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MEMBERS

MAKE

CO-OP^s



WORK



PREFACE

This publication is part of a series designed to visually present basic information about cooperatives. Illustrations have been created for easy conversion to 35mm slides or overhead transparencies.

The series consolidates and updates an initial group of highly illustrated publications developed by C. H. Kirkman, Jr., former cooperative education specialist and Gene Ingalsbe, former director of information, both now retired. Series content covers what a cooperative is and how one is organized, what functions cooperatives perform, and the responsibilities of key participants — members, employees, the manager, and directors.

This publication focuses on members. It covers who members are and what their responsibilities are as owners, with particular emphasis on control, financing, and patronage.

Cooperative Information Report 12
February 1993 Reprinted September 1997

MEMBERS MAKE CO-OPS WORK



cooperative is a distinct form of business recognized as part of our private enterprise system. A brief yet general definition is: A cooperative is a user-owned and democratically controlled business from which benefits are received in proportion to use.

Users of a cooperative have been called “members,” historically. Other terms include member-owner, member-patron, or stockholder. However, the latter term can confuse their unique role with that of a stockholder of an investor-oriented stock corporation. The only definition common to both is that the holder of stock has evidence of a capital investment in the organization. The fundamental and major difference is that benefits in a cooperative are distributed on the basis of use of the cooperative’s services rather than on the amount of stock held.

Members of a cooperative can be individuals, businesses, or other organizations. The basic requirement necessary to draw them together is a mutual interest that can be fulfilled by joining in a cooperative enterprise. In some cooperatives, however, a member must meet the legal requirements for membership as described in the cooperative’s bylaws, State statutes, and certain Federal laws. For example, a member of an agricultural cooperative must be a producer, and in some cases the producer of a specific commodity such as citrus fruit or cranberries.

A cooperative’s basic purpose is to fulfill the needs of its members. They are the owners. They must tell the cooperative what needs must be fulfilled, and tell the cooperative when those needs change. They must provide enough financing so the cooperative can meet their needs. They make certain, through elected and hired representatives, that the cooperative has the right management, personnel, facilities, and equipment. And, finally, members must do the most important thing for the cooperative to achieve its purpose—they must use it.

Summed up, members make co-ops work, by exercising their responsibilities of ownership, control, financing, and patronage.

EXERCISING  **OWNERSHIP** RESPONSIBILITIES

MAINTAINING  **CONTROL**

PROVIDING  **FINANCING**

USING  **PRODUCTS** &  **SERVICES**

OWNERSHIP



Members use a cooperative just as they do other businesses, so they recognize their user-relationship to their cooperative. But many lack understanding of their ownership relationship and their responsibilities associated with ownership. These responsibilities are far greater than owning shares of stock in an investor-oriented business to earn a return on that investment.

Cooperatives are created by and for members to serve their needs. As owners of a business, they have certain legal responsibilities. These include:

- *incorporating the cooperative initially as charter members;*
- *approving (and changing) articles of incorporation, bylaws, and major policies;*
- *signing marketing agreements and other binding contracts;*
- *electing directors who oversee management and give direction to their cooperative;*
- *voting on significant actions affecting their cooperative, such as major facility additions, mergers, or other asset changes, and if necessary dissolution; and*
- *ensuring that their cooperative adheres to general business laws and those unique to cooperatives, such as taxation.*

Most cooperatives are incorporated and, therefore, give members limited liability protection. Even though this protection means their maximum loss from cooperative failure is only the capital they've invested in the cooperative, inattention to their ownership responsibilities can often adversely affect the value of the cooperative to them as users. For example, capital used to defend the cooperative because of a lawsuit or fines for violating regulations is money that could have been used to enhance the ability of the cooperative to serve its members.

A member may have many "partners" in cooperative ownership, but each member should recognize the importance of associated legal responsibilities as though he or she were the sole owner.

CO-OP OWNERS' LEGAL RESPONSIBILITIES INCLUDE. . .

