Texas Cooperative EXTENSION
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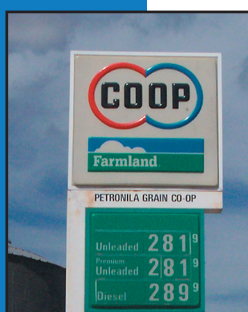
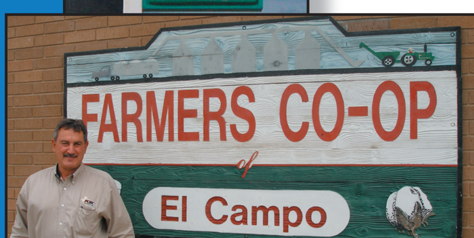
Defining the co-op'er • a'tive

Cooperative businesses are a common sight across rural America. Yet, they are often misunderstood—sometimes by those who use them. A basic understanding of their origin, operation, and challenges bring newfound respect for this unique type of business.

Businesses today come in different forms defined by various factors like ownership, benefits, and taxation. Among the more common business structures, you will find an entrepreneurship, a partnership, and a corporation. Each differs in terms of ownership and benefits, and each has advantages and disadvantages. While less common, a cooperative corporation can be a powerful business form that competes very well with these others when it is founded for the right purpose on a solid business plan.





However, cooperatives are often misunderstood due to their historical origins and strong social ties. Presented here is a brief and simple discussion that we hope will define the cooperative. It all starts with the underlying principles.

Cooperative Principles

A cooperative may look like any other business in its performance, operations, and physical appearance, yet a cooperative is founded on principles that make it fundamentally different from other business types.

In 1844, the Rochdale Society of Equitable Pioneers in Great Britain was the first successful organization to formally state these principles of cooperative business. Of the twelve original principles outlined by the Pioneers, three are recognized today as the defining principles that give a cooperative business an advantage in this competitive market and sets them apart from other service providers.

1. Voting in the business is by member-users on a democratic or proportional basis.

Common Forms of Business

Entrepreneurship	Partnership	Regular Corporation	Cooperative Corporation
Owned by One Person	Owned by Partners	Owned by Stockholders	Owned by Member/Patrons
Has Regular Customers	Has Regular Customers	Has Regular Customers	Most Customers are the Owners/Patrons
Operating proceeds go to the owner	Operating proceeds go to the partners in proportion to their share in capital	Operating proceeds go to the stockholders in proportion to their share in stock	Operating proceeds go to the patrons in proportion to their patronage
Owner determines policies	Partners determine policies	Stockholders and Directors determine policies	Member/Patrons and Directors determine policies

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2. Equity is provided by patrons, the very same people who use the cooperative.
3. Net income is distributed to patrons through patronage refunds on the basis of use.

These three principles are simple and flexible but cover a wide array of modern cooperative practices. What's more, they form the basis of a definition.

Defining the Cooperative

The USDA defines a cooperative as:

> *"A user owned and controlled business from which benefits are derived and distributed equitably on the basis of use."*

A cooperative business is voluntarily owned and controlled by its users and operates to their benefit. This personal involvement of the customers is the hallmark of a cooperative. A cooperative business allows these user-owners access to goods and services that otherwise might not exist in the marketplace. Further, because the members also own the business, a cooperative is a way for them to vertically integrate their own operations into another level of the supply chain, increase their profitability, and diversify their risk.

In the United States, a cooperative is a corporate business that competes in a free enterprise market economy. While this legal business structure gives some advantage to avoiding the double-taxation faced by owners of the more familiar c-corporations, the cooperative shouldn't be confused with the modern concept of a "non-profit" organization. A successful cooperative operates for profit!

One Person, Many Roles

The users of the cooperative actually have more than one relationship to the business. A regular corporation may separate ownership, use, and control, but a cooperative does not. Users of the cooperative have four basic roles.

1. **Customer:** The user utilizes the products and services offered by the cooperative.
2. **Patron:** The user has contributed to the success of the business and shares in the distribution of net income.
3. **Owner:** The user provides an equity investment in the cooperative.
4. **Member:** The user has control over the business through democratic representation. Members elect a portion of the board of directors in a vote each year.

