Agribusiness Management Series: Understanding Cooperative Principles and Practices

OSU EXTENSION FACTS

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Farmers' cooperatives are an important part of U.S. agriculture. In 1985, there were 5,625 cooperatives serving the needs of 4,781,000 farmers (USDA).[1] Of this total, there were 3,441 cooperatives engaged primarily in marketing activities with total net marketing business of $47.3 billion. Cooperatives accounted for 28 percent of all farm products marketed in 1985. In 1985, cooperatives handled 33 percent of all grain and soybeans marketed. In Oklahoma, there were 140 farmers' cooperatives with a combined membership of 100,149 in 1985. Net business[2] by these cooperatives totaled $769 million.

The purpose of this Extension Facts is to provide an overview of farmers' cooperatives. The discussion is organized around a series of questions which highlight cooperative principles and practices.

What is a cooperative?

"A cooperative is a business owned and controlled by the people who use its services. They finance and operate the business for their mutual benefit. By working together, they can reach an objective unattainable by acting alone. This objective can be summarized as all of the "services" the cooperative can beneficially provide.

"These services can include obtaining production supplies, processing and marketing members' products, or providing functions related to production and marketing. The cooperative may be the vehicle to obtain services otherwise unavailable or that are more beneficial to members. The underlying function of the cooperative is to increase individual income or in other ways enhance members' way of living." (Ingalsbe and Goff)

How do cooperatives differ from other methods of doing business?

A business can be organized as either a sole proprietorship, a partnership, or a corporation. Partnerships are either general or limited. Corporations are classified as either investor-owned or patron-owned (cooperative). The alternative methods of doing business differ in terms of who uses the services, who owns the business, who votes, how voting is done, who determines policies, if returns on ownership capital are limited, and who gets the operating proceeds (Table 1).

Cooperatives differ from investor-owned corporations in the following ways:

1. Cooperatives do business primarily with its patron-owners. Investor-owned corporations generally do business with non-owner customers.

2. Cooperatives are owned chiefly by patrons, i.e., those that do business with the organization. Investor-owned corporations are owned by stockholders who may or may not do business with the organization.

3. Cooperatives are controlled by member-patrons who usually vote based on one-member, one-vote. Investor-owned corporations are controlled by stockholders who vote by shares of common stock held.

4. Returns on ownership capital is generally limited in a cooperative to eight percent, whereas in an investor-owned corporation there is no limit.

5. The operating proceeds in a cooperative are distributed to patron-owners on a patronage basis. In investor-owned corporations,

[1] Estimated membership includes members (those entitled to vote for directors) but does not include non voting patrons. (Some duplication exists because some farmers belong to more than one cooperative.)

[2] Estimated net business represents the value at the first level at which cooperatives transact business for farmers.

operating proceeds are distributed to stockholders in proportion to the stock held.

What are the advantages and disadvantages of a cooperative?

The advantages of a cooperative over other forms of doing business are that benefits are tied to use, control is shared equally, and the organization is safe from outside "takeovers." Cooperatives often are associated with the disadvantages of limited sources of financing, the need to educate members, and limitations on the scope of permissible business activities (Kirkman).

What are distinctive cooperative features?

Five distinctive features which set agricultural cooperatives apart from other forms of business are democratic member-user control, service at cost, limited returns of capital invested, member-owned and financed, and limited operations.

Democratic member-user control. The Capper-Volstead Act states that cooperatives can be organized for "the mutual benefit of the members." To ensure that members benefit from participation in the cooperative, the act requires that voting in the association be restricted to one-member, one-vote (regardless of the amount of stock owned) or that returns on capital invested be restricted to eight percent per year.

In some cooperatives, the basic membership vote is supplemented to permit additional votes based on the amount of business done by the individual with the association. The democratic principle is steadfastly maintained by relating voting power to use of the cooperative's services. (Many states, including Oklahoma, prohibit voting on any basis other than one-member, one-vote regardless of the amount of stock owned or the amount of business done by the individual with the association.)

Members exercise control in the organization by voting to elect members of the board of directors which, in turn, are charged with the responsibility of representing the members' interests in deciding policy and providing direction to management.

Service at cost. Cooperatives provide service at cost. Since it is often difficult to accurately predict costs, cooperatives typically charge market prices and return any net savings (profits) to members in the form of patronage dividends at the end of the year. Patronage dividends are required by law to be at least 20 percent in the form of cash (Cobia et al.).

Limited returns on capital invested. Cooperatives are organized to benefit user-members rather than nonuser-investors. Restrictions on investment returns discourage exploitation by individuals more interested in returns on investment than service to members. Most state statutes limit returns on capital invested (Barda).

Member-owned and financed. Cooperatives are owned and financed by the individuals that stand to benefit from doing business with the organization, i.e., the member. A desired objective is that members finance the cooperative in proportion to their patronage of the organization.

