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ABSTRACT

SOURCES OF CAPITAL FOR LIMITED RESOURCE COOPERATIVES

by Garth H. Holmquist

Cooperative group actions are undergoing a resurgence in popularity in close concert with an increasing awareness of the problems of rural poverty and a belief that group actions can serve as a partial solution to those problems. There are several elements necessary for the economic success of a cooperative, of which the absence of any one may preclude economic success and thus greatly diminish or eliminate the usefulness of cooperatives as an anti-poverty tool.

This paper examines capital resources as one prerequisite for economic success by reviewing capital needs and capital sources. The availability of capital as well as the comparative advantages and disadvantages of the various sources are examined as they apply to limited resource cooperatives. From this discussion general guidelines are drawn for the use of cooperative managers and members engaged in acquiring capital resources and as food for thought for those individuals and agencies involved in promulgating or supporting limited resource cooperative enterprise.

SOURCES OF CAPITAL  
FOR LIMITED RESOURCE COOPERATIVES

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## INTRODUCTION: LIMITED RESOURCE COOPERATIVES

Cooperative enterprise is a particular form of group action which holds promise of economic improvement for cooperators, or cooperative members, and which also has political and social overtones for cooperative members and for society and the economy as a whole. Cooperatives have long been viewed as a vehicle for redistributing wealth to those who have only a limited command of resources, via a shift of strength in the market place to those with limited resources.

Within this context cooperatives have in the last ten years or so, experienced a new surge of popularity as a tool for social and economic change. This renewed interest in cooperatives for low-income people, or limited resource cooperatives as I shall hereafter refer to them, has come about largely as a result of, and parallel to, a growing awareness of the extent and seriousness of the poverty problem in our economy. That the poverty problem is real and is urgent has been well documented in recent years. Whether or not limited resource cooperatives are a partial solution to that problem has not been fully determined although there is a growing circle of support for such group actions.

To determine the adequacy of limited resource cooperatives in fulfilling the role as an economic and social change agents, it is necessary to first determine the criteria for a successful cooperative enterprise and then to determine whether or not that criteria can be met within the confines of the particular set of circumstances encountered

for each limited resource cooperative considered. Limited resource cooperatives, and all cooperatives for that matter, have several general prerequisites for success. If those prerequisites can be met there is an opportunity for economic success. If the limited resource cooperative can be an economic success then there is the possibility of it becoming a viable organization and force for social change.

The prerequisites for success in their simplest terms are recognized need and interest on the part of cooperators, leadership and management ability, and capital resources. These prerequisites are highly interrelated and to separate one from the others may appear to give that one undue importance, but advocates of cooperative enterprise maintain that need and desire are present, and also that potential for leadership and management ability is present and can be cultivated and developed. The unknown quantity remaining, which has been a major stumbling block for many limited resource cooperatives of the past and present, is the presence or availability of capital resources to finance cooperative activities.

Adequate capital resources are a problem for several reasons. By definition the cooperators under consideration have low incomes and low levels of capital resources which they can invest as equity capital. Equity capital in the form of retained earnings is simply not present at the beginning or organizational stage and is scarce in a business struggling to establish itself. Borrowed capital from the commercial sector is not always readily available at favorable interest rates and government support in the form of grants and loans has fluctuated in the past few years. Nor are leaders of limited resource cooperatives always aware of government and private assistance

which is available. The result is confusion and uncertainty over what capital resources are available and over how limited resource cooperatives can acquire the use of what is available.

In light of the growing reliance on limited resource cooperatives to solve part of the poverty problem and because capital resources are an important part if not the principle factor in cooperative success, it is necessary to closely examine capital availability both internal and external in order to judge the economic viability of limited resource cooperatives. It is to this question of capital availability that this paper is addressed. It is not my intention to advocate limited resource cooperatives as a change agent nor to address the question of whether limited resource cooperatives should be organized and supported. The question of rightness or desirability of limited resource cooperatives in fulfilling a certain role I will leave to the theorists and advocates. What is intended is an examination of capital needs and capital sources so that a determination can be made of whether or not one prerequisite for success can be met.

## COOPERATIVE CAPITAL

Capital in its essence is the result of withholding funds from current consumption and of holding those funds in such a way that they will contribute to future production or consumption. Capital for limited resource cooperatives, as for all businesses, must come from savings whether it be savings from proceeds (retained earnings), savings from members (share capital, undistributed surplus and member deposits) or savings from outside sources acquired through loans, trading credit, or grants.

Capital resources over which the cooperative has control will be either equity capital owned by the cooperative and cooperative members or it will be borrowed capital from one or a number of outside sources. Historically, capital resources have ranged from virtually 100% share capital to almost 100% borrowed capital. The Rochdale Pioneers, in one of the first business enterprises based upon cooperative principles, accumulated sufficient share capital to cover all needs before beginning operations and after starting, financed additional needs from undistributed surplus and from members' savings. The Raiffeison Credit Societies, also a pioneer cooperative enterprise, on the other hand had no share capital and relied almost exclusively on borrowed funds which were secured by pledging the unlimited liability of members.<sup>1</sup> Limited resource cooperatives in today's world will most likely utilize both equity capital and borrowed capital, including trade credit, simultaneously to meet capital needs.

