry, all operated cooperatively by the citizens who would also live together communally. Owen originally conceived of these communities as a solution for unemployment, but later believed (like Fourier) that they were a better alternative to private capitalism and competition, providing self-employment opportunities and other conditions that would provide universal happiness. Fourier called his planned communal cities “phalanxes.”
Owen and Fourier were not abstract thinkers; they laid out very specific details for their communities. For instance, they believed that the communities should contain 1,000-1,800 people living on a relatively small tract of land. Fourier was more explicit: the area should be three square miles. Wealthy supporters of Owen’s ideas were willing to finance the creation of such communities. Four were eventually created: New Harmony, Indiana (USA); Orbiston, Scotland; Ralahine, Ireland; and Queenswood, England. All ultimately failed.

Fourier never found philanthropists willing to fund the creation of a phalanx. After his death, several were attempted in France and more than thirty organized in the United States. The most notable in the United States were Brook Farm, near Cambridge, Massachusetts (1842-1846), and one in Fond du Lac County (now the city of Ripon), Wisconsin (1845-1850). The phalanxes suffered from a conflict between treating everyone equally and rewarding those who provided more capital and labor. The phalanx model, however, influenced the successful kibbutzim in Israel (discussed later).

Owen was a visionary idealist, not a realistic cooperative developer. He was not at all interested, therefore, in helping the early consumer cooperatives in England: “Joint stock retailing is not the Social System which we contemplate…and will not form any part of the arrangements in the New Moral World.” In 1839 he did not even bother to respond to an urgent request by Charles Howarth to visit Rochdale, England to discuss organizational plans for a new retail cooperative.

King believed that cooperatives should start small with the original capital supplied by members, a significant deviation from Owen and Fourier’s large-scale operations funded by wealthy investors. King did not necessarily object to Owen’s self-sustaining cooperative communities, as long as they were funded with the members’ own capital and were restricted to Christians. King was a religious fundamentalist who believed that biblical scripture should guide the ethics and operations of cooperatives. He also taught that cooperatives should not pay patronage refunds, but instead reinvest all net profits to increase the scope of their activities and to employ as many members as possible. King also proposed the following guidelines for consumer cooperatives:
members should pay cash for all merchandise purchased at the cooperative; (2) the co-op should adopt democratic principles of governance; and (3) it should publicize the cooperative movement.

In addition to the advocacy of Owen and King, the cooperative movement in England was supported by a number of short-lived cooperative journals, which were circulated between 1825 and 1830. Cooperative congresses also advocated and promoted cooperation; the first took place in 1830 in Manchester, the second in 1831 in Birmingham, and the third in 1832 in London. Owen’s influence and rhetoric were exhibited in these and later congresses. For instance, the Third Congress stated that “the grand ultimate object of all cooperative societies is community on land.”

What began with a few cooperative societies in 1826 quickly grew to about 300 consumer cooperatives by 1830, many patterned after King’s Brighton Cooperative Trading Association. King’s ideas may have also influenced early American cooperatives. A treasurer of a cooperative in Brighton, England, William Bryan, helped organize a consumer cooperative in New York City in 1830.

King was compelled to discontinue his active role in the cooperative movement in the late 1830s for two reasons: his medical practice was suffering and poor management and internal discontent plagued individual co-op stores. By 1840, the cooperative movement in England was basically at a standstill and King’s ideas were forgotten, ignored in the cooperative literature for several decades.

The Rochdale Pioneers

In the first wave of consumer cooperatives, a short-lived society was created in Rochdale, England in 1833. James Smithies, one of the original organizers, was inspired by King’s cooperative magazine and shared it with his co-founders. Their ultimate cooperative goals, however, echoed Owen’s teachings. Although their first co-op effort failed after only two years, a core group of 28 continued to work actively for social reform and eventually created the prototype cooperative model for a modest shop on Toad Lane in 1844.

The so-called Rochdale Pioneers were ambitious and had lofty goals for their co-op: (1) to sell provisions at the store; (2) to purchase homes for their members; (3) to manufacture goods their members needed; and (4) to provide employment for their members who were either out of work or poorly paid. In sum, they wanted to “establish a self-supporting home colony of united interests” and to “arrange the powers of production, distribution, education, and government” in the interests of its members. In addition, they hoped to open a “temperance hotel” in one of the cooperative houses to promote sobriety.

The foundation for the Rochdale cooperative was built upon the intelligent combination of various ideas that had been tried by previous cooperatives. The Pioneers learned from the co-op failures of the past. For example, the business practices they adopted for their small store, later called the Rochdale Principles (sidebar), were novel primarily in their combination; many had been borrowed from other cooperatives.

The original Rochdale Cooperative shop on Toad Lane. It is now preserved as a museum.
Some of the Rochdale Principles, such as democratic control (one-member, one-vote) and limited dividends on equity capital, are still followed by most cooperatives around the world. Other principles, such as cash trading, are clearly outdated in most countries where credit cards and (in agricultural co-ops) seasonal loans are the norm. As a set of guiding principles, they are not necessarily appropriate for all types of cooperatives in all locations. They are after all a product of a historical period and economy and were meant to govern a small retail store (see chapter 4 for further discussion of cooperative principles).

The phenomenal success of the Rochdale cooperative, which is still in operation today, was just the boost that the cooperative movement in England needed. Rochdale became the cooperative beacon for others to follow. It provided the organizational pattern that became the prototype for other cooperatives and spurred on the cooperative movement in Europe and North America.

The first cooperative law
The Industrial and Provident Societies Act, authorized in England in 1852, was a major development in the cooperative movement. Prior to the enactment of this law, the Friendly Societies Acts of 1834 and 1846 regulated the registration of cooperatives, even though these acts were designed for mutual-aid groups and not for businesses engaged in trade. Therefore, the consumer cooperatives did not have the proper legal protection essential for their business operations. The acts further prevented them from selling to people other than their members.

The Industrial and Provident Societies Act provided both important legal protections for the cooperatives while also imposing some operating restrictions. It protected the property of the societies, gave binding legal authority for their rules, safeguarded the savings of their investors, allowed them to sell to non-members, and provided legal status so that an association could sue fraudulent officials. It allowed cooperatives to pay patronage refunds on purchases but limited dividends on shares of stock to five percent. Although members still faced unlimited liability for cooperative debts, share limits of £100 per member were enforced.

The passage of the Industrial and Provident Societies Act of 1862 loosened some of the restrictions and provided limited liability for members, meaning they would be liable only for co-op debts less than or equal to the value of their stock. Share limits were increased to £200 per member and cooperatives were permitted to invest in other cooperatives. As a result of these changes, the organization of the North of England Co-operative Society became possible. Established in 1863 to create cost savings for members by purchasing a variety of goods in bulk, today the Co-operative Group comprises a family of businesses employed in a wide range of activities (food, finance, farms, funerals, etc.). It is a unique consumer-owned business that is the largest of its kind in the world.
The beginnings of cooperative credit

During the 1840s, later called “the Hungry Forties,” famine and extreme hardship spread throughout Europe. A blight ruined potato crops in many European countries, although Ireland was the most severely hit, during 1845-47. The shortage of potatoes drove up other food prices. Low fishing yields further exacerbated the food shortage, which caused millions of deaths and led to severe economic depression, high unemployment, and political unrest in the region. The Communist Manifesto was published in 1848.

During this same year, F.W. Raiffeisen, a mayor of a group of villages in Northern Germany, created a cooperative society to alleviate some of the suffering in his community. The cooperative gave potatoes and bread to the poor. He soon realized, however, that charity alone could not solve the problems of poor farmers; they needed to become self-sufficient and earn more money. Raiffeisen then started to organize loan societies, which embraced various cooperative features. Although Raiffeisen continued to advocate self-help, his first societies were mainly efforts to transfer money from the rich to the poor. Raiffeisen then started to organize loan societies, which embraced various cooperative features. Although Raiffeisen continued to advocate self-help, his first societies were mainly efforts to transfer money from the rich to the poor. In 1862, he helped the rural farmers of the little town of Anhausen organize a truly cooperative loan society.

Meanwhile, Herman Schulze had created a somewhat similar credit institution among artisans in Eilenburg in 1850. He further refined this model to fit the credit needs of artisans and other small-scale industries and developed other credit organizations. Raiffeisen may have been familiar with these organizations and used them to inform his own co-op development efforts. Both the Raiffeisen and Schulze cooperative bank models rapidly spread across Europe. Features of both models were used to form credit unions in North America. Incidentally, the Credit Union National Association’s headquarters in Madison, Wisconsin was called “Raiffeisen House” for a number of years.

Early agricultural marketing and farm supply cooperatives in Europe

Denmark is generally regarded as the most outstanding example of early and successful cooperative farm marketing and farm supply organizations. The first cooperative creamery in Denmark was established in 1875 at Kaslunde. The early cooperative creameries incorporated some significant improvements in the butter-making process, including a standardized grading system. The high quality butter was marketed under a government brand to reflect their supervision of the grading.

The first cooperative creameries were very successful. News of their success and popularity spread to other rural areas of Denmark; many others were soon organized throughout the country. These developments took place without government assistance or subsidies.

The early and striking success of cooperatives in Denmark can be primarily attributed to the role of the Folk High School. An institution unique to the country, this school educated young adults in rural areas. The schools were inspired by the philosopher and clergyman, Bishop Nikolai (N.S.F.) Grundtvig (1783-1873), and popularized by Kristen Kold, an educator. Grundtvig established the first Folk High School in 1844; the one created by Kold in 1851, however, was more successful and widely replicated. The mission of the schools was to enlighten Danish citizens (beyond what they were learning in primary schools) so they could participate in the governance of the kingdom. They were not meant to be vocational or cooperative training schools but rather designed to expose students to new ideas and experiences. Today, we would call them liberal arts schools. Numerous such schools still thrive in Denmark. Although supported financially by the state, they are free to set their own curricula and are required to be nonvocational and without examinations.
Folk High Schools created trained, rural leadership. They also established bonds of trust among those who came to live and study at the schools. The students developed a willingness to think together, work together, and play together—in short, to cooperate. Although not an intended outcome, the spirit of cooperation produced in these schools has been, without doubt, an important factor in the growth of Denmark’s cooperative movement.

Cooperatives around the world

The cooperative movement gradually spread around the world in the 19th century (table 2.1). Another notable cooperative advocate is Sir Horace Plunkett (1854–1932), an Irishman (who spent 10 years as a cattle rancher in the United States in the 1800s) famous for advocating the benefits of agricultural cooperatives in Ireland and beyond.21 He was instrumental in creating an international cooperative movement and promoting the cooperative principle of political neutrality. The Irish Cooperative Organization Society (formerly the Irish Agricultural Organization Society), originally founded by Plunkett in 1894, is located in The Plunkett House in Dublin.

Today, cooperative businesses are found in nearly all countries, from the developing nations of Africa, Asia, and South America to the industrial countries of Europe and North America. Northern Europe, where the cooperative movement took hold very early, still contains a strong cooperative presence, especially in agriculture. Many of the cooperatives in these countries have long histories and are extremely successful. However, as is the case in the United States (see chapter 3), economic pressures have been met with cooperative mergers and consolidations. As a result, cooperative numbers in these countries appear quite low (tables 2.2 and 2.3).

Cooperative numbers in India, even on a per capita basis, are by comparison astounding. In the case of India and other countries with relatively high cooperative numbers, this situation typically reflects the existence of numerous, local cooperatives. More cooperatives do not imply necessarily that the cooperative sector as a whole is stronger or more competitive, however.

The spread of the cooperative business model from 18th century England to such diverse countries as India, Korea and Uganda, points to the universal adaptability and diversity of the cooperative model.

Cooperative businesses are found in nearly all countries, from the developing nations of Africa, Asia, and South America to the industrial countries of Europe and North America.
Table 2.1. Historical cooperative statistics for selected countries

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<th>First co-op law</th>
<th>% of population</th>
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<td>1884</td>
<td>4.8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1860</td>
<td>1855</td>
<td>41.1</td>
</tr>
<tr>
<td>Norway</td>
<td>1851</td>
<td>1935</td>
<td>36.4</td>
</tr>
<tr>
<td>Poland</td>
<td>1816</td>
<td>1920</td>
<td>NA</td>
</tr>
<tr>
<td>Portugal</td>
<td>1871</td>
<td>1867</td>
<td>21.9</td>
</tr>
<tr>
<td>Romania</td>
<td>1852</td>
<td>1903</td>
<td>28.5</td>
</tr>
<tr>
<td>Russia</td>
<td>1825</td>
<td>1907</td>
<td>9.5</td>
</tr>
<tr>
<td>Spain</td>
<td>1838</td>
<td>1885</td>
<td>11.1</td>
</tr>
<tr>
<td>Sweden</td>
<td>1850</td>
<td>1895</td>
<td>53.7</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1816</td>
<td>1881</td>
<td>50.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>1863</td>
<td>1867</td>
<td>12.9</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1750</td>
<td>1852</td>
<td>16.6</td>
</tr>
<tr>
<td>United States</td>
<td>1752</td>
<td>1865</td>
<td>56.7</td>
</tr>
<tr>
<td>Yugoslavia</td>
<td>1870</td>
<td>1925</td>
<td>6.5</td>
</tr>
</tbody>
</table>

NA = not available

### Table 2.2. Cooperatives and membership by international region

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of countries</th>
<th>Organizations</th>
<th>Societies</th>
<th>Individual members</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>12</td>
<td>19</td>
<td>27,214</td>
<td>9,561,443</td>
</tr>
<tr>
<td>Americas</td>
<td>18</td>
<td>61</td>
<td>43,945</td>
<td>182,486,437</td>
</tr>
<tr>
<td>Asia</td>
<td>28</td>
<td>64</td>
<td>480,648</td>
<td>414,383,079</td>
</tr>
<tr>
<td>Europe</td>
<td>35</td>
<td>88</td>
<td>197,293</td>
<td>118,473,862</td>
</tr>
<tr>
<td>Total</td>
<td>93</td>
<td>232</td>
<td>749,100</td>
<td>724,904,821</td>
</tr>
</tbody>
</table>


### Table 2.3. Agriculture cooperative statistics from select countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Number of co-ops</th>
<th>Membership (millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>4,744</td>
<td>3.74</td>
</tr>
<tr>
<td>Canada</td>
<td>7,880</td>
<td>14.52</td>
</tr>
<tr>
<td>Columbia</td>
<td>1,936</td>
<td>4.82</td>
</tr>
<tr>
<td>Denmark</td>
<td>1,446</td>
<td>1.39</td>
</tr>
<tr>
<td>Egypt</td>
<td>6,992</td>
<td>4.28</td>
</tr>
<tr>
<td>Finland</td>
<td>46</td>
<td>1.07</td>
</tr>
<tr>
<td>France</td>
<td>23,573</td>
<td>17.49</td>
</tr>
<tr>
<td>Germany</td>
<td>9,112</td>
<td>21.64</td>
</tr>
<tr>
<td>India</td>
<td>446,784</td>
<td>182.92</td>
</tr>
<tr>
<td>Israel</td>
<td>256</td>
<td>0.03</td>
</tr>
<tr>
<td>Japan</td>
<td>3,860</td>
<td>42.84</td>
</tr>
<tr>
<td>Mexico</td>
<td>NA</td>
<td>0.63</td>
</tr>
<tr>
<td>Morocco</td>
<td>9,635</td>
<td>0.68</td>
</tr>
<tr>
<td>Norway</td>
<td>4,259</td>
<td>1.59</td>
</tr>
<tr>
<td>Repub. Korea</td>
<td>7,669</td>
<td>17.07</td>
</tr>
<tr>
<td>Sweden</td>
<td>15,106</td>
<td>4.78</td>
</tr>
<tr>
<td>Switzerland</td>
<td>16</td>
<td>1.51</td>
</tr>
<tr>
<td>Uganda</td>
<td>3,131</td>
<td>0.64</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>42</td>
<td>9.04</td>
</tr>
<tr>
<td>United States</td>
<td>27,076</td>
<td>156.19</td>
</tr>
<tr>
<td>Zambia</td>
<td>2,174</td>
<td>0.57</td>
</tr>
</tbody>
</table>

Cooperatives are neither indigenous to the United States, nor are they an American invention. As Fairbairn reminds us, “The idea of the co-op was both imported by the colonists from Europe and also independently developed and adapted by settlers of European origin under North American conditions.”22 Pilgrims coming to the new world on the Mayflower in 1620 signed the Mayflower Compact, which described the operations of an organization, or constitution, with cooperative characteristics. Once they arrived, the early settlers worked together collectively to clear the land, build homes and communities, start farming, and provide protection for their families.23 The overview of cooperative development in the United States provided here supports the idea that cooperatives in the United States are both an artifact of early settlers’ European heritage and a collective response to harsh living conditions in rural areas.

The driving forces behind cooperative development in the United States include the following five interrelated dynamics:

1. Market failure (monopoly power, excess supply, missing markets, etc.).
2. Economic crises (depressions and recessions).
3. New technology.
4. Farm organizations and cooperative advocates.
5. Favorable public policy (presidential interest, legislative initiatives at both state and federal levels, and judicial interpretation).

The relative importance of these forces at different periods will become apparent as we trace the path of cooperative development. Since some of the most significant contributions Americans have made to the cooperative model and movement have been in the agricultural sector, farm cooperatives will dominate this discussion.

The first American cooperatives

The first recognized cooperative business in the United States (a mutual insurance company) was founded in 1752, almost a quarter-century before the birth of the country (America achieved independence in 1776). Benjamin Franklin, one of the signers of the Declaration of Independence, worked with other members of fire fighting associations to create the first successful fire insurance company in the colonies: The Philadelphia Contributionship for the Insurance of Houses from Loss by Fire.24 Franklin had already formed the Union Fire Company in 1736, which became the model for volunteer fire fighting companies. Franklin had witnessed the success and importance of mutual societies when he was living in England. The Philadelphia Contributionship was based on a similar London association created in 1696.25

“Although European models and European immigrant cultures remained influential, it was in agriculture that co-ops began to take root in new and distinctive North American forms.” 26

American farmers first attempted to organize in 1785 with the establishment of the Philadelphia Society for Promotion of Agriculture. The first formal farmer cooperatives were created in 1810: a dairy cooperative in Goshen, Connecticut, and a cheese manufacturing cooperative in South Trenton, New Jersey. On the heels of these organizations, other cooperatives involving different commodities were formed in many parts of the country (table 3.1). There was no identified coordinated leadership and most cooperatives restricted their operations to their local community. Most of the early agricultural cooperatives were ultimately unsuccessful.
<table>
<thead>
<tr>
<th>Year</th>
<th>Cooperative</th>
</tr>
</thead>
<tbody>
<tr>
<td>1752</td>
<td>Philadelphia Contributionship for the Insurance of Houses from Loss by Fire (Philadelphia, Pennsylvania)</td>
</tr>
<tr>
<td>1810</td>
<td>Dairy cooperative (Goshen, Connecticut) and cheese cooperative (South Trenton, New Jersey)</td>
</tr>
<tr>
<td>1820</td>
<td>Hog marketing, slaughtering, and packing cooperative (Granville, Ohio)</td>
</tr>
<tr>
<td>1853</td>
<td>Irrigation cooperative (Tulare County, California)</td>
</tr>
<tr>
<td>1857</td>
<td>Grain elevator (Madison, Wisconsin)</td>
</tr>
<tr>
<td>1862</td>
<td>Tobacco marketing cooperative (Connecticut)</td>
</tr>
<tr>
<td>1863</td>
<td>Purchasing cooperative (Riverhead, New York)</td>
</tr>
<tr>
<td>1867</td>
<td>Fruit marketing cooperative (Hammonton, New Jersey)</td>
</tr>
<tr>
<td>1874</td>
<td>Poultry marketing cooperative (Illinois)</td>
</tr>
<tr>
<td>1877</td>
<td>Cattle rustling protection cooperative (Texas)</td>
</tr>
<tr>
<td>1885</td>
<td>Citrus marketing cooperative (California)</td>
</tr>
<tr>
<td>1887</td>
<td>Cotton gin (Wagner, Texas)</td>
</tr>
</tbody>
</table>

### The early American cooperative movement in agriculture

Politics and cooperative development have been intertwined in the United States from the very beginning. The first organized cooperative development effort was launched by the Order of the Patrons of Husbandry, commonly known as the Grange, one of the first farm organizations in the United States. A U.S. Department of Agriculture (USDA) employee named Oliver Hudson Kelley founded the Grange in 1867 as a “fraternal order” to help restore relationships between farmers in the north and south after the Civil War. However, the poor economic conditions most farmers faced at the time soon compelled the Grange to instead focus its energies on improving farm conditions. It believed that cooperatives were part of the solution and thus helped organize hundreds of agricultural marketing and purchasing cooperatives between 1870 and 1890. By 1875 the Grange had 858,000 members in thirty-two states. At its 1875 annual convention, the Grange adopted a recommendation endorsing the Rochdale Principles (it had sent a representative overseas to gather information about European cooperation). As a result, the Rochdale Principles soon became familiar to farmers in many parts of the United States.

As the Grange declined in influence, other farm organizations took more prominent roles in fostering the development of cooperatives. Though short-lived, the Farmers’ Alliance, formed in 1875 in the South, and the American Society of Equity, formed in 1902, were both more political than the Grange and also essential to early cooperative development efforts. The Farmers’ Alliance was fairly radical; it grew out of protests against rail and elevator monopolies and eventually helped affiliated candidates gain political power. The Society of Equity was the creation of a farm magazine editor, J.A. Everitt, who advocated the organization of farmers. In Wisconsin, the Society of Equity supported the progressive politics of Robert M. La Follette and a broad cooperative movement in the state.

By virtue of their long existence and organizational strength, the American Farm Bureau (established in 1919 and now the largest farm organization in the United States) and the National Farmers Union (which grew out of the Farmers Educational and Cooperative Union of America, established in 1902) have contributed the most to the development of farmer cooperatives in the United States. They have supported cooperative organizations directly by providing technical assistance, and indirectly by influencing the enactment of favorable cooperative state and federal legislation. Several of the largest agricultural cooperatives today can trace their roots back to these two groups. The National Farmers Union helped establish CHS, Inc. (today, the largest farm supply and grain marketing co-op in the United States) and the Farm Bureau helped create Growmark (another large farm supply and grain marketing co-op) and Nationwide Insurance Companies.
Creating a cooperative infrastructure: The laws and government institutions that supported cooperative development

The first cooperative marketing statute was enacted in 1865 in Michigan. Other states followed suit: Massachusetts adopted a cooperative law in 1866, New York in 1867, Pennsylvania in 1868, Connecticut and Minnesota in 1870 and so on. By 1911 twelve states had enacted special cooperative laws. Wisconsin passed its first cooperative law in 1887. After 1920, numerous state laws were passed. The basic provisions of these laws mirrored the Rochdale Principles. They generally included the following edicts: (1) cooperatives could issue shares but the number of shares held by each member would be limited; (2) voting rights were to be tied to membership not investment; (3) each member had one vote; and (4) individual cooperatives would decide how to distribute their net profits. Today, all states have cooperative statutes that are remarkably uniform. Many were patterned after the state cooperative laws in Wisconsin, Nebraska, and Kentucky.

At the national level, the government was not as supportive of agricultural cooperatives. The Sherman Antitrust Act was passed in 1890 in reaction to the negative influences of railroad, oil, and other monopolies at the time. Although the act contained no explicit reference to cooperatives, it made illegal every contract or conspiracy that restrained trade or commerce. Since agricultural cooperatives allow farmers to set a common price, several attempts were made to declare them illegal through court action. From 1890 to 1910, directors and officers of marketing cooperatives were indicted under state antitrust laws in six states under the Sherman Act. Further, in 1897 the Texas antitrust law was held unconstitutional since it exempted agriculture. In 1902, the Illinois antitrust law, similar to that in Texas, was also held unconstitutional for basically the same reason.

The precarious position of cooperatives was partially corrected at the federal level with the passage of the Clayton Act in 1914. This act exempted “agricultural, or horticultural organizations, instituted for the purposes of mutual help, and not having capital stock or conducted for a profit” from the Sherman Act. Although this helped non-stock, non-profit, cooperative marketing associations, it did not clarify the status of capital stock cooperatives.