INC  RP  RATING

APPRO  ING LEGAL DOCUMENTS

ELECT  NG DIRECTORS

MAKING MAJOR DECISI  NS

OWNERSHIP, continued



cooperative's existence and its degree of success depend largely on how well members understand what it is and how it operates. Understanding the cooperative as an owner enables the member to make business decisions, either directly or through elected representatives, that produce benefits to the member as a user.

People who spend money for many products, particularly expensive ones, expect them to come with an "owner's manual" so they can understand how the product works and how they can best use it. Similarly, members should expect their cooperative to give them an "ownership manual." Content should include the:

- *definition of a cooperative, and an explanation of its unique principles and practices;*
- *history of when and how the cooperative got started;*
- *mission statement;*
- *articles of incorporation and bylaws;*
- *organization and staffing;*
- *Products handled and services offered; and*
- *operating policies.*

Members who understand their cooperative likely will have fewer questions or complaints. When they do, they will know better how to go about getting their concerns resolved. Good understanding of their cooperative also enables members to offer constructive criticism and suggestions and to make enlightened decisions affecting the cooperative's future.

OWNERSHIP REQUIRES MEMBERS TO UNDERSTAND THE CO-OP'S:

(**dĕf • i • nish • un**)



Legal Documents

PR  **DUCTS & P**  **LICIES**

CO-OP



CO-OP



MEMBERS = MAGE

MEMBERS HAVE A RESPONSIBILITY TO:

PARTICIPATE IN

- PROMOTE**
- EXPLAIN**
- DEFEND**
- CORRECT**

THE CO-OP

CONTROL

Owning a cooperative doesn't necessarily mean members control the cooperative. They have several ways to exercise control. Some control measures are "set in concrete" in the form of legal documents that cannot be changed without their approval. Others can be delegated, while some can be lost through apathy or failure to exercise their financial responsibilities.

Members shape the legal framework for the cooperative in the articles of incorporation and the bylaws. The board of directors and hired management must legally abide by the provisions of these documents. Only the membership can change the documents.

Articles of incorporation describe in broad terms the type and purpose of the cooperative and the scope of business. The articles include the cooperative's name, place of business, capital structure, names of incorporators, and other general information.

Bylaws describe how the cooperative is organized and how it will operate. Major provisions include qualifications for membership, duties of officers and directors, meeting and voting procedures, raising and paying back member capital, and procedures and rights in case of dissolution.

Two other basic control documents are the membership application and marketing agreement.

The most numerous and specific control measures are contained in the cooperative's policies. These policies reflect the cooperative's operating philosophy and serve as a guide for actions it will take to fulfill its mission. Members delegate the responsibility for development, review, and change of policies largely to the board of directors. Policies cover topics such as employee conduct and work rules, office hours, board/manager functions, member credit, safety, risk management, public relations, and any other topic deemed important for harmonious and successful conduct of the cooperative's business.

Articles of Incorporation

BYLAWS

Memberships
Applications

AND/OR

**Marketing
Agreement**

Policies

CONTROL, continued



With the legal document framework and policies in place, members control the continuing operations of their cooperative through a board of directors. Electing this leadership group from among themselves is members' most important responsibility. The board, typically seven to nine individuals, provides overall policy direction, monitors and evaluates cooperative performance, and plans for the future.

In selecting board candidates, members look for individuals who are active in cooperative affairs, exhibit good business judgment and character, are able to communicate, and are willing to take the time to be an effective board member. Directors are elected democratically, usually with each member having one vote. Occasionally, proportional voting based on volume of business is used but with a vote maximum specified in the bylaws to preserve governance by majority.

Members delegate critical control responsibility to the board of directors. This governing body is charged with:

- *preserving the cooperative character as set forth in legal documents and State and Federal statutes and regulations;*
- *hiring a manager to direct day-to-day operations;*
- *safeguarding members' assets with prudent oversight and decisionmaking;*
- *developing and maintaining relevant policies;*
- *determining equitable distribution of benefits produced by cooperative operations; and*
- *planning for the future so the cooperative continues to fulfill member needs.*

Members place the health of their cooperative in the hands of the board of directors. They control that leadership group through the democratic election process, affirming performance by re-electing directors or seeking improvements by electing new board members.

