

WHAT

ARE

COOPERATIVES



PREFACE

This updated publication by Galen Rapp, Program Leader, Education/Member Relations (RBCDS-CS) is part of a series designed to visually present basic information about cooperatives. Illustrations are created for easy conversion to 35mm slides or overhead transparencies. This is part of a series of publications that focus on cooperatives—what they are, how they function, and the responsibilities of key participants: members, employees, the manager, and the board of directors.

The series consolidates and updates an initial group of illustrated publications developed by C.H. Kirkman, Jr., former cooperative education specialist, and Gene Ingalsbe, former director of information. Both are now retired.

The publication focuses on cooperatives—what they are, their basic functions and how they are organized.

Cooperative Information Report 10
Revised March 1995

CIR 10, What Are Cooperatives?

WHAT ARE COOPERATIVES?

There are many ways to conduct business in the United States. On Main Street USA, the businesses have different names, different products, and different services. People can buy, sell, trade, borrow, insure, and conduct all kinds of business transactions. But, each business may differ based on:

- who owns the business,
- who controls the business,
- who buys from the business, and
- who gets the profit.

There are three basic business types:

A proprietorship owned by one person who operates, manages, and receives the profits. This is the simplest and oldest business type.

A partnership owned by two or more people who share proportionally in the risks, management, and the profits.

A corporation of which there are two types, general and cooperative. Both usually have multiple owners, offer goods and services to customers, and use sound financial practices. They operate under State-granted articles of incorporation. Policy is set by a board of directors, while day-to-day business operations are the responsibility of a hired manager.

Most corporations are general corporations such as IBM, General Motors, Xerox, and Wal-mart.

THERE ARE THREE BASIC BUSINESS TYPES:



WHAT ARE COOPERATIVES?, continued

 cooperative corporations have familiar names too, such as Sunkist, Ocean Spray, and Land O'Lakes. But they are different than general corporations in their business purpose, ownership, control, and distribution of benefits. Three principles distinguish cooperatives from general corporations:

- user-owner,
- user-control, and
- user-benefits.

The user-owner principle means the people who use the cooperative own and finance the business. Cooperatives are financed by members purchasing stock, paying membership fees, or accepting self-imposed assessment on products purchased and/or sold or fees for services. In some cooperatives, members reinvest their earnings (profits) to capitalize the business.

User-control stems from the majority of the customers being members who are also responsible for selecting the members of the board of directors. As representatives of the members, the directors are responsible for setting policy and providing oversight on all the cooperative's business practices.

User-benefits explain that the cooperative's primary purpose is to provide and distribute benefits to members. Distribution of these benefits is based on members' use of the cooperative, not on the amount of capital they have invested. Benefits also include providing market access, providing needed services, or supplying "best-value" products.

A cooperative is thus a user owned and controlled business in which benefits are distributed according to a member's use of the association.

USER-**O**WNER



USER-**C**NTROL



USER-**B**ENEFITS



THE UNIQUENESS OF COOPERATIVES

One of the unique characteristics of a cooperative is the role of the users. Users include employees, individuals, or companies offering goods and services, directors, and customers, owners, patrons, and members. The last four are the most unique. They could be the same individual. Depending on orientation and purpose of the cooperative, the same individual could view his/her particular role in the cooperative differently. Understanding each of these roles will help you understand this unique characteristic of cooperatives.

Customers buy and sell through the cooperative or use its services. They expect to receive “best value” for the goods and services they purchase or high market value for the products they market.

Owners prefer limiting their initial investment in the cooperative and quickly recovering the additional money they invested to capitalize the cooperative. These investments are called members equity. Cooperative owners may also own and operate their own private businesses which need capital. Capitalizing the cooperative becomes a secondary priority.

Members maintain democratic control of the cooperative with their votes.

Patrons want adequate earnings (profits) so the cooperative can pay a higher portion of the earnings back in cash based on their purchases or volume marketed by the association. The earnings returned back to the members are called patronage refunds.

CUSTOMERS



OWNERS

PATRON



MEMBERS





CHALLENGE TO MANAGEMENT

The different needs of customers, members, patrons, and owners challenges the cooperative's board of directors and manager to make good business decisions. Business earnings of the cooperative must be great enough to systematically rotate the investment of members, pay patronage, and offer goods and services at reasonable prices or pay fair market value for customers' products. This unique business structure dictates that the manager, board of directors, and members understand the business and cooperative structure.