The Capper-Volstead Act, sometimes referred to as the “Cooperative Bill of Rights,” authorized the right of farmers to unite and market or process their agricultural products cooperatively without violating antitrust laws.

In 1922, U.S. Congress made a bolder gesture in favor of cooperatives when it passed the Capper-Volstead Act. The act, sometimes referred to as the “Cooperative Bill of Rights,” authorized the right of farmers to unite and market or process their agricultural products cooperatively without violating antitrust laws. It made clear that eliminating competition between agricultural producers by their collective action in a marketing or processing cooperative in and of itself did not constitute a violation of the Sherman Act and its amendments. The Capper-Volstead Act recognized both capital stock and non-stock associations (this distinction in cooperatives is described in more detail in chapter 4). In short, it grants limited exemption from anti-trust laws to agricultural producers who act together in associations that collectively process and market their commodities. This exemption is provided only if the following three criteria are met:

1. The association operates for the mutual benefit of producer members (co-op members have to be agricultural producers);
2. A one-member, one-vote rule is followed, or dividends on stock or membership capital are limited to eight percent per annum; and
3. Non-member business must be less than 50 percent of the cooperative’s total business.

Even when these three criteria are met, Capper-Volstead does not give cooperatives complete exemption from anti-trust laws. For instance, cooperatives cannot force producers to join and they cannot buy out non-cooperative businesses in order to create monopolies. There have been several instances of cooperatives brought to court for anti-trust allegations even with this law in place. In addition, farm supply and service cooperatives are not given any exemption (see the end of the chapter for a more detailed description of the Capper-Volstead Act). Finally, Section 2 of Capper-Volstead authorizes the Secretary of Agriculture “to issue a cease and desist order” if he or she has reason to believe that any such association has monopolized or restrained trade to the extent that the price of any agricultural product is “unduly enhanced.”

The federal government went beyond merely establishing legal legitimacy for cooperatives; it helped support organizational efforts by providing technical assistance, research, information and credit. The Morrill Land-Grant College Act of 1862 established the land-grant university system and the Smith-Lever Act of 1914 formalized cooperative agricultural extension programs in the United States. The research and extension efforts of land-grant universities were instrumental in creating many of the farm cooperatives that exist today. The Cooperative Marketing Act of 1926 broadened and formalized the USDA's support and encouragement of farmer cooperatives. It established an agency (today called the Rural Business— Cooperative Service) to conduct research and provide technical assistance and information to foster increased awareness about cooperatives.

The Agricultural Marketing Act of 1929 established commodity advisory boards for cooperatives and the Federal Farm Board, which was charged with expanding the cooperative movement. Since access to credit was (and still is) a barrier to cooperative development, the government passed the Farm Loan Act of 1916, which created the Federal Land Bank for the purpose of providing loans to purchase land, and the Farm Credit Act in 1933. The Farm Credit Act helped institute Production Credit Associations that provided farmers with reasonable operating loans and established thirteen Banks for Cooperatives (now merged into one called CoBank) to provide credit to cooperatives and farmers who were organizing cooperatives. These agencies make up the Farm Credit System (described in more detail in chapter 4).
The Rural Electrification Act was passed in 1936 as part of President Franklin D. Roosevelt’s New Deal programs. This act established the USDA Rural Electrification Administration (REA) as a lending agency to finance the extension of electric power to rural areas. Nonprofit organizations were given first preference for funds, but existing power companies meeting REA loan provisions could also receive funds. Farmers moved quickly to establish cooperatives that could take advantage of the new program. As a result, a formidable argument could be advanced that rural electric cooperatives are responsible for bringing about one of the more profound changes in U.S. agriculture—the adoption of electricity.

With a strong cooperative infrastructure in place, cooperatives flourished during the first decades of the 1900s. Many of today’s cooperatives were established during this period. The first telephone cooperative was organized in 1912 and the first day-care cooperative in 1916. One of the first large housing cooperatives was established in New York City in 1927. A group of credit unions created the CUNA Mutual Insurance Group in 1935.

In this sunny period of growth, agricultural cooperatives were prudent enough to form trade organizations to protect their interests if public policy were ever to shift against them. They established state- and national-level associations that would provide commodity information and educational services to their cooperative members as well as influence legislation. The Cooperative League of the USA (now called the National Cooperative Business Association), the National Milk Producers Federation, the American Institute of Cooperation (AIC), and the National Council of Farmer Cooperatives (the American Institute of Cooperation is now part of the National Council of Farmer Cooperatives) were all created between 1916 and 1925.

Early American cooperators

Early American “cooperative thinkers” were distinguished by their commitment to building cooperative business models instead of building utopian communities or developing co-op philosophy. As Abrahamsen aptly stated, “Their thinking led to no fine-spun theories in the realm of social and political philosophy. Rather, they were concerned with cooperative business efficiency and performance so as to best serve the practical needs of farmers.”

Aaron Sapiro and Edwin G. Nourse remain the most recognized examples of early cooperative leaders and represent two distinct American schools of cooperative thought that have influenced agricultural cooperative development.

Sapiro (1884-1959) promoted the organization of large-scale, centralized co-ops (legal monopolies) along commodity lines to help producer members capture greater market shares and thereby achieve better prices. As a lawyer, it is perhaps not surprising that he also advocated long-term contracts between growers and the co-op (instead of relying on member loyalty) to ensure timely and sufficient product delivery. Sapiro’s influence was greatest in his native state of California and the Pacific Coast, in part because in the early 1900s his ideas were better suited to the specialty crops grown in that region.

Sapiro was a forceful and dynamic speaker who was able to sway large numbers of farmers towards his way of thinking. As a result, during the 1920s many cooperatives were formed around the ideas promoted by Sapiro. Sapiro created a uniform cooperative marketing law in 1919 that was adopted in whole or part by 26 states; it also influenced the wording of the Capper-Volstead Act. Since the ability of cooperatives to capture a dominant portion of supply seemed highly unlikely in the early 20th century, Sapiro’s ideas were only briefly popular. Indeed, most of the early Sapiro-inspired cooperatives failed. However, his ideas seem to be more relevant in today’s agricultural environment.
Edwin G. Nourse (1883-1974), who grew up on a small farm in Illinois and eventually earned a Ph.D. in economics from the University of Chicago, was staunchly opposed to monopolies of any kind. In stark contrast to Sapiro’s ideas, Nourse promoted locally organized and controlled co-ops that would be large enough to capture only enough market share to force non-cooperative firms into behaving more competitively. This idea is often called the “competitive yardstick hypothesis.” To help the small, local co-ops achieve economies of scale and compete with larger firms, Nourse advocated the creation of a federated system. In a federated system, local co-ops coordinate their purchasing and marketing activities (but retain their autonomy) through a larger, regional co-op.

As an academic who held numerous faculty positions over the course of his career, it is not surprising that Nourse believed in member education to ensure member loyalty rather than the “iron-clad” contracts espoused by Sapiro. Nourse also felt member education was essential to ensure the democratic governance of the cooperative would be sustained. Nourse served as chairman of the President’s Council of Economic Advisors under President Harry S. Truman and was an initial founder of the AIC.

Cooperative restructuring

The growth in new agricultural cooperatives, cooperative associations, and cooperative laws slowed to a crawl after the zenith of the 1920s and 30s. Cooperatives in the United States, like all other types of innovations, have followed a typical expansion and diffusion route:

- Innovation and experimentation phase
- Take-off phase (a rapid expansion in co-op numbers)
- Stabilization phase (co-op numbers stay constant or low growth)
- Consolidation phase

The number of agricultural cooperatives in the United States peaked in 1930 at about 12,000 but has been steadily declining since (figure 3.1). By the 1940s, agricultural cooperatives had started to enter the consolidation phase and a major reorganization of cooperatives, which continues today, began. Mergers and consolidations as well as the expansion of regional cooperatives became common. The number of agricultural cooperatives declined from 10,600 to 9,163 during the 1940s and 50s. Yet, during that same period membership

Table 3.2. U.S. agricultural cooperative numbers, membership, and net business volume

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of cooperatives</th>
<th>Membership</th>
<th>Net business volume ($ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1915</td>
<td>5,424</td>
<td>651,186</td>
<td>1</td>
</tr>
<tr>
<td>1929-30</td>
<td>12,000</td>
<td>3,100,000</td>
<td>2,500</td>
</tr>
<tr>
<td>1940-41</td>
<td>10,600</td>
<td>3,400,000</td>
<td>2,280</td>
</tr>
<tr>
<td>1950-51</td>
<td>10,064</td>
<td>7,091,120</td>
<td>8,147</td>
</tr>
<tr>
<td>1960-61</td>
<td>9,163</td>
<td>7,202,895</td>
<td>12,409</td>
</tr>
<tr>
<td>1970-71</td>
<td>7,995</td>
<td>6,157,740</td>
<td>20,556</td>
</tr>
<tr>
<td>1980</td>
<td>6,282</td>
<td>5,378,888</td>
<td>66,254</td>
</tr>
<tr>
<td>1985</td>
<td>5,625</td>
<td>4,781,216</td>
<td>65,601</td>
</tr>
<tr>
<td>1996</td>
<td>3,884</td>
<td>3,642,000</td>
<td>106,069</td>
</tr>
<tr>
<td>2000</td>
<td>3,346</td>
<td>3,085,100</td>
<td>99,700</td>
</tr>
<tr>
<td>2002</td>
<td>3,140</td>
<td>2,794,000</td>
<td>96,750</td>
</tr>
</tbody>
</table>

numbers increased from 3.4 million to over 7.2 million (table 3.2). Cooperatives were also increasing their share of the market. By 1955, cooperatives marketed more than 19 percent of farm commodities (as measured by percent of cash receipts) and supplied more than 13 percent of farm inputs (as measured by percent of farm expenditures). Agricultural cooperatives were also becoming more diversified and vertically integrated. By the 1950s, fertilizer and grain inter-regionals (regionals serving multiple states) were created with some grain cooperatives moving into international markets.

Cooperative consolidations, changes within the agricultural industry, and declining farm numbers have all contributed to the decline in cooperative and cooperative membership numbers. The number of farms in the United States peaked in 1935 at just over 6.8 million while membership in agricultural cooperatives peaked in 1955 with approximately 7.7 million members (table 3.2). The early 1980s was a difficult period for agricultural cooperatives. Both farmers and cooperatives had over-extended themselves with debt during the prosperous agricultural growth period of 1973-79.

Figure 3.1. U.S. agricultural cooperatives, 1930-2000

![Graph showing the number of agricultural cooperatives from 1930 to 2000]


Figure 3.2. Membership numbers in U.S. agricultural cooperatives, 1930-2000

![Graph showing the membership numbers in agricultural cooperatives from 1930 to 2000]

By 1980, U.S. agricultural exports had declined sharply. As a result, grain and oilseed prices dropped sharply bringing down land values, creating an agricultural downturn similar to the 1930s. Double-digit interest rates and falling land values forced farmers to refinance and downsize, and some were forced into bankruptcy. Farmers had difficulty paying their bills and some cooperatives were forced to close their doors. While cooperatives’ market shares had grown during the previous 30 years, by 1988 market shares for almost all commodities and farm inputs had stabilized while some declined. Cooperative shares of farm marketings and farm inputs both fell to 25 percent by 1988. The number of agricultural cooperatives declined to fewer than 5,000 and membership fell to 4.2 million.

Cooperative merger activity increased dramatically in the 1990s and cooperative numbers and membership continued to decline. The economy and farm sector overall gained strength during the 1990s and GATT (General Agreement on Tariffs and Trade) and NAFTA (North American Free Trade Agreement) opened more international market opportunities to agricultural businesses. The larger, more competitive cooperatives that grew out of the consolidation trend were able to capture some new international market opportunities. As a result of these trends, cooperative net business volume and market shares once again increased during the 1990s.

Nevertheless, farmers realized that they still faced flat or declining farm returns. To generate greater profits, they began to explore more intensive value-added activities (processed commodities capture a greater percentage of consumer expenditures than raw commodities). Younger farmers, who are likely to invest in the stock market, were also demanding increased and more immediate returns on their cooperative investment. This forced cooperatives to consider alternative financing arrangements.

This environment helped spur a cooperative revival in the Midwest. Over 100 new generation cooperatives (NGCs) were organized in the Dakotas and Minnesota during 1990-2000. The NGCs retain many of the characteristics of traditional cooperatives, but concentrate on value-added activities and require significant up-front equity contributions that may result in higher annual cash patronage refunds (see chapter 4 for a more complete description of NGCs).

Cooperatives in the 21st Century

The restructuring of agricultural cooperatives that began in the 1930s continues today. Traditional agricultural cooperatives continue to consolidate and merge as they become more diversified, vertically integrated, and international in focus. The continued restructuring and reinventing of cooperatives appears to be paying off. For some commodities and farm inputs, market shares continue to increase.

The success of the NGCs and continued interest in value-added agriculture (which is capital intensive) has spurred further cooperative innovation. Largely in response to cooperative laws they felt restricted their ability to attract equity from non-members, a group of Wyoming lamb producers initiated a new state cooperative statute passed in July 1, 2001. This statute allows non-patronage (investor) members to have unlimited returns on their equity investment and voting rights (including board eligibility). A similar law (308B) was enacted in Minnesota on August 1, 2003 and introduced in Wisconsin and Iowa for legislative consideration in 2004. (See chapter 4 for a more detailed description of NGC and Wyoming Cooperatives.) This “Wyoming Cooperative Model” (WCM) is clearly a departure from the way cooperatives have traditionally been defined in the United States and elsewhere. This model opens the door to non-user ownership and non-user control, and to benefits distributed based on equity, not use. However, many cooperative leaders feel that new cooperatives have no choice. They need larger pools of capital.

Another significant development was the conversion of a few large, successful agricultural cooperatives (including one NGC) to non-cooperative corporations in 2002. This was part of a larger cooper-
ative conversion trend. The primary motivation was to gain access to larger pools of capital. Some members may support conversions if they receive substantial cash payments for their cooperative equity. The new cooperative models might also initiate dramatic changes in state and federal cooperative policies and support since the differences between the new agricultural cooperatives and investor-owned firms are not very transparent.

Growth in cooperative development during the 21st century is more likely to take place as a result of rural and urban community economic development initiatives. The last two farm bills (1996 and 2002) encouraged and funded the organization of cooperatives in rural communities as a mechanism for local economic development. As will be discussed in the next chapter, the cooperative sector in the United States is extremely varied and continues to grow.

### Major federal laws that cover cooperatives in the United States

Federal laws that mention cooperatives cover a wide range of activities: antitrust action, legal organization, financing, taxation of net income, regulatory measures that call for special treatment of cooperatives, etc. The major laws and a brief description are presented here.

- 1890: Sherman Antitrust Act—business acts that restrained trade and conspiracies were declared illegal.
- 1898: War Revenue Act—first tax law to specifically exclude farmers’ cooperatives.
- 1909: Corporate Tax Statute, Section 38—exempted agricultural and horticultural associations from income tax.
- 1913: Income Tax Statute—exemption granted to “labor, agricultural, or horticultural associations.”
- 1914: Clayton Act—amended the Sherman Antitrust Act and legalized non-stock agricultural or horticultural cooperatives.
- 1916, 1918, 1921, and 1926 Revenue Acts—1916 and 1918 exempted from federal tax marketing cooperatives serving as sales agents; 1921 also exempted farm supply cooperatives; 1926 eliminated the requirement that cooperatives serve only as agents for their members.
- 1916: Federal Farm Loan Act—created federal land banks and federal land bank associations to make long-term loans to farmers to purchase land or farms.
- 1922: Capper-Volstead Act—basic federal enabling act for farmers' marketing cooperatives, either stock or non-stock.
- 1923: Federal Intermediate Credit Act—provided for 12 Intermediate Credit Banks. These banks sell debenture bonds to the investing public to provide funds for the farm credit cooperatives.
- 1926: Cooperative Marketing Act—created the division of cooperative marketing in the United States Department of Agriculture for research, education, and service work with farmer cooperatives. Its name was changed from time to time and today, this is the USDA Rural Business-Cooperative Service.
- 1929: Agricultural Marketing Act—provided for a Federal Farm Board and a $500 million revolving fund to make loans to cooperatives to purchase surplus commodities for the purpose of stabilizing farm prices, and to assist cooperatives generally.
- 1933: Farm Credit Act—created 12 regional and one central Bank for Cooperatives to make loans to agricultural cooperatives; and established the Production Credit Associations to make loans to farmers for production purposes.
- 1934: Federal Credit Union Act—to charter credit unions under federal law.
- 1936: Rural Electrification Act—establish the REA, a loaning agency to rural electric cooperatives, rural telephone companies (Oct. 1949 amendments to REA of 1936), and other utilities serving rural areas.
- 1936: Robinson-Patman Act, Section 4—cooperatives can make patronage refunds to members and not non-members and not be guilty of price discrimination.
1937: Agricultural Marketing Act—has provisions stating how and when cooperatives can act for individual farmers in voting, pooling of returns, and servicing producers under marketing agreements and orders.

1940: District of Columbia Consumers’ Cooperative Act—allowed consumers’ cooperatives in the District or elsewhere to incorporate.


1962 and 1966: Revenue Acts—established how cooperatives are currently taxed. The 1962 act established that exempt cooperatives must pay at least 20 percent of net savings allocated to members on the basis of patronage in cash and obtain “consent” from member-patrons for the remainder, if it wished to exclude from federal income taxes retained patronage savings; 1966 added similar tax treatment for “per unit retain.”


1978: Act to establish National Cooperative Bank—Congress provided for the National Cooperative Bank to provide financing to cooperatives not eligible to borrow from the Banks for Cooperatives or the REA. In 1981, the Bank was privatized and is now totally owned by its borrowers.

The Capper-Volstead Act of 1922

The Capper-Volstead Act has never been amended and still provides exemption for certain agricultural and horticultural cooperatives in the United States today. The following are the principal provisions of the Act:

- It authorizes associations of producers of agricultural products.
- The members of such associations must be “engaged in the production of agricultural products as farmers, planters, ranchmen, dairymen, nut or fruit growers.”
- The cooperative may collectively process, prepare for market, handle, and market in interstate and foreign commerce.
- Cooperatives must operate for the mutual benefit of members as producers.
- One cooperative may join with others to have marketing agencies in common, i.e., federated associations are permissible.
- The cooperative may be incorporated or unincorporated.
- Cooperatives may have marketing contracts with their members.
- Cooperatives may be organized with or without capital stock.
- Cooperatives must conform to one or both of the following requirements:
  - No member of the association may have more than one vote,
  - The association may not pay dividends on stock or membership capital in excess of eight percent per annum
- The cooperative must not deal in the products of nonmembers greater in value than those handled by it for members.

Since some read more into the act than is actually there, the following is a list of areas it does not cover:

- It does not regulate agricultural production nor establish quotas.
- It does not prevent cooperatives from monopolizing the market of an entire commodity through voluntary internal growth. It may, however prevent such monopolization if it occurs through mergers or acquisitions.
- It does not give cooperatives special immunity from antitrust or other laws, which would not apply to other businesses firms under similar situations. Congress did not intend to completely exempt cooperatives from the antitrust laws nor to exclusively empower the Secretary of Agriculture to supervise their conduct. This was brought out in a number of court cases decided by the Supreme Court, appeals court, and the lower courts.
It does not apply to purchasing or service associations, but is exclusively restricted to farmers’ marketing and bargaining cooperatives.

It does not prevent price increases, but undue price enhancement might invite prohibitory action by the Secretary of Agriculture and/or the Justice Department. In the history of the act, such action has never been taken.

It does not enable cooperatives to incorporate under it.

It does not permit members to buy products and then sell them through the association as dealers or speculators. It is restricted to members as producers of the products marketed.

It does not automatically grant eligibility to borrow from Bank for Cooperatives.

It does not require cooperatives to incorporate to qualify under the act.

It does not grant exemption from payment of federal or state income taxes. Whether a cooperative pays federal or state income taxes depends on whether or not they allocate net earnings on the basis of patronage.

It does not prevent pooling of commodities, expenses, sales receipts, or net earnings.

Chapter 185: The Wisconsin Cooperative Law

Wisconsin enacted its first cooperative law in 1887. In 1911 Wisconsin passed a largely revised cooperative law that was copied by 16 states. Wisconsin revised its cooperative laws in 1921, in 1955 and most recently, in 1989. This Wisconsin cooperative law is referred to as Wisconsin Chapter 185. The principal provisions of that law follow:

Cooperatives may be organized under this chapter for any lawful purpose except banking and insurance.

Five or more adults, one of whom must be a resident, may form a cooperative by signing, acknowledging and filing articles.

Each member who is entitled to vote shall have one vote, but local associations affiliated with a central association (a federated structure) may vote on the basis of number of members the local has, or on the amount of business transacted with the organization.

Proxy voting is not allowed, but voting by mail is permitted.

A quorum must be present to legally transact business.

The business and affairs of the cooperative should be managed by a board of directors of not less than five persons; in a cooperative with fewer than 50 members, the number of directors shall not be less than three.

The members elect directors. Every director shall be a member or a representative of a member, which is a business entity. Unless the bylaws provide otherwise, a director may be removed upon a majority vote of all members.

Directors elect amongst themselves officers of the board.

Marketing contracts are permitted but cannot exceed 5 years. They may be self-renewing for periods not exceeding 5 years each, subject to the right of either party to terminate at the end of each term. Such contracts may require liquidated damages to be paid by the member in event of a breach of the contract. The association may file in the office of the Register of Deeds of the county in which the member-maker of the contract resides. This serves as public notice. Any third party who interferes with the completion of the contract between the member and the cooperative may become liable for damages to the cooperative.

Once annually the directors shall determine and distribute the net proceeds after all operating expenses are met and reasonable and necessary reserves are set aside. An amount not to exceed 5 percent may be set aside as an educational fund to be used in teaching or promoting cooperative organization or principles.

A share of the net proceeds may be set aside or paid to officers or employees, or both.

Dividends may be paid on shares of capital stock up to 8 percent per annum; the remaining net proceeds, after a reasonable and necessary reserve for depreciation and obsolescence
of physical property, doubtful accounts, and other valuation reserves, shall be paid as patronage refunds either to member patrons only, or to member and non-member patrons alike, or to non-member patrons at a lower proportion than to member patrons. Net proceeds from non-member business cannot be paid out as patronage refunds to members, but may be used to pay dividends on capital stock.

▪ The books of a cooperative may be examined by a member or stockholder at any reasonable time and for a proper purpose upon written application.

▪ Only cooperatives may use the term “cooperative,” or any variation thereof as part of their corporate or business name.

▪ At any member meeting a cooperative may adopt any amendment to its articles, if a statement of the nature of the amendment was contained in the notice of the meeting. The amendment is adopted by two-thirds of the member votes cast thereon. It also requires a two-thirds approval by votes cast by stockholders, other than membership stock, if the amendment has a potential impact on the value of the stock.

▪ Mergers of cooperatives must be approved by two-thirds of all member votes cast thereon and two-thirds of the votes of all stockholders (other than membership stock) cast thereon. Members of a cooperative may amend their articles to allow for approval with a majority of votes cast.

In Wisconsin, Chapter 186 of Wisconsin statutes relates to the organization and operation of credit unions. Town mutual insurance companies are organized under Wisconsin Chapter 612. No special state laws for consumer cooperatives exist in Wisconsin (just as in most other states); they can be incorporated under Chapter 185.
In many ways, the “kaleidoscopic diversity” of cooperatives defies classification. They exist in nearly every sector of the economy and many serve multiple functions. They range from very small, locally oriented associations to multinational business conglomerates. In spite of this diversity, for ease of explanation and analysis, cooperatives are often classified in one of three ways:

1. **Primary business activity.** Cooperatives are often categorized as production, marketing, purchasing, consumer, or service. Each of these broad groups includes more refined categories that reflect the wide variety of products handled and functions performed by cooperatives.

2. **Market area.** Cooperatives can be classified by the size of their market area: local, super-local, regional, national, or international.

3. **Ownership structure.** Six distinct co-op ownership models can be identified: (1) centralized; (2) federated; (3) hybrid—some combination of centralized and federated; (4) new generation co-ops (NGCs); (5) the new “Wyoming cooperatives”; and (6) worker-owned co-ops.