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THE 
BOARD
OF
DIRECTORS. . .



PRESERVES CO-OP CHARACTER



SAFEGUARDS ASSETS



HIRES MANAGER



SETS POLICIES



PLANS FOR THE FUTURE

CONTROL, continued

People who make the decisions control an organization. It's that simple. They may not even be the owners. Members control their cooperative by making decisions themselves, or delegating decisionmaking to others while holding them accountable.

But decisionmaking is more than just casting a vote. That's only the end result. Decisionmaking involves the entire process of collecting information and opinions, analyzing alternatives and courses of action, and then selecting and implementing the best alternative. Whether the process is formal or informal, members are exercising a form of control by participating. If they don't, someone else will decide for them.

Formal decisionmaking usually takes place at the annual meeting and is illustrated by nominating and electing directors, amending the bylaws, accepting the audit report, voting on major actions or policies proposed by the cooperative's board and operating management, and voting on resolutions and motions.

Participating in decisionmaking informally includes serving on various advisory committees, taking on special assignments, expressing opinions in discussions with other members or directors, or providing feedback to employees and management. Taking the time to respond to surveys seeking attitudes and assessments, product and service evaluations, buying and marketing intentions, and other information on how needs are changing is critical and helps board and operating management keep the cooperative focused on serving member needs.

Members' continual involvement in this decisionmaking process is how they maintain control of their cooperative's scope, direction, and orientation.

MEMBERS CONTROL THE CO-OP BY...

VOTING
EXPRESSING OPINIONS
SERVING ON COMMITTEES

FINANCE



cooperative idea doesn't have a chance of becoming a cooperative business until it passes the "pocket book" test. That means prospective members are willing to risk their own money in the business venture. Their financial commitment needs to be large enough so they have a continuing concern about how their invested money is being managed and, therefore, will be motivated to carry out the responsibilities of ownership.

The amount of startup capital needed is determined as part of the organizing process based on economic feasibility studies and financial cost analyses. In other words, organizers have determined the size of cooperative business that could fulfill prospective members' needs and they have determined the cost to open for business. Startup costs include legal fees, facilities and equipment, inventory, salaries of manager and staff, insurance, office furniture, and various administrative supplies.

Depending on the type of cooperative, initial capital contributions may take the form of a flat membership fee or, more appropriately, an amount based on their estimated use of the cooperative. Members' upfront investment becomes part of their equity (ownership) capital account. Though members do not need to finance the entire startup cost, their investment must be significant enough for other lending sources, such as banks for cooperatives, credit unions, or local commercial banks, to also risk investing money in the venture.

Members invest in a cooperative to fulfill a need, rather than just to earn a monetary return on their investment. That need may be providing services, purchasing goods or supplies, or marketing products. Consequently, members often elect not to receive interest — or perhaps only a nominal amount — while their money is being used in the cooperative. Their "payment" for the use of their equity capital comes from the marketing-purchasing-service benefits the cooperative provides.

MEMBER INVESTMENTS START THE CO-OP, AND THIS EQUITY. . .

ENSURES MEMBER **COMMI+MEN+**

HELPS PAY **STAR+-UP COST+S**

A++RAC+S LENDERS

FINANCE, continued

The age-old business axiom is that it takes money to make money. So after having provided capital to get the cooperative started, members have a continuing responsibility to provide funds to keep the business operating. These funds are called operating capital.

Many of the startup costs continue on a frequent basis, such as salaries, utilities, and inventory. Other costs are long term and need to be considered in advance, such as replacing vehicles and equipment, remodeling plants, or expanding with new facilities. And it's sound business management to set aside a reserve fund for bad debts or other unexpected events that could adversely affect the cooperative.