CHALLENGE TO

MANAGEMENT:

TO MAKE GOOD

BUSINESS DECISIONS



TYPES OF COOPERATIVES

There are over 40,000 cooperatives in the United States. One of every four U.S. citizens belongs to at least one cooperative. Cooperatives provide housing, health care, and electrical, telephone, and electronic services. Members use purchasing cooperatives to buy food, consumer goods, and business, and production supplies. They provide transportation, credit, housing, recreational equipment, and facilities. Cooperatives also market and process members' products.

TYPES OF COOPERATIVES



COOPERATIVE OBJECTIVES



Members have a range of objectives (*or reasons for starting*) cooperatives. Some cooperatives may provide multiple objectives for members while others are more specialized.

Regardless of the type, size, geographical location, or purpose, all cooperatives provide at least one of the following:

- **Improve bargaining power when dealing with other businesses**—combining the volume of several members leverages their position.
- **Reduce costs**—volume purchasing reduces the purchase price of needed supplies. Earnings of the cooperative returned to individual members lower their net costs.
- **Obtain products or services otherwise unavailable**—services or products that would not attract private business are often supplied by cooperatives.
- **Obtain market access or broaden market opportunities**—value added to products by processing. Offering larger quantities of an assured type and quality attracts more buyers.
- **Improve product or service quality**—value added to their products, competition, and improved facilities and equipment increase member satisfaction.
- **Increase income**—distribution of the cooperative's earnings boosts the income of members.



HOW TO START A COOPERATIVE

Starting a new cooperative takes energy and resources. By following a planned step-by-step procedure, the process can be completed in an efficient and timely manner. Because cooperatives are people-driven organizations, the first key to their success is to identify individuals with like needs who want to explore the feasibility of forming a cooperative business. Without this important first step, the chance for a successful cooperative business is slight.

The Starting Point

The original group of individuals are usually potential users of the cooperative. They often have leadership and organizational skills. They organize informational meetings for other potential users and discuss topics such as:

- how the proposed cooperative could meet identified needs,
- cooperative operational practices,
- advantages and disadvantages of the cooperative business structure,
- member investment and financial requirements, and
- member commitment needed.

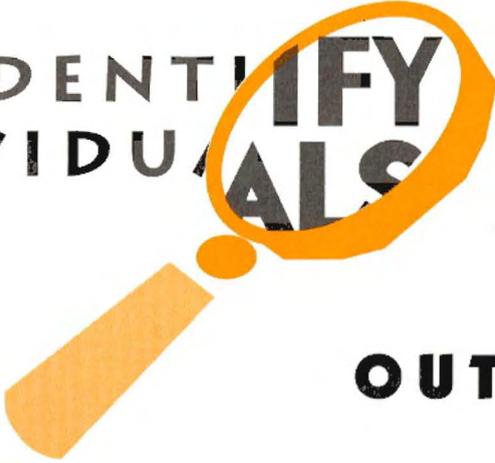
Using Outside Advisors

Use of outside advisors experienced in cooperative development work, legal, tax, and finance issues, and product experts may save the group from making expensive mistakes and losing valuable time.

Sources of competent outside advisors may be found in the Rural Business and Cooperative Development Service at State and national levels, land-grant universities, regional cooperative development centers, State extension services, State cooperative councils, and cooperative banks.



IDENTIFY
INDIVIDUALS

An orange magnifying glass icon with a wooden handle, focusing on the word 'INDIVIDUALS' in the text above.

OUTSIDE ADVISORS

An orange briefcase icon with a handle and a latch, positioned to the right of the text.

ORGANIZE

An orange icon representing an organizational chart, with a single person at the top and three people below, arranged in a pyramid structure.

TEN STEPS IN ORGANIZING A COOPERATIVE

Step One—Potential members meet to select a steering committee. If sufficient interest is generated, a steering committee is selected from the group. Although these six to eight individuals have no legal authority, they will be responsible for bringing the interests and concerns of the group to outside parties and meeting with resource people. The steering committee meets regularly and reports its activities and findings to the larger group. Leadership skills, sound business judgement, and a desire to reach decisions are valuable qualities for committee members.