There are three basic problems involved in financing cooperatives including 1.) an assesment of financial requirements, 2.) a search for

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<sup>1</sup>Helm, Franz C., The Economics of Cooperative Enterprise, University of London Press, Ltd., London. 1968, p. 198.



sources of funds to meet requirements and 3.) the application and control of funds. The assesment of need and the application and control of funds will be discussed in this section on cooperative capital. Sources of funds will be examined in detail later in the paper.

### Capital Needs

The capital needs of a cooperative fall into three general categories. They are organizational funds, long term capital and operating funds.<sup>2</sup> The organizational funds are needed to cover such cash outflows as permits and liscences from government agencies, legal and recording fees and promotional expenses incurred in organizing and establishing the cooperative.

Long term or fixed capital is required for investment in land, buildings, equipment and possibly vehicles needed by the cooperative. If the local limited resource cooperative is to be a member of a federated cooperative for purposes of markets or supplies then an additional need for fixed capital is for membership shares or investment in the federation.

Operating funds, or short term capital, are needed to conduct normal business operations within one business period. Operating funds are used for advances to members in the case of a marketing cooperative, labor inventories, supplies, debt service and other current expenditures. If the limited resource cooperative extends credit to customers financing is also necessary for the accounts receivable.

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<sup>2</sup>Roy, Ewell Paul, Cooperatives: Today and Tomorrow, Interstate Printers and Publishers, Inc., Dansville, Ill., 1964, pp. 319-320.

Not all of the above mentioned needs for capital will be encountered by any one particular cooperative. In general, capital requirements are a function of the type and size of the cooperative, extent of ownership or rental of fixed factors, business volume or size, availability of borrowed funds and capability of members to subscribe capital, as well as the type and extent of services to be provided by the cooperative.<sup>3</sup>

The requirements for organizational funds can be reduced by relying on members for promotional activities and for organizing the cooperative venture. Fixed capital requirements can be reduced by renting or leasing the required land, buildings, and equipment and thus shifting the commitment of capital to operating capital cash flows. Operating capital requirements in turn can be reduced by buying on credit and maintaining a large accounts payable liability or by buying on consignment with payment due after final sale of the goods. The operating capital needs may also be reduced by requiring all payment with orders or requiring cash on delivery and thus maintain a low accounts receivable balance. Still another alternative is to discount accounts receivable with another financial institution.<sup>4</sup> Any of the alternatives listed above for reducing capital requirements may be employed separately or may be used in combination. Limited resource cooperatives in particular may find it necessary to minimize fixed capital commitments, to rely heavily on members to supply needed manpower, and to reduce operating capital needs by minimizing outstanding accounts receivable while making full use of available short term credit. In general cooperatives, and limited resource cooperatives in particular, should strive for a high ratio of volume to investment by committing no more capital to investments than is absolutely necessary for the expected volume of business to be done.

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<sup>3</sup>Roy, p. 32.

<sup>4</sup>Helm, p. 197.

## Check List for Estimating Capital Requirements<sup>5</sup>

### I. Fixed Capital

A. Land and site development	_____
B. Buildings (specify type and size)	_____
C. Plant equipment (itemize)	_____
D. Trucks and vehicles	_____
E. Office equipment	_____
F. Utility development (water, gas, electricity, sewage, etc.)	_____
G. Legal and organizational	_____
H. Other	_____
_____	_____
_____	_____
_____	_____
Total <sup>a</sup>	=====

a) A minimum subscription of 25% of total fixed capital is highly desirable. A more optimal level would be member subscriptions approaching 50% or more.

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<sup>5</sup>Based on: Ott, Gene O., Determining the Economic Feasibility of a Cooperative, New Mexico Agr: Ext. Serv. Circ. 412, Las Cruces, New Mexico, Aug. 1968. As reported in: Roy Ewell P. and Blake A fallo, Economic Analysis of Selected Low-Income Farmer Cooperatives in Louisiana, D.A.E. Research Report No. 434, Dept. of Agricultural Economics and Agribusiness, Louisiana State University, Baton Rouge, Louisiana, January 1972, pp. 74 - 75.



## Financial Planning and Budgeting<sup>6</sup>

Budgets and financial planning are the key to successful planning of any cooperative business activity. The objectives of budgeting are to predict capital shortages and future financial needs and to predict uncommitted capital accumulations. The results or benefits of budgeting are two fold. First, a budget allows for adjustments to meet predicted temporary shortages and adjustment in rate of capital accumulation or credit sources to meet long term capital needs. The second major benefit is that of using uncommitted short term capital accumulations to save through quantity purchases and sales discounts or to save on interest charges by early pay-off of interest bearing liabilities (such as notes payable). To improve the accuracy of future planning budgets, a continuous comparison of budget to actual results should be carried on.

