

*Notheast Texas Initiative for  
Cooperative Development*  
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*Managing Cooperatives*

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*Seminar Series*

Ag Workshop Room, Room 149, Agricultural Sciences Building  
2600 South Neal Street, Commerce, TX 75428  
March 16<sup>th</sup>, 2013

# A Brief Introduction to Agricultural Cooperatives

EM 8665 • Revised March 2004



**OREGON STATE UNIVERSITY**  
**EXTENSION SERVICE**

Source: <http://extension.oregonstate.edu/catalog/pdf/em/em8665.pdf>

# *What is a Cooperative?*

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- It's owned and financed by its members, who are also its customers.
- Its purpose is to provide services to members at the lowest possible cost – not generate the highest possible return to investors.
- It is controlled by members, usually on a one-person, one-vote basis.
- Profits are distributed to members based on how much they use the cooperative, not on how much they've invested in it.

# *Why Do Something Cooperatively?*

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- Compelling needs may lead to forming an agricultural cooperative
  - Expand in existing markets
  - Develop new markets beyond the bargaining power or supply potential of your business
  - Need group effort to secure lower-cost inputs or larger quantities of inputs
  - Increase quality through joint efforts
  - Increase net income generated by your business

# *Similarities and differences to partnerships, corporations, and limited liability businesses*

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## **Similarities**

- Physical facilities, functions, and business practices may be identical
- Has articles of incorporation and bylaws that govern its actions
- Has board of directors and usually managed by professionals under policy set by the board

## **Differences**

- Cooperative's purpose, ownership, control, and distribution of benefits
- Intent is to provide services to its members (not to generate the highest possible return to investors)
- Net income usually is returned over time to its members based on the use
- Generally, democratic control
  - One-member, one-vote basis

# *Key People for Success*

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- Members, as users-owners, must be active
  - Participate in decision-making
  - Interested in affairs of the cooperative
  - Present ideas for improved performance
  - Promote the cooperative's use by others
- Members must be willing to make a capital investment in the cooperative
- The board of directors must provide leadership
- Good communication among board of directors, professional staff, and members is critical
- Well-educated and trained employees can improve member relations; enhance the cooperative's image with customers, vendors, and regulators; and increase the general public's understanding of the cooperative

# Avoiding Common Mistakes

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- Forming a cooperative will not automatically solve business problems faced by individual operations
- Cooperatives are subject to the same economic forces, legal restrictions, and interpersonal relations as other businesses
- A cooperative generally restricts the volume of product delivered from its members, but cannot control how much its members will produce
- It is challenging for a cooperative to pool the labor resources and machinery needed by its members during the production activities
- A cooperative may improve marketing practices, but generally doesn't eliminate marketing functions needed to move products to the consumers