Operating capital is provided several ways, voluntarily or as a condition of membership:

- **Capital investment**—Some members, either at startup or later, may be willing to provide capital above their fair share. Though they do not gain additional voting rights, they do receive a certificate as evidence of their investment and are paid interest for the use of their money.
- **Deferred patronage refund**—At the end of the year when members receive a patronage refund based on their share of the cooperative's net income, they re-invest a certain percent of their refund as determined by the board of directors. However, Federal tax law requires that at least 20 percent of the refund must be paid to members in cash to help them meet the tax liability they incur on the total refund. Deferred patronage is revolved back to members over a period of years.
- **Per-unit retain**—Members use this method to invest each time they do business. The cooperative retains a specified amount per physical unit—pounds, bushels, cartons, etc.—involved in the transaction. Retains are also revolved back to members over time.
- **Base capital**—Members contribute capital according to their use of facilities and service, with adjustments made from time to time. The level of obligated financing is set by the board of directors each year, with any excess returned to members.

OPERATING CAPITAL PROVIDED BY . . .



FINANCE, continued



ontrol follows finance. Those three words explain the importance of members' responsibility to finance their cooperative. Further, they should provide financing in proportion to their use of the cooperative.

A desirable goal is to have members contributing equity capital amounting to a majority of total capital requirements. Then with a good business plan, they can usually attract others to lend the cooperative additional money, called debt capital. Providers of debt capital include members, credit unions, banks for cooperatives, and commercial banks.

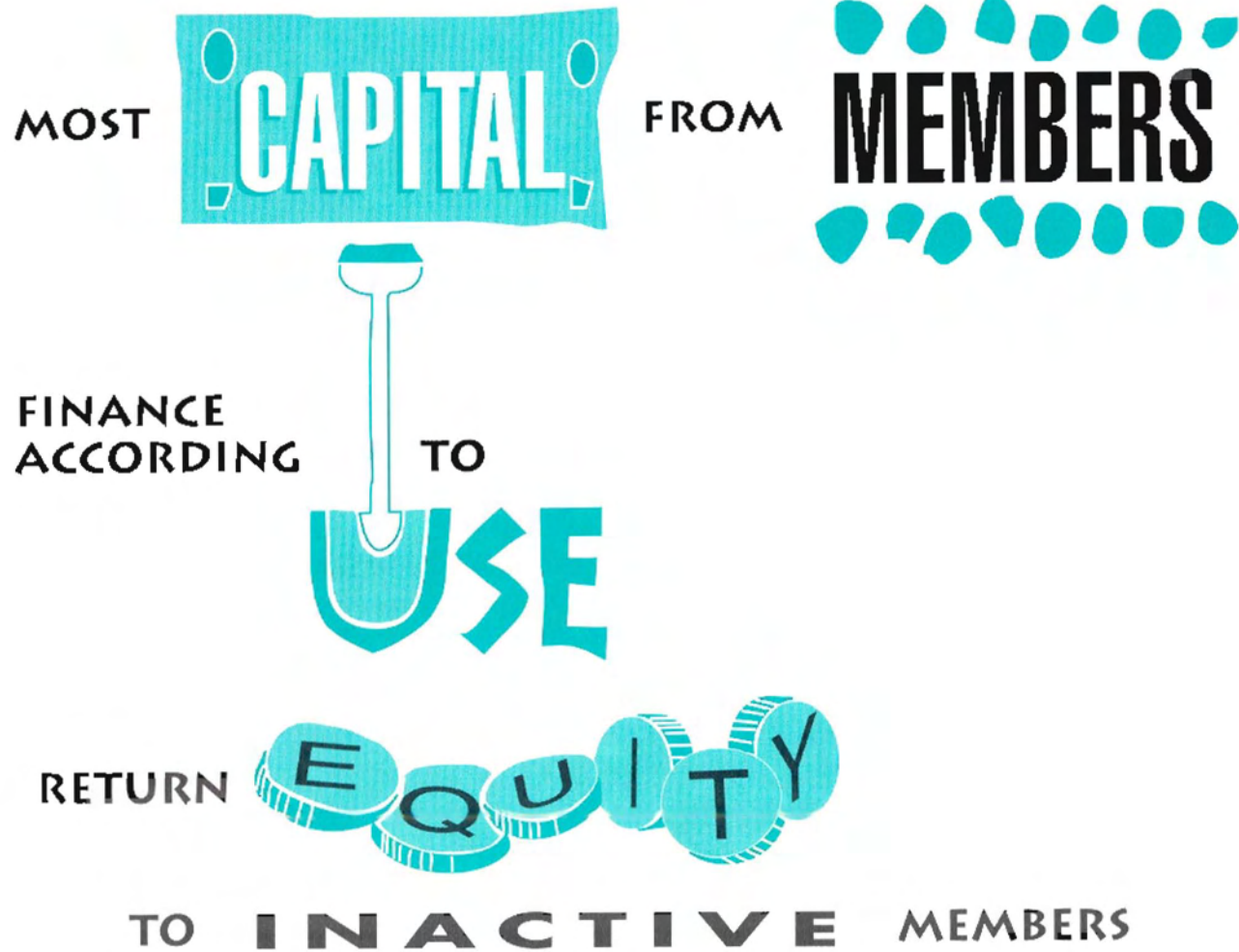
Debt capital helps members pay for high-cost items such as land, buildings, and equipment. Other uses are to supplement operating capital when a cooperative experiences seasonal highs in labor costs, purchasing supplies, or paying members for products at harvest time.