The actual budgets will be of two types. A long term budget can be employed for either the general future of a cooperative or for a proposed special project. The long term budget is used to establish capital requirements in the future in order to adjust capital accumulations or to arrange for credit to meet those needs. The period of time covered depends on the length of a business cycle of the cooperative and on the type of project being considered.

The second type of budget is a short term budget of operating capital and a prediction of cash flows. It consists of a rough estimate of cash income and outflows for the coming two weeks to a month. It is used to make the best use of cash on hand and to prevent cash shortages.

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<sup>6</sup>Helm, pp. 213 - 214.

## Short Term Budgets - Examples?

## I. Operating Budget - Business Cycle

WEEK	DATES	EST. PAYMENTS	EST. RECEIPTS	BALANCE <sup>a</sup> (+, -)
1st. Week	1st-7th Jan.			
2nd. Week	8th-14th Jan.			
"	"			
"	"			
"	"			
TOTAL FOR YEAR				

a) Balance positive or negative is estimate of expected surplus or shortage for coming business cycle.

## II. Operating Budget - Fine Estimate for the Next Two Weeks to a Month

DATE	AMOUNTS DUE	EXPECTED RECEIPTS	
	TOTAL	TOTAL	BALANCE <sup>b</sup> (+, -)

b) Balance positive or negative reveals expected cash on hand or need for immediate credit.

<sup>7</sup>Helm, pp. 213 - 214

## CAPITAL SOURCES: EQUITY CAPITAL

Equity capital for a limited resource cooperative will come initially from either share contributions in exchange for capital shares, entrance fees, or grants from outside sources. After the cooperative begins operations additional equity capital can be accumulated through undistributed profits or surplus from operations. Each of these classes of equity capital have inherent advantages and disadvantages which affect the future growth potential of the cooperative.

Methods of Subscribing Equity Capital:<sup>8</sup>

There are several ways in which the capital contributions of members can be collected by the cooperative. The most common method of acquiring initial equity capital is payment in cash at the time of joining. However, among the low-income members of limited resource cooperatives cash is not always plentiful and members may not be able to make the cash payment. A second alternative is a promissary note from the member but such a note may be difficult to discount with an outside institution and so does not necessarily represent the cash which a cooperative needs. Two ways of acquiring cash and building the equity accounts are to make deductions from the receipts going to members and to apply patronage refunds toward the capital subscriptions.

Normally when members are unable to pay for share capital or membership subscriptions in cash a combination of the above methods is used. Some cash payment is usually required which serves the purposes of both providing liquid assets to the cooperative and of insuring that the member will patronize the cooperative where he has a vested interest.<sup>9</sup>

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<sup>8</sup> Roy, p. 329.

<sup>9</sup> Roy, p. 319.

Then as the member patronizes the cooperative deductions are made from his accounts and his equity contribution is built up.

#### Common Stock Share Contributions:<sup>10</sup>

In a stock cooperative each member is required upon joining to purchase one or more shares of common stock and in some cases additional share ownership is required of members in proportion to their volume or level of patronage. The reason for requiring share contributions is that voting rights, and consequent control of the cooperative, are vested in the owners of the shares of common stock. The advantage is that a portion of equity capital is then determined both by the number of members and the volume of business being conducted.

The principle disadvantage of share contributions as a capital source for limited resource cooperatives is that the low incomes and limited resources of members and prospective members do not allow for investments of any size in a high risk venture such as the limited resource cooperative is. As a result share capital is often based on a member's ability to pay rather than on the needs of the cooperative. Another major disadvantage is that share capital can fluctuate downward as well as upward in the event of cooperators withdrawing from membership. Additional disadvantages include a limited return on shares and lack of growth potential as profits or surplus from operations is distributed to patrons as patronage refunds.

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<sup>10</sup> Helm, p. 199.



### Entrance Fees and Membership Fees:<sup>11</sup>

Non-stock cooperatives which do not issue shares of stock in exchange for members' capital contributions normally require a membership fee be paid by new members. The membership fee as a source of capital has somewhat the same advantage and disadvantages as common stock contributions with two exceptions. The first is the way membership fees are held as equity capital reserves. A member who subsequently wishes to withdraw from the cooperative does not have claim to a refund of his membership fee. This feature allows for a more constant level of equity capital. However, because there is no refund a member is not encouraged to contribute more than the minimum.

### Preferred Stock and Capital Certificates:

Preferred stock in a stock cooperative and capital certificates in a non-stock cooperative serve as an additional source of equity capital but do not carry the voting rights as do common stock and membership certificates. The preferred stock and capital certificates carry a fixed rate of return and dividends are paid before patronage refunds are declared and allocated to patrons. Because of their preferred status they represent a somewhat better investment and have more potential as a capital source. If outside investors (ie non-members) are allowed to purchase preferred shares or certificates the base from which to recruit equity capital is much larger. However, investors may still be reluctant to purchase preferred shares or certificates because of the high risk nature of a limited resource cooperative and the uncertainty of a new business venture. The

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<sup>11</sup> Roy, p. 329.

potential of preferred investments by members and outsiders as a capital source depends ultimately on the cooperative's ability to offer competitive returns and to make regular dividend payments.