# *Avoiding Common Mistakes*

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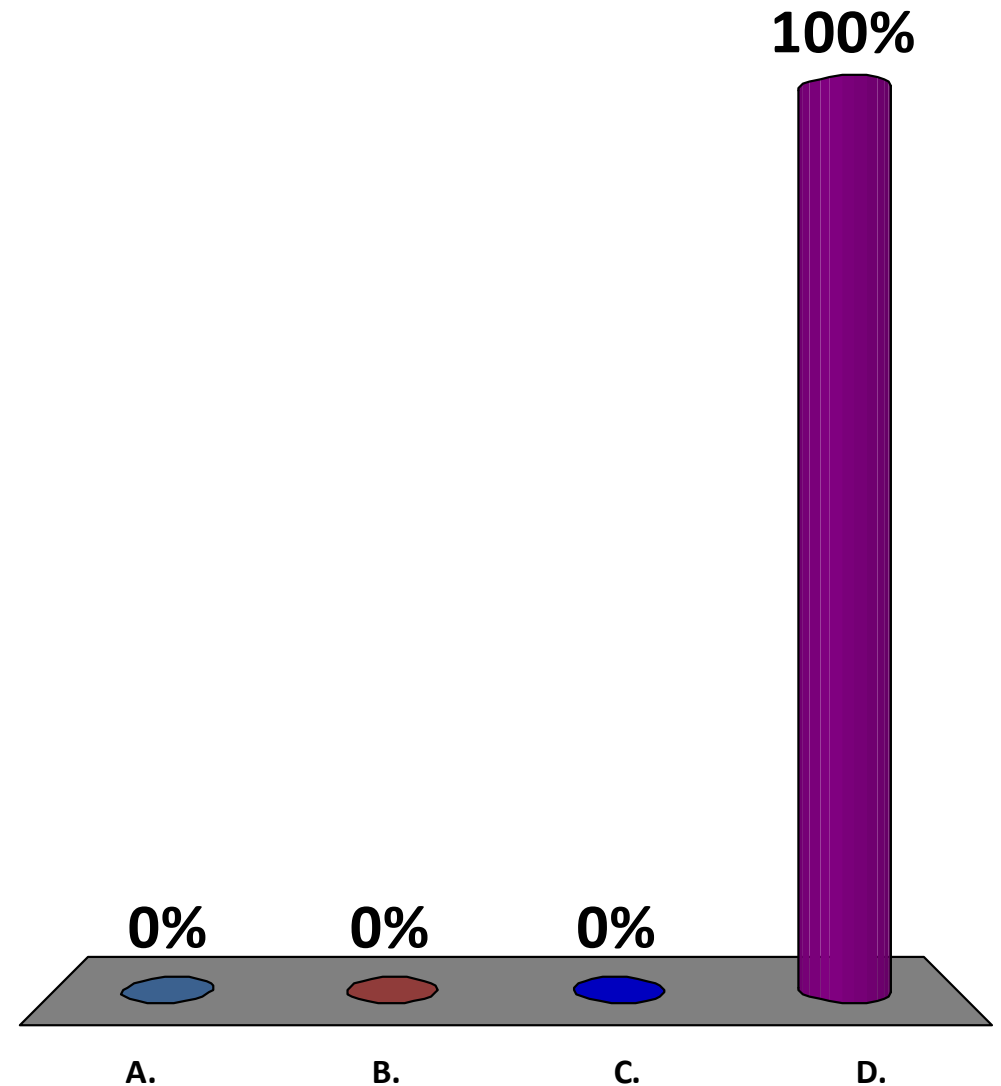
- Cooperatives cannot be expected to help members sell their surplus or poor-quality products
- Cooperatives cannot be expected to deliver supplies and services to its members at rock-bottom prices
- Be aware that additional problems may occur due to the fact that the cooperative is owned by many members



# Which of the Following can You Expect from a Marketing Cooperative?

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- A. To be able to control members' production
- B. To be able to raise prices for their products
- C. To be able to sell members surplus or poor-quality products
- D. None of the above



# *Making a Cooperative a Success*

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- At the beginning, seek professional advice for decision making
  - Managers, committee structures, experienced advisors, etc.
    - Seek members
    - Choose site and develop facilities
    - Devise legal structures
    - Acquire capital and finance operations
    - Enhance communication
- Timely decision making is critical
- Keep members informed and involved
  - May encourage members to invest time and money