Members may hold the right to mark a ballot that elects leadership or approves major actions in a cooperative, but providers of financing have veto power with their decision of whether to lend money or they may heavily influence how their money is to be used. At the extreme, if lenders have justified doubts on whether their loans will be repaid, they can force the cooperative into bankruptcy.

Conflicts of interest can occur within the cooperative unless financing is largely provided by active member-users. Otherwise, former and long-time members may pressure the board to allocate funds to redeem old equity while current members want more money invested in new facilities and better services. Other members, perhaps new and as yet having little invested, may be pushing for higher cash patronage refunds. Though the board of directors must resolve these divergent interests democratically, the principal decision factor likely will be that control follows finance.

Financing provided by active member-users results in a membership more likely to have common interests and objectives.

MEMBERS CONTROL THE CO-OP THROUGH FINANCING:



PATRONAGE

Using the cooperative is members' easiest responsibility to carry out, and use is critically important. Their patronage makes the cooperative work as a business. Using their cooperative is essential, also, toward fulfilling their responsibilities of ownership, financing, and control.

By using the cooperative as much as they can, members help the cooperative directly to succeed as a business in several ways:

- *A certain amount of business is needed just to cover the cost of opening the doors each day, such as costs for maintaining buildings and equipment, utilities, and salaries. Greater volume reduces these costs per unit of sale. Plants can operate closer to capacity. Equipment and employees can be more productive. All together, the cooperative is able to generate more income above costs and return patronage refunds to members at the end of the cooperative's business year.*
- *Using the cooperative helps provide the financing to keep it operating and growing as needed. Regardless of the method of member financing, the financing is provided on the basis of the member's use of the cooperative.*
- *Using the cooperative is how members gain the benefits they sought when they formed the cooperative in the first place. And the more they use the cooperative, the more they benefit from it.*

Maximum use helps the cooperative, and ultimately members, indirectly as well. The stronger the cooperative is, the more competitive it can be in the marketplace. The cooperative may be able to influence suppliers to provide products or services specialized to members' needs. And the cooperative may be able to reach markets unavailable to members acting individually. A prosperous cooperative with the solid support of its members often results in the cooperative's being recognized as a business leader in its community or industry.

Summed up, a cooperative can accomplish something members cannot achieve acting individually, but what it can accomplish depends directly on how much members use it.

USING THE CO-OP IS ESSENTIAL TO . . .

ACHIEVE  SUCCESS

FULFILL MEMBER 

PRODUCE 

PATRONAGE, continued

Economic benefits members gain from owning a cooperative can be as obvious as cash in hand, or so difficult to measure that their value could be realized only after the cooperative ceased to exist.