#### Retained Earnings:

Retained earnings, also known as retains, deferred patronage refunds, reserves, etc., are essentially the excess of revenues over costs which are held by the cooperative as additional equity capital rather than paid out as patronage refunds. Because of the various terms applied to retained earnings and the various ways in which retained earnings can be accounted for, there is some confusion about the status of funds held and about possible liabilities incurred. If retained earnings are accounted for as valuation reserves against expected future expenses such as taxes, equipment replacements or uncollectable accounts then they should not properly be classified as retained earnings because they do not represent excess revenues above costs and are not properly a source of future patronage refunds. These reserves do represent, however, an increase in liquid assets and so are a source of capital funds for operations or investments.

Retained earnings which are held as capital reserves are the true undistributed patronage refunds. The equities are realized only if patronage refunds are allocated but the funds are held in equity accounts rather than distributed. If the surplus is allocated and held with an explicit due date for future payment the result is a liability which will be discussed in the next section. However if no date for future payment is declared the result is an addition to owner equities.<sup>12</sup>

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<sup>12</sup> Roy, pp. 336 - 341.

Reserves have a distinct disadvantage for limited resource cooperatives. They reduce the amount of patronage refunds received by cooperators in the present period which in effect forces the cooperative member to defer consumption to future periods. Thus the retained earnings represent a reduction in present income for the individual and are a disincentive to trading with the cooperative. Also, limited resource cooperatives which are attempting to provide greater services at lower cost to members are of necessity operating on low margins. To generate surplus which can be allocated to retained earnings the cooperative must increase margins which in turn reduces the competitiveness of the cooperative.

Reserves do not entail any interest expense as do borrowed capital and preferred stock or certificates and thus are the least expensive source of capital other than common stock and entrance fees. Also because the reserves are generated from surplus rather than coming directly from members, this source is not so closely tied to the low-incomes of members. Reserves are a function of the volume of business and so can be expanded in proportion to an expansion in business. Because members have no direct claim on non-allocated reserves, the capital from this source is not tied to fluctuations in membership and represents a more constant equity base than do common stock shares. In addition the cooperative has discretionary use of funds from reserves and is not subject to restrictions, as can be the case with borrowed funds.

#### Revolving Funds:<sup>13</sup>

Reserves which are held as equity capital are often channeled through a revolving fund. As the reserves are accumulated the revolving

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<sup>13</sup> Hubert, Helim H., Nelda Griffin and Kelsey B. Gardner, Methods of Financing Farmer Cooperatives, General Report 32, Farmers Cooperative Service of U.S. Department of Agriculture, Washington D.C., June 1957, p.39.

fund builds up to a predetermined level which is deemed adequate to meet the capital needs for which the fund is established. When the desired level of equity capital is reached the new funds from retained earnings are used to retire the oldest equities within the fund by paying out the previously declared but undistributed patronage refunds. In this way reserves "revolve" through the fund and members receive their patronage refund at some later date than when it was credited to their account.

A revolving fund has the advantage of requiring capital contributions of those who are patrons and are currently using the cooperative. Furthermore capital contributions are made by patrons in proportion to the amount of business they do with the cooperative and hence to the level of benefit which they derive from the cooperative.

#### Grants:

One additional source of equity capital which is from the outside, i.e., capital not coming from member contributions or surplus from operations, is grants from interested third parties. Grants received are properly classified as equity capital because the cooperative has full control of the funds, or of the property in the case of a grant-in-kind, and no future repayment is demanded.

It is difficult to assess the availability of grants or to enumerate possible sources as the situation has changed greatly in recent years and is still fluctuating. Some funds from the federal government have been available through the Office of Economic Opportunity under Title IV of the Economic Opportunity Act of 1964. However that agency has not been funded as of fiscal 1974 and at present apparently no funds are

available. Foundations, churches and secular organizations have also provided grants for organizing and operating limited resource cooperatives but these sources have not been systematically catalogued or organized for easier access.

At best grants as a source of equity capital must be considered as difficult to identify and can not be relied upon without a firm commitment from the granting agency. Obtaining a grant is primarily a matter of identifying and enumerating the needs of the cooperative and then finding a concerned third party with the means of providing assistance.

There are several shortcomings of grant assistance to limited resource cooperatives. Grants do not require the economic discipline which is necessary to repay loans and so may contribute to inaccurate assessments of the viability of the cooperative. Future cooperative membership and membership participation may also suffer if the grant is non-renewable and the cooperative is unable to sustain services to the members which were made possible by the original grant.<sup>14</sup> However, if a grant is viewed properly as a base for establishing an economically viable enterprise, then it can be regarded as an important capital source for the limited resource cooperative.

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<sup>14</sup> Marshall, Ray and Lamond Godwin, Cooperatives and Rural Poverty in the South, The John Hopkins Press, Baltimore, 1971, pp 92 - 93.

### CAPITAL SOURCES: BORROWED CAPITAL

Capital resources which are available to limited resource co-operatives but which are not classified as equity capital, are those capital resources which are borrowed by the cooperative. As well as being resources which can be utilized by the cooperative, they also represent liabilities and must be repaid at some future time. The length of time before repayment is due depends upon the source and upon the terms under which the loan is made.