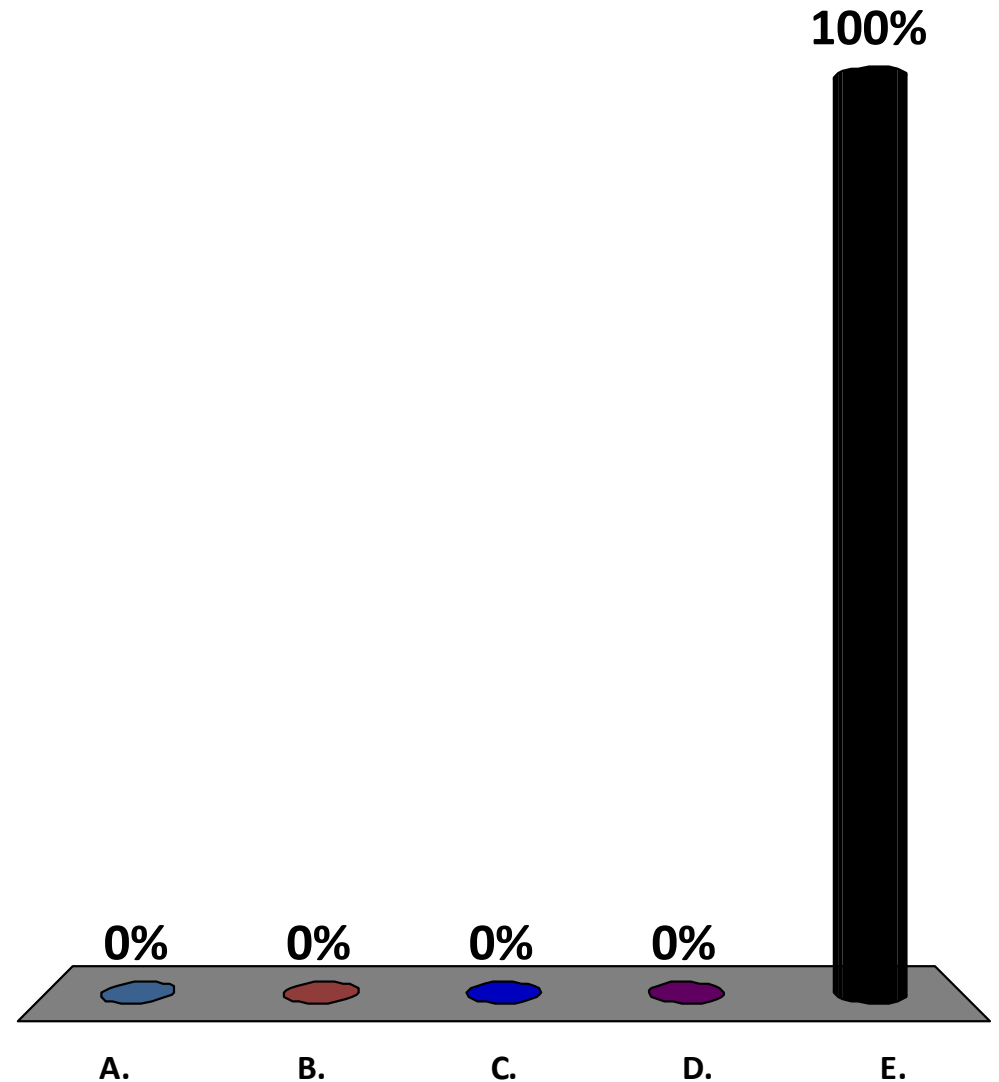
# *Making a Cooperative a Success*

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- Follow sound business practices
  - Developing an appropriate accounting system
  - Preparing operating budgets and financial reports
  - Conducting short- and long-term planning
- Conduct businesslike meetings
- Maintain a formal board/management working
- Continuing education is vital to the successful operation of a cooperative

# Which of the Following is Key to Success?

- A. Professional advisors
- B. Communicating with members
- C. A mindset that encourages sound business practices
- D. Conduct businesslike meetings
- E. All of the above



# *Underlying Principles of Cooperation*

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- Cooperatives are formed to do something better than individuals could do for themselves or through a noncooperative form of business
  - Develop power in order to sell products at higher prices
  - Enter new markets
  - Obtain or deliver inputs such as feed, seed, petroleum, and fertilizer more economically
- Acting together members can take advantage of economies of size or develop bargaining power
- Cooperatives attempts to fulfill member needs at the least possible cost.