This chapter provides a more comprehensive discussion of the various types of cooperatives that exist and the extent of their economic success in the United States.

### Cooperatives by primary business activity

#### Agricultural production cooperatives

Collectively producing food on community-owned land is rare in the United States but more prevalent in other countries of the world. Collective farms still exist (and now they are voluntary) in Russia and other parts of the former Soviet Union. Production cooperatives are also part of the agrarian land reform movements in many Central and South American countries.

The *kibbutzim* and *moshavim*, established in Israel in 1948, are unique forms of the village-based cooperative. In a *kibbutz*, the community owns all the land and equipment and all production decisions are made collectively. In a *moshav*, individual households own plots of land and make their own production decisions. A village-level cooperative provides inputs, operates a machinery pool, and helps market member products.

In the United States only a few dairy, hog, fruit and vegetable production cooperatives exist. In these cases, farmers have banded together to organize relatively large operations to achieve greater profits and to add value to their products (e.g., corn farmers raise hogs collectively, using their corn as feed).

While technically not a cooperative, community supported agriculture (CSA) represents a relatively new approach to collective farming in the United States. CSAs are part of a growing movement...
where producers and community members share responsibility for their food production. Members or “shareholders” pay an annual fee to cover the cost of production for the upcoming season. In return, members receive a portion of the farm’s produce each week throughout the growing season. This system can provide farmers with a more equitable return for their labor and investment while relieving some of the burdens and uncertainties associated with conventional marketing.

Marketing cooperatives
As their name suggests, the primary function of marketing cooperatives is to market the products of their members. Beyond that, there is a great range of additional functions the cooperatives in this group perform. Bargaining cooperatives (or associations) are at one end of the spectrum. These associations negotiate with processors and other businesses in the supply chain for better terms of trade for their members. A pure bargaining association does not physically handle or take title to the product involved but merely bargains for price and other terms of sale. Bargaining associations are most prevalent in the dairy and fruit and vegetable sectors.

Two or more cooperatives that are involved in marketing may create a separate business to perform this bargaining function. This business, which is commonly called a marketing agency-in-common, has a single purpose: to serve as the marketing agent for its co-op members. It does not physically handle products and it generally does not take title to them.

At the other end of the spectrum, some marketing cooperatives also grade, process, package, label, store, distribute, and merchandise products. Processing or manufacturing cooperatives focus on the processing of raw farm products rather than on the marketing and often leave that responsibility to brokers or regional cooperatives. In general, marketing cooperatives in the United States are becoming larger and more vertically integrated by increasing their ownership and control of facilities beyond the first buyer level, and in some instances, all the way to the retail level. Some regional marketing cooperatives have established well-recognized brand names (e.g., Land O’Lakes).

The Land O’Lakes “Indian Maiden” logo is one of the most recognized brands in America. It was created during the search for a brand name and trademark in 1928. In 1939 it was simplified and modernized by Jess Betlach, a nationally recognized illustrator.

In 2002, cooperatives marketed 27 percent of all farm products in the United States and had a combined net business volume of $69.6 billion (table 4.1). Dairy and grain cooperatives accounted for nearly 60 percent of that figure ($40.5 billion). Cooperatives are more important to the dairy industry than to any other major agricultural commodity. In 2002, 196 cooperatives marketed 139.2 billion pounds of members’ milk, or 86 percent of the country’s milk as it left the farm, up from 78 percent in 1985 (table 4.1). Cooperatives also comprise a sizable share of dairy manufacturing. Cooperatives account for about 85 percent of dry milk products, 71 percent of butter, 40 percent of natural cheese marketed, and 7 percent of packaged fluid milk in the United States. Dairy cooperative product lines also include ice cream, ice milk, bulk condensed-milk products, condensed whey, dry whey and whey products, and frozen product mix. Dairy cooperatives are heavily involved in brand merchandising, accounting for more than half of all the cooperatives that market products under their own brands.
### Table 4.2. Agricultural cooperative statistics, 2002

<table>
<thead>
<tr>
<th>Type of cooperative</th>
<th>Number of cooperatives</th>
<th>U.S. market share&lt;sup&gt;2&lt;/sup&gt; (%)</th>
<th>Net business volume (million dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PRODUCTS MARKETED</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cotton</td>
<td>14</td>
<td>56</td>
<td>2,461</td>
</tr>
<tr>
<td>Dairy</td>
<td>196</td>
<td>86</td>
<td>23,038</td>
</tr>
<tr>
<td>Fruits and vegetables</td>
<td>212</td>
<td>19</td>
<td>7,338</td>
</tr>
<tr>
<td>Grains and oilseeds</td>
<td>768</td>
<td>35</td>
<td>17,474</td>
</tr>
<tr>
<td>Livestock and poultry</td>
<td>85</td>
<td>14</td>
<td>12,304</td>
</tr>
<tr>
<td>Rice</td>
<td>15</td>
<td>40</td>
<td>748</td>
</tr>
<tr>
<td>Sugar</td>
<td>48</td>
<td>55</td>
<td>2,440</td>
</tr>
<tr>
<td>Other products</td>
<td>219</td>
<td>8</td>
<td>3,852</td>
</tr>
<tr>
<td><strong>Total marketed products</strong></td>
<td><strong>1,557</strong></td>
<td><strong>27</strong></td>
<td><strong>69,655</strong></td>
</tr>
<tr>
<td><strong>SUPPLIES PURCHASED</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Crop protectants</td>
<td>n.a.</td>
<td>32</td>
<td>2,713</td>
</tr>
<tr>
<td>Feed</td>
<td>n.a.</td>
<td>21</td>
<td>5,573</td>
</tr>
<tr>
<td>Fertilizer</td>
<td>n.a.</td>
<td>42</td>
<td>4,315</td>
</tr>
<tr>
<td>Petroleum</td>
<td>n.a.</td>
<td>42</td>
<td>7,157</td>
</tr>
<tr>
<td>Seed</td>
<td>n.a.</td>
<td>12</td>
<td>1,086</td>
</tr>
<tr>
<td>Other supplies</td>
<td>n.a.</td>
<td>n.a.</td>
<td>3,035</td>
</tr>
<tr>
<td><strong>Total farm supplies</strong></td>
<td><strong>1,201</strong></td>
<td><strong>27</strong></td>
<td><strong>23,879</strong></td>
</tr>
<tr>
<td>Services and other</td>
<td>380</td>
<td>n.a.</td>
<td>3,416</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>3,138</strong></td>
<td>n.a.</td>
<td><strong>96,950</strong></td>
</tr>
</tbody>
</table>

<sup>1</sup> Many cooperatives are multi-functional; they are classified by USDA according to their predominant commodity or function as indicated by business volume.

<sup>2</sup> Market share estimates are based on data from several sources. Cooperative shares of farm marketings are estimated by calculating “farmer payments” (= cooperative net business volume-gross margins) and dividing them by the appropriate total U.S. cash receipts. Cooperative farm supply shares are estimated by calculating adjusted business volumes (= cooperative net business volume-export business volume-sales to other firms-supplies sold for non-farm purposes) and dividing them by the appropriate total U.S. cash expenditures (Kraenzle and Eversull, “Co-ops increase share of farm marketings,” Rural Cooperatives, May/June 2003).

In 2002, 768 cooperatives marketed grains and oilseeds. These cooperatives accounted for 35 percent of the nation's market share, up slightly from 33 percent in 1985. In grain and oilseeds, the marketing cooperative's role is most extensive in aggregating, storing, and marketing. Relatively few co-ops process grain. Those that do operate soy oil refining plants, rice mills, flaxseed and sunflower seed crushing plants, durum flour mills, and corn wetmilling plants that produce syrup and starch.

Cooperatives also market nearly every type of fruit, vegetable, and nut grown in the United States. They play a major role in marketing oranges, grapes, apples, cranberries, potatoes, and almonds. In 2002, growers of these commodities owned 212 cooperatives that marketed products valued at $7.3 billion. These sales accounted for 19 percent of the market share. Many fruit and vegetable cooperatives market products under their own brands; consumers are probably most familiar with Blue Diamond, Ocean Spray, Sunkist, Sun-Maid, Sunsweet, Tree Top, and Welch's.

Marketing cooperatives also play an important role in the livestock and poultry sector. Marketing activities include selling and buying on commission and dealer operations (buying stations with a central sales desk buying feeder livestock for some members and buying slaughter and feeder livestock from others). Some cooperatives go beyond marketing and are involved in the production of feeder animals; contract hog production; and slaughtering, processing, and meat distribution. In 2002, 85 cooperatives handled livestock and poultry products with a net business valued at $12.3 billion. These cooperatives accounted for 14 percent of the total U.S. livestock marketing volume at the first handler level, up from 8 percent in 1985.

**Purchasing cooperatives**

Purchasing cooperatives provide members with dependable supplies at competitive prices. By purchasing in bulk, the co-op receives volume discounts, which are then passed on to the members. Most farmers use purchasing (farm supply) cooperatives for their farm inputs (feed, seed, fertilizer, petroleum products, farm equipment, hardware, and building supplies). Over 1,200 farm supply cooperatives sold 27 percent of all major supplies purchased by farmers in 2002 (table 4.1). Today, many farm supply co-ops also serve non-farmers (a growing population in many rural communities in the United States), and handle such items as heating oil, lawn and garden equipment, and household appliances. Some also operate groceries, convenience stores and restaurants, especially when no other business is willing to support such operations in small, rural towns. The total net business volume of farm supply co-ops in 2002 was $23.9 billion.

Cooperatives play a vital role in providing petroleum products to rural communities. Their range of activities includes exploring for crude oil and natural gas, refining and manufacturing, wholesale and retail distribution, and related operations such as research and product testing. By value, petroleum products are the largest component of coop-
erative farm supply activity: $7.2 billion or 30 percent of supply cooperatives’ net business volume in 2002. Farm supply cooperatives accounted for 42 percent of farmers’ fuel purchases in 2002. Feed sold at farm supply cooperatives in 2002 had a net business value of $5.6 billion. This volume amounted to 21 percent of farmers’ total feed purchases.

Farmers have used cooperatives to secure fertilizer sources such as potash and phosphate rock. One of the largest fertilizer manufacturing companies in the United States is the interregional farmer cooperative, CF Industries. In 2002, cooperative fertilizer sales in the United States were valued at $4.3 billion. This represented 42 percent of the total fertilizer purchased by farmers.

Supply cooperatives also provide farmers with crop protection products such as insecticides, fungicides, herbicides, rodenticides, soil treatments, and wood preservatives. In 2002, farmers purchased 32 percent of their crop protection products through a cooperative, up from 29 percent in 1985. The net business value was $2.7 billion.

Non-farm related purchasing cooperatives sell to independent retailers. For example, the owners of America’s independent hardware stores organized purchasing cooperatives to pay less for the products they eventually sell, which in turn helps them compete with big warehouse chains like Home Depot. Over 6,000 True Value dealer-owned hardware stores are members of the TruServ purchasing cooperative, established in 1948 with 25 members. The ACE Hardware dealer-owned cooperative, established in 1924, now serves over 4,800 stores.

Similarly, fast-food restaurants have formed purchasing cooperatives (owned by the franchises) that supply over 10,000 restaurants with almost everything they need – food, restaurant supplies, equipment, advertising, insurance, etc. Restaurants like Burger King, Dairy Queen, Kentucky Fried Chicken, and Taco Bell have all organized purchasing cooperatives.

To better serve consumers, many independent grocers also depend on cooperative wholesalers. Examples include Certified Grocers, Piggly Wiggly, and Wakefern Food Corporation (owned by ShopRite grocery stores). These wholesalers provide their member-grocers with the identity, brand names and buying power they need to compete with the large grocery chains.

Hospitals have also formed purchasing cooperatives to buy supplies at lower prices.

**Consumer cooperatives**

Consumer cooperatives are a specific type of purchasing cooperative. Food cooperatives, especially natural food stores, are America’s quintessential consumer cooperative. An English immigrant in New York City established the first food co-op in the United States in 1822. Many food co-ops were organized during the Great Depression, when people everywhere were trying to save money on household expenses. Many of these food co-ops still exist. Today, however, food cooperatives are more commonly associated with supplying natural or organic products. There are nine natural food cooperative wholesalers across the United States. *Cooperative Grocer*, an industry magazine, estimates that natural food co-ops have 550,000 members while 4,000 food buying clubs boast another 88,000 members. Altogether, they have a combined retail volume of $600 million. Most food cooperatives serve non-member customers, although they customarily charge them higher prices. Some cooperatives require members to work a certain number of hours in addition to or in lieu of a membership fee.

**Service cooperatives**

Farmers, consumers, and businesses use cooperatives to obtain a wide variety of specialized services. In some cases, these services may be provided as a division or subsidiary of a cooperative whose primary function is either marketing or purchasing. Agricultural service cooperatives provide a wide variety of services, including artificial insemination, milk testing, cotton ginning, trucking, storage, grinding, crop drying, and livestock shipping. Other common types of service cooperatives include finance, electric, telephone, housing, and health care.

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**Chapter 4**

**Cooperative classification**
Finance. Eighty four million people are members of 9,569 credit unions in the United States. Credit unions are the fastest growing type of cooperative, not only in the United States, but worldwide. Credit unions offer a variety of services, savings and loans, credit cards, and retirement accounts. Today, one can find credit unions for schools and universities, federal employees, communities, companies, etc. Increasingly, low-income communities have come to view credit unions as a force for economic development.

The Farm Credit System, created by Congress in 1916, is the oldest and largest financial cooperative in the United States. It provides loans, crop insurance, and other financial services to more than a half million farmers, agribusinesses, agricultural cooperatives, and rural utility cooperatives. It is a nationwide network of cooperative financial institutions and service organizations (six Farm Credit Banks and one Agricultural Credit Bank, which serves over 100 local Farm Credit associations). It is estimated that today the Farm Credit System provides more than 25 percent of U.S. agricultural credit.

CoBank, the national bank charged with providing credit to cooperatives, is part of the Farm Credit System. It was created in 1989 as the result of the consolidation of 11 out of the original 13 Banks for Cooperatives established by the Farm Credit Act of 1933. In 1999, CoBank merged with the St. Paul Bank for Cooperatives, making it the national leader in cooperative lending. CoBank is owned by approximately 2,500 stockholders (cooperatives, Farm Credit associations, and other rural businesses).

Other financial institutions that serve cooperatives include the National Rural Utilities Cooperative Finance Corporation (CFC), which has loaned funds to rural electric and telephone cooperatives since 1969, and the National Cooperative Bank (NCB), a leader in providing loans to housing, consumer, and other non-agricultural cooperatives in the United States.

Insurance. Since the 1920s, cooperative insurance companies have proven to be among the nation's most reliable suppliers of insurance. Mutual Service Insurance (MSI) was established in the early 1930s to provide insurance to farm co-ops. In 2004, MSI Insurance Companies merged with Country Insurance and Financial Services (operating under the latter name) and provides property and casualty insurance to agribusinesses and cooperatives, as well as life and homeowners policies to individuals. Members of Ohio Farm Bureau created Nationwide Insurance Enterprise to sell auto insurance to Ohio farmers in 1926. Today, Nationwide is one of the largest insurance and financial services companies in the world, with more than $148 billion in assets. It offers a full range of insurance products (auto, fire, life, health, and commercial) and financial services (administrative services, annuities, mutual funds, and retirement plans).

Utilities. Rural utility cooperatives are essential to rural community development in the United States. They built the infrastructure to provide electricity and telephone service to rural areas when no other companies felt they would make enough return on that type of investment. In 2002, nearly 900 rural electric cooperatives provided electricity to 37 million people in 47 states. Sixty-five are generation and transmission cooperatives (G&Ts), which means they generate and transmit electricity for other distribution cooperatives. Rural electric and telephone cooperatives also invest in their local communities, providing distance learning programs for schools and establishing industrial parks.

Housing. As housing costs in the United States continue to climb, housing cooperatives have become an increasingly attractive housing option. Housing cooperatives make housing affordable to millions of Americans from every walk of life and every income level. Housing cooperatives today take the form of retirement villages, mobile home parks, co-housing communities, apartment complexes for low-income residents, and even houseboats. College students have been living in cooperative housing for decades. One of the largest, the University Students’ Cooperative Association (USCA) in Berkeley, California, accommodates close to 1,300 students (approximately four percent of the total University enrollment) in 20 buildings.
Health care. In at least a dozen cities in the United States, companies have established member-owned cooperatives to purchase health care for their workers. Community health care centers, another form of cooperative health care, can be found in many rural areas and inner city neighborhoods. Health maintenance organizations (HMOs), many of which are organized as cooperatives, provide health care to more than 1 million Americans. HMOs have built their reputation by concentrating on primary care, or preventive medicine. Among the biggest HMOs in the nation is Group Health Cooperative of Puget Sound, Washington, which provides medical services to 477,800 people, one of every 11 residents in the state of Washington.

Others. Examples of other consumer and service cooperatives include cooperative memorial societies (approximately 140 exist in the United States with 500,000 members), outdoor recreation retailers (Recreation Equipment Inc., or REI, is the largest consumer-owned co-op in the United States), hotels (created as a cooperative in 1946, Best Western is the world’s largest lodging chain), florists (Florists Telegraph Delivery Service—FTD), and a cooperatively owned cable TV channel (C-Span, founded by owners and operators of the nation’s cable television channels).

Cooperatives by market area

Local cooperatives

Local cooperatives have typically operated in relatively small geographic areas (serving members who live within a radius of 10 to 30 miles or within a single county). Usually they have only one facility (e.g., a single store or plant). Mergers and acquisitions, however, have enlarged the operating size of many locals in the United States. Some farm supply and grain locals are now as big as regionals were in the 1950s. Super locals cover a multi-county area, often with several locations.

Interregional and national cooperatives

Large cooperatives serving one or more states in an area are called regional cooperatives. Interregional and national cooperatives serve a major portion of the United States. Although regional cooperatives are sometimes in competition with one another, they cooperate through these national associations to better serve their members.

Major interregional and national cooperatives include CF Industries and Universal Cooperatives. CF Industries is owned by eight regional farm supply cooperatives; it serves over one million farmers in 48 states and Canada. Universal Cooperatives is owned by 17 regional agricultural cooperatives; it provides manufacturing, distribution and purchasing services to over 8,000 retail outlets and over two million co-op customers worldwide. Products supplied range from tires to detergents to food products. Universal owns the CO-OP brand name, one of the oldest trademarks in the United States.

International cooperatives

International cooperatives serve members and operate in more than one country. Today, several agricultural cooperatives that began in the United States operate in several countries. For example, Growmark has operations in the United States and Canada; Land O’Lakes has investments in farm supply and dairy processing operations in Eastern Europe; and the International Cooperative Petroleum Association, headquartered in the United States, has member cooperatives in Belgium, Denmark, Egypt, France, and other countries.
Figure 4.1. The centralized cooperative structure with one business location

Figure 4.2. The centralized cooperative structure with more than one business location

Legend:

= flow of goods and services
= ownership and control

Figure 4.3. The federated cooperative structure
Cooperatives by ownership structure

Centralized cooperatives

Centralized cooperatives are owned directly by their members (figure 4.1) and are typically local with a single branch. Most cooperatives in the United States are centralized cooperatives. Regional, national, and international cooperatives may also be centralized, although it is not as common. Larger centralized cooperatives may have several branches or retail outlets but operational control and authority are centralized at the headquarters of the cooperative (figure 4.2). Centralized cooperatives have one main office, one board of directors, and one CEO or general manager.

The service area of a centralized regional cooperative is often divided into districts. Each district usually has a given number of delegates depending on the size of the cooperative membership. Members within each district elect the delegates, who in turn elect the board of directors. The board hires the CEO or general manager. The CEO hires managers to oversee the daily operations of each branch.

Ocean Spray, the cranberry juice company, is a well-known centralized regional cooperative. It is owned by more than 800 cranberry growers and 126 grapefruit growers located throughout the United States and Canada. The headquarters are located in Massachusetts, but fruit receiving stations and processing and bottling plants are located throughout the United States and Canada.

Federated cooperatives

A federated cooperative is a cooperative owned and controlled by other cooperatives (figure 4.3). Local cooperatives elect, through their board or elected delegates, the board of the federated regional cooperative. Board directors at the regional level typically represent geographic districts weighted by the number of local cooperatives in a given area. For example, CHS has eight regions and 17 directors; the number of directors per region varies from 1 (regions 2, 7, and 8) to 5 (region 1, which has the most members) (see figure 4.4).

Federated regional board members may all be members from the locals, or they may represent a combination of members and managers of local cooperatives. The number of voting delegates may be one per cooperative or it may be based on membership size, business volume with the federation, equity investment with the federation or a combination of these factors.

Local cooperatives receive benefits (patronage refunds) in proportion to their patronage with the federated cooperative. They also invest equity in the federated co-op, which can be lost should the co-op go bankrupt. This happened when Farmland, one of the largest federated farm supply cooperatives in the United States at the time, went bankrupt in 2003.

Hybrid cooperatives

Some large cooperatives have both centralized and federated features. In these cooperatives, called combination or mixed, both individuals and autonomous cooperatives are direct members. For example, Land O’Lakes is owned by more than 7,000 producer-members and approximately 1,300 local cooperatives.

Figure 4.4. The regional map for CHS (2004). As with other federated cooperatives, board representation is weighted based on the number of cooperatives in each region.
Other business structures

Cooperatives can use several other types of structural arrangements to take advantage of economic opportunities. A **subsidiary** is a corporation organized, owned, and controlled either directly or through trustees by a parent cooperative. To legally isolate the parent cooperative from the subsidiary, there needs to be clear separation of management and profits between the two organizations. The purpose of the subsidiary is to assume certain duties and functions of the parent cooperative.

A **joint venture** is an association of two or more participants, persons, partnerships, corporations, or cooperatives that carry on a specific economic operation, enterprise, or venture. The identities of these participants, however, remain separate from their ownership or participation in the venture. Use of joint ventures among cooperatives involves a partnership arrangement between two or more cooperatives. This type of activity has become commonplace among both local and regional cooperatives. Regional supply cooperatives have formed joint ventures to manufacture feed and fertilizer or to refine petroleum products. More recently, cooperatives have become involved in joint ventures with investor-owned firms (IOFs).

A **holding company** is a corporate entity with controlling ownership in one or more operating companies. This degree of ownership can vary widely, as long as the holding company can exercise control through the operating company’s board of directors. Normally, the holding company generates no revenues from operations. Income is limited to returns from investments in the operating companies. Cooperative Resources International (located in Wisconsin) for example, is a holding company for three cooperative subsidiaries: Genex, an artificial insemination (AI) cooperative; AgSource, a milk testing and related service cooperative; and Central Livestock, a livestock marketing cooperative.

An **information sharing organization** comprises two or more cooperatives that market and price independently, but exchange production and market information. Improved information allows participating cooperatives to improve their marketing and pricing efforts. For example, one group of dairy cooperatives in the United States exchanges their production, inventory, and market information for dry whey weekly; another group does the same for non-fat dry milk.53

New generation cooperatives (NGC)

New generation cooperatives (NGCs), also referred to as new wave or value-added cooperatives, have two structural characteristics that distinguish them from other types of centralized agricultural cooperatives.54 First, NGCs tie membership shares to “delivery rights.” Members purchase shares that give them the right and obligation to sell a certain quantity of product to the cooperative. For example, one share may mean the member will be required to deliver 1,000 bushels of wheat to the cooperative each year. If the member fails to deliver, the cooperative has the right to assess the member some fee to cover the cost incurred from the co-op purchasing the shortfall elsewhere. Second, NGCs have limited or closed membership. Through the sale of delivery rights, the cooperative limits the number of members and the quantity of product it receives from members.

The initial membership share price is determined by dividing the total amount of equity capital needed from members by the number of units of product that will be processed by the cooperative plant. When they want to leave the cooperative, or reduce the amount they sell to the co-op, members can sell their shares to other producers. This marketability means membership shares can also change in value, either increasing or decreasing. Share value depends on cooperative performance. Since members typically provide significant equity, they receive a relatively high portion of the co-op’s annual profits as cash patronage refunds. If the cooperative needs additional capital for growth, it may issue additional shares of delivery rights.
The Wyoming cooperative model

As noted in the previous chapter, a new Wyoming cooperative statute was enacted July 1, 2001. It legalized the creation of a limited liability company (LLC)–cooperative hybrid, which will be referred to here as the Wyoming Cooperative Model (WCM) although other states (such as Minnesota) have passed or are considering similar cooperative statutes. The WCM allows two classes of members: patron members, those who use the cooperative, and investment members, those who do not use the cooperative but invest equity capital. All members can have the same voting rights, although bylaws can be written to subscribe more complex voting rights. The law does not require investment members to be afforded the right to vote, therefore, bylaws can be written that do not give them voting rights.

Patron member votes are counted collectively. For example, assume patron members possess 60 of the total 100 voting rights in a cooperative. If a majority of the patron member votes, say 40, are cast in favor of a proposal, 60 votes are actually counted as favoring the proposal. Any member can be elected to the board of directors, although the board must include at least one patron member, and patron members must represent at least half of the voting power of the board. Thus, the cooperative statutes provide some protection of patron member control.

Annual net profits are divided between two pools: a patronage and an investment pool. Net profits are distributed to patron members on the basis of use and to investment members on the basis of investment. For instance, assume the cooperative chooses to allocate $100,000 of its annual net profits to its members. Patron member A, whose patronage of the cooperative represents 5 percent of the cooperative's total profits, would receive $5,000. Investment member B, whose investment represents 10 percent of the cooperative's equity, would receive $10,000. However, patron members as a group must receive at least 15 percent of the profit allocations.

The WCM is eligible for partnership (Subchapter K), limited liability, or cooperative tax status. This decision is up to the board of directors.

Clearly, the primary advantage of the WCM is its ability to attract “outside” investors such as venture capital companies. Since many financial institutions require at least a 50-50 debt-to-equity ratio, this additional influx of capital means many new ventures become feasible. The WCM advantages are balanced by some fairly substantial drawbacks. Perhaps most significantly, it is not protected by the Capper-Volstead Act. Further, it is not eligible to receive loans from CoBank (although CoBank is pursuing a change in its cooperative definition that would allow it to make loans to WCMs).

Worker-owned cooperatives

As the name implies, employees own worker-owned cooperatives. Most worker-owned cooperatives operate in the processing or service sectors. With this type of arrangement, usually (but not always) profits and losses from the business are allocated to the members based on their individual labor contributions rather than their patronage. Worker-owned cooperatives have existed in the United States since colonial times. They are created to preserve jobs, improve working conditions, wages, and productivity, spread ownership of capital resources more broadly, and establish more democratic work environments. The economic downturn and high unemployment rates of the 1980s generated a surge of interest in worker cooperatives in the United States. Today, there are an estimated 300 worker-owned cooperatives in the United States.55

Two structures related to worker-owned cooperatives are worker collectives and Employee Stock Ownership Plans (ESOPs). The term “collective” in this context refers to a management style rather than an ownership model. Thus, a worker-owned cooperative can also be a collective. Collectives are managed by the entire membership instead of a select management team; they have a flat management structure rather than a hierarchical one.
ESOPs developed out of the U.S. Employee Retirement Income Securities Act of 1974. This act changed the federal tax code to allow special employee ownership through the employee’s pension plans. The purpose of an ESOP is to enable employees to acquire beneficial ownership within their company without having to invest their own money. Many businesses with ESOPs are not completely employee owned; it is often a corporation/employee mix. Also, there is no requirement for democratic control, unlike the structure of cooperatives. An estimated 10,000 firms in the United States are ESOPs, employing 10 million people.

Conclusion

In the United States, as in other countries, cooperatives play a prominent role in national and local economies. They exist in nearly every sector, serve multiple functions, and range in size from very small, local cooperatives to international businesses. They also vary in terms of ownership—most cooperatives are owned directly by their members, but others are owned by other cooperatives. Some cooperatives limit their membership to a certain number, others to their workers. Today, in some states, cooperatives are opening their memberships to include an investor class. All legally recognized cooperatives in the United States, however, comprise a single business class: Subchapter T corporations. The relative merits of the cooperative structure, as compared to other forms of business are the subject of the next chapter.
Cooperatives have a remarkable history and many positive attributes. However, the cooperative model is not the best structure for all business ventures. Choosing the most appropriate business structure is an important strategic decision for business owners. In the United States (and in Canada, Europe, and other countries) there are essentially five primary business structures from which to choose:56

1. individual (sole) proprietorship,
2. partnership,
3. limited liability company (LLC),
4. corporation (Subchapter C and S), and
5. cooperative corporation (Subchapter T).

The business structure should be chosen based on the following general criteria:

- What makes the best business sense in the short-run?
  - How easy is it to get the business started?
  - How easy will it be to raise start-up capital?
- What makes the best business sense long term?
  - Is the structure flexible enough for growth?
  - Where will future capital for growth come from?
  - Does it offer the possibility for easy conversion to another structure down the road?
- What level of control is required and desired?
  - Can management be delegated?
  - Will ownership be time consuming?
  - Who will share in decision-making?
- What type of legal liability are owners subject to?
- What are the tax implications of the various structures?

This chapter briefly describes each business structure within the context of the decision criteria outlined above. Table 5.1 provides a summary of the comparison. Cooperatives, for obvious reasons, are dealt with more extensively.

**Individual (sole) proprietorships**

In a proprietorship, one person owns and controls the business. This person assumes the risk of ownership, keeps all profits, and bears any losses. They are personally responsible for the investment in the business, the actions of the firm, and for any growth or expansion of the business. Unless otherwise provided for, the business ceases to exist after the death of the owner. If the business is sold, the owner receives the appreciated or depreciated value from the equity invested. Individual proprietorships have what is called pass-through taxation. All business income is reported on the owner's personal tax return and taxed at the owner's individual income rate. The Internal Revenue Service (IRS) does not consider a separation of employers from owners in this business arrangement, so the business cannot deduct fringe benefits paid to employee-owners.

There are advantages to this method of doing business. The owner is his or her own boss. Any net profits belong to the owner and need not be shared with anyone. This does not preclude, however, a profit-sharing plan with employees. Individually owned businesses are easy to set up. No incorporation papers need to be prepared, no incorporation fee needs to be paid, and no bylaws need to be adopted.57 Personal talents and initiative are fully rewarded; financial compensation (all of the business profits) provides the incentive for the owner to see that the business succeeds.

There are also disadvantages to individually owned businesses. The available capital is limited to what the owner has or can borrow. As a result, many proprietary firms are small. The owner faces significant financial risk since business losses are borne by the owner alone. The owner has unlimited liability, which means he or she faces not only the loss of whatever equity is invested in the business but also other personal assets (e.g., their car or house) to cover business debts. Decision-making rests with one individual, so success is limited to the business ability of the owner.

Notwithstanding these potential drawbacks, individual proprietorships remain the most prevalent business structures in the United States.
form of business in the United States (figure 5.1). It is the most common form of business for small companies since it is the simplest form of business. Therefore, individual proprietorships account for a relatively small share of all business income in the United States (figure 5.2).

**Individual proprietorship**

+ Easy and inexpensive to organize
+ Owner has complete control
+ Owner receives all income
  - Owner has unlimited liability
  - Owner is taxed on all business profits
  - Not suitable for large or complex businesses

**Partnerships**

Partnerships are formed when two or more persons own and operate a business jointly. Each person in the business is a partner but not necessarily on an equal basis. Together they pool their resources, borrow on their shared credit strength, share in the decision-making process, and collectively bear the debts. Votes on management decisions may be in proportion to their individual investment or management agreement. There are two types of partnerships: general and limited. A limited partnership may have one or more partners who are restricted from participating in management and whose business liability is limited to their investment in the business. General partners face unlimited liability. In either case, partners divide the net earnings of the business as well as its losses according to a contractual agreement. The contractual agreement for the division of net earnings or losses may be in proportion to investment, contribution of labor, a combination of the two, or by some other means.

Partners realize the benefits from equity appreciation (depreciation) upon the sale of the partnership. Partnerships also have pass-through taxation. The partnership does not pay income taxes; rather, net taxable income is divided among the partners and they pay individual income taxes on their share. As with proprietorships, the business cannot deduct fringe benefits paid to employee-owners. The partnership ends with the death or withdrawal of any partner.

The combination of capital, skills, and experience that the partners can jointly provide is a major advantage of partnerships. Flexibility in defining other aspects of the business (for instance, how profits are divided) is another advantage.

There are some disadvantages with partnerships. Limited partners are personally liable for any debts of the business and commitments made by any partner. Partnerships can be uniquely challenging because they may involve many different personalities. Partners need a high degree of mutual trust and respect to make the arrangement last.

**Figure 5.1. Percent distribution of all U.S. firms by legal form of organization, 1997**

![Figure 5.1](Image)

**Figure 5.2. Percent distribution of all U.S. firms’ receipts by legal form of organization, 1997**

![Figure 5.2](Image)
Partnerships
+ Easy to organize
+ Partners share control
+ Partners receive all income
− Some partners have unlimited liability
− Partners are taxed on all business profits
− Personality differences may cause problems

Limited liability company

Limited liability companies (LLCs) are a relatively new business trend in the United States and share many of the characteristics of a partnership. In this arrangement, all owners enjoy limited liability. In decision-making, the owners have voting rights proportionate to their investment or by some other mutual agreement. Most LLCs require the unanimous consent of owners on many important issues. Profits are divided in proportion to each owner’s level of investment or by some other mutual agreement. Owners may withdraw their assets at will, but transfer of ownership interest may require unanimous approval of the remaining owners. LLCs also generally require unanimous approval by the remaining owners to continue the joint venture after the withdrawal of any one owner. However, unlike partnerships, an LLC may institute a “continuity of life” clause if the owners agree in advance to give the consent necessary to avoid dissolution upon the disassociation of a member.

LLC owners pay individual income taxes on their share of the firm’s profits. There is no separation of employers from owners and therefore, the business cannot deduct fringe benefits paid to employee-owners. However, an LLC has the option to elect to be taxed as a general business corporation.

The LLC model is gaining in popularity in the United States because it combines the flexibility and advantageous tax treatment of a partnership (pass-through tax treatment) with the limited liability of a corporation. It is less complex and therefore less costly to set up and manage than a corporation. By the 1990s, farmers were choosing LLCs over cooperatives for many new businesses. The LLC has also been used as a vehicle for organizing joint ventures among established corporations, including those involving cooperative and investor-owned firms. The disadvantages of an LLC center around the consensus required among members for certain key business decisions. Consensus is difficult to consistently achieve over time. The relative ease of exit, which can threaten long-term stability, is another significant disadvantage of the LLC.

Limited liability companies (LLCs)
+ Easier to organize than a corporation
+ Democratic control
+ Limited liability
− Owners are taxed on all business profits
− Too easy for owners to exit
− May be cumbersome with a large number of partners

C o r p o r a t i o n s

A corporation is a legally chartered institution formed by a group of people or other businesses who are granted, as a body of one, certain legal powers, rights, and privileges distinct from those of the individuals making up the group. The corporation is generally chartered under the laws of the state where the principal or home office of the company is located and operates under those laws. The corporation can be thought of as an individual. It owns assets, has the right to the company’s net income, and is liable for debts, losses, and other claims. It may also vote in certain instances, for example, if it owns stock in another corporation. The corporation can maintain perpetual existence. If an owner dies or sells equity to another owner or back to the corporation itself, the owner’s disassociation does not cause the dissolution of the corporation as it would in a proprietorship or often in a partnership. There are three primary types of corporations in the United States: Subchapter C, Subchapter S, and Subchapter T. The subchapter status reflects different state and federal tax policies.

Subchapter C-corporations are often referred to as “for-profit” corporations, which is misleading. Most businesses, unless organized as non-profits, need...
to generate profits in order to stay in business. Ownership shares (stock) in C-corporations are generally offered on public stock market exchanges (such as the New York Stock Exchange). The purpose of the C-corporation, to generate returns for its investors (stockholders), distinguishes it from cooperatives. Profits, after corporate taxes, are distributed to stockholders in proportion to their investment (number of shares of stock) in the corporation. Hence, C-corporations are also commonly referred to as investor-owned or investor-oriented firms (IOFs). There are no limits on the returns to individual stockholders. They gain or lose any appreciation or depreciation in the value of their stock.

A board of directors, which is elected by the stockholders, and the corporate officers make the main business decisions in a C-corporation. Each stockholder usually has as many votes as the number of shares of voting stock he or she owns. A general manager or chief executive officer (CEO) is hired by the board to provide overall management of the business. Neither the directors nor investors have any obligation to use the firm's products or services.

A C-corporation is subject to double taxation: the firm's net profits are taxed at the corporate rate before being distributed to stockholders. Once they are distributed, the stockholders also pay income tax on these funds. Despite this unfavorable tax treatment, there are several advantages with the C-corporation model. Stockholders enjoy limited liability. In the event of company losses or bankruptcy, each stockholder will at a maximum lose the amount represented by the stocks he or she owns. The corporation can exist indefinitely unless it is purposely dissolved or is only incorporated for a specific number of years. Investment in the corporation through the purchase of shares of stock is fairly straightforward and easily accommodates both large and small investors, since share values can be kept low enough to attract many investors. Transfer of ownership is also accomplished rather easily. Finally, since the corporation is a separate and distinct entity from any of its stockholders, its ability to borrow money and attract capital is greater than that of any of its individual owners.

The cost and difficulties associated with creating C-corporations are its major disadvantages. Keeping stockholders informed, distributing dividends, and paying corporate taxes, generate business expenses greater than those associated with other business models. Further, each stockholder has limited and usually very little, if any, control over the business. Proxy voting and cumulative voting may give more control to some stockholders than others.

**C-corporations**

+ Owners have limited liability
+ Larger pool of investors and easier to raise capital
+ Business life is perpetual
  - Complex and costly to organize
  - Double taxation to corporation and to stockholders
  - Owners have little control

**S-corporations**

+ Owners have limited liability
+ Business life is perpetual
+ Taxed as a partnership
  - Limit of 75 stockholders

A Subchapter S-corporation shares most of the characteristics of a C-corporation. It has perpetual life, limited liability of investors, and is controlled by a board of directors elected by stockholders and a general manager hired by the board. The major difference from a C-corporation (and the S-corporation's major advantage) is that it is taxed as a partnership (pass-through taxation). Net profits are distributed to the stockholders in proportion to their investment; only stockholders pay tax on the net profits. S-corporations are limited to 75 stockholders and no other corporations or nonresident aliens may purchase its stock; this limitation is the great disadvantage of the S-corporation. The S-corporation was designed for small businesses (e.g., family farms) that wanted the limited liability of a corporation, but the tax treatment and control of a partnership.
Non-profits

Any corporation (including cooperatives) may be incorporated as a non-profit business (501c) as long as it meets state statutes. Non-profit firms try to operate at cost and generate very limited profits; any profits earned are retained within the business. Exceeding state-dictated profit limits could mean loss of the corporation’s non-profit status. In this event, it would then be treated as a C-corporation. The purpose of most non-profit firms is to provide some type of essential service (e.g., day care and affordable housing). The corporate status gives the providers of the service some legal protection in terms of limited liability. Although some refer to cooperatives as “non-profit corporations,” this is erroneous; most cooperatives are profit seeking.

Cooperatives

A cooperative is also a corporation (Subchapter T) and therefore has perpetual life, limited liability of investors, and is controlled by a board of directors elected by members. However, it has certain structural characteristics and a guiding body of principles that set it apart from other corporations. Like all corporations, cooperatives need to generate profits in order to survive and grow. However, in cooperatives, all or most of the profits are distributed back to the member-users on the basis of use (patronage refunds), not on level of investment. This creates a different set of objectives for the cooperative corporation—the cooperative must be member-oriented rather than investor-oriented; this difference in orientation and objectives creates the biggest distinction between cooperatives and other corporations. Cooperative members may or may not believe that profit maximization is the best goal for their cooperative. A cooperative will provide goods and services demanded by its members that a C-corporation might not because of profitability concerns.

Cooperatives are not operated to create profits at the expense of members. A substantial portion of profits should be distributed back to members as patronage refunds. Cooperatives may also elect to return profits as equity dividends. However, under the Capper-Volstead Act, marketing cooperatives must either limit dividends to eight percent annually or restrict voting rights to one-member, one-vote. In Wisconsin, all cooperatives are required to limit dividends to eight percent annually and to restrict voting rights to one-member, one-vote (see chapter 1 for additional information on cooperative voting rights and chapter 4 for more details on Capper-Volstead). Cooperatives are at a disadvantage in terms of their ability to raise capital. Not only are they legally required to cap investment (equity) returns, they are also not allowed to give investors any voting rights within the organization nor any representation on the board of directors. Cooperatives can sell preferred (non-voting) stock on a public stock market, and some (e.g., CHS) have been reasonably successful at doing this. However, when average market returns exceed eight percent, cooperative stock is less attractive than other options.

Taxation of cooperatives

Generally speaking, cooperatives are subject to the same taxes at the same rate as regular corporations: they pay social security taxes, real estate taxes, sales, personal property, excise, franchise, and any other taxes corporations pay. However, both state and federal laws make some special provisions for the income tax treatment of cooperatives.

Under the Federal Internal Revenue Code all profits of a cooperative are taxed at either the co-op or member level in the year earned. If the co-op allocates the profits earned from member business on the basis of patronage, and there is member consent (qualified allocation), it does not pay corporate income taxes on those funds (they are deducted from corporate taxable income). This is often referred to as single (or pass-through) taxation. A 1962 Internal Revenue tax law dictates that qualified allocations require (a) member consent, and (b) at least 20 percent of patronage refunds must be paid in cash, with no more than 80 percent retained as allocated equity to be redeemed later. Since members are required to pay individual income tax on 100 percent of the
patronage refund in the year earned (and not just the cash portion), it makes sense that they would need at least 20 percent in cash to pay the taxes. Obtaining member consent to accept this patronage refund as taxable income in the year earned is crucial. The IRS recognizes member consent given in one of three ways: (1) Members agree in writing; (2) joining or continuing as a member of a cooperative that has in its bylaws that membership constitutes consent and members have received a copy of this bylaw; or (3) the member endorses and cashes a patronage refund check with a printed statement that endorsing and cashing the check constitutes patron consent to include it as taxable income. Later, when the cooperative redeems this allocated retained patronage refund, the member has no tax obligation.

If member consent is not received, or 20 percent in cash is not paid, the allocated patronage refund is considered an unqualified allocation. In this case, the cooperative pays corporate income taxes on the allocated income in the year earned. If later the cooperative redeems the allocated retained patronage in cash, it receives a tax credit and the member pays individual income tax in the year received.

Whether or not a member is obligated to pay individual income taxes on patronage refunds depends upon whether the patronage was related to business activity or personal consumption. For example, a farmer-member may purchase fertilizer, feed or other inputs from a farm supply cooperative. These are tax-deductible farm business expenses. The patronage refund is viewed by the IRS as a savings in these expenses and, therefore, must be included as taxable income. However, if home heating oil was purchased, the patronage refund would not be considered taxable income. In the case of marketing cooperatives, such as a dairy or grain co-op, a member would include the milk or grain check as taxable income. If the cooperative pays a patronage refund on profits generated from marketing the milk or grain, the member has received additional income that must be included as taxable income. Since household expenditures are not tax deductible, any patronage refunds from consumer cooperatives (e.g., food cooperatives) are not considered taxable income for members.

Co-op profits that are unallocated are taxed at the cooperative level in the year earned at the corporate tax rate. Further, any profits paid as dividends on equity are double taxed; the cooperative pays corporate income tax before any dividends are paid and the member (regardless of whether they are a consumer or farmer) pays individual income tax when they are received.

Under the Federal Internal Revenue Code, agricultural marketing and farm supply cooperatives can qualify as either exempt (Section 521) or non-exempt cooperatives. Section 521 cooperatives are allowed certain additional deductions from their corporate taxable income. The two major deductions are (1) non-patronage income (for example, rent and interest earned on bank deposits) and income from non-member business distributed to members on a patronage basis; and (2) dividends paid on capital stock. However, since 521 requirements are quite strict, most marketing and supply cooperatives are non-exempt. For instance, the co-op must treat members and non-members alike in regards to pricing and patronage refunds. If a marketing cooperative, they must do no more than 50 percent of business with non-members. If a farm supply cooperative, no more than 15 percent of the business may be with non-producers.

Per unit capital retains (for example, 5 cents per bushel of corn marketed) can also be allocated or unallocated. If allocated and there is member consent, the member pays individual income tax on the retained allocation in the year earned. However, unlike patronage refunds, the IRS does not require 20 percent of the per unit capital retain to be paid in cash in the year earned. If the per unit capital retain is unallocated, the cooperative pays corporate income tax in the year earned.
Cooperative principles

Cooperative principles have evolved over time. The Rochdale principles (described in chapter 2) were the first established set of cooperative principles and included organizational points that manifested social and political as well as business concerns. The most widely recognized contemporary set of cooperative principles is that sanctioned by the International Cooperative Alliance (ICA). The ICA has adopted three formal statements of cooperative principles, in 1937, 1966, and 1995. The seven principles adopted in 1995 are

1. **Voluntary and open membership.**
   Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

2. **Democratic member control.** Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives members have equal voting rights (one member, one vote). Cooperatives at other levels are also organized in a democratic manner.

3. **Member economic participation.** Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. **Autonomy and independence.** Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. **Education, training and information.** Cooperatives provide education and training for their members, elected representatives, manager, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefits of cooperation.

6. **Cooperation among cooperatives.** Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional, and international structures.

7. **Concern for community.** Cooperatives work for the sustainable development of their communities, through policies approved by their members.

Of course, not all cooperatives adopt all of the ICA principles. The basic three “defining” principles (user-ownership, user-control, and proportional distribution of benefits) are more commonly accepted as the only principles necessary to guide cooperatives. Many cooperative leaders and scholars believe that the additional principles should serve only as recommendations. They may not be appropriate (or make the best business sense) for all co-ops in all environments. For example, housing cooperatives do not have open membership policies; they are physically limited to the number of members they can admit. Credit unions restrict membership based on financial criteria; otherwise, they could face significant financial risk.
Conclusion

In many respects, cooperatives are quite similar to other types of corporations. They all participate in the same labor and capital markets and must pay similar wages, management compensation, and interest rates. Many operational practices, such as packaging, storing, transporting, processing, and advertising, would also be the same across all business models. Research studies have shown that cooperatives and other corporations are equally efficient. And certainly, general economic conditions—unemployment, interest rates, inflation, etc.—affect all corporations the same. The casual consumer usually cannot tell whether they are doing business with a cooperative or a non-cooperative (unless of course “cooperative” is part of the company name).