The principle sources of borrowed capital are cooperative members, federal and state government agencies through various assistance programs, commercial banking institutions, business associates and trade partners, and federated cooperatives and other cooperative associations.<sup>15</sup> The different sources vary as to the restrictions placed upon funds and as to the length of time which borrowed capital can be used before repayments are due. Each source has distinct advantages and disadvantages which should be weighted before funds are borrowed. An individual cooperative may utilize one or more types of borrowed funds along with one or more methods of acquiring equity capital as described previously in order to meet its short term and long term capital needs.

#### Capital Borrowed From Members

Funds can be borrowed from cooperative members through loans made on an individual basis and bearing interest. In this case it is strictly a private transaction and varies little from commercial borrowing

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<sup>15</sup> Helm, p. 199.

which will be discussed in a subsequent section. The advantage of this type of loan lies in the fact that the member already has a vested interest in the success of the cooperative which will be strengthened as he invests more. Thus his welfare will be more closely tied to the success of the cooperative and he has a greater incentive to support the cooperative through both trade and active participation in decision-making. However if the cooperative relies too heavily on one or a few members for credit sources there is a risk that the cooperative will tend to be dominated by those same members. Domination by one or a few can come overtly or more subtly through threat of withdrawal of support if other members do not follow the leadership of the member-creditors.<sup>16</sup> It is uncertain that private loans from members can be an important source of capital within the low-income population of concern in this report.

Funds from members can also take the form of deposits made by members and held by the cooperative as member savings. In many states though, regulations prohibit all cooperatives except those organized primarily as a banking facility from holding deposits. In these instances the cooperative can act only as a collection agency and must turn the deposits over to a commercial bank thus losing the use of those funds. Whether or not member deposits can serve as a source of funds depends upon the primary functions of the cooperative and upon regulations in effect in the particular area.

The third method of obtaining borrowed capital from members is a revolving fund scheme similar to that discussed under equity capital. In this case the funds represent a deferred payment of

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<sup>16</sup> Helm, p. 200.

patronage refunds, or are acquired through a levy on units purchased from or sold to the cooperative. The difference is that the allocated funds are accounted for as an acknowledged, interest bearing liability and the cooperator is entitled to the funds plus interest at some predetermined date, or when the fund reaches a predetermined level equal to capital needs and excess funds are used to retire the oldest debts. The revolving fund technique of handling borrowed capital has all of the advantage and disadvantages of a revolving equity capital fund plus it does promise a greater return to cooperators thus encouraging participation and it does not require collateral as most other loans do. It also represents a liability to the cooperative which equity capital does not.

#### Federal Government Assistance

There are several federal government agencies which provide technical assistance and financial assistance of use to limited resource cooperatives. Some funds are designated for the exclusive use of low income or disadvantaged individuals and business and other funds are available for specific uses to a specific segment of the economic community. A comprehensive catalog of federal assistance programs has been compiled by the Office of Economic Opportunity.<sup>17</sup> The catalog lists types of assistance available, eligibility requirements and the sponsoring agency. A few of the federal agencies which appear to have assistance programs of particular interest to limited resource cooperatives are listed below. An individual cooperative with its own particular set of functions and objectives should refer to the Catalog of

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<sup>17</sup> Refer to U.S. Office of Management and Budget, Catalog of Federal Domestic Assistance, U.S. Government Printing Office, Washington, D.C. Latest edition is 1972.



Federal Domestic Assistance to determine which programs are most suited to meet their needs.

Farmers Home Administration: Loans available to individuals and to organizations for purposes of providing housing. Can be used for private dwellings, rental units, and cooperative housing. Assistance is restricted to farmers and rural residents.<sup>18</sup>

Housing and Urban Development: Funds are provided for interest reduction payments on rental and cooperative housing.<sup>19</sup> The program is restricted to housing for low-income families. Also HUD will provide mortgage insurance on cooperative housing mortgages.<sup>20</sup>

Small Business Administration: Economic opportunity loans are available for small business organization and operation as well as lease guarantees. Also management and technical assistance is available to minority businesses and disadvantaged businesses.<sup>21</sup>

Bureau of Fisheries: Loans are available to fishery marketing cooperatives for operating purposes.<sup>22</sup>

Bureau of Indian Affairs: Loan funds are available for organization and operation of cooperatives which draw membership primarily from Indian, Eskimo, or Aleut populations.<sup>23</sup>

Federal Home Loan Banks: District federal home loan banks provide reserve credit for member savings and loan associations and cooperative banks.<sup>24</sup>

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19 U.S. Office of Management and Budget, section 10.415.