Limited operations. The Capper-Volstead Act permits farmers to join together for the purpose of marketing their products. However, to obtain this limited antitrust exemption, the act requires that the cooperative be operated for the mutual benefit of its members (agricultural producers) and can do no more than half of its business with nonmembers.

What are the benefits of cooperative membership?

The benefits of cooperative membership include expanded member control, increased farm income, increased availability of services, the assurance of dependable sources of supplies, enhanced market competition, and improved market access (Mather and Preston).

Expanded member control. Participation in a cooperative enables farmers to own and control an enterprise established for procuring their supplies and services and marketing their output.

Increased farm income. Farm income is enhanced by increasing prices received for products marketed or reducing prices paid for supplies and services purchased. Benefits also result from reducing per unit handling or processing costs.

Increased availability of services. Cooperatives are operated to serve the mutual interests of members by providing services which are either unavailable to members, available at prohibitively high costs, or unavailable at the quality level needed.

Assurance of dependable sources of supplies. Cooperatives provide members with a dependable source of supplies at reasonable prices. This benefit is especially critical at times of scarce supply when prices may be excessive.

Enhanced market competition. Strong, well-managed cooperatives exert competitive pressure in the markets in which they compete. One justification of cooperatives is that they provide a competitive "yardstick" against which the performance of noncooperatives can be measured.

Improved market access. Marketing cooperatives assist farmers in gaining access to markets by pooling products of specified grade or quality and by developing export markets. Markets for products have also been increased by processing and manufacturing activities engaged in by cooperatives. Cooperatives involved in such activities include Farmland Industries, Inc., Land O'Lakes, Inc., Ocean Spray Cranberries, Inc., and Sunkist Growers, Inc. (Ward and Morrissy).

How are cooperatives organized?

Cooperatives are classified by their form of organization. Cooperatives which are owned entirely by producer-members are known as centralized cooperatives. Cooperatives which are owned by other cooperatives are known as federated cooperatives. Cooperatives which are owned by both producer-members and other cooperatives are known as mixed cooperatives.

What do cooperatives do?

Cooperatives engage in marketing, purchasing, and service activities. Marketing cooperatives market products produced by members. Purchasing cooperatives, also called farm supply cooperatives, provide members with supplies used in agricultural production. Service cooperatives are organized to provide services related to the production and marketing of farm products or to meet needs in other areas. Examples of service cooperatives include Farm Credit Services, rural credit unions, rural electric cooperatives, and rural telephone cooperatives.

What are the essential people involved in a cooperative?

Four groups of people are essential to the successful operation of a cooperative: members, the elected board of directors, the hired management, and employees. Members need to be actively involved in the decisions that are made to ensure that their interests are represented. The board of directors is responsible for providing long-term direction to the firm. The hired management is responsible for assisting in setting long-term goals, developing strategy, and coordinating day-to-day activities. Employees need to understand cooperative principles and be informed of the goals of the organization.

What challenges are facing cooperatives today?

With changes in the nature of agricultural production, cooperatives today are facing the need for strategic adjustments. Issues which need to be addressed by cooperatives include: 1) a declining number of farms with the average size of farms increasing, 2) declining loyalty of members to cooperative principles and practices, 3) a reassessment of prevailing cooperative philosophies underlying strategic, tactical, and operational decisions, 4) increasing cooperative-to-cooperative competition, 5) a failure to educate and involve members in decision making activities, and 6) a lack of director development education for board members (Black and Knutson).

What is the future of agricultural cooperatives?

The reasons for the formation of cooperatives in the past still remain today. To continue to receive the benefits associated with cooperative membership, members need to take an active role in the strategies pursued by their organizations. Change is inevitable and those cooperatives that will prosper in the future will do so by improving the quality of leadership and management.

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Table 1. Features of the Methods of Doing Business

Features compared	Individual	Partnership	Corporation	
			Investor-owned	Cooperative
Who uses the services?	Nonowner customers	Generally nonowner customers	Generally nonowner customers	Chiefly the owner patrons
Who owns the business?	The individual	The partners	The stockholders	The member-patrons
Who votes?	None necessary	The partners	Common stock-holders	The member-patrons
How is voting done?	None necessary	Usually by partners' share in capital	By shares of common stock	Usually one-member, one-vote
Who determines policies?	The individual	The partners	Common stock-holders and directors	The member-patrons and directors
Are returns on ownership capital limited?	No	No	No	Usually 8%
Who gets the operating proceeds?	The individual	The partners in proportion to interest in business	The stockholders in proportion to stock held	The patrons on a patronage basis

Source: Kirkman, C. H., Jr., Advising People About Cooperatives, U.S. Department of Agriculture, Agricultural Cooperative Service, Cooperative Information Report No. 29, revised June 1983.