# *Basic Principles Underlying Modern Cooperatives*

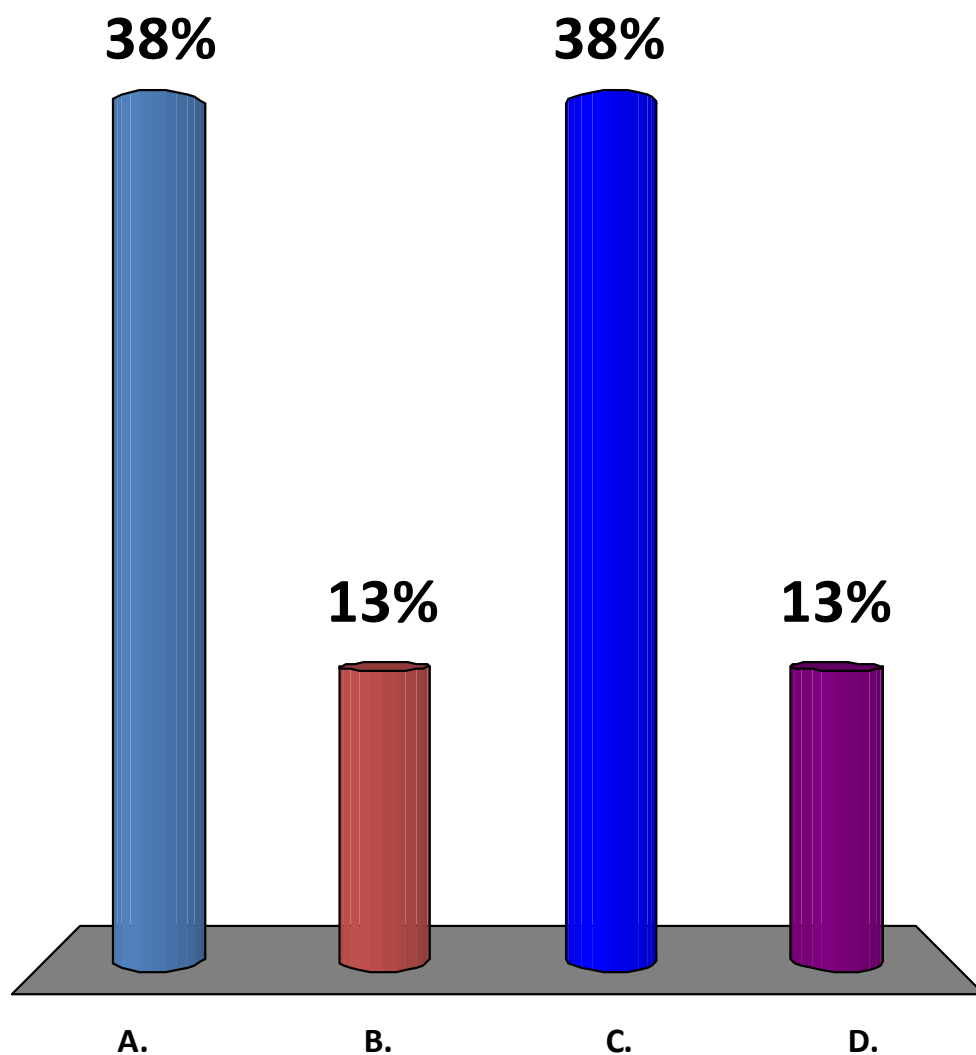
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- **The user-owned concept :** The users own and finance the cooperative.
- **The user-control concept:** The users control the cooperative.
- **The user-benefits concept:** A cooperative provides and distributes benefits to its users based on the amount of their use.

The \_\_\_\_\_ concept says that people who own and finance the cooperative should be its users.