Step Two—Conduct survey

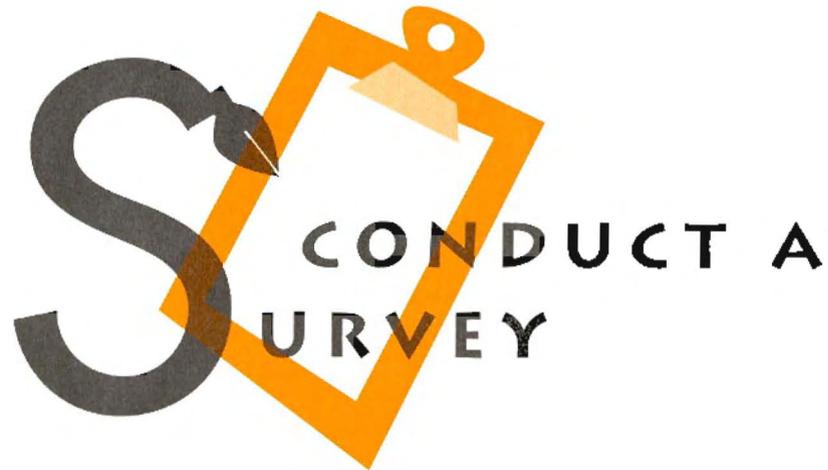
Under the guidance of the steering committee and resource persons, potential cooperative members are surveyed. Topics include:

- need for services,
- volumes to be purchased or marketed,
- willingness to join, finance, and use a cooperative, and
- use of and familiarity with cooperatives.

Step Three—Analyze the Market

When the analysis of markets and sources of supply and available services is completed, the findings are reported to the potential members. The potential members vote if they want to continue with the development. If a positive economic advantage is indicated, the committee's deliberations continue.

FORM A STEERING COMMITTEE





Step Four—Develop a Business Plan

A business plan is developed that emphasizes financial analysis. The proposed cooperative must be a financially sound business venture.

Components of the business plan include:

- capitalization supplied by members and loans,
- descriptions of facilities and equipment, and
- financial business projections such as fixed and variable operating costs, sources of income, and pro forma statements.

Step Five—Reconfirm commitment

Prospective members vote to reconfirm their commitment to continue development of a cooperative. Any changes in steering committee members may be made at this time.

Step Six—Develop legal documents

Under the guidance of professional advisors, the steering committee should draft legal documents for approval by prospective members. These documents are:

- articles of incorporation;
- bylaws;
- other legal documents.

Most cooperatives are incorporated in the State of their primary business operations. The articles of incorporation declare the cooperative's purpose. The bylaws provide instruction on how the cooperative will conduct its declared purpose. Other legal documents, such as membership applications and marketing agreements, are necessary to meet a cooperative's special needs.

**DEVELOP
A BUSINESS
PLAN**



RECONFIRM COMMITMENT



**DEVELOP
LEGAL
DOCUMENT**





Step Seven—Approve documents and elect a board

Conduct a charter membership meeting to adopt legal documents and elect a board of directors.

Step Eight—Implement the business plan

The board of directors is organized by electing officers and making committee appointments. A schedule is drawn for assigned committees and individuals to complete various tasks of the business plan. Arrangements are made to finance the business according to the business plan.

Step Nine—Hire a manager

One of the most important responsibilities of the board of directors is to hire a competent manager. The manager implements policies set by the board and oversees the day-to-day operations of the business.

Step Ten—Acquire facilities and begin operations

The directors must acquire the necessary facilities for business operations. Actual operations may begin after all facility transactions are completed and the manager has hired the needed complement of employees.



ELECT A BOARD

IMPLEMENT

A BUSINESS PLAN



BEGIN OPERATIONS



HIRE A MANAGER

SUMMARY



cooperative is a unique form of business used by people and businesses for their mutual benefit. Regardless of its purpose or membership, starting a cooperative requires considerable time, energy, commitment, and technical resources.

Recognition of a common need is fundamental to the formation and successful operation of a cooperative. Potential members must devote much time and energy to developing their new business. A cooperative requires member commitment to finance and use the business and select knowledgeable directors who hire a competent manager. A strategic business plan is important to harmonize all of the elements for the cooperative's success.

INFORMATION

U SDA's Rural Business and Cooperative Development Service has more information that focuses on what cooperatives are, their functions, and how they are organized. Cooperative Services conducts research, collects statistics, provides on-site technical assistance, and develops educational materials. It 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. Cooperative Services also publishes Farmer Cooperatives, a monthly magazine oriented to the cooperative business community. Other publications particularly valuable to members include:

Cooperative Benefits and Limitations, CIR 1, Section 3
Cooperative Member Responsibility and Control, CIR 1, Section 7
Cooperatives in Agribusiness, CIR 5
Organizations Serving Cooperatives, CIR 1, Section 5
How To Start a Cooperative, CIR 7
Co-op Marketing Agreements, RR 106
Cooperative Finance and Taxation, CIR 1, Section 9
Members Make Co-ops Go, CIR 12
What Co-op Directors Do, CIR 14
What the Co-op Manager Does, CIR 16
What Co-op Employees Do, CIR 18

To order these publications or for general information on cooperatives write:
USDA/RBCDS/Cooperative Services
Ag Box 3255
Washington, DC 20250-3255

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