

AGRICULTURAL ALTERNATIVES

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Cooperatives

Cooperatives (often referred to as “coops”) are an ancient concept where a group works together to meet common needs. This informal arrangement evolved over time into a formal business organization. Cooperatives have special status under tax laws in the United States and most other countries.

A cooperative is a business voluntarily owned and controlled by its member-patrons and operated for them on a nonprofit or cost basis. This implies that the cooperative exists to help its members with their primary business, rather than to be a profit-making entity itself. In fact, this view is simplistic in that successful cooperatives must be well-run businesses that resemble ordinary for-profit firms in many ways.

Cooperatives for farmers involve farm inputs (e.g., seed, fertilizer, and fuel), marketing cooperatives (e.g., those selling milk, grain, or other farm products), service cooperatives (e.g., those providing breeding services, dairy herd performance information, or electricity), and financial services (especially credit). Nonagricultural cooperatives include cooperatives that provide services for cooperatives (e.g., the Bank for Cooperatives), electric generation cooperatives, and business cooperatives (e.g., those providing inputs for hardware or grocery stores).

Why Form a Cooperative?

The first question people should ask when considering whether to form a cooperative is why it may work for their type of business. Cooperatives address six issues:

1. Cooperatives allow people in similar situations to work together to meet common needs. These people may be



farmers, consumers, operators of small businesses, and so forth. Although this publication focuses on agricultural cooperatives, hundreds of thousands of other cooperatives exist.

2. Cooperatives can help the member businesses get services that are otherwise not available because the market is small or unique in some way.
3. Cooperatives may also help producers get market access.
4. Cooperatives can provide access to quality supplies and services at reasonable costs.
5. Cooperatives can provide members with increased power in the marketplace.
6. Lastly, cooperatives can allow their members to share in the earnings of a related business. Many processing cooperatives are formed to help farmers escape the markets for the commodity products they produce and participate in the value-added activities that occur after the product leaves the farm gate.

This publication was developed by the Small-scale and Part-time Farming Project at Penn State with support from the U.S. Department of Agriculture-Extension Service.

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A cooperative can help the members solve a common problem. However, it will not make a bad idea into a good idea. The underlying economics of the business must be sound. Many new cooperatives fail for many reasons; common problems involve a lack of commitment to the cooperative by some of the members, an unrealistic business plan, and insufficient funds to get started. In all cases, the board and the management must be forward looking. Directors must be willing to put the interests of the cooperative first. Members must share the vision of the cooperative.

When considering a new cooperative several questions should be answered: Will group action achieve a goal that individual action won't? Can you work as a group? How will you finance the business? Who will manage it?

How Do Cooperatives Work?

In a cooperative, the members act as a group to solve a problem. They do this by each investing some money in the business. They organize, elect officers, and set up the business. They will then buy or sell the goods at regular retail prices. Any profits they earn from this business will be distributed to members. Cooperative governance is based on one vote per person rather than a weighted system, such as one voter per share that corporations use.

Cooperatives have a few underlying principles. First, the cooperative is formed to benefit the members, primarily to get services otherwise not available or improved market access. Members share benefits proportionate to use so a big user will get more benefits. By definition, cooperatives are owned by the member-users who also control the business and act as the board of directors.

Related to these principles are some specialized practices. The profits are distributed through a patronage refund, in which the profits are shared based on volume of business done. The rate of return on equity capital is limited since the cooperative prices at about cost and passes the benefits on to members. Although not essential to the success of the operation, cooperatives are expected to collaborate since they have a lot in common.

Financial and Tax Planning

A cooperative is going to require some operating funds. Initially, this will involve direct investment by the members. The members will receive shares of stock for their investment. Once it is operating, the cooperative can retain earnings for a period and can also require members to build up per-unit capital retains (e.g., keep a certain number of dollars per hundredweight of milk sold through the cooperative for plant and equipment). Of course, money earned from business to nonmembers can be used to build equity as well.

A cooperative must organize under the laws of its state. This generally involves registration, filing of bylaws, and some other paperwork. Although not onerous, these steps are essential to establish the advantageous tax status that is afforded to cooperatives.

Membership Responsibilities and Cooperative Leadership

The responsibilities of members are to patronize the cooperative, be informed, vote wisely, provide capital, and evaluate business performance. Participation in the governance and management of the cooperative is critical. For this, cooperatives have directors and officers (generally a president, vice president, secretary, and treasurer) that are selected by the membership.

One of the more difficult jobs in a cooperative is that of director. The directors are chosen by the members to guide the overall operation of the cooperative. The directors should make broad decisions, hire the manager, develop policy, plan strategy, monitor finances, approve the budget, hire the auditor, hold the annual meeting, and determine the patronage refund and amount of retained earnings. The directors must work as a group to help the cooperative do as well as it can. This requires that the directors put their individual interests aside and make decisions based on what is best for the cooperative. Although directors are often elected by a geographic area, they are not like members of Congress, who make decisions based on what is best for their district. Instead, it must always be what is best for the cooperative. Although there will be votes among the directors, the board should try for a consensus, not just a majority that approves an action. If the board is sharply divided about a decision, then they might consider not taking the action, even if a majority favors it. Once a decision is made, directors in the minority must support the majority decision. The members of the board should present a united view to the members and explain what was decided and why and not question the decision after the fact.