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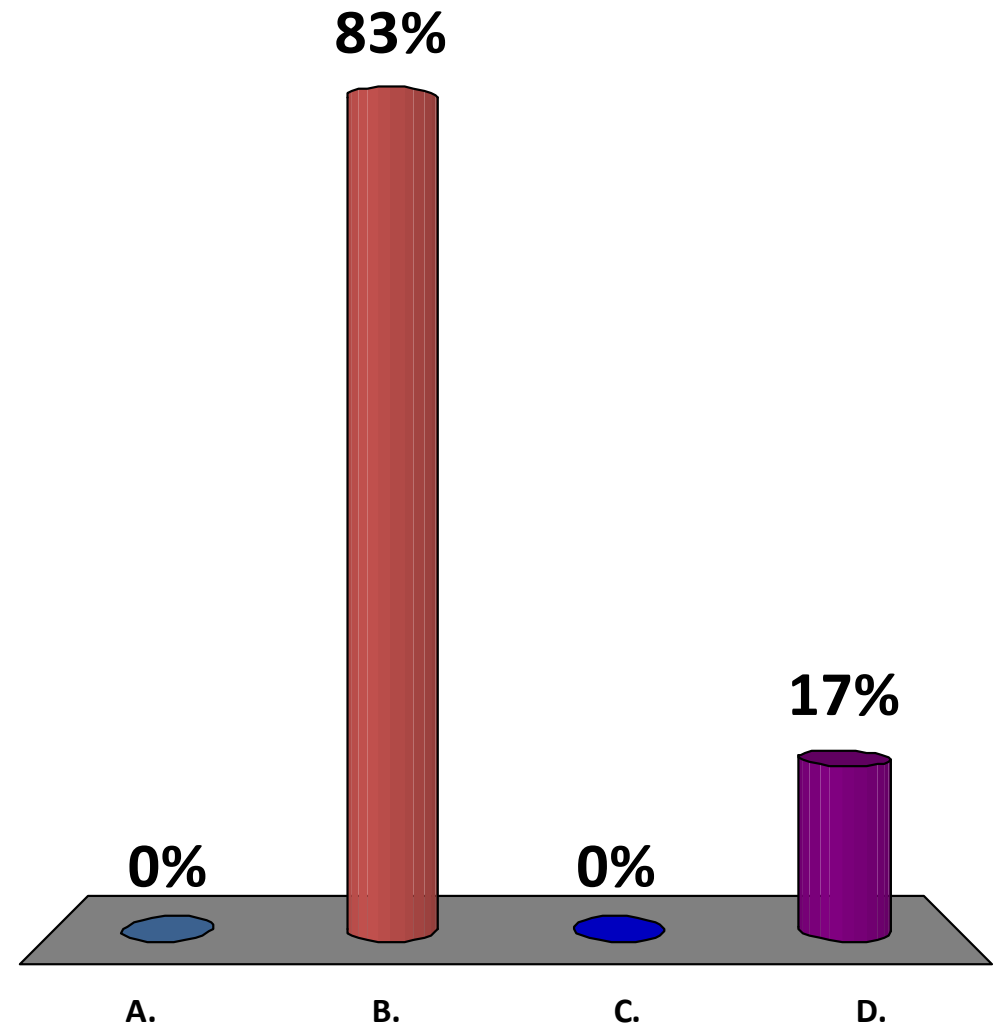
- A. User-control
- B. User-benefits
- C. User-owner
- D. None of the above



The \_\_\_\_\_ concept says that a cooperative distributes benefits to its users based on the amount of their use.

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- A. User-control
- B. User-benefits
- C. User-owner
- D. None of the above