20 U.S. Office of Management and Budget, section 14.103.

21 U.S. Office of Management and Budget, sections 14.115 - 14.137.

22 U.S. Office of Management and Budget, sections 59.001 - 59.009.

23 Roy, p. 354.

24 Roy, p. 355.

25 Roy, pp. 356-357.

Rural Electric Administration: REA offers loans to non profit cooperatives and mutual associations for purposes of financing construction of electric power lines and telephone lines to provide services to residents of otherwise unserved rural areas.<sup>25</sup>

#### Individual State Cooperative Finance Agencies

In some states, state agencies provide funds for loans to agricultural cooperatives. These funds are usually loaned as supplemental funds to other loans obtained from different sources such as the Bank for Cooperatives or other government agencies. Information concerning this possible source should be obtainable from the state agriculture department.<sup>26</sup>

#### Commercial Credit

A cooperative may avail itself of commercial credit sources by direct borrowing on a long or short term note or mortgage, by selling bonds, or by borrowing against receivable. In general if a cooperative utilizes a commercial credit source it must pay interest rates competitive with those paid by profit making businesses. In addition private commercial lenders attempt to maximize profits while minimizing risks and so are often reluctant to extend credit to a limited resource cooperative.<sup>27</sup> Funds on notes and mortgages can be obtained by a cooperative if the cooperative venture appears economically sound and/or can provide reliable securities.

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<sup>25</sup> Roy, p. 358.

<sup>26</sup> Roy, pp. 360 - 361

<sup>27</sup> Marshall and Godwin, p. 93.

Bonds may be sold by a cooperative as a means of securing capital in the form of a mortgage bond which is secured by assets, an income bond which is unsecured and represents a claim against earnings, or a debenture bond which is also unsecured but represents a claim against income and assets second only to a mortgage bond. Bonds sold by businesses which do not have experience and do not have a high net worth are often discounted or sold for less than face value. The result is a smaller return to the firm and a greater interest expense.

When a cooperative borrows against receivables the face value of the receivables is discounted to allow for probable uncollectable accounts and to return interest to the lender. Because of the nature of the cooperative and the low incomes of members it is likely that the discounts will be relatively large resulting in a high interest expense.

#### Federated Cooperatives and Associations

There are numerous federated cooperatives and cooperative associations to which an individual cooperative may belong and from which the local cooperative may be able to borrow funds for organization, operation, or expansion. Each federation or association has membership regulations which may include only certain types of local cooperatives and each also may stipulate the purposes for which credit may be used as well as required security or collateral. The local cooperative serves as a member of its association and is required to invest in or pay a membership fee to the association. The association is more likely to be sympathetic to credit needs of members and will often offer better terms than can be obtained from commercial sources. The individual cooperative should seek out federations and associations with which it might be

elegible for membership and should obtain memberships with one or more which have promise as a favorable credit source.

The Bank for Cooperatives is composed of twelve district banks and a central bank in Washington, D.C. It is a cooperative owned by co-operatives with membership restricted to farmer cooperatives only. Three types of loans are made including physical facility loans which are limited to 60% of the appraised value of the property, short or medium term operating loans and short term commodity loans which are secured by the commodity. Restrictions on loans are a limiting factor for limited resource cooperatives. The bank does not normally supply more than 50% of the total loan requested. The balance must come from other sources. Also the bank requires security on loans made.

The Federation of Southern Cooperatives is open to any cooperative in seventeen southern states in which it operates.<sup>28</sup> It was formed in 1967 by twenty-two limited resource cooperatives for the purposes of providing technical and financial assistance to member cooperatives. Financial resources are obtained from federal grants, annual dues from members, and contributions from foundations and individuals. While providing training for cooperative leaders and technical assistance to members FSC has also made some emergency loans to member cooperatives. However the primary financial objective of FSC is to serve as a clearing house by identifying sources of financial assistance and referring the member cooperative to the appropriate source.<sup>29</sup>

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<sup>28</sup> The states are Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, Texas, Virginia, and West Virginia.

<sup>29</sup> Marshall and Godwin, p. 42.

### Trade Credit

A cooperative can utilize trade credit as a source of short term operating capital by adopting the appropriate accounts payable and accounts receivable policies. By utilizing credit purchases to fullest extent, (i.e., maintaining a large accounts payable liability), and minimizing the accounts receivable current asset by requiring cash payments in advance or at time of sale, cash balances and current assets are maximized. It is possible that losses in patronage and/or cooperator dissatisfaction will be the result of a too diligent pursuit of this policy. Also overuse of available purchase credit may result in this credit being withdrawn in the future. The gain from the increase in liquid assets must be weighted against the risk of adverse reaction in order to determine the desirability of using this source of capital.

## SUMMARY

Proponents of cooperative actions by low-income individuals maintain that limited resource cooperatives can be a vital tool in socializing and politicizing economically alienated citizens by bringing them into the mainstream of economic activity. To do this the cooperatives for poor people must first be an economically viable organization and in turn economic success depends upon several factors, not the least of which is adequate capital resources.

Capital resources are needed for organizational expenses, to pay for fixed assets and long term commitments, and for operational expenses within the business cycle. Capital can be classified as either equity capital, owned by the organization, or as borrowed capital which comes from outside the cooperative and over which the cooperative has only limited discretionary control. Equity capital has the advantage of being relatively less expensive but borrowed capital increases total capital resources, leading to a wider range of options and opportunities for the cooperative.