How Does This Business Work?

In a cooperative, farmers are said to operate "at cost" through patronage refunds (price adjustments made after an accounting cycle). Patronage refunds are distributed based upon the amount of business the member did with the cooperative in the given accounting cycle.

For example, a cooperative that has revenue of $200,000 and has $150,000 in expenses is left with $50,000 in net income, which can be paid out through patronage refunds with the approval of the board of directors.

For a member to receive their share of patronage, their amount of business to the cooperative in the given accounting cycle, ($5,000 in this example) would be divided by the cooperative's net income ($200,000 in this example). Another way to look at this is 5,000/200,000 = 2.5%. In turn 2.5% of the 50,000 is $1250 and it is that amount that is to be paid to the particular member if the entire net income was distributed to the members. Part of this distribution will be given to the members in cash, and another part kept by the cooperative as "stock" to be redeemed at a later date. The board of directors has full control over the benefits derived from the business and is responsible for managing its growth.

Roles and Responsibilities...

Members *Select and evaluate directors*	**Board of Directors** *Hire and supervise management*	**Managers** *Implement board policy*
- recognize ownership and adopt legal papers - understand, use, and support the cooperative - provide necessary capital and information - obtain new members and participate in affairs	- represent and inform cooperative members - initiate and adopt long range plans - acquire and preserve the cooperative's assets and character - determine capital structure and cooperative policies - assess the cooperative's performance	- initiate and adopt short range plans - coordinate, organize, and staff everyday operations - control, direct, and manage daily business activities

Clearly defined roles help to keep the cooperative business operating at a steady pace. Too often the temptation exists for an involved and caring board to slip into management decisions. This results in a double threat to the business…a lack of strategic oversight, and the undermining of manager effectiveness.

As stated previously, the cooperative members elect a board of directors from amongst themselves. The board then is responsible for hiring and supervising the manager and providing the strategic direction for the business. The manager in turn is responsible for all operations, employees, and serving the members.

The members, board of directors, and managers each have their own specific duties. Often these responsibilities tie into each other, but it is important that they do not overtake another's role. When working together, a great management team can ensure a successful cooperative.

Regionalized Cooperatives

As the cooperative business grows, it generally takes on one of two forms: a centralized cooperative, or a federated cooperative. A centralized cooperative serves the needs of users directly, sometimes through branch offices. Centralized cooperatives have individuals customers as its members. On a larger scale, the members of a federated cooperative are smaller local cooperatives that are operated by local managers responsible to a local board of directors.

These local cooperatives are separate corporate entities. The local cooperative holds the voting stock rather than individual members. Federated cooperatives have their own general manager with the board of directors elected by their local affiliated cooperatives.

Reasons for Cooperation

Through cooperation, people in a "group" are more effective in serving their needs and solving their problems than acting alone. As a member of a cooperative, individuals have the chance to gain a larger market share and can afford things they normally would not be able to do when acting alone. Examples include promoting a name brand, developing a transportation system, and combining their research and development activities. Other reasons for cooperation include:

- Influence markets and improve market power in competitive markets
- Gain access to industrial goods and services that are not otherwise provided
- Achieve greater economies of scale and improve cost efficiency of operations
- Provide members with tools for risk management and combat unfair market power
- Pool financial resources and improve members incomes and their rural economy
- Improvement in prices paid or received in excess production capacity of usage
- Gain access to more business activities with opportunities to buy and sell from co-op

    -Purchase inputs/services at lower costs

    -Receive better market prices and market access

Economic Realities of Co-ops

Cooperative businesses can bring great things to you and your community. As with any business, careful consideration and planning is essential before venturing into something new.

- Producer patrons are co-op owners.
- Producers economic incentive is to invest as little as possible and use as much as possible.
- Must have capital to purchase assets.
- Assets are funded by equity (risk) capital and debt capital.
- Debt capital liekly only avaibale if sufficient equity capital.
- Equity capital likely only available if can demonstrate and communicate co-op value.