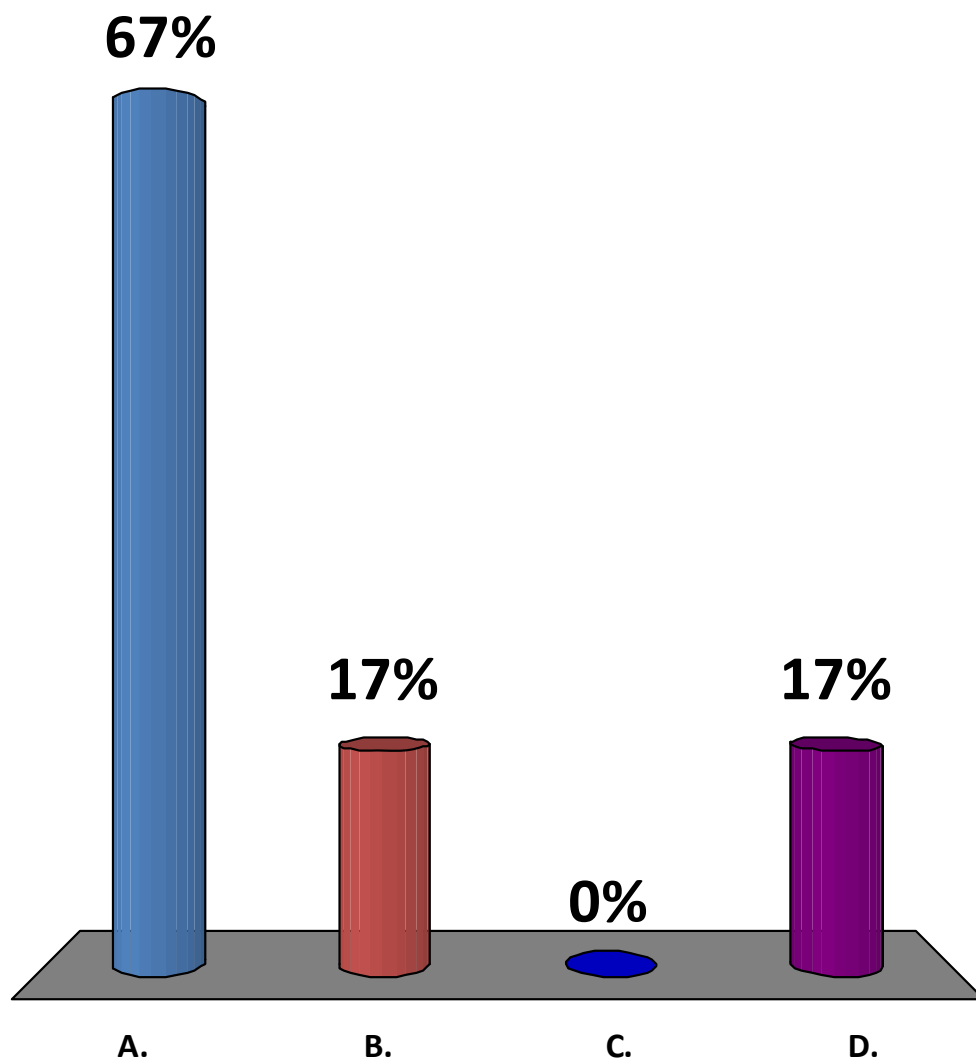




The \_\_\_\_\_ concept says that the controllers and users of a cooperative are one and the same.

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- A. User-control
- B. User-benefits
- C. User-owner
- D. None of the above



# *Direct and Indirect Benefits*

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## **Direct**

- Better assurance of supply sources
- Access to product markets

## **Indirect**

- Greater influence on input and output markets
- Increased business knowledge
- Participation in research and development activities

# *Access to Capital*

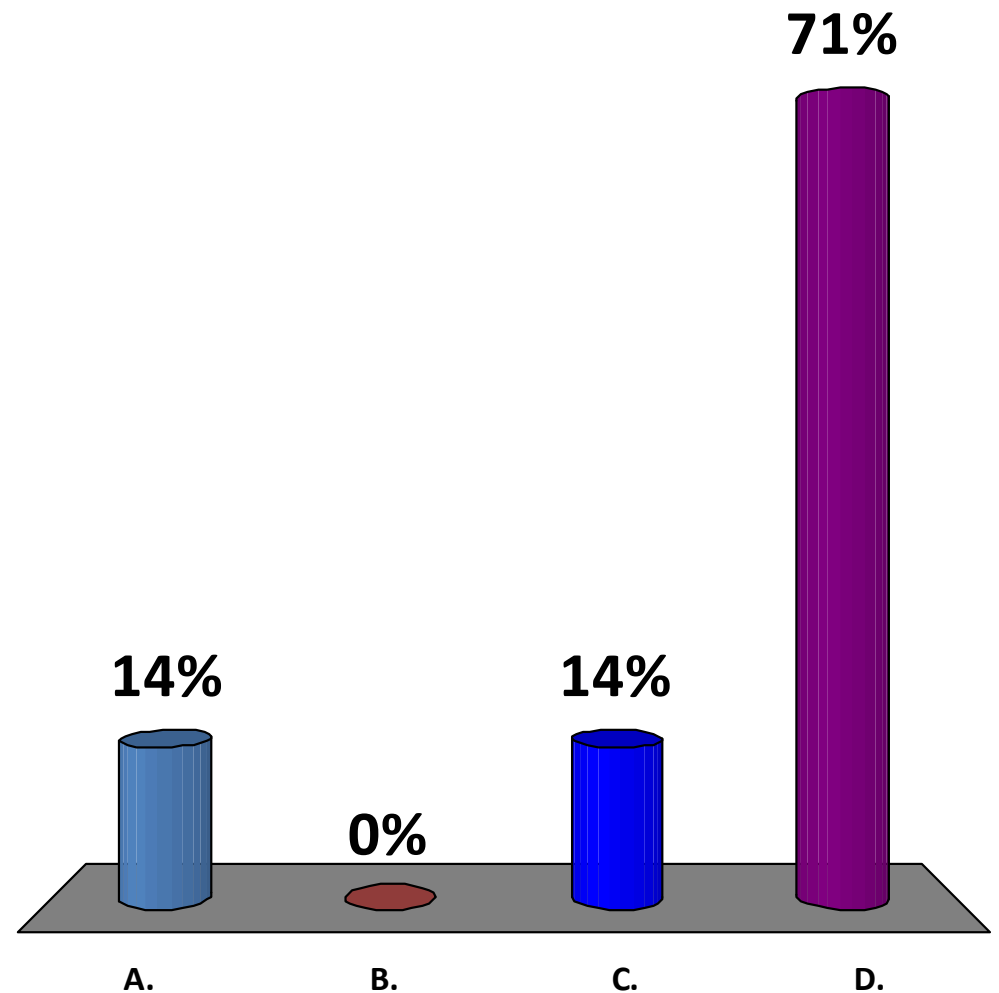
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1. Direct investments by members. For example, a condition for membership may be an initial fee, which may buy a stock or a certificate of membership.
2. Retaining a portion of the net income from its members rather than paying it out as patronage refund.
3. Create capital retains from earnings. Rather than paying back some net income to its members, it is paid as equity capital stock.