Because of the nature of limited resource cooperatives and the lower economic status of members it is extremely difficult to acquire equity capital from within. Grants from government agencies, foundations, and private sources have been utilized by a few limited resource co-operatives but these sources are identified and utilized more by happenstance than by a systematic matching of available funds with objectives and needs.

Borrowed capital is also often difficult to find or to acquire. In general credit for cooperatives is fairly plentiful but is often restricted to a certain class such as rural cooperatives or farmer cooperatives or

acquisition is limited by collateral requirements which are difficult for the limited resource cooperative to meet.

In summary, only a limited number of capital sources are applicable to the needs of limited resource cooperatives and diligent efforts are required on the part of cooperative managers and members to identify and exploit them to their fullest potential.

#### Implications for Managers and Cooperative Members

Members of limited resource cooperatives are attacking the basic problem of creating wealth through more efficient economic activity. The most basic problem is often the most difficult to solve and acquiring capital for use of limited resource cooperatives in order to improve economic efficiency and generate wealth for members is no exception. For cooperators to accumulate inside capital and employ that capital profitably, they must be willing to use present savings and/or to withhold additional amounts from present consumption.

To acquire outside capital for use by the limited resource cooperative there are two basic steps to follow. A realistic determination of capital needs is of paramount importance and this must be an integral part of comprehensive short run and long run plans which also include goals, and methods of achieving those goals. When realistic goals and needs have been determined a search should be made of all possible government agencies, institutions, associations, and private sources which may be of assistance. Then the cooperative management must secure sufficient funds through a demonstration of ability and determination to make the best use of those funds.

### Implications for Concerned Parties and Policy Makers

In 1933 the Banks for Cooperatives were initiated by the federal government for the expressed purpose of providing credit to established farmer cooperatives which were having trouble obtaining credit from traditional sources. It was apparently felt at the time that farmer cooperatives were desirable economic organizations and were worthy of support when capital was otherwise unavailable. Those cooperatives which made use of their cooperative banks have generally prospered and they have become a very important part of their economic sphere. However economic conditions have changed and the character of limited resource cooperatives have changed in that they are no longer exclusively farmer cooperatives or rural cooperatives. As a result the Banks for Cooperatives do not operate in such a way that they meet the needs of emerging and struggling limited resource cooperatives.

If it is still felt that cooperatives can be a viable economic tool for raising the incomes of the poor and if it is felt that bringing the poor and alienated into the economic and social mainstream is a desirable accomplishment, then it would logically follow that some apparatus, perhaps patterned after the Banks for Cooperatives which have been so successful, should be organized and operated to provide adequate capital resources to the limited resource cooperatives. Marshall and Godwin in Cooperatives and Rural Poverty in the South advocate the creation of a federal rural development bank which would utilize a supervised credit approach to providing credit and technical assistance to cooperatives during the period of transformation from limited resource cooperatives to self-sufficient economic entities.<sup>30</sup>

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<sup>30</sup> Marshall and Godwin, p. 95.



Another approach to the scarce capital resources problem is a re-evaluation of credit policies of present government and private agencies to better meet the needs of the limited resource cooperatives. Since private or commercial credit agencies are unwilling to undertake greater risk it may be necessary for some federal agency to reduce the risks involved by undertaking greater activity in insuring or guaranteeing loans to cooperatives and in providing technical guidance to those cooperatives who utilize commercial credit.

The Farmers Home Administration has in the past had funds which were designated for use by limited resource cooperatives. However, the eligibility requirements were such that some cooperatives could not qualify for funds on the basis of low incomes of members even though a large share of the members did in fact have low incomes. The reason being that some members had incomes above a predetermined ceiling. Credit assistance was effectively denied to those who needed it because of a restrictive credit policy. A different interpretation of what constitutes a limited resource cooperative, to include those cooperatives with both low income members and higher income members, would extend coverage and make this type of program more effective.

Regardless of which approach or combination of methods are used to increase credit availability it does seem necessary to reinforce recommendations for cooperative group actions with access to sufficient resources in order that some level of success may be reasonably expected.

## APPENDIX

## COOPERATIVE ASSOCIATIONS, GOVERNMENT AGENCIES AND INSTITUTIONS:

## Sources of Information and Assistance

The following is a partial list of associations and agencies which have in the recent past provided funds and/or technical assistance to limited resource cooperatives. This list is intended to serve as an introduction to some of the many sources of assistance and it will, it is hoped, lead to more sources, and to sources of more specific information and assistance.

American Institute of Cooperation  
1129 20th St. N.W.  
Washington, D.C. 20036

Publishes an annual yearbook of current thinking regarding agricultural cooperatives, and booklets and pamphlets dealing with various aspects of cooperative organization, management, financing and cooperative activities.

Appalachian Regional Commission  
1666 Connecticut Ave., N.W.  
Washington, D.C. 20235

A regional development commission which has assisted in approaching the problems of limited resource cooperatives in the Appalachian region.