The range and importance of benefits will be determined by the type of cooperative and its purpose. A cooperative providing services to members as individuals, such as a daycare nursery or credit union, would have benefits somewhat different from the following benefits of a cooperative owned by members to support their farm or other business:

Bargaining power greater than acting alone when dealing with buyers and sellers;

Extended control, through ownership of the cooperative, over factors affecting the farm or other business, such as supplies purchased and products marketed;

More dependable sources of quality production supplies and services through influence with suppliers or negotiated specifications with manufacturers;

Lower costs through volume buying and selling;

Broader access to markets through volume selling or meeting needs of specialized markets;

Higher returns from lowering operating costs, adding value through further processing, and improving market access; and

Accumulation of assets as represented by investments in the cooperative over time and paid back according to provisions in the cooperative's bylaws.

While members should expect their cooperative to achieve respectable net income each year, they should realize that the "bottom line" on the statement of operations may be only the "tip of the iceberg" in terms of the cooperative's total value to them.

USING THE CO-OP PRODUCES ECONOMIC BENEFITS:



BARGAINING POWER

EXTENDED CONTROL

MORE **DEPENDABLE** SOURCES

LOWER COSTS

BROADER ACCESS TO MARKETS

HIGHER RETURNS

A CCUMULATION OF ASSETS

SUMMARY

The cooperative form of business is available to any group of individuals who have mutual interests and who could gain mutual benefits by uniting their efforts. As a business, the cooperative needs effective operating management, a visionary board of directors, and supportive members who recognize their responsibilities as owners.

Members carry out their responsibilities to finance, control, and use their cooperative to gain the economic benefits they sought in organizing the cooperative. In taking an active ownership role by expressing their views and needs, participating in decisionmaking, and evaluating how well the cooperative is performing, they gain other benefits as well.

They get a well-rounded business education. They learn what is necessary for a business to be successful. They learn what benefits can be gained by working together.

Members gain valuable leadership training. Expressing their views in various meetings, participating on committees, serving on the board of directors, speaking in behalf of the cooperative—these experiences are transferable to other personal and business pursuits.

Participation in cooperative business affairs can add to a member's personal stature in the community, in the industry in which the cooperative operates, and in governmental affairs affecting the cooperative's business climate.

All in all, sharing in the ownership of a cooperative business can give a member a well-earned sense of achievement.



**CO-OP OWNERSHIP BRINGS
A SENSE OF ACHIEVEMENT**

INFORMATION



Rural Business-Cooperative Service (RBS) in the U.S. Department of Agriculture has much more information that focuses on member roles and responsibilities in a cooperative.

RBS conducts research, collects statistics, provides onsite technical assistance, and develops educational materials. RBS helps farmers and other rural residents organize cooperatives and provides continuing assistance as needed. It develops both general and specific educational materials on cooperative organization and operation. Periodically, the staff conducts workshops for key participants in new cooperatives. RBS publishes *Rural Cooperatives*, a bimonthly magazine oriented to the cooperative business community.

A catalog, *Rural Cooperative Publications*, Cooperative Information Report 4, lists about 150 titles on cooperatives. A few other publications particularly valuable to members include:

- Cooperative Benefits and Limitations, CIR 1, Section 3
- Cooperative Member Responsibility and Control, CIR 1, Section 7
- Equity Redemption Guide, CIR 31
- Keeping Cooperative Membership Roles Current, CIR 37
- Cooperatives in Agribusiness, CIR 5
- What Are Patronage Refunds?, CIR 9
- What Co-op Directors Do, CIR 14
- Working with Financial Statements: Guide for Cooperative Members, CIR 43
- How to Start a Cooperative, CIR 7
- Income Tax Treatment of Cooperatives, CIR 44, Parts 1-4
- Co-ops 101: An Introduction to Cooperatives, CIR 55

**U.S. Department of Agriculture
Rural Business-Cooperative Service
1400 Independence Ave., SW, Stop 3257
Washington, D.C. 20250-3257**

Rural Business-Cooperative Service (RBS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The cooperative segment of RBS (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs. RBS also publishes research and educational materials and issues Rural Cooperatives magazine.

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