The fundamental difference between cooperatives and other corporations is member-versus investor-orientation. Cooperatives focus on generating benefits (which may or may not be profits) to members, while other corporations focus on creating returns for their investors. Because of this difference, the operating philosophies between the two can differ greatly. Cooperatives are often created to correct market failures (e.g., provide an important local service) and not to simply make corporate profits.
### Table 5.1 Comparison of business models in the United States

<table>
<thead>
<tr>
<th>Topic</th>
<th>Individual (sole) proprietorship</th>
<th>Partnership</th>
<th>Limited liability company</th>
<th>Subchapter S</th>
<th>Subchapter C</th>
<th>Cooperative (Subchapter T)</th>
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<tr>
<td><strong>OWNERSHIP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Who are the owners?</td>
<td>Individual proprietor</td>
<td>General and limited partners&lt;sup&gt;2&lt;/sup&gt;</td>
<td>Usually two or more individuals, but can have one</td>
<td>Minimum of two individuals; maximum of 75</td>
<td>Stockholders (general public and other businesses)</td>
<td>User-members (can be other businesses); minimum of five members in Wisconsin</td>
</tr>
<tr>
<td>How is the business financed?</td>
<td>Owner investment and retained profit from operations</td>
<td>Partners’ investment and retained profit from operations</td>
<td>Same as partnership</td>
<td>Sale of stock and retained profits</td>
<td>Sale of stock and retained profits</td>
<td>Sale of stock/shares to members and retained profits</td>
</tr>
<tr>
<td>How is ownership transferred?</td>
<td>Privately negotiated</td>
<td>Privately negotiated; current voting partners usually approve new partners</td>
<td>Privately negotiated; may require corporate approval</td>
<td>Privately negotiated or publicly traded; if public, anyone with enough money can purchase stock</td>
<td>Usually highly restricted; transfers to other members not typical; new members subject to board approval</td>
<td></td>
</tr>
<tr>
<td>What is an individual owner’s legal liability?</td>
<td>Unlimited</td>
<td>General = unlimited&lt;br&gt; Limited partnerships = limited</td>
<td>Limited</td>
<td>Limited</td>
<td>Limited</td>
<td>Limited</td>
</tr>
<tr>
<td><strong>BENEFITS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Who receives profits?</td>
<td>Owner</td>
<td>Partners in proportion to investment or by agreement</td>
<td>Same as partnership</td>
<td>Stockholders in proportion to investment (stock)</td>
<td>Stockholders in proportion to investment (stock)</td>
<td>Members in proportion to their purchases or use of services (patronage)</td>
</tr>
<tr>
<td>What earnings are possible on invested capital?</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Unlimited</td>
<td>Limited by law in most states; usually at 8%</td>
</tr>
<tr>
<td>Who benefits from equity appreciation?</td>
<td>Proprietor, realized upon sale of business</td>
<td>Partner, realized on sale of business</td>
<td>Partners, upon dissolution of LLC or sale of LLC interest</td>
<td>Investors, upon sale of stock</td>
<td>Investors, upon sale of stock</td>
<td>Equity does not appreciate (except with NGCs and then members benefit)</td>
</tr>
</tbody>
</table>

(continued)
Table 5.1 Comparison of business models in the United States, continued

<table>
<thead>
<tr>
<th>Topic</th>
<th>Individual (sole) proprietorship</th>
<th>Partnership</th>
<th>Limited liability company</th>
<th>Subchapter S</th>
<th>Subchapter C</th>
<th>Cooperative (Subchapter T)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who pays income taxes?</td>
<td>Owner at individual rates (pass-through taxation)(^3)</td>
<td>Partners at individual rates (pass-through taxation)</td>
<td>Individuals at individual rates (pass-through taxation), unless investor is a corporation, in which case corporate taxation applies</td>
<td>Corporation pays at corporate rate; stockholders pay at individual rates on dividends and capital gains (double taxation)</td>
<td>Co-op pays no corporate taxes on qualified patronage refund allocations to members (pass-through taxation), but does pay corporate taxes on unallocated net profits, net profits from nonmember business, and equity dividends; members pay individual income tax on cash and deferred patronage refunds and dividends</td>
<td></td>
</tr>
</tbody>
</table>

**CONTROL**

<table>
<thead>
<tr>
<th>Who votes?</th>
<th>Not applicable</th>
<th>Partners</th>
<th>Partners</th>
<th>Stockholders</th>
<th>Stockholders</th>
<th>Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>How are votes distributed?</td>
<td>Not applicable</td>
<td>Among partners in proportion to investment or by agreement</td>
<td>Same as partnership</td>
<td>Only one class of stock (common). One vote per share</td>
<td>One vote per share of common stock owned. May also issue preferred stock</td>
<td>One vote per member in most cases</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Who establishes policy?</th>
<th>Owner</th>
<th>Partners</th>
<th>Partners</th>
<th>Board of directors elected by a majority vote of the owners</th>
<th>Board of directors elected by a majority vote of the owners</th>
<th>Board of directors elected by a majority vote of the owners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Who manages the business?</td>
<td>Owner or hired management</td>
<td>All partners or a general partner in the case of a limited partnership</td>
<td>All partners may participate in management or hired management</td>
<td>Board of directors or hired management</td>
<td>Hired management</td>
<td>Hired management</td>
</tr>
</tbody>
</table>

\(^1\)Subchapter status reflects distinctions in the federal tax code.

\(^2\)A limited partnership may have one or more general partners and one or more limited partners; limited partners are generally restricted from participating in management decisions.

\(^3\)Pass-through taxation is also referred to as single taxation.
Cooperative are owned and controlled by their members. The members elect a board of directors, who in turn hire a general manager or CEO. Although the board is legally responsible for the cooperative, each of these agents—the members, the board, and the CEO—has a unique set of roles and responsibilities, which will be covered in turn in this chapter. It is essential that all cooperative agents understand and are held accountable for their responsibilities. Chaotic organizational structures and weak leadership creates inefficient businesses, regardless of the firm structure.

Cooperative governance and control

Membership responsibilities

It is not unusual for members to believe that they have very little role to play in their cooperative (beyond patronage), especially if it is large. Yet, the role of members is essential—it is placed at the top of the “control” diagram below. Their money helps finance the cooperative and they alone reap the benefits and suffer the losses associated with the cooperative’s performance. Since members share in both ownership and control, they have important duties to perform to ensure their cooperative remains viable.

Cooperatives are democracies and as such depend on the active participation of all constituents.

Therefore, the most important obligation of cooperative members is participation in the governance of the cooperative. In practice, this means they need to: keep informed about the cooperative from reliable sources (not neighbor gossip), attend cooperative meetings, and take their turn at committee and board service. It is important to remind members that probably everyone could claim they are “too busy” and if no one is willing to give some time, the cooperative will fail. As a board member they will gain valuable exposure to ideas and techniques that can be used to improve the performance of their own business and that of other organizations in which they may be involved.

Members are responsible for establishing the purpose of the cooperative and defining how those goals should be achieved. Members approve the articles of incorporation (and any amendments), which establish the cooperative as a business. They also approve the bylaws, which establish the broad rules for operating the cooperative. In addition, membership approval is required for major changes in the cooperative (for example, a merger or dissolution). The following list provides more specific details of membership responsibilities.

Membership responsibilities

- Attend and actively participate in all cooperative annual meetings.
- Serve on cooperative committees and be willing to run for a board seat.
- Only criticize the cooperative in a constructive manner and do not expect special treatment.
- Keep informed about the cooperative by reading newsletters, news articles, and annual reports.
- Adopt and amend articles of incorporation, bylaws, and any resolutions or motions presented at cooperative annual meetings.
- Elect and remove directors.
- Help ensure that directors, management, and employees abide by the cooperative’s bylaws and policies.
- Require an annual review of the co-op’s financial standing and the CEO’s performance.
- Contribute equity to the cooperative.

Figure 6.1. Cooperative governance and control
Patronize the cooperative to the fullest extent possible and pay accounts promptly.

Abide by the decisions of the cooperative board and management.

Choose to leave the cooperative if unhappy, rather than ruining it for other members.

Perhaps members' most critical task is the election of a good board of directors. It is generally not possible for members to know all the operating details of the cooperative so they delegate power to the board of directors to act on their behalf. Therefore, it is very important that members elect capable people for the board.

It needs to be stressed that members can only exercise their governance authority in legally sanctioned meetings. In most states, cooperative statutes do not permit voting by proxy and voting by mail is limited to specific conditions. Election of directors and major cooperative decisions are made on the basis of those members who exercise their voting privilege, for example by two-thirds or the majority of those voting.

### Board of director responsibilities

The primary duties of the board of directors are to safeguard the assets of the members and to represent their interests. The board of directors is legally responsible for the cooperative's continued viability. They are also charged with establishing policies to implement the cooperative's mission.

Cooperatives can be thought of as a large ship heading towards a destination: The members establish the destination; the board of directors set the course and make sure it is being followed. In practice, this involves setting performance standards for the business, measuring performance, comparing actual performance to the standards, and determining corrective action if the standards are not being met. The board of directors is responsible for setting the overall performance goals for the cooperative (e.g., annual net profit levels).

The directors hire and supervise a CEO or manager to steer and run the daily operations. Therefore, the hiring and supervision of a CEO is one of the most significant roles the board plays. They need to select a competent person and be willing to pay a salary high enough to attract and retain a well-qualified individual. Compensation packages vary, but generally cooperatives pay the same base salary as their non-cooperative competition and some offer bonuses tied to performance standards.

Hiring a CEO or general manager may be challenging for a board since most directors typically have limited experience in hiring decisions. The search is made easier if the board has an up-to-date job description that clearly describes the duties and expectations attached to the job. A list of required and desired skills will also make the hiring process smoother.

The following list includes a detailed list of additional board responsibilities.

**Board of director responsibilities**

- Attend every board meeting, actively participate, and be willing to ask questions.
- Be prepared for every board meeting (read the packet of information sent by management; keep informed by reading newsletters, news articles, and past annual reports).
- Seek additional information or training when needed to make the right decisions (e.g., financial training).
- Elect board officers (chair, vice-chair, etc.).
- Hire and supervise the CEO or general manager. Ensure that management abides by the cooperative's bylaws and policies.
- Do not micromanage the CEO; let him or her do the job you specify.
- Do not expect special treatment by the cooperative and do not vote on issues where there is a conflict of interest.
- Bring appropriate decisions to the broader membership for approval and make sure the decisions are implemented.
- Raise capital, supervise loan repayments, manage member equity, and determine and distribute annual patronage refunds and dividends.
- Select financial institutions (banks) and auditors.
Remove board members who are not doing their job and help fill any board vacancies.

- Keep written records of all board meetings.
- Establish long-term plans and objectives for the co-op.
- Patronize the cooperative to the fullest extent possible and pay accounts promptly.

**Strong and effective boards make strong and effective cooperatives.**

Clearly, the board of directors has weighty responsibilities and selection of an active, well-qualified board is critical to the success of a cooperative (see election procedures in sidebar on next page).

Strong and effective boards make strong and effective cooperatives. Most state cooperative statutes require that board members be active members of the cooperative. Usually outside (non-member) directors may serve only in an advisory, non-voting capacity. Co-op members with the following traits should be encouraged to run for board seats:

- Good business judgment;
- Independent thinking and a willingness to ask critical questions;
- Respect for other members;
- Integrity;
- A strong work ethic (works well with others, makes and keeps commitments, manages time effectively); and
- A comprehensive understanding of cooperatives.

Seven to nine board members are common for local cooperatives. Wisconsin statutes, for example, require a minimum of five board members, unless the cooperative has fewer than 50 members, and in that case a minimum of three board members. The board elects officers, usually a president (chair), vice-president (vice-chair), secretary and treasurer. In some cooperatives, the bylaws allow employees and members who are not on the board to serve in secretary and treasurer positions, otherwise board members serve in those positions. Many boards divide their work among permanent and ad-hoc committees. For example, they may have audit, building and equipment, and membership committees. The committees make recommendations to the board for action.

Board decisions may only be made in an official board meeting. Individual board members have no authority to take action on their own and are expected to uphold board decisions. Boards should only speak as one voice; this means that individual directors who disagree with a board decision should not express their opinion publicly. Doing so could undermine the cooperative.

Board members, unlike general members in a cooperative, face unlimited liability. Failure to make a good faith effort to fulfill their duties (due diligence) may subject board members to legal action. Board members can be held personally liable for any losses experienced by the cooperative if they are absent from a meeting without cause, if they fail to disclose a conflict of interest, if they knowingly participate in or perpetuate a fraudulent or illegal act, or if they act imprudently. Many cooperatives carry insurance that covers board members in the case of lawsuits by members. However, the insurance is only valid if the director carries out his or her duties responsibly (with due diligence).

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**Evaluating CEOs**

The CEO should be evaluated on a regular basis, at a minimum annually. An evaluation begins with the job description, which details the areas and tasks for which the employee can be held responsible. Generally, the evaluation compares actual performance to a pre-determined standard. The evaluation should point out the following:

- What the employee has done well;
- Areas of work that need improvement;
- Recommended resources (training, equipment, etc.) to help the employee succeed;
- Reasons work performance was sub-standard (within employee control or not); and
- Corrective actions.
Manager responsibilities

The CEO or general manager is the sole employee of the board of directors and is ultimately responsible for the day-to-day operations of the cooperative. The CEO is responsible for ensuring that the cooperative’s daily activities are leading towards the realization of the cooperative’s objectives and mission. He or she sets more specific performance objectives (e.g., target sale volumes for different departments) that ultimately lead to the larger performance goals set by the board.

The most important function the CEO plays is hiring and supervising all other co-op employees. Employees need to understand the cooperative’s mission, they need to be motivated, and trained well. Making certain that employees see how their efforts fit into the overall goals of the cooperative is a key component of a manager’s job. This can be a difficult and time-consuming process.

Coordination of human and physical resources becomes more challenging when the cooperative operates in seasonal markets. For example, agricultural input cooperatives usually experience a peak demand for their products each spring, marketing cooperatives experience a peak in the fall, and electric cooperatives face seasonal and daily peaks in demand for energy. Seasonality increases the importance and difficulty of coordination because the cooperative needs sufficient resources, including people, to handle demand during a peak period, but doesn’t want those resources underutilized during slack times.

Managing a cooperative is, in many ways, more challenging than managing a comparable investor-owned business. One feature that makes managing a cooperative more difficult is that cooperative objectives may not be as clear-cut as those in other forms of business. In investor-owned firms (IOFs), for example, the goal is to maximize investor returns—the bigger the corporate profits are, the better. For cooperatives, profit maximization is rarely, if ever, the only objective. The membership wants to see their cooperative survive and continue to serve their needs but they would rather see net profits increase on their own farms rather than at the corporate level. Thus, members

Board of director election procedures

The most common and the most traditional way—particularly for new and small cooperatives—to find board candidates is to ask for nominations from the floor during the co-op’s annual meeting. Although this is the least-complicated method, and some may view it as the most democratic, it has some serious drawbacks. The pool is limited to those who attend the meeting, who may be neither the most qualified nor the most representative of members.

A better approach, and one used by most established cooperatives, is to appoint a nominating committee to find well-qualified board candidates. The nominating committee (generally three to five people) is selected by the board and may comprise board members, the manager, and members. The committee should represent (or be familiar with) the different geographic areas of the co-op’s membership, should understand the duties of the position, be objective, and bring different perspectives to the process. As a group, they prepare a slate of candidates, with at least two nominees for each open position.

Once nominated, the cooperative should publish the candidates’ credentials (experience, education, etc.) and other pertinent information in a newsletter or website several weeks prior to the voting. The board should still accept nominations from the floor before voting proceeds.

Voting by secret, anonymous, written ballots is the most common and preferred method. Voting by proxy is typically not allowed in most states (including Wisconsin), but delegate systems, where a delegate votes for a certain portion of the membership, are accepted.
may view profit maximization by the cooperative as being in direct conflict with their goals. Given this, it is more difficult to define success for the cooperative and many managers and boards of directors struggle with establishing long-term goals for their cooperative.

The manager’s interpersonal skills are critical as virtually every transaction in most cooperatives is between the firm and one of its owners. Unlike the manager of an IOF, the cooperative manager is indirectly the employee of every member and each member feels entitled to voice his or her opinion about the cooperative’s products, prices, services and general practices. This feedback provides valuable information that an astute manager can use to position the cooperative for future success. There are, however, two less beneficial aspects of this constant scrutiny. First, the manager has to be judicious at filtering truly valuable constructive criticism from baseless complaints. Second, the managers of many cooperatives, particularly smaller locals, live in a fish bowl. Some members are resentful of the salary a general manager receives, particularly when they themselves have had a poor year. This resentment complicates member relations and may restrict the manager’s ability to perform his or her various functions.

In general, the skills needed by cooperative managers are the same as those needed by managers of other firms, though perhaps in different proportions:

- Decision-making skills
- Interpersonal skills
- Goal setting skills

It is worthwhile to note that members should not be employed in managerial positions. When a co-op member is manager, it may become more difficult for the board to exercise authority over the manager.

The board and manager relationship

The ability a cooperative board and CEO to form a seamless relationship is generally a strong indication of an efficient, well-managed cooperative. This relationship requires each party to understand the boundaries of their responsibilities. Board members should not micro-manage and the CEO should not try to usurp the policy-making and oversight functions reserved for the board. Table 6.1 outlines some general rules for separating the responsibilities of the board and manager.

Table 6.1. Division of responsibilities between board and management

<table>
<thead>
<tr>
<th>Board responsibility</th>
<th>vs. Management responsibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ideas</td>
<td>Actions</td>
</tr>
<tr>
<td>Decisions about what the cooperative should be doing</td>
<td>Decisions about how the cooperative does something</td>
</tr>
<tr>
<td>Long-term and substantial commitments of resources</td>
<td>Short-term and moderate commitments of resources</td>
</tr>
<tr>
<td>Personnel development to ensure executive depth and capable succession</td>
<td>Job-related training for people other than the management team</td>
</tr>
<tr>
<td>Monitoring board and managerial performance</td>
<td>Evaluating employee performance</td>
</tr>
</tbody>
</table>
The board of directors is responsible for defining the main elements of the strategic plan: namely, the fundamental reason for the cooperative’s existence, the general means by which the cooperative will achieve its goals, and the underlying values that will guide the cooperative’s actions. The operational plan, which is a blueprint for implementing the strategic plan, is the responsibility of management.

Once the strategic and operational plans have been developed, the board must monitor the cooperative’s progress. If there are significant deviations from the plan, the board should attempt to determine the cause of the deviation and take appropriate action. That may mean revising the plans or requesting the manager to modify the business strategies.

Cooperative communication and education

Leadership, control, and financial ownership of a successful cooperative require informed and educated members. This is recognized by the inclusion of member education, training, and information as one of the seven cooperative principles endorsed by the International Cooperative Alliance. Cooperatives generally support this principle, but the level of implementation and financial support for education and information programs vary widely. Communication and educational efforts range from informal and ad-hoc efforts (e.g., sending board members to training workshops) to creating a well-funded education and communication department. All cooperatives have either a stipulation in their bylaws or follow state cooperative laws that mandate communication with members. These requirements often include holding annual meetings, notifying members of special meetings, and informing members about significant changes in financial operation or structure.

The importance of communication and education

Cooperatives have special communication and education needs because of their unique ownership and governance structures. Cooperatives involve a wide range of people in the decision-making and management process. Consequently, communication within cooperatives must be continuous and effective and involve all agents (members, board, management, and employees).

Cooperatives in northern Europe have a common saying that “a cooperative without an education program will last for a generation and a half.” The task of educating new and younger members and developing new leadership is a continual and growing challenge for most American cooperatives. New members need to know the value of the cooperative, why it was formed, what it has accomplished, and its future goals.

Effective communication and education becomes particularly critical as cooperatives grow and become more complex, making them increasingly difficult for members to comprehend. Further, many members feel removed from the cooperative since their voice seems lost in large memberships—it may be difficult to see how the cooperative contributes to their own bottom-line. Most cooperatives were relatively small and single-product organizations when they were established. It was simple for the members to visualize the impact of their decisions on the cooperative and how it contributed to their well-being. Finally, the heterogeneous needs and characteristics of members in a large cooperative often require a variety of different services. As a result, concerns over pricing policies and fairness often arise.

Money spent on quality member communication programs is a sound cooperative investment. Member support and loyalty is a type of capital that can be drawn on in times of crisis. Members who understand the cooperatives’ objective, policies, and actions, are more likely to patronize the cooperative, stay with the cooperative through difficult times, have fewer complaints, offer more constructive criticism and suggestions, and take a greater interest in the co-op. Informed members serve as effective salespeople for the cooperative,
helping promote new products and services. They will also be able to help inform the community regarding the cooperative's contributions to community development.

Cooperatives must also provide training for management and directors. Many new and inexperienced directors must be informed and educated about the cooperative business model. Cooperative managers, if they are new to cooperatives, will also need to be educated about some of the unique facets of cooperatives (e.g., the division of board/manager responsibilities and patronage refunds).

Since cooperatives frequently consider and decide major policy actions in a semi-public environment (with all cooperative members) rather than behind closed doors, cooperatives should educate the public to avoid opposition that results from misunderstandings about cooperative objectives. For example, during the past few years many cooperatives have been forced to close local plants, elevators, and stores. When this occurs, cooperative members and employees as well as community leaders and the public need to understand the reasons behind the closures and how they will be carried out. Public education is also essential to maintain the favorable public policy cooperatives now enjoy.

To be truly beneficial to the cooperative, information must flow from the board and management to members and the public, and from members and the public to the board and management.

**Establishing a communication strategy**

To create a successful communications program, cooperatives need a board and management team committed to the idea. The program must be well planned and should include continuous evaluation and feedback from members, employees, public citizens, government and education agencies, and other cooperatives. An adequate budget is needed to support a well-trained staff that will conduct the planning, implementation, control and evaluation. Successful programs are operated continuously and not just when the cooperative has a problem or crisis.

The first step in planning is to gather information about the cooperative's members, the market, competition, and current economic conditions. Careful internal analysis based on systematic research provides the foundation for successful public relations and education programs. Member and employee profiles are especially important. Their profiles should include demographic data, including age, income, education and geographic location. The level of cooperative knowledge members possess also needs to be determined in order to establish what needs to be communicated. The following questions can be used to elicit this information:

1. Do members know and understand the distinguishing features, objectives, goals, policies, and philosophies of their cooperative? Do they know the potential benefits and limits of the cooperative?
2. Are members familiar with the organizational structure and operation of their cooperative?
Do they know where to get information and where to take their problem? Do they understand how they are represented on the board of directors?

3. Do members understand their cooperative’s financial statement, their policy on equity formation and redemption, and member and cooperative tax obligations?

4. Are members familiar with the background and history of the cooperative?

5. Do the members understand the different member programs offered by the cooperative? Are they getting correct and adequate information on the services offered? To what extent do members use the cooperative as a source of technical information?

6. Do members realize the business climate in which the cooperative operates? Do members understand the effects of business trends on the cooperative? Are they aware of government policies and regulations that affect their business? Is this information readily available elsewhere, or should the cooperative provide it?

**How to communicate**

There are many ways to communicate with people (table 6.2). The most effective form of communication is still probably personal contact. Small group discussions are also effective. In both cases there is an opportunity for instant feedback and reaction. Even in moderate-sized meetings, there is some opportunity for feedback. Unfortunately, in most cooperatives, personal contact is limited to that between employees and members because the

<table>
<thead>
<tr>
<th>Communication channel</th>
<th>Media type</th>
<th>Method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Personal contact</strong></td>
<td>Individualized</td>
<td>Management, directors, employees, members, member committees</td>
</tr>
<tr>
<td><strong>Mass media</strong></td>
<td>Field days, open house, tours</td>
<td>Annual meeting, district meeting, Community meeting, Trade shows, fairs</td>
</tr>
<tr>
<td><strong>Print</strong></td>
<td>Individualized</td>
<td>Personal letters, newsletters, member magazines</td>
</tr>
<tr>
<td><strong>Mass media</strong></td>
<td>Direct mail</td>
<td>Annual report, Trade journals, Newspapers</td>
</tr>
<tr>
<td><strong>Audio/Audio-visual</strong></td>
<td>Individualized</td>
<td>Telephone, Email, Conference calls</td>
</tr>
<tr>
<td><strong>Mass media</strong></td>
<td>Websites</td>
<td>Video, CD-ROM, Radio, television</td>
</tr>
</tbody>
</table>
general manager and his or her staff may be located at distant headquarters.

One of the best opportunities for the cooperative to communicate with the membership is the annual meeting. A well-planned annual meeting can be used to showcase the year’s activities. Conducting a successful annual meeting requires planning, advertising, contacting members and public citizens, developing an effective agenda, organizing an interesting meeting, selecting a satisfactory location and facility, and providing necessary services.

An integral part of every annual meeting includes the preparation and presentation of the annual report of the cooperative. Annual reports can range from simple financial statements listing the current balance sheet and statement of operations, to elaborate accounting reports prepared by the board chairman and management. These might include pictures of new facilities, equipment, employees and directors, and graphic presentations of the past year’s business activities. An adequately designed annual report can also provide an effective tool for informing the members and the public about the cooperative throughout the year.

Meetings directed toward local audiences are often more effective than large annual meetings. Consequently, most cooperatives that cover a fairly large area divide their territory geographically, and each division usually has its own annual district meeting. These meetings present a good opportunity for members to meet management, to get feedback directly to management, and to become better informed about their organization.

One of the most effective forms of written communication is the newsletter, which may be a single sheet or a magazine of several pages. Whatever the form, all information should be clearly and concisely presented, should be of interest to the members, and should be sent out regularly. New information and a novel approach to writing the newsletter help engage the reader. In a number of research studies, members have listed the newsletter as their most important source of information from the cooperative.