Central Bank for Cooperatives  
425 13th Street, N.W.  
Washington, D.C. 20044

A centralized banking facility for the 12 regional Banks for cooperatives which provide credit and credit supervision for member cooperatives. Request the name and location of the regional bank serving your area from the central bank.

Cooperative Institute Association  
4-E, Crescent Road  
Greenbelt, Maryland 20770

An Association of non-agricultural cooperatives providing educational and guidance materials.

The Cooperative League of the USA  
59 E. Van Buren Street  
Chicago, Illinois 60605

Makes available books and pamphlets on the various subjects of cooperative organization, management, and functions.

CUNA International, Inc.  
P.O. Box 431  
Madison, Wisconsin 53701

Publishes information regarding all aspects of credit unions.

Farm Credit Administration  
U.S. Department of Agriculture  
Washington, D.C. 20250

Bulletins available include subjects of finances and financial reports.

Farmers Cooperative Service  
U.S. Dept. of Agriculture  
Washington, D.C. 20250

FCS provides research, management, and educational assistance to cooperatives. Numerous publications are available covering all aspects of cooperatives. Request FCS information 4, "Lists of Publications".

Farmers Home Administration  
U.S. Department of Agriculture  
Washington, D.C. 20250

Financing and assistance available for purposes of housing for rural residents.

Federal Extension Service and State and County  
Cooperative Extension Services

Provides educational services and information to residents. Refer to the Cooperative Extension Service in your county for assistance.

The Federation of Southern Cooperatives  
52 Fairlie St. N.W.  
Atlanta, Georgia 30303

Information and assistance available on organizing and managing cooperative enterprise.

International Cooperative Training Center  
Room 603, 606 State Street  
Madison, Wisconsin 53703

Cooperative publications of international interest. Also conducts cooperative manager training seminars.

National Association of Housing Cooperatives  
1012 14th Street, N.W.  
Washington, D. C.

Publications available on various areas of cooperative interest.

National Council of Farmer Cooperatives  
1129 20th Street N.W.  
Washington, D.C. 20036

Current information regarding legislature developments on federal level which are of interest to cooperatives.

North American Student Cooperative Organization  
Room 2546, 515 E. Jefferson St.  
Ann Arbor, Michigan 48104

A Canadian and American federation of student cooperatives. Some materials available including a newsletter of a student cooperative developments.

Organization of the Cooperatives of America  
P.O. Box 686  
Rosevelt, Puerto Rico

Informational materials regarding cooperatives in Western Hemisphere are available in Spanish and English.

Plunkett Foundation for Cooperative Studies  
10 Doughty St.  
London, W.C.I., England

Publish an annual yearbook dealing with various topics of agricultural cooperation.

Small Business Administration  
Washington, D.C.

Printed materials, personal assistance and financial assistance to eligible applicants is offered to small business managers and entrepreneurs. Small Business Administration field offices are operated in 74 locations throughout the United States. For addresses and telephone numbers of field offices look under "United States Government" in telephone directory.

University Center for Cooperatives  
Lowell Hall, 610 Langdon St.  
Madison, Wisconsin, 53706

Maintains an extensive library of publications and documents on international and U.S. Cooperatives.

## GLOSSARY

Assets. Property and service rights held by a business in expectation of future value.

Capital. Financial and physical assets which are utilized in a business.

Capital Certificate. A certificate of recognition of capital contributed to a non-stock cooperative.

Common Stock. Certificates of membership which entitle the owner to voting rights in cooperative elections.

Cooperative. A business organized, managed, and controlled by persons who have a common need or interest. Cooperative enterprise is distinctive in that operations are accounted for at cost and limited returns are offered on investments but surplus (profits) are refunded to patrons who are members.

Cooperative Association. An association of cooperatives for purposes of mutual support. See also Federation.

Cooperator. A member patron of a cooperative.

Equity Capital. The portion of assets which is owned by the business.

Federation. Also federated cooperative. A cooperative whose member patrons are other cooperatives.

Fixed Capital. Capital resources which are committed for a period of time exceeding the length of the business cycle.

Liabilities. Claims against the assets of a cooperative.

Limited Resource Cooperative. A cooperative owned and managed by members with low incomes, ie those with limited resources.

Membership Certificate. A recognition of membership and voting rights in a non-stock cooperative.

Non-stock Cooperative. A cooperative which does not issue shares as recognition of ownership and/or investments.

Operating Capital. Capital resources used or committed to use for activity in present or immediate future periods.

Patronage. Financial support afforded a business by customers.

Patronage Refund. A return to a member patron of a pro rata share of the excess of revenues over costs, based upon the member patron's proportion of total business volume.

Preferred Stock. Stock shares issued in recognition of capital contributions. Do not invest voting rights in owner.

Reserves. Funds which are held by the cooperative for future use rather than distributed as patronage refunds.

Retained Earnings. Also retains, etc. See Reserves. Funds which are held by the cooperative as additional capital.

Share Capital. Capital resources acquired through the issuance of shares of stock.

Stock Cooperative. A cooperative which issues stock certificates as recognition of membership, ownership, and/or capital contributions.

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