# Which of the following is NOT an option for a cooperative to acquire capital?

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- A. Conditioning new members to buy a stock to become a member
- B. Retaining some net income at the end of the year
- C. Giving stocks to members as net income
- D. Selling the cooperative's fixed assets



# *Typical Vs. Alternative Approaches*

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## **Typical**

- Cooperative sells a stock or a certificate of membership.
- Democratic control to decision making.
- Membership restricted to agricultural producers only.

## **Alternative**

- Cooperative sells “preferred-type stock”, which is sold primarily to nonmembers. It does not confer voting rights. Investors expect dividends to be paid on a regular basis.
- “User-benefit” approach to decision making.
- Membership restricted to “commercial” operators who produce goods or services for the Co-op economic gain.

# Common Cooperative Functions

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- Frequently, cooperatives are classified by the type of commodities they handle or the functions they perform.
- Marketing cooperatives
  - Ranging from helping members sell their products at the first-handler level, to processing, distributing, retailing, and exporting
  - Some perform limited activities but others assume responsibility for all marketing functions
- Supply cooperatives (also referred as purchasing cooperatives)
  - Supply a wide variety of farm supplies, equipment, and other products at reasonable prices to members
- Service cooperatives
  - Provide specialize services such as trucking, storage, drying, grinding, credit, utilities, insurance, etc.
- Other types of cooperatives
  - They may be involved in business activities as varied as general merchandise, medical services, utilities, or banking

## *Underlying Economic Principles that May Invite Creation of Cooperatives*

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- When a relatively large number of small producers face few large buyers, the buyers may pay less than competitive prices
- When a relatively large number of small producers face few large input providers, input providers may sell inputs above competitive prices
- Transportation costs may deter agricultural producers from looking outside their local areas for better commodity prices or input costs
  - Producers may find only one firm serving their selling or purchasing needs
  - Encourages high costs and low output prices for producers

# *Increasing Returns through Collective Action*

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- Economies of size
  - As the size of the operation increases, per-unit costs are expected to decrease
    - Fixed costs spread over a larger volume of goods
    - Labor-saving machinery and equipment through the operation of larger production and distribution facilities
  - At some point, however, per-unit costs are expected to increase, as inefficiencies associated with oversized facilities begin to occur
  - Cooperatives need to choose the optimal size that will bring the greatest return to its members



# *Increasing Returns through Collective Action*

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- Vertical integration
  - Higher returns may be obtained by collectively buying an existing business such as an input supplier or processor
- Market power
  - Gain market power through cooperative action
  - Higher returns may be obtained by assuring a source of supplies or market outlets
  - Negotiate terms of trade in favor of members