Cooperatives have also expanded their use of technology for member communications. Young cooperative leaders like the convenience of communicating with their cooperative through e-mail or the Internet. Many cooperatives now have websites and use television and video in their communications programs. Speed and relatively low cost are prime advantages of mass media. Good media coverage can keep members informed about the cooperative’s activities and also can build interest in the cooperative by the general public. Several large regional organizations use closed-circuit television to transmit parts of their annual meeting by satellite to different geographic areas and involve members directly through interactive conference broadcasts.

Employees may be one of the most important elements in any communication program. In most cooperatives, employees often make the greatest impression on members and have the most frequent contact. In fact, it might be the check-out person, the person who delivers the fuel, the clerk in the credit union, the milk hauler, the field representative, the technician, or the general manager, who “is the cooperative” in the eyes of the individual member. Therefore, it is important to educate all employees about the cooperative’s history, programs, and policies. Every organization needs skilled employees, but cooperatives need employees that are specially trained and understand cooperative principles and practices, possess adequate knowledge about products and services, and have the ability to transmit that information to the membership.

**When to communicate**

The board and management are frequently caught between two opposite positions on when to disseminate information to the membership. Too much information, too soon may help the competition discover the cooperative’s plans and prevent the cooperative from seizing business opportunities. Supplying too little information too late may generate false rumors and an angry membership, thereby leading to the same conclusion—missed business opportunities.
Although each cooperative has to decide when to release information, two guidelines might be useful:

1. If the information could help competitors, relay it only to the board and key management (unless critically needed for member decision making).

2. The more controversial the issue, the greater need for the cooperative to provide timely, factual, and reliable information to members. Otherwise, the cooperative can develop a negative image with the members and public due to misunderstandings about the cooperative’s objectives.

Adding a new product or changing store hours may require only a routine announcement in the cooperative’s newsletter. However, a proposed merger, closing an existing facility, or a change in the way members are represented may require the cooperative to communicate a large amount of additional information before the issue is resolved. To minimize controversy and ensure a smooth transition, those members affected by the change need facts to dispel rumors and fears. Cooperative leadership must provide enough timely information for their members to make intelligent decisions.

Conclusion

Creating a strong and competitive cooperative is the shared responsibility of members, the board of directors, management, and employees. Multiple firm objectives and democratic governance make cooperatives uniquely challenging businesses. A skilled CEO or general manager is critical to the success of the cooperative, as is a quality communication and education program. The changing business environment and growth of cooperatives has accelerated the need for member information. Communicating with new members, potential members, government agencies and the public will continue to be a major challenge for cooperatives.

A list of general communication and education resources is provided in the appendix. While the primary mission of most cooperative councils is to represent their members before legislative and rule-making bodies, many have very active education programs. Often these programs are carried out in cooperation with state extension services, university centers, and industry trade associations. Several universities have active cooperative centers that teach cooperative courses as part of degree-granting programs, conduct research related to cooperative businesses, and provide outreach education, usually through the Cooperative Extension Service.
As suggested in the preceding chapter, the most important responsibility of cooperative boards and CEOs is financial management and decision-making. The board of directors and management need to have a good understanding of their cooperative’s financial situation to make the best short-term business decisions as well as to guide long-term strategic planning. Two essential financial statements need to be reviewed on a regular basis (at least annually): the balance sheet and statement of operations. Both will be discussed later in the chapter.

One of the most important tasks of cooperative leadership is to estimate the co-op’s current and future capital requirements. Adequate capital is a fundamental principle of sound business operation. In cooperatives, a significant portion of capital must come from the membership. If a cooperative is to provide services at reasonable cost and if members expect to benefit from its operations, then members must also assume the responsibility of financing the cooperative. Plans for financing must be consistent with the principles of cooperation as well as with state and federal legislation. This chapter outlines two different equity redemption plans that help cooperatives meet these requirements.

The importance of capital

Cooperatives need adequate capital to function efficiently and to grow. They need reserves for depreciation and unpredictable contingencies. Not only is it important to have sufficient capital initially, including during organization, but it is also vital for daily operations and growth. Increasing the cooperative’s business volume and services requires additional capital.

Costs of organizing the cooperative include such items as legal and incorporation fees. Before a cooperative actually starts business operations, money may also be needed to cover the cost of membership drive meetings and feasibility studies. Capital is also clearly needed to purchase the necessary physical facilities such as land, buildings, and machinery (fixed assets). This is particularly true with manufacturing or processing co-ops. The members should provide most of the money for the fixed assets to give the cooperative a strong financial beginning and a good credit base. It is seldom desirable to borrow more than 50 or 60 percent of the market value of the fixed assets. It may be better to lease physical facilities when they can be leased at favorable rates. To own such facilities ties up large amounts of capital that might be more productively used as working capital in day-to-day operations. It is good business to inquire what savings—service and financial—can be made from leasing facilities instead of owning them.

Cooperatives, like any other corporation, have to cover working capital requirements: payroll, maintenance, utilities, taxes, insurance, repairs, raw materials, fringe benefits, etc. Working capital is also used for advances or partial payments to members for commodities delivered to marketing cooperatives. It is not only desirable, but also necessary, to pay members something at the time, or shortly after, the product is delivered. Moreover, the cooperative can generally borrow for this purpose more easily and at lower rates of interest than can individual members.

When products are paid for in full within a few days, or even a few weeks after delivery, advances or partial payments usually are not made. However, in some cooperatives, final payments are delayed several weeks or even months due to an extended storage or marketing period. Such cooperatives may handle goods harvested seasonally but marketed over a much longer period (e.g., corn or wheat). In these cases, advance payments of 50, 75 or even 90 percent of the expected price and value are frequently made so the producer can pay his/her bills incurred while producing the raw product. In farm supply co-ops, the co-op may offer a seasonal operating loan to farmer members who need to offset the costs of feed, fertilizer, seed, chemicals, equipment, and other inputs until after their farm products are harvested and sold. More commonly, farmers borrow operating capital from a financial institution and pay the cooperative when the inputs are purchased.

Of course capital needs vary greatly depending on the size of the business; whether the physical facilities are leased or owned; whether large or small
inventory stocks are carried; and future plans for growth. Often, cooperatives have enough money for fixed assets, but have too little operating capital. If the members have furnished the money for fixed assets, then these fixed assets can be used as security for borrowing money for operating purposes. However, the co-op needs to be fairly certain that its annual profits will be sufficient to service the operating loans. If fixed assets are also underfinanced, then leasing the facilities and using member investments for working capital might solve the shortage of capital.

Adequate working capital allows management to take advantage of cash discounts when purchasing supplies. It also permits buying in large volume, making substantial savings possible. Prompt payment of bills adds to the business reputation of a cooperative. In addition, the plant and equipment are likely to be kept in better repair, and thus operate more efficiently, when adequate working capital is available.

### Sources of capital

There are two types of capital: debt capital and equity capital. Debt capital includes loans (short and long term), bonds, and any other type of credit obtained from commercial banks, cooperative banks, and other financial institutions. Equity capital is provided by co-op members, nonmember investors, and from successful business operations. It is the equity that the owners have in the business. Equity capital may or may not be returned to members and may or may not bear dividends. These considerations are left largely to the discretion of the board of directors. Equity capital is obtained in four ways:

1. Selling common stock or membership certificates to members.
2. Selling preferred (non-voting) stock to members and non-members.
3. Deferred patronage refunds and per unit retains from member business (allocated equity).
4. Retained profits from member and non-member business (unallocated equity).

As owners, cooperative members are responsible for providing the cooperative with adequate capital. Since cooperative profits are distributed on a proportional basis, and this is accepted as an equitable practice, it seems logical to require members to contribute capital in proportion to their patronage as well. Both ownership and control should be vested in active patrons to maintain the cooperative character of the association.

### Common stock and membership certificates

Cooperatives can be organized as either stock or non-stock cooperatives, although in practice the difference is fairly trivial. Almost all agricultural cooperatives, for example, are organized as stock cooperatives. However, typically only one share of common stock (generally priced at $100 or less) is required for membership. Non-stock cooperatives offer membership certificates, which members receive when they pay a nominal membership fee. In either case, initial membership payments are not a large source of equity capital for most cooperatives (NGCs are the exception, see chapter 4).

Common stock shares cannot be traded; if a member chooses to leave the cooperative he or she must sell the shares back to the cooperative at their par value (original purchase price). For example, if a member purchased a share of common stock for $25 in 1970, he or she will only be paid $25 for it when it is redeemed to the cooperative in 2004, even though the book value (the appraised value of all assets divided by the total number of shares outstanding) might be $200. Only at dissolution, merger, or bankruptcy is the book value of the common stock shares significant. Again, NGCs are an exception. In NGCs, membership shares can be traded and can increase (or decrease) in value.

Low-priced shares and certificates make it possible to diffuse and extend membership to more people (since more can afford membership). However, higher membership fees create both membership commitment as well as a strong financial position for the co-op. Further, with more initial equity, a
greater portion of patronage refunds can be distributed as cash. This is the logic behind the high up-front equity investments required by NGCs; the average cost of membership in NGCs in the United States during the 1990s was about $30,000.

**Preferred stock**

Stock cooperatives may also sell preferred, or non-voting shares of stock, although doing so is still relatively uncommon. They can sell this type of stock to both members and non-members (see the CHS example in chapter 4). As with common stock, the board of directors determines annually what dividend rate, if any, is to be paid on preferred stock (although most states limit the dividend to 8 percent per annum). Such dividends may be allowed to accumulate. The holders of preferred stock have a prior claim over common stockholders when dividends are issued and in the case of dissolution. If a cooperative files bankruptcy, it is required to pay bank loans first, preferred stock second, and common stock third.

**Allocated and unallocated equity**

Established cooperatives generate new capital from business profits as well as additional earnings from other co-op investments. To generate net profits (also called net earnings or savings), co-op revenues must exceed all operating expenses. At the end of each business year, the cooperative board calculates net profits and chooses a portion to retain as unallocated equity and a portion to allocate to members (figure 7.1). Since the cooperative needs to retain capital for regular operating costs, unexpected capital requirements, and future growth, only part of the annual net profits should be redeemed as cash patronage refunds. In most agricultural cooperatives in the United States, only about 30 to 40 percent of net profits are paid out as cash refunds to members.

The unallocated reserves are permanent capital and considered the shock absorbers for a business. Sudden losses, shifting consumer demand, and many other market changes create financial uncertainty; reserves help alleviate this uncertainty. The portion of retained earnings that are deemed unallocated equity represents general cooperative funds; the co-op is under no obligation to return this capital to its members. Profits from non-member business are generally placed in unallocated equity accounts.

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**Figure 7.1. Example of allocation choice for annual co-op profits**

<table>
<thead>
<tr>
<th>Total annual net profits: $1,000,000 ($200,000 from nonmember business, the remainder from member patronage)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unallocated equity: $200,000</td>
</tr>
<tr>
<td>Patronage refunds: $800,000</td>
</tr>
<tr>
<td>Deferred patronage refunds (allocated equity): $560,000</td>
</tr>
<tr>
<td>Cash patronage refunds: $240,000</td>
</tr>
</tbody>
</table>
Unallocated reserves are permanent capital and are considered the shock absorbers for a business.

Net profits are allocated to members according to the amount of business (patronage) they conducted with the cooperative during that year. This amount can either be paid out to members in cash (cash patronage refunds) or deferred (deferred patronage refunds form the basis of the members’ allocated equity accounts). For example, assume that member A marketed $1,000 worth of grain through the co-op in 2003. The grain marketed by all of the co-op’s members in 2003 had a total value worth $100,000. Therefore, member A would receive 1 percent (1,000/100,000) of the co-op’s allocated profits in 2003. If allocated profits for all members were $800,000, member A would receive $8,000 in patronage refunds. As discussed in chapter 3, federal laws in the United States require that at least 20 percent of the allocated profits be paid as cash, so member A would receive at least $1,600 (0.20 x 8,000) in cash and the remainder would be deposited in that member’s allocated equity account.

Per unit retains are capital contributions withheld from patron payments for products received or products purchased. For example, a dairy cooperative might withhold 5 cents per hundredweight of milk from a farmer’s monthly milk check. Thus, over the course of the year, a dairy farmer selling 500,000 pounds of milk would contribute $250 to his allocated equity account. Although per unit retains could theoretically be withheld in purchasing associations (for example, 2 percent of purchases) it is seldom done.

Allocated equity, as the term suggests, is technically owned by individual cooperative members and the cooperative is legally obligated to redeem it at some future point in time. Allocated equity accounts seldom earn interest, but if they do, they are quite comparable in many respects to investments in cooperative preferred stock (some cooperatives report allocated equity as preferred stock). The board of directors generally decides what rate of interest, if any, shall be paid on allocated equity. The directors also decide when to redeem equity.

Many cooperatives issue certificates of equity to members. The certificates state the amount of equity allocated to the member. Others simply send notices to members stating the amount of capital credited to them during the year in the cooperative’s books. When this is done, no formal certificates of equity are issued. These notices have considerable merit over formal certificates of equity since the certificates are sometimes lost or destroyed. Such notices need to be given so patrons will know the amount of their investment and will have the information to report on their personal income taxes (for a more detailed discussion of the tax implications, see chapter 5).

Equity redemption plans

Today, at least in agriculture, cooperatives require members to make significant equity investments. To obtain capital from members, cooperatives need to show that (1) the expected returns will exceed the opportunity cost and (2) the capital will eventually be returned.

Equity redemption means the cooperative returns its retained allocated equity in cash to the members who helped generate it. Many cooperatives still practice unsystematic or ad-hoc equity redemption, for example, returning allocated equity to members only when the member reaches a certain age, moves out of the co-op’s trade area, or retires; or financial hardships. Some co-ops only retire equity upon death of the member (settling with the member’s estate).

Under equity redemption plans, capital is provided by members, used for a time by the cooperative, and then redeemed or repaid to the members on a systematic basis. Once equity redemption has begun, additional equity will still be withheld from active members. Revolving equity requires continuous withholding of funds each year (new money replacing old money). An equity redemption plan ensures that the burden of co-op financing is transferred from those who started the organization, many of whom may have become inactive members, to those who use the cooperative. Compared to returning equity on an ad-hoc basis,
a plan helps the cooperative meet long-term equity goals and helps raise new equity.

A good equity redemption plan treats members fairly and leads to investment in proportion to use. Cooperatives should have fair equity redemption plans described in either their by-laws or operating policies. This section discusses three such plans that have been adopted by cooperatives in the United States and other countries: the revolving fund plan, the base capital plan, and the percentage of all equities plan.

The revolving fund plan redeems allocated equity based on the age of the equity (the year the equity was retained), using a first-in, first-out order. The most common method redeems only one year of retained equity each year. Thus, members' money withheld in 1995 might be repaid in 2000, that of 1996 redeemed in 2001, and so on.

This plan is one of the most effective ways to accumulate capital and is a lot easier than selling new shares of stock. It helps ensure that current members furnish funds in proportion to their use and provides a systematic way of returning investments to members. New organizations may begin with this plan at the very start and older organizations may also adopt the plan. A disadvantage to the revolving plan is that it is difficult to maintain an established and fixed revolving plan with a fluctuating or declining volume of business.

The base capital plan is simple in principle but complex in practice. The board can establish an equity capital “base” target for the cooperative as a whole, or for individual members. In either case, it redeems all cooperative equity that exceeds this “base” equity capital target. For instance, if a co-op has $10 million in assets and the board decides that it wants 60 percent of the cooperative financed with equity capital, then its base equity capital target is $6 million. If at year’s end the cooperative has retained $6.25 million in equity, it redeems the $250,000.

Alternatively, the co-op could also establish that the allocated equity accounts for each member be kept in proportion to their use. For example, member A mentioned earlier would be required to contribute 1 percent of the co-op’s allocated equity accounts or the equity capital target.71 If the account exceeds this amount, the excess is redeemed. If the account is short, no equity is redeemed and only 20 percent of the patronage refunds are redeemed in cash.72 Once a member’s patronage and equity are in equal portions, 100 percent of their patronage refunds are paid in cash (thus keeping the ratio stable).

The advantage of the base capital plan is that each member’s investment is proportional to his or her use. The disadvantage is that it places a heavier burden on younger farmers who may need cash refunds for their farm more than established farmers. Base capital plans are not easily approved by members since many would have to forgo some of their cash patronage refunds. Recognizing that this may unduly burden some members, especially young farmers just starting out, some cooperatives have adopted a targeted base capital plan, meaning members can slowly build up their equity contribution over time, if desired.

The percentage of all equities redemption plan involves repaying a certain percentage of the designated equity pool each year, regardless of the equity’s age. An illustration of this plan is shown in table 7.1. During the first five years the cooperative’s capital was built up to a desirable level and no equity was revoked. During this time the member contributed varying amounts based on his or her volume of business. In the sixth year the cooperative retired 20 percent of its capital contributions under the plan and thus retired $500 of this member’s investment. Since this member only contributed $400 to the capital fund that year; thus, the total investment was reduced to $2,400.

In subsequent years, the amount retired also varied according to the decision of the board of directors. It is apparent from table 7.1 that the amount refunded during a year has no relation to the specific amounts withheld in previous years, making this seem somewhat arbitrary for members. Also, it does not ensure that an individual’s investment is proportional to their use; the same percentage is redeemed for all members.

However, it is more flexible than the base capital plan.
Regardless of the plan, boards need to remember that if revolving equity is delayed a long time, say 10 to 15 years (the average revolving period for farming cooperatives in the United States was still about 19 years during the 1990s), then patrons can suffer from the depreciated value of their investments as a result of inflation. Further, it will sometimes be necessary to deviate from an established redemption plan if major capital needs arise or if business fails to turn a profit for a long period of time. This can be challenging and may require a lot of communication with members to make sure they understand the reasons behind such changes in plans.

An equity redemption plan can only be sustained with proper financial planning. Equity decisions must allow sufficient flexibility to protect business performance. Any redemption plan should be tied to business objectives.

**Table 7.1. An illustration of the percentage of all equities redemption plan**

<table>
<thead>
<tr>
<th>Year</th>
<th>Capital contributed</th>
<th>Capital redeemed</th>
<th>Net capital investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>200</td>
<td>0</td>
<td>200</td>
</tr>
<tr>
<td>2</td>
<td>300</td>
<td>0</td>
<td>500</td>
</tr>
<tr>
<td>3</td>
<td>500</td>
<td>0</td>
<td>1,000</td>
</tr>
<tr>
<td>4</td>
<td>750</td>
<td>0</td>
<td>1,750</td>
</tr>
<tr>
<td>5</td>
<td>750</td>
<td>0</td>
<td>2,500</td>
</tr>
<tr>
<td>6</td>
<td>400</td>
<td>500 (20% of 2,500)</td>
<td>2,400</td>
</tr>
<tr>
<td>7</td>
<td>1,000</td>
<td>480 (20% of 2,400)</td>
<td>2,920</td>
</tr>
<tr>
<td>8</td>
<td>800</td>
<td>292 (10% of 2,920)</td>
<td>3,428</td>
</tr>
<tr>
<td>9</td>
<td>750</td>
<td>857 (25% of 3,428)</td>
<td>3,321</td>
</tr>
<tr>
<td>10</td>
<td>600</td>
<td>830 (25% of 3,321)</td>
<td>3,091</td>
</tr>
</tbody>
</table>

**Financial statements**

In today’s complex and global marketplace, it is crucial that directors and management understand the financial situation of their cooperative. Regular review of financial statements is necessary to make prudent business decisions, to protect the equity invested by members, and to make sound long-term strategic plans. Reviews should be conducted at least once annually. The fact that directors may not have formal training in accounting and financial analysis does not decrease their financial responsibilities. Competent accountants and other financial analysts should be hired to help directors evaluate and interpret cooperative finances. The balance sheet and operating statement (also called profit and loss statement, income statement, or earnings report) are the most essential financial statements and should be provided to the board and management monthly. Together they provide a picture of the cooperative’s financial position, its performance, and its ability to meet its financial obligations.

**The balance sheet**

The balance sheet presents a financial snapshot of a cooperative at a specific point in time (generally the last day of the business year). It also typically includes the balance sheet for the prior year to allow for comparisons. A sample balance sheet is shown in table 7.2. Key financial terms are defined in table 7.3. The balance sheet is broken into three parts: assets, liabilities, and equity. The parts must always balance because the total resources or assets of a business equal the amount owed to others. In other words,

\[
\text{Assets} = \text{Liabilities} + \text{Members' Equity}
\]

Assets are normally divided into three categories (current, fixed, and other) according to the time it takes to convert the asset into cash. Current assets are expected to be converted within the year. They include cash, accounts receivable, and inventories. The reported value for inventories is equal to the lesser of their cost or market value. Fixed assets are not expected to be sold (hence the name fixed). They include the “bricks and mortar” of the cooperative, the buildings, equipment, and land. Their net...
### Table 7.2. Balance sheet for two years

<table>
<thead>
<tr>
<th></th>
<th>YEAR 1</th>
<th>YEAR 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ASSETS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$154,263</td>
<td>$497,156</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>579,215</td>
<td>417,853</td>
</tr>
<tr>
<td>Inventories</td>
<td>609,041</td>
<td>469,782</td>
</tr>
<tr>
<td>Other</td>
<td>236,250</td>
<td>77,756</td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>1,578,769</td>
<td>1,462,547</td>
</tr>
<tr>
<td><strong>Fixed assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land</td>
<td>175,111</td>
<td>175,111</td>
</tr>
<tr>
<td>Buildings &amp; equipment</td>
<td>3,524,572</td>
<td>3,560,822</td>
</tr>
<tr>
<td>Less: Accumulated depreciation</td>
<td>(1,393,027)</td>
<td>(1,560,589)</td>
</tr>
<tr>
<td><strong>Total fixed assets</strong></td>
<td>2,306,656</td>
<td>2,175,344</td>
</tr>
<tr>
<td><strong>Other assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in regional co-ops</td>
<td>877,416</td>
<td>907,839</td>
</tr>
<tr>
<td><strong>Total other assets</strong></td>
<td>877,416</td>
<td>907,839</td>
</tr>
<tr>
<td><strong>TOTAL ASSETS</strong></td>
<td>4,762,841</td>
<td>4,545,730</td>
</tr>
<tr>
<td><strong>LIABILITIES &amp; MEMBER EQUITY</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>188,701</td>
<td>8,253</td>
</tr>
<tr>
<td>Seasonal operating loan</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Current: Long-term debt</td>
<td>142,000</td>
<td>142,000</td>
</tr>
<tr>
<td>Accrued expenses / other</td>
<td>211,893</td>
<td>294,568</td>
</tr>
<tr>
<td><strong>Total current liabilities</strong></td>
<td>542,594</td>
<td>444,821</td>
</tr>
<tr>
<td><strong>Long-term liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes payable: bank</td>
<td>921,980</td>
<td>779,980</td>
</tr>
<tr>
<td>Notes payable: members</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total long-term liabilities</strong></td>
<td>921,980</td>
<td>779,980</td>
</tr>
<tr>
<td><strong>Members’ equity</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock</td>
<td>15,650</td>
<td>15,650</td>
</tr>
<tr>
<td>Deferred patronage refunds</td>
<td>2,404,601</td>
<td>2,398,027</td>
</tr>
<tr>
<td>Unallocated equity</td>
<td>878,016</td>
<td>907,252</td>
</tr>
<tr>
<td><strong>Total members’ equity</strong></td>
<td>3,298,267</td>
<td>3,320,929</td>
</tr>
<tr>
<td><strong>TOTAL LIABILITIES &amp; MEMBER EQUITY</strong></td>
<td>4,762,841</td>
<td>4,545,730</td>
</tr>
</tbody>
</table>
book value, not their market value, is reported. The net book value equals the original cost minus depreciation. All fixed assets, except land, are subject to depreciation. Depreciation accounts for an asset’s loss of value due to normal wear and tear over time. A new car is worth more than a 5-year old car, for example. Other assets include investment in regional cooperatives and other investments.

Like assets, liabilities are also segmented according to time (current, long-term, and other). Current liabilities are debts due within one year. They include trade accounts, seasonal operating loans, cash patronage refunds due members, and taxes and insurance. Long-term liabilities are debts or portions of debt with more than a one-year due date. They include long-term loans from banks (e.g., mortgages) and long-term contracts. Deferred or other liabilities are obligations without specific payment terms. They include deferred income tax liabilities and deferred compensation to employees.