The president is the principal executive officer of the cooperative and presides at all meetings of the members and the board. The president also signs (with the secretary) certificates of membership and any deeds, mortgages, deeds of trust, notes, bonds, contracts, or other instruments authorized by the board and in general performs all duties incident to the office of president and such other duties as may be prescribed by the board.

The vice president, in the absence of the president or in the event of his inability or refusal to act, performs the duties of the president. While so acting, the vice president has all the power of, but is also subject to, all the restrictions of the president. The vice president also performs such other duties as from time to time may be assigned by the board.

The secretary is responsible for keeping the minutes of the membership and board meetings in books provided for that purpose and seeing that all notices are duly given in accordance with the bylaws or as required by law. The secretary is also responsible for safekeeping corporate books and records and the seal of the cooperative, affixing the seal of the cooperative to all certificates of membership and to all other authorized documents, keeping a register of the names

and addresses of all members, signing (with the president) certificates of membership that have been authorized by the board of trustees or the members, keeping on file (ready for inspection by members) a complete copy of the articles of incorporation and bylaws of the cooperative (with any amendments), furnishing on request (at cooperative expense) a copy of the bylaws (with any amendments) to any member, and in general performing all duties incident to the office of secretary and such other duties as from time to time may be assigned by the board.

The treasurer is responsible for custody of all funds and securities of the cooperative. This includes the receipt of and the issuance of receipts for all monies due and payable to the cooperative and the deposit of all such monies in the name of the cooperative in such banks as shall be selected in accordance with the provisions of its bylaws, and in general performing all the duties incident to the office of the treasurer and such other duties as from time to time may be assigned by the board.

The board may appoint a manager, who may or may not be a member of the cooperative. The manager performs duties and exercises such authority as the board of trustees may vest in him. In general, the manager must work with the board on cooperative goals, supervise employees, and provide the board with information needed to make informed decisions. Any employees of the cooperative must understand the purpose and objective of the coop. In addition to performing their regular duties, they must understand the relationship of a cooperative to the member/owners. And, like employees of any organization, they must favorably represent the cooperative.

Getting Started

To begin a cooperative, a small group of prospective members must have a common problem and some idea that might solve it. These people will be the leadership team for developing the cooperative. They must provide expertise, enthusiasm, practicality, dedication, and determination to see that the project is completed. The following list from the USDA publication *How to Start a Cooperative* details the steps your team must follow.

1. Invite leading potential member-users to meet and discuss issues. Identify the economic need a cooperative might fill.
2. Conduct an exploratory meeting with potential member-users. If the group votes to continue, select a steering committee.
3. Survey prospective members to determine the potential use of a cooperative.
4. Discuss survey results at a second general meeting of all potential members and vote on whether to proceed.
5. Conduct a needs or use cost analysis.
6. Discuss results of the cost analysis at a third general meeting. Vote by secret ballot on whether to proceed.

7. Conduct a feasibility analysis and develop a business plan.
8. Present results of the feasibility analysis at the fourth general meeting. If participants agree to proceed, decide whether to keep or change the steering committee members.
9. Prepare legal papers and incorporate.
10. Call a meeting of charter members and all potential members to review and adopt the proposed bylaws. Elect a board of directors.
11. Convene the first meeting of the board and elect officers. Assign responsibilities to implement the business plan.
12. Conduct a membership drive.
13. Acquire capital and develop a loan application package.
14. Hire the manager.
15. Acquire facilities.
16. Begin operations.

The Competitive Environment

Like any business, a cooperative must understand the nature of its competitive environment in order to survive and prosper. If a cooperative is doing something completely new, it may not have much competition. In other cases, however, there may be someone who actively does not want it to succeed. Any start-up group must look at the competition, both present and future, and ask whether their cooperative will be able to adapt to the demands of such an environment. No competitor is going to greet you with open arms.

Other Sources of Information

The United States Department of Agriculture (USDA) has many valuable publications about starting and running different types of cooperatives at <http://www.rurdev.usda.gov/rbs/pub/cooprpts.htm>. These downloadable publications address many pertinent topics. Of particular interest is the publication *How to Start a Cooperative*, <http://www.rurdev.usda.gov/rbs/pub/cir7/cir7rpt.htm>.

In addition, many states have rural development field representatives that can provide some help. Their site at <http://www.rurdev.usda.gov/rbs/coops/csdir.htm> will help you find these people.

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Additional financial support for this publication was provided by the Risk Management Agency of the United States Department of Agriculture and the Pennsylvania Department of Agriculture.



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Pennsylvania, and the U.S. Department of Agriculture.

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Produced by Information and Communication Technologies in the College of Agricultural Sciences

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