Members’ equity (also called net worth or owners’ equity) represents the capital members have invested in the cooperative, or the portion of cooperative assets they own. Equity is often called risk capital because it is the last to be paid (or the first loss) in bankruptcy and it alone bears the risk of asset value fluctuations (since liabilities will stay fixed). Members’ equity is typically divided into three categories on the balance sheet: common stock, deferred patronage refunds (or allocated equity), and unallocated equity.

### The statement of operations

The operating statement records the cooperative’s operations for a given period, usually for one business year. Like a student’s report card, it shows the progress the cooperative has made. It also typically includes the operating statement for the prior year to allow for comparisons. The operating statement has three sections: income, expenses, and savings. A sample statement of operations is presented in table 7.4.
### Table 7.4. Statement of operations covering two years

<table>
<thead>
<tr>
<th></th>
<th>YEAR 1</th>
<th>YEAR 2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grain Sales</td>
<td>$2,089,852</td>
<td>$1,972,194</td>
</tr>
<tr>
<td>Farm Supply Sales</td>
<td>+12,699,517</td>
<td>+12,007,710</td>
</tr>
<tr>
<td>Total Sales</td>
<td>14,789,369</td>
<td>13,979,904</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>12,127,283</td>
<td>11,874,601</td>
</tr>
<tr>
<td><strong>GROSS MARGINS</strong></td>
<td>2,662,086</td>
<td>2,105,303</td>
</tr>
<tr>
<td><strong>OTHER INCOME</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service Income</td>
<td>252,781</td>
<td>225,275</td>
</tr>
<tr>
<td>Finance Charges</td>
<td>+70,204</td>
<td>+66,622</td>
</tr>
<tr>
<td>Total Other Income</td>
<td>322,985</td>
<td>291,897</td>
</tr>
<tr>
<td><strong>GROSS INCOME</strong></td>
<td>2,985,071</td>
<td>2,397,200</td>
</tr>
<tr>
<td><strong>EXPENSES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personnel Expense</td>
<td>1,357,663</td>
<td>1,143,445</td>
</tr>
<tr>
<td>Fixed Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>162,821</td>
<td>165,874</td>
</tr>
<tr>
<td>Depreciation</td>
<td>181,324</td>
<td>174,087</td>
</tr>
<tr>
<td>Insurance</td>
<td>26,113</td>
<td>25,140</td>
</tr>
<tr>
<td>Property Taxes</td>
<td>50,410</td>
<td>48,975</td>
</tr>
<tr>
<td>Variable Expenses</td>
<td>902,816</td>
<td>825,476</td>
</tr>
<tr>
<td><strong>TOTAL EXPENSES</strong></td>
<td>2,681,147</td>
<td>2,382,997</td>
</tr>
<tr>
<td><strong>SAVINGS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local Savings (Loss)</td>
<td>303,924</td>
<td>14,203</td>
</tr>
<tr>
<td>Patronage Refunds Rec’d.</td>
<td>23,990</td>
<td>47,770</td>
</tr>
<tr>
<td><strong>NET SAVINGS (LOSS)</strong></td>
<td>327,914</td>
<td>61,973</td>
</tr>
</tbody>
</table>
Income includes all revenues received by the cooperative during the period being reported. The total or gross income accounts for all cooperative sales, what the cooperative pays for its raw materials or product (cost of goods sold), and any other income received. Other income includes finance charges, rent, and investment income.

Expenses reflect what the cooperative pays to do business. They are generally divided into three categories: personnel, fixed, and variable. Personnel expenses include employee salaries and benefits (insurance, retirement, and social security). Fixed expenses are incurred regardless of the cooperative’s volume of business. They consist of interest payments on loans, depreciation, property taxes, and insurance premiums. Variable expenses are directly related to the cooperative’s daily operations and comprise equipment and vehicle maintenance, utilities, advertising, and other expenses related to production and management.

Savings is simply income minus expenses and represents the net profits of the cooperative for the year being analyzed. Local savings is the figure that cooperatives want to pay attention to since this is actually what they control. Patronage refunds received from regional cooperatives may be important, but do not actually reflect the viability of their co-op’s business.

Financial ratios

To make informed business decisions, the financial statements have to be interpreted and analyzed. Comparisons across time and with industry standards are an important piece of the analysis. However, care needs to be taken when making comparisons. Since size and volume make comparing different cooperative businesses difficult, financial ratios are often used. Ratios are also helpful when comparing a single business’ results across time. Financial statements are usually analyzed using four categories of ratios: profitability, liquidity, efficiency, and solvency.

- **Profitability** reflects the cooperative’s ability to generate savings and includes ratios for returns on sales and returns on assets.
- **Liquidity** measures the ability of the cooperative to meet current financial obligations on time and can be gauged using short-term cash flow, the interest coverage ratio, working capital-to-sales ratio, the current ratio, and other ratios.
- **Efficiency** evaluates the productivity of the firm with ratios, such as expenses-to-sales and labor-to-income.
- **Solvency** reveals the long-term financial health and stability of the cooperative (the ability to stay in business over the long run). It includes debt-to-fixed assets and equity-to-assets ratios.

To gauge the financial performance of the cooperative, the board of directors and management need to establish financial standards (a target value or range) for various performance indicators (choosing only a few to track over time). Next, they should compare their cooperative’s measures with the established standards. Benchmarking raises red flags and helps in financial planning. However, it should be remembered that each cooperative is unique and therefore may have reasons for not achieving industry standards. Finally, all financial measures are historical and are not perfect predictors of the future.

Conclusion

Adequate financial skills and sufficient data will help ensure that the cooperative board and CEO make sound financial and business decisions. This chapter provides a very brief introduction into some financial basics; board members and managers are encouraged to attend training sessions for more in-depth information. Equity redemption is another key decision board members and managers face. It is important for cooperatives to establish redemption programs for two reasons: it keeps investment in proportion to use (i.e., equity is provided by the active members) and helps attract future capital.
Cooperatives need to be well designed and, as you have read in the previous chapters, must be soundly financed and skillfully managed. But success also depends on the foundation built during organization. Successful businesses are not started overnight. Careful and deliberate planning must be started long before the co-op opens its doors. The following section outlines nine steps that should be taken when organizing any cooperative. From initial concept to the start of operations, this process typically takes from six months to two years. Some co-ops may take even longer to be established. At every step, the organizing group must decide whether or not to move ahead to the next step. While completion of this process does not guarantee success, lack of planning and commitment guarantees, if not failure, at the least a difficult start-up phase.

**Step 1: Preliminary exploration**
**GOAL:** Find out as much as possible about the needs and expectations of potential members, about cooperatives in general and about the relevant industry. Is there a need for the proposed cooperative?

**Step 2: Gauging broader interest**
**GOAL:** Provide adequate information to potential members to allow them to make an informal decision about whether or not to pursue starting the proposed cooperative.

The idea of starting a cooperative usually comes from a few people or perhaps only one individual. They discuss the plan with friends and associates. To proceed further, one or more meetings should be called to put the idea before others in the area. These preliminary discussions are very important. They provide an opportunity, before formal organization is undertaken, for prospective members to weigh the probable advantages of starting the co-op against roughly estimated costs. It gives those interested a chance to bring up possible problems and make suggestions to guide the organizational process. These initial discussions will often lead to modifications of the original idea.

If, as a result of these open discussions, there seems to be general support and approval of the proposed cooperative, the next step is to form a steering committee, which will do a careful study of the conditions under which the cooperative is to operate.

**Step 3: Form a steering committee**
**GOAL:** Select a steering committee to direct and carry out the cooperative’s development process. Steering committees usually consist of about 5-9 volunteer members. This group either assumes the remaining development tasks themselves or coordinates and guides other members or outside consultants. Regardless of who performs each task, the steering committee is responsible for making sure the tasks are accomplished. One of their main roles is keeping potential members informed of their progress; without regular updates, potential members may lose interest. They also coordinate future organizational meetings. Steering committee members should be prepared to spend a substantial amount of time with this effort.

Steering committee members can be elected from a group of potential members or organized by the core leadership who initiated the co-op development process. The steering committee as a whole should exhibit the following characteristics:

- Enthusiasm and the willingness to work hard
- Determination to succeed
- Good communication skills
- Flexibility and resiliency
- Strong decision-making skills
- The ability to mobilize and organize resources
- Previous business and leadership experience
- Financial management skills and experience
- Knowledge of the industry
- The ability to work as a team!
The steering committee should meet on a regular basis to complete the following tasks:

- Develop a mission statement for the cooperative;
- Explore the general interest level of potential members in the proposed cooperative;
- Identify any potential obstacles to the early stage development of the cooperative;
- Initiate (and fund if necessary) a feasibility study.

Step 4: Clarifying the purpose of the business

**GOAL:** Clarify the purpose of the cooperative and establish potential member interest and resources.

The first and most basic project the steering committee will undertake is to determine the fundamental purpose of the proposed cooperative business. What will the cooperative do? What specific products or services will be provided? Will these products or services fill a previously unmet demand or somehow improve upon what currently exists (e.g., in a more convenient location or at better prices)? Or, will a new market (demand) need to be created? A mission statement is a succinct and formalized statement of the cooperative’s purpose. The mission statement will serve as a compass for cooperative organization and operation.

Once the steering committee has established a mission statement for the cooperative, they can survey potential membership to gauge interest levels and further refine their business idea. What experiences have potential members had with the cooperative model? A community in which people have had positive experiences owning and patronizing cooperatives is more likely to organize new cooperatives than a community with either few or negative experiences. The reception of a new idea depends upon general attitudes, which are affected in turn by economic considerations, cultural biases, education, etc. All of these factors determine the amount of effort and time it will take to make the cooperative a reality. The steering committee needs to honestly evaluate how favorable the general environment is to their cooperative idea. The steering committee must also estimate the potential number of members and the volume of business they will do with the cooperative. Will the members do enough business to meet operating expenses with a small margin for savings and growth? To obtain this information, the survey should include questions such as: Would you be interested in receiving this service from a cooperative? If so, how often, or in what quantity, and at what price? What product or service need do you currently have that might be filled by the cooperative? What are you currently paying for these products or services and what would you be willing to pay? The survey results form the base for the next steering committee task, the feasibility study.

Step 5: Conduct a feasibility study

**GOAL:** Is the cooperative based on a sound, viable business idea? A feasibility study should provide the steering committee with enough information to answer this question.

A feasibility study will provide an estimate of the cooperative’s viability and probability of success. It may take the form of a formal, contracted study or a more informal assessment by members of the steering committee. Feasibility studies should be prepared by a person or team who is objective, reliable, and has the right expertise. They should have knowledge of the industry and the ability to forecast market trends. Often, co-ops will have to pay for a good feasibility study. To find references, contact other cooperatives, cooperative development specialists, or university small business or cooperative centers.

The feasibility study provides essential information for the business plan. Perhaps more importantly, it also identifies any obstacles to the business before more time and money are invested in organization efforts. The study should include three major components: a market analysis, an organization and technical analysis, and a financial analysis. Contents from a typical feasibility study are shown in the
sidebar. A feasibility study should provide enough information to allow the steering committee (and others) to answer at a minimum the following questions:

**Who will be served by the cooperative?** How many potential members are there, where are they located geographically, and what is their level of interest in the cooperative? Will these members be able to financially support the development of the cooperative? What kind of return do the members want or need to make their cooperative investment worthwhile?

**What does the market look like?** Is there a market for what the cooperative plans to provide? How big is that market, where is it located, and who is serving it now? How much will it cost to produce the product or service and is that competitive with other comparable companies? How much revenue is required to meet operating expenses? What is the probability that revenue level will be achieved? A comprehensive analysis that looks at worst- and best-case scenarios for each market indicator is key.

**How will the cooperative operate?** What kinds of operations will the cooperative need to set up? Will the cooperative own or rent buildings or trucks? Is complex processing equipment needed? It is often a good idea to rent real estate or equipment until operational strategies are settled into a final form. At what point will the cooperative purchase land and equipment?

**What kind of money will be needed and where will it come from?** What will it cost to operate the cooperative? What kinds of funds will be needed for start up, what will be needed until the cooperative breaks even, and when will that be? Does the cooperative have access to sufficient capital? The study should indicate the expected portion of the funding that will come from the membership and how much must be borrowed.

**Who will run the cooperative?** Within the steering committee, are there leaders competent and willing to undertake the development and operation of the cooperative? The steering committee, and later the elected board of directors, will probably have to work hard for two or three years to get the cooperative from the idea stage into operation. Are they up to the task? Once the cooperative is up and running, how much will qualified management cost (and how much can the cooperative afford to spend)? How many employees will be needed and what is the salary rate for comparable jobs in the area?

The feasibility study should provide the steering committee with a comprehensive understanding of the industry and where the proposed co-op will fit within that industry. It should also highlight the key factors that will allow the co-op to succeed. It is important to remember that all feasibility studies are predictions. They cannot guarantee that the predictions will be realized. Therefore, it is important to ask for at least three scenarios: the best possible conditions, the most likely outcome, and the worst-case scenario.

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### Sample contents of a feasibility study

I. Introduction and scope of study
   - A. Domestic market profile
   - B. International market profile
   - C. Target market
   - D. Overall market feasibility

II. Market analysis
   - A. Review and analysis of survey results
   - B. Supply outlook

III. Producer survey and supply analysis
   - A. Review and analysis of survey results
   - B. Supply outlook

IV. Organization and technology analysis
   - A. Organizational capacity analysis
   - B. Technology and equipment needs
   - C. Operational scenarios

V. Transportation and processing analysis
   - A. Map of producer locations
   - B. Supply outlook

VI. Financial analysis
   - A. Financial analysis and feasibility summary
   - B. Assumptions and methods

VII. Overall feasibility evaluation
   - A. Summary and conclusions
   - B. Recommendations
It is also important to critically review the feasibility study. How valid is the data? For instance, were potential customers surveyed regarding their preferences? Also, what assumptions were used in the predictions?

Step 6: The membership drive

**GOAL:** Sign a sufficient number of prospective members to membership agreements and gather additional seed funds.

The steering committee should review the feasibility analysis results and decide if it makes sense to proceed with the organization of the cooperative. If the answer is yes, the next step is to undertake a membership drive. It is not uncommon, however, for a membership drive to be started before a full feasibility study is completed, to draw in financial support and volunteers to support the feasibility study.

In a membership drive, steering committee members and other volunteers go out into the community to explain the proposed cooperative and to garner support. To generate initial membership interest, the committee can set up information tables at fairs or other events or arrange meetings that are open to the public and publicize them in the media. To create greater understanding and a more committed membership, smaller, invite-only meetings might also be necessary.

A set of quality written materials that clearly explain the co-op’s mission and financial expectations are key to a successful membership campaign. Prospective members should be asked to sign a membership agreement that will become legally binding once the cooperative is incorporated. Prior to that, it simply clarifies for both the cooperative and the member what is expected from each. It should clearly state cooperative objectives and financial commitments expected from membership (the price and minimum number of shares required for membership).

If the number of members who sign agreements with the co-op falls short of a pre-determined goal, a special meeting may be called to decide if the project should be folded or revised. If the project ends, the fees collected from prospective members should be returned unless a portion is needed to cover the organizational expenses.

Step 7: Develop a business plan

**GOAL:** Establish in detail the business structure of the cooperative and get a group of potential members to approve and commit to the plan.

The business plan is important because it is the blueprint of business operation for the cooperative, and because it is the foundation of any funding application package. The purpose of the business plan is to increase the co-op’s chances of success by conducting extensive research and planning. It builds on the feasibility study but provides more complex and comprehensive analysis. It should include an objective assessment of how well the business will work, the risks entailed, and a detailed plan of action. A business plan is necessary to secure funding from financial institutions and investors. It also helps establish a shared vision for the future of the cooperative that should help members avoid planning conflicts. It becomes a working document that should be continually referenced and, if necessary, updated.

External, skilled individuals should write the business plan under the guidance of the board. It should contain many of the same topics as a feasibility study (see table 8.1) although the content will be more detailed and comprehensive. An executive summary should give a brief synopsis of the plan. The market analysis should describe the cooperative’s target market, projected market share, and competitive advantage both in the short and long run. A marketing plan should include a description of marketing and sales activities and a general sales strategy. The business plan should also include details regarding production, research and development, and delivery methods. Personnel issues (employee requirements, hiring plans, and compensation expectations) and member responsibilities should be presented in the management and ownership section.
All aspects of the financial picture, including sources of capital, should be laid out in the financial section, which should also include budgets and several years of cash flow projections. The capital structure of the cooperative is a key decision the steering committee and potential members must make as part of the business plan development. The following steps should be helpful in the process:

1. Estimate the amount of capital required to start the co-op and fund operations through the first business year. This figure should be based on the projected business costs and cash flow requirements calculated in the feasibility study and the desired level of accumulated reserves (unallocated and allocated equity).

2. In general, most lending agencies require that members (plus grants) provide at least half of the equity. For instance, if you decide the co-op will require $50,000 in capital to get started, a maximum of $25,000 can be borrowed from a bank (debt capital). The remainder would have to be financed by member equity and/or grants. Lenders evaluate their willingness to loan money to businesses based on this initial equity and on other characteristics detailed in the business plan, such as projected cash flow, degree of risk, and quality of management.

3. It is not always easy obtaining capital from members. They may be unwilling or unable to provide funding. It will be important to remind members that their initial investment represents their ownership stake in the cooperative. Getting members to provide equity also reflects their level of commitment to the success of the business. It should be high enough that failure of the business would have a negative consequence and yet not so high as to preclude new members. At this point, the co-op also needs to establish its equity redemption program. Clearly spell out how members’ equity will be revolved.

4. Estimate the loan amount and sources of funding. Determine the best lending sources and prepare loan application packages.

Step 8: Prepare legal documents and incorporate

GOAL: Incorporate the cooperative as a legal entity and specify business-operating rules.

Incorporation

Incorporation as a cooperative can happen at several points along the organizational timeline. Some groups choose to incorporate early, as it helps with name recognition in the community and can help in recruiting members and obtaining funding. Others choose to wait until they know that the project is truly feasible. Regardless of when it happens, the procedure is the same.

All cooperatives, no matter how small, should incorporate to limit the liability of individual members for the debts and obligations of the association. Legal advice is recommended in drawing up or reviewing the incorporation papers. The articles of incorporation are, in effect, a charter from the state or federal government that authorizes the entity to do business. Most cooperatives incorporate under state laws, though credit unions often incorporate using federal laws.

Almost all states have laws specifically written for cooperatives. In Wisconsin, for example, cooperatives register their articles of incorporation with the Department of Financial Institutions. They must be signed by at least five people, with at least one person residing in the state. The articles include the name of the cooperative, its purpose and location, and the number of directors (in Wisconsin at least five unless the co-op has fewer than 50 members, then it is three). Membership classes and the type, amount and value of capital stock (if a stock cooperative) are also described.

The original and notarized copies plus the filing fee are sent to the Department of Financial Institutions. Upon receiving a certificate from the register of deeds that the duplicate articles of incorporation have been recorded in the county of the cooperative’s location, the secretary of state issues a certificate of incorporation.
Bylaws

The articles of incorporation and the bylaws constitute the two primary sets of rules that dictate cooperative procedure. After the cooperative has been incorporated, a temporary board should be formed that will adopt bylaws and elect officers. The bylaws are an internal document that includes, among other issues, membership restrictions, how the board of directors and officers are nominated and elected, how decisions are made by the board and members, stock requirements, patronage allocations and distribution, details on how to change the bylaws and a dissolution plan for the cooperative. In addition to the bylaws, the cooperative will eventually also establish policies that deal with board-management relations and governance responsibilities. Sample bylaws and articles of incorporation can be obtained from the University of Wisconsin Center for Cooperatives. Bylaws are generally not filed with the state, but they are legally binding documents and should be well understood by the presiding board officers.

Step 9: Early start-up phase

GOAL: Elect the first board of directors, acquire capital, and hire a manager. Get the co-op off to as strong a start as possible.

First membership meeting

At the first official meeting of the cooperative the draft bylaws are presented, discussed and approved, and the first official board of directors is elected. Often state incorporation statutes will dictate how much advance notice must be given to members before this meeting can be held. In Wisconsin, for example, the notice must be given at least 7 but no more than 30 days before the meeting. Recruitment of members to run for the initial board of directors is an important task since this group will take the cooperative from the idea stage into operation. Board candidates should be experienced in business and have an understanding of the sector in which the cooperative will operate. Members should receive advance information about board candidates so they can choose effective leaders. Once elected, the board will meet and select officers. One of the first things that the new board should do is coordinate the business plan, which will provide a blueprint for the operation of the cooperative.

Setting up the business

Once the board is comfortable with the business plan, they need to set up the business. This will include approaching members and other investors to accumulate the necessary capital, hiring management, and making decisions on building and equipment purchases or leasing.

Once the cooperative is up and running, the board should redefine their role. They should no longer be involved in the daily operations of the cooperative—that becomes the responsibility of the management team. The board needs to focus instead on planning, establishing cooperative goals and making sure the management decisions are leading to those goals, and monitoring the cooperative’s finances.

The purpose of planning is to identify the cooperative’s mission, vision, and guiding principles. The process should, ideally, involve multiple layers of the firm (the board of directors, management, and employees). Planning helps the cooperative avoid “institutional drift,” a condition where a business has failed to identify clear goals or a plan for achieving them. Successful planning focuses on what the cooperative wants to achieve; how it proposes to achieve its goals; and why it wants to pursue these goals. Planning forces the cooperative, and in particular the board of directors, to define explicit goals for the cooperative and to examine its competitive environment. Planning may also help the cooperative avoid crises and emergencies by requiring the planners to think through the implications of various ideas. Planning is often divided into strategic planning, which focuses on the long run (typically a three to five year time horizon), and operational planning, which deals with the short term (generally the next business year).
Conclusion

Creating a new cooperative is a time-consuming
and often frustrating process. It requires a great
deal of commitment from the steering committee.
All businesses are prone to failure and coopera-
tives are no exception. The good news is that once
they are established, cooperatives tend to have a
lower failure rate than other types of businesses.

Success depends on a few key factors. Establishing
a core group of committed members and broad-
based community support is essential since
members will need to contribute start-up capital. A
comprehensive feasibility study, involving objec-
tive financial and market analysis, is another
important ingredient. This will determine demand
for the cooperative's products and services and its
potential for success.

The cooperative should have a clearly defined
purpose (mission) and vision to which all members
and management strive to achieve. Clearly defined
business goals and targets help management and
members see where they are and what they need
to do to fulfill further goals. This keeps everyone
on the same page and prevents the organization
from getting sidetracked, allowing it to remain
focused on achieving its mission.

The co-op needs to follow sound business prac-
tices. It needs to know its market and how to serve
that market well and profitably. The board and
management need to maintain accurate records of
financial activities. It is advisable to use an inde-
pendent accounting firm for assistance, especially
before any sale of stock or a large collection of
money, and for annual financial audits. The
manager and board must know exactly where the
business stands financially to make sound
business decisions. In addition, the cooperative
should have an annual audit by an outside
accounting firm. The cooperative needs to have
adequate start-up and growth capital, including at
least 50 percent held by members as equity invest-
ments. The cooperative should also schedule
annual education and training for directors, man-
agement, and members to improve their business,
communication, and cooperative skills.

Cooperative development specialists are readily
available at little or no cost (see the appendix for a
reference list) in most areas to help guide the
steering committee through the development
steps and offer useful tips learned from other orga-
nizational efforts. Lawyers and accountants should
also be hired to ensure that the appropriate laws
are being followed and that finances are in order.
However, the ultimate decisions regarding how the
cooperative should be structured and run, and
most importantly whether it is viable, will be up to
the co-op's future members.
The preceding chapters have hopefully given the reader an introduction to cooperative principles and practices and an appreciation of the cooperative movement. Springing from modest beginnings in England at the end of the 18th century, the cooperative model has evolved to successfully accommodate a myriad of different businesses in virtually every country. The cooperative model will continue to change, reflecting fluctuations in social and business environments.

There remain, however, three defining cooperative principles: user-ownership, user-control, and proportional distribution of benefits. To continually provide benefits to members year after year, cooperatives must be well organized, well financed, well managed, well governed, and supported by a committed membership. They must be progressive, anticipating business changes, and flexible, responding to changing member needs. Some will need to be innovators in their business sector. Others will need to supply products and services to their members that are simply more convenient or at better prices. As with any other business, there must be demand for a cooperative’s goods and services for it to survive.

The unique aspect about cooperatives is that most of the demand comes from its members. This member-driven orientation makes co-ops fundamentally different from other corporations. Ultimately, cooperation is voluntary; members must realize enough benefits from their cooperative to make their financial and time commitment worthwhile.

**General benefits**

Cooperatives allow people to pool their human and financial resources and raise more capital. Individuals who may have been unable to start a business on their own can do so through cooperative action. Benefits to members and to the community are both tangible and intangible. Tangible benefits may be seen immediately in improved services, more product availability, and better prices, whereas it may be some time before the intangible value from organizing cooperatives becomes apparent. Through organizing and governing their cooperative (through committees and the board of directors), members develop leadership and problem-solving skills and confidence in their ability to help themselves. Cooperatives encourage members to rely on themselves to solve economic and social problems instead of on the government.

Cooperatives in the United States receive some protection from anti-trust laws. This gives members the opportunity and incentive to share valuable production, marketing, and consumer information with each other since they can work together rather than act as competitors. Cooperatives should also provide access to additional information and training by organizing member education events. Through ongoing education, cooperatives can help members improve product quality, adopt new technology, and gain a better understanding of modern business methods and economic issues.

Cooperatives can have a significant and positive impact on the communities in which they are located. They create and retain local jobs, have a more long-term commitment to remaining in the community and provide local leadership and development. Since cooperative profits are returned to local owners (and not to investors who may live outside the community), more money is spent in the community, strengthening the local economy. In many cases, marketing, supply, and service cooperatives also benefit non-members by increasing the competition (the competitive yardstick theory). Monopolies (as well as monopsonies) have the power to charge outrageous prices and deliver only the most profitable services. For instance, in many rural areas in the United States, internet companies would not install the necessary technology because of low population (and thus, demand). In some cases, rural residents have banded together to form cooperatives to provide such technology, which is then available to the whole community.

**More specific benefits**

Marketing cooperatives help their members increase their sales volume by reaching new and bigger markets with greater bargaining power. Cooperatives often help farmers improve their product quality through careful grading, branding,
and packaging. As a result, members receive better prices for their goods, which in turn leads to more personal profits. Some cooperatives also provide business assistance services, which can also lead to more effective marketing and better prices.

Processing cooperatives add value and profits to their members’ raw products. For instance, durum wheat is transformed into pasta, milk into butter, etc. The portion of profits that usually go to non-cooperative “middlemen” processors are instead diverted to cooperative members. In addition to more revenue, marketing and processing cooperatives also give farmers a sense of security; members know that the cooperative provides a secure market for their products, which is especially important with perishable products such as milk.

Supply cooperatives help their members buy in larger volume and therefore, at lower cost. Collectively co-op members have a bargaining power that no individual could exert alone in the marketplace. The cooperative also negotiates with vendors, which means more quality control over the goods it purchases for members. Because this type of cooperative may also fill a gap in the marketplace, members may have increased access to goods and services not previously available to them (e.g., affordable housing or organic food). Consumer cooperatives, in comparison to other non-cooperative retail stores, may be more responsive to member preferences and needs, especially as they change over time.

Service cooperatives also help members save money and meet unmet demand. Mutual insurance companies save members tens of millions of dollars annually on premiums. Credit unions have taught millions of families thrift and financial management and have loaned them money for useful purposes that could not have been borrowed as easily elsewhere. The comfort and satisfaction that comes from rural electric service and from modern telephone service are not measurable in dollars, yet the great majority of farmers and other rural residents in the United States did not experience these until cooperatives provided them.

Worker-owned cooperatives can create improved working conditions for employees, including job security. Since the employees share company profits and losses, they have the incentive to work harder. These factors can lead to low employee turnover, high productivity, and strong profits.

**Cooperative limitations**

Cooperatives are clearly not a panacea for every economic problem and they may not be the best choice for every business opportunity. Farm supply cooperatives, for instance, have difficulty competing with large corporations such as Cargill; most simply can’t move that type of volume. Marketing cooperatives also face a major challenge competing with large (often multinational) food corporations and serving large retailers. However, the federated structure and larger inter-regional cooperatives help smaller local cooperatives overcome this challenge.

Non-agricultural purchasing cooperatives have difficulty competing with large discount stores like Wal-Mart. They are also inappropriate when members only require goods and services on an infrequent basis (e.g., purchasing a car or real estate). Employees who want to turn their business into a worker-owned cooperative face the challenge of having few models and support services to help them with the process.

Regardless of the business, the cooperative model poses unique challenges and sometimes limitations. As discussed in chapter 8, organizing a cooperative requires a great deal of time, effort, and leadership. It also requires members to invest capital. In some cases, such as new generation processing cooperatives, the capital contributions can be significant. Further, in some countries, although not usually in the United States, cooperatives may have more difficulty securing funding from banks since they may not be as well understood as other types of firms.

Finding developers, attorneys, and financial analysts who are familiar with the cooperative model, may also be challenging. A failure to understand cooperative complexities can lead to inappropriate assistance and advice. Cooperative gov-
ernment agencies and trade associations, as well as university-based cooperative centers, can help cooperatives find the right technical assistance. Once the cooperative is in operation, continuous member education is critical. An on-going communication and education program is critical to keeping members involved and committed to the cooperative. Cooperatives in their second or third generation may cease to operate cooperatively; that is, members no longer play an active role in the organization. A strong communication and education program can help prevent this from happening.

Educating board members is particularly essential, especially in large, complex cooperative businesses. New directors may have little prior experience or training for their position. However, even with well educated and well-informed members and directors, decision-making in cooperatives (as with any democracy) can be slow and inefficient. In some business sectors, this inefficiency can hinder a cooperative’s competitive performance. The need to inform members of cooperative business can also be at odds with a cooperative’s business strategy. If leaked to the competition, key financial information or news of a merger may lead to lost business opportunities for the cooperative.

Maintaining adequate capital reserves and finding new capital for growth are perennial problems for cooperatives. A lack of capital is bad for any business. Perhaps the greatest limitation of the cooperative model is the restriction that members must provide the majority of the capital. This is a challenge for members who have limited capital or are heavily in debt. Further, a basic cooperative standard is that equity financing should be proportional to patronage. This means that not only do cooperatives need to find adequate operating capital, but they must also redeem old equity capital and replace it with new capital from current members.

That fact that cooperative benefits spill over to non-members is certainly good for the community. However, it can reduce membership and patronage. Why invest in the cooperative when you can receive many of the benefits anyway? This “free-rider” problem also occurs amongst members. Without binding patronage contracts, members are free to take their business elsewhere to find the most attractive price. Uncertain patronage (supply and demand) makes optimal performance and strategic planning challenging.

Public support

In many countries, including the United States, cooperatives today are generally granted favorable public policy treatment. For instance, federal laws and policies protect cooperatives from anti-trust and other regulations and federal and state agencies issue grants to support their development as well as offer free technical assistance. In return, cooperatives may also lessen the government’s burden (especially in rural areas) by providing essential goods and services other firms would not and playing the competitive yardstick role by keeping prices down through competition.

In the United States relatively little industry is run by local, state or federal governments. However, the government can do a number of things more effectively than private industry. This is especially true with projects characterized by significant financial risk. In these cases few private groups would invest capital and bankers would be unlikely to loan money. Or, the project may require so much capital (as in the building of a huge dam) that only the government could arrange for its construction. Finally, some services and products may not be profitable enough for private business, or they may not be able to recoup any profits (military protection and highway construction, for example). Thus, if it were not for government, these public goods and services would go unmet.

In some instances, we are now seeing cooperatives being formed that are more successful in providing these same services. For example, there are excellent cooperative models in the areas of health care and housing that have been more successful than federal housing and health care projects. The sense of ownership and control by the member-users makes the difference. Therefore, cooperatives can help replace some government business, allowing the government to focus on other initiatives. This role for cooperatives is extremely important in developing countries.

2 The ICA was founded in London in 1895. Its members are cooperative organizations in all sectors: agriculture, banking, consumer, energy, fisheries, housing, industry, insurance, and tourism.

3 Some cooperatives have membership agreements that restrict when members can quit. Marketing cooperatives, for example, may require members to continue marketing their commodities through the cooperative for a given period of time (e.g., the remainder of the year) or face financial penalties.

4 This type of cooperative should not be confused with factories owned by cooperatives where people work on a strictly employer-employee basis.

5 National Cooperative Business Association (NCBA) October 2003 statistics.


12 Friendly Societies are still prevalent in the United Kingdom today. For more information, visit the Association of Friendly Societies site: www.afs.org.uk.


15 Bakken and Schaars.

16 In their time, they were known as socialists. They were labeled “utopian” later by Karl Marx.


18 Bakken and Schaars.

19 Birchall, p. 22.

20 Bakken and Schaars.


22 Fairbairn, p. 27.


26 Fairbairn, p. 29.

27 Fairbairn and Bakken and Schaars make this point.

28 Fairbairn.

29 The Grange still exists today, although it is largely a social organization.

30 Fairbairn.

31 Fairbairn.
While the 1865 Michigan law is generally considered the first cooperative marketing law, in 1857 New York and Ohio passed laws that legalized mutual town cooperative fire insurance companies. The 1865 Michigan statute originally only authorized mechanic and other labor associations; it was amended in 1875 to include agricultural and horticultural associations (Bakken and Schaars).

Bakken and Schaars.

From Section 6 of the Clayton Act.

The Capper-Volstead Act has never been amended. Proposals for additions and changes have been suggested, but no congressional action has been taken.

It wasn't until 1978 that Congress chartered The National Cooperative Bank (NCB) to provide financing to cooperatives not eligible to borrow from Banks for Cooperatives.

The New Deal (1933-1938) was a government initiative to help end the Great Depression (1892-1933).


Bakken and Schaars.

See Fairbairn and others for a more detailed description of this process.

A study conducted in 2003 found that conversions of cooperatives to investor-owned structures were rare, but the economic pressure to do so was growing (E.G. Nadeau and Rod Nilsestuen, *Strengthening Cooperative Business Structures: Lessons Learned from Demutualization and Cooperative Conversions*, 2004).

The Capper-Volstead Act does not mention "cooperatives," but rather associations of producers. For example, the National Farmers Organization, which is not a cooperative but rather a producer bargaining agency and a major farm organization lobbying group but gets its authority under the act.


CSAs were originally created in Japan in 1965 by a group of women who wanted to purchase locally produced food (John Hendrickson, 1996 MS thesis, University of Wisconsin–Madison).


Ibid.

In 2003, Land O'Lakes, Inc. purchased Purina Mills and is now the largest feed company in North America.

2003 United States Credit Union Statistics.

www.farmcredit.com

The NCB was chartered by Congress in 1978, but became private in 1982.

www.usca.org.

Since these are informal organizations they are not incorporated and have no business name.

NGCs also incorporate traditional cooperative practices such as democratic control, with a board of directors elected by the membership, and patronage refunds based on usage.


In reality, a business can combine elements of various types of businesses, although the fundamental differences in structures would still allow them to be categorized as one of the five described business types.

In the United States, as in most other countries, all businesses need to file registration papers with the appropriate state and federal agencies.

Wyoming enacted the first LLC law, in 1977, to allow for all of the properties discussed in this section (the most common characteristics of LLCs today); other states quickly followed suit.
The Internal Revenue Code categorizes corporations in numerous subchapters according to their special tax circumstances.

Some service and purchasing cooperatives operate at near break-even levels and do not generate many profits at the firm level.

CHS began selling preferred stock on the NASDAQ Preferred Listing under the symbol CHSCP in 2003. The stock has a par value of $25. The shares entitle their owners to receive an annual cash dividend equal to eight percent of the original issue price ($25 per share) as declared by the company’s board of directors. Dividends are paid on a quarterly basis.

In Wisconsin, any cooperative incorporated under Chapter 185 is exempt from filing Wisconsin business income tax.

Some managers may receive compensation packages tied to cooperative performance, but the primary claimants to any benefits (or losses) are still the members.

Some states do allow outside directors with voting power.


There are two primary types of stock sold by cooperatives: common stock (often called "A" stock) has voting rights while preferred stock ("B" stock) carries no voting rights. Membership usually only requires the purchase of common stock.

As explained in chapter 5, the member would be required to pay tax on the entire $8,000.

Deferred patronage refunds usually make up the largest portion of a member’s allocated equity account since they accumulate over several years.

In 1998, the average total equity per member in all agricultural co-ops was $5,952, up from $3,217 in 1989. USDA.
acquisition – one firm purchasing another; a type of merger.

antitrust laws – laws declaring illegal any trusts or combinations that restrain trade (both state and federal laws).

articles of incorporation – a legal document filed with the appropriate state agency (for example, in Wisconsin, articles are filed with the Department of Financial Institutions) showing the purpose, capitalization, address, and names of the incorporators of a company.

asset – that which is owned, such as property, money, goodwill.

association – an organization of people with a common purpose united in a formal structure.

audit – an examination and verification of the records and financial accounts. An unqualified audit is an audit using generally acceptable accounting procedures and prepared by a qualified accountant or auditor, who reports the audit to be accurate without reservation as to the balance sheet and operating statement.

balance sheet – a statement showing the assets, liabilities, and net worth (or owner equity) of a business on a specified date, usually the end of the year.

bargaining cooperative – a cooperative whose sole or principal function is to bargain for terms of sale. It does not handle the actual products as an operating cooperative does.

book value of stock – refers to the dollar value of common stock certificates. It equals the appraised value of all assets of a business less liabilities and value of preferred stock divided by the number of shares of stock outstanding.

broker – an agent who receives a fee (brokerage) for his/her selling or purchasing service. He/she does not physically handle the product.

bylaw – a standing rule, not included in the constitution or articles of incorporation, which specifies operational practice and policy.

capital – money, or dollar value of property, used in a business whether supplied by owners and/or borrowed.

capital stock – book value of the invested money in a company represented by the total shares of stock in a corporation including those fully or partially paid for as well as for those as yet unissued.

certificate – a paper which certifies the condition, status, obligation, rights, etc. of the holder of the paper.

certificate of equity, of investment, revolving fund certificate – usually a certificate without a maturity date issued as evidence of retained patronage refunds or per unit retains. These retained funds legally constitute an investment in the capital of the cooperative and, therefore, are part of the association’s net worth.

certificate of membership – sets forth the rights, privileges, and conditions of membership in a nonstock cooperative. It is given to the member upon payment of the membership fee.

charter – the articles of incorporation under which a corporation is legally organized. It consists of the powers, rights, and liabilities of a corporation granted to the incorporators. It is the authority to proceed as a corporation subject to the constitution and laws of the state where the incorporation took place.

common stock – ownership capital in a corporation divided into shares or stock certificates which carry voting rights, unless otherwise indicated, and which are eligible to receive dividends. There is no due date on such stock and it carries all the risks associated with the investment. Sometimes common stock is split into Class A common stock which has voting rights and Class B common stock which does not.

consolidation – a merger of two or more companies in which a new company is organized to replace the original companies.

consumer cooperative – a purchasing association which sells primarily consumption goods – food, clothing, fuel, household goods, furniture, etc. It may also provide services for consumers, such as health care and housing.

contract, marketing – a legal agreement between a cooperative and its members under which the member agrees to market salable products mentioned in the contract through the association, and the association agrees to market the
products for the member. A local association may also contract to market its products through a central marketing cooperative.

cooperative – a user-owned and user-controlled business that distributes benefits on the basis of use.

corporation – a legal entity created under the corporation laws of a state (or sometimes under federal law) whose powers, liabilities, and rights are separate and distinct from those of the individuals constituting the corporate body.

credit union – a cooperative organized to create a source of loanable funds for useful purposes and to educate its members in financial matters.

director – one of several persons elected by the members to govern or control the affairs of the cooperative.

dividend – a sum of money taken out of a corporation's net profits and paid to shareholders based on their equity investment.

equity – the ownership interest of a company's members or stockholders as distinguished from that of bond holders or lenders; investment rights in a company; the total assets less the total liabilities.

farm supply cooperative – a purchasing cooperative through which its patrons obtain farm supplies such as feed, seed, fertilizer, gasoline, chemicals, appliances, and other production goods.

federation – an association of local cooperatives in which the local associations elect a board of directors to govern the central association, with the locals retaining their autonomous character. Farmers are members of locals and locals (or regionals) are members of the central association.

gross margin – the difference between the selling price and buying price, generally indicated as a percentage of the selling price.

incorporating – the act of setting up a corporation by filing incorporation papers with the appropriate state agency.

integration, horizontal – the act of combining two or more like production units or marketing agencies under central control and management, as for example, two or more retail stores.

integration, vertical – successive bargaining units in the marketing channel brought under central control and management. Example, wholesale and retail units owned and operated by one firm.

interest – payment for the use of borrowed money.

liabilities – amounts owed by a business to its creditors, either short- or long-term; also designated as current liabilities (payable within a year) and fixed liabilities (payable after a year).

limited liability – in a corporation, the stockholder as an investor is liable for the debts of the corporation only to the extent of the value of the shares owned.

member – each of the persons composing an association. In a capital stock association a person must have purchased at least one share of common voting stock to fully qualify as a member. In a nonstock or membership association, he or she typically pays a membership fee. In some cooperatives (e.g., Alto and Foremost), neither a membership fee nor purchase of stock is required for membership.

membership agreement – an agreement between a person and a cooperative under which the person agrees to become a member of a cooperative (sometimes confused with a marketing contract).

membership fee or membership capital – the amount or fee paid by a member for membership in a nonstock association or in an unincorporated cooperative.

merger – two or more companies brought together as one in which the acquiring company continues but the acquired one is liquidated. (See acquisition, consolidation.)

middleman – a business firm which physically transfers and exchanges title to products in their passage through the marketing channel from producer to ultimate consumer.
mutuals – similar to cooperatives, an association of members.

net margin – gross margin minus the operating expenses; same as net earnings, profit, net revenue, or net savings from business operations.

net worth – owners’ equity in a business firm. It is the excess of the value of assets over liabilities.

nonstock cooperative – a membership organization formed without capital stock.

open membership – an unrestricted membership policy of a cooperative; a very liberal policy with few restrictions as to admission of members.

operating statement – an itemization of business income and expenses for a given period, usually a year.

par value (of stock) – the dollar value of a share of common or preferred stock which is stated on the stock certificate. This value may be equal to, greater, or less than its market value which represents the amount for which the stock can actually be sold.

retain (per unit) – funds withheld from patrons to build up capital under a revolving capital plan of financing (also called capital retains).

revolving capital plan of financing – a financing plan in which capital funds are obtained from member patrons through capital retains or retention of patronage refunds, are used for a time by the cooperative and later repaid to the member patrons; a plan for rotating all or part of the capital funds of an association.

revolving fund certificate – see certificate of equity.

service cooperative – a cooperative that deals solely or primarily in the rendering of services (such as housing, financing, insurance, artificial breeding, electricity, and telephone service) as distinguished from handling commodities.

sole proprietorship – a business or firm owned by one individual.

stock or share – a certificate showing investment in the cooperative as well as ownership rights.

value-added – in strictly economic terms, the difference in prices received for raw products and the retail value of the transformed products.

wholesaler – a merchant middleman operating between the processor (or manufacturer) from whom he/she buys and retailers to whom he/she sells; usually does not sell directly to the end user.

working capital – total current assets minus total current liabilities.
About UWCC

Since its inception in 1962, the University of Wisconsin Center for Cooperatives (UWCC) has strived to study and promote cooperative action as a means for meeting the economic and social needs of people. The Center organizes various extension and outreach programs directed at all aspects of the cooperative business: organizing cooperatives, cooperative financing, cooperative structure, and cooperative management, leadership and governance. The Center is part of the Cooperative Education Alliance, a partnership between the Wisconsin Federation of Cooperatives, Minnesota Association of Cooperatives and UW Extension.

UWCC outreach efforts are supported by one of the largest collections of cooperative materials in the United States held at the Truman Torgerson Library (madcat.library.wisc.edu) as well as by a popular and comprehensive website that receives an average of more than 120,000 hits a year (www.wisc.edu/uwcc).
**Cooperative university centers**

**United States**

**Arthur Capper Cooperative Center**
Dept. of Agricultural Economics
305 Waters Hall
Kansas State University
Manhattan, KS 66506
Phone: (785) 532-1508
Fax: (785) 532-6925
Website: www.agecon.ksu.edu/accc/

**Cooperative Enterprise Program**
Cornell University
Ithaca, NY 14853-7801
Phone: (607) 255-8800
Fax: (607) 255-9984
Website: cooperatives.aem.cornell.edu/

**Quentin Burdick Center for Cooperatives**
North Dakota State University
P.O. Box 5636
Fargo, ND 58105
Phone: (701) 231-1016
Fax: (701) 231-1059
Website: www.ag.ndsu.nodak.edu/qbcc/

**University of Wisconsin Center for Cooperatives**
230 Taylor Hall
427 Lorch Street
Madison, WI 53706-1503
Phone: (608) 262-3981
Fax: (608) 262-3251
Website: www.wisc.edu/uwcc

**Canada**

**British Columbia Institute for Cooperative Studies**
University of Victoria
University House 2 - Room 109
PO Box 3060 STN CSC
Victoria BC V8W 2Y2
Canada
Phone: (250) 472-4539
Fax: (250) 472-4541
Website: web.uvic.ca/bcics/

**Centre for the Study of Cooperatives**
101 Diefenbaker Place
University of Saskatchewan
Saskatoon, Saskatchewan S7N 5B8
Canada
Phone: (306) 966-8509
Fax: (306) 966-8517
Website: coop-studies.usask.ca

**Coady International Institute**
Cooperative Development Programs
St. Francis Xavier University
P.O. Box 5000
Antigonish, Nova Scotia B2G 2W5
Canada
Phone: (902) 867-3960
Fax: (902) 867-3907
Website: www.stfx.ca/institutes/coady

**Cooperative development resources**

**Cooperative Development Services**
131 West Wilson Street, Suite 400
Madison, WI 53703
Phone: (608) 258-4396
FAX: (608) 258-4394
Website: www.cdsus.com

**Credit Union National Association**
P.O. Box 431
Madison, WI 53701-0431
Phone: (800) 356-9655
Fax: (608) 231-4263
Website: www.cuna.org

**National Association of Housing Cooperatives**
1707 H Street, NW, Suite 201
Washington, DC 20006
Tel: (202) 737-0797
Fax: (202) 783-7869
Website: www.coophousing.org

**National Cooperative Bank/NCB Development Corporation**
1725 Eye Street, NW Suite 600
Washington, DC 20006
Phone: (800) 955-9622
Fax: (202) 336-7800
Website: www.ncb.coop
National Cooperative Business Association  
1401 New York Avenue. NW, Suite 1100  
Washington DC 20005  
Phone: (202) 638-6222  
Fax: (202) 638-1374  
Website: www.ncba.coop

National Cooperative Grocers Association  
19 Main Street SE  
Suite 500  
Minneapolis, MN 55414  
Phone: (612) 331-9103  
Fax: (612) 331-9145  
Website: www.ncga.coop

Northcountry Cooperative Development Fund  
19 Main Street SE  
Suite 500  
Minneapolis, MN 55414  
Phone: (612) 331-9103  
Fax: (612) 331-9145  
Website: www.ncdf.coop

National Rural Electric Cooperative Association  
4301 Wilson Boulevard  
Arlington, VA 22203  
Phone: (703) 907-5500  
Website: www.nreca.org

World Council of Credit Unions  
5710 Mineral Point Rd.  
P.O. Box 2982  
Madison, WI 53705-4493  
Phone: (608) 231-7130  
Fax: (608) 238-8020  
Website: www.woccu.org

USDA-Rural Business Cooperative Services  
1400 Independence Avenue  
Stop 3250  
Washington DC 20250-3250  
Phone: (202) 720-7558  
Fax: (202) 720-4641  
Website: www.rurdev.usda.gov/rbs/

For a complete list of cooperative specialists by state, visit the USDA-Rural Business Cooperative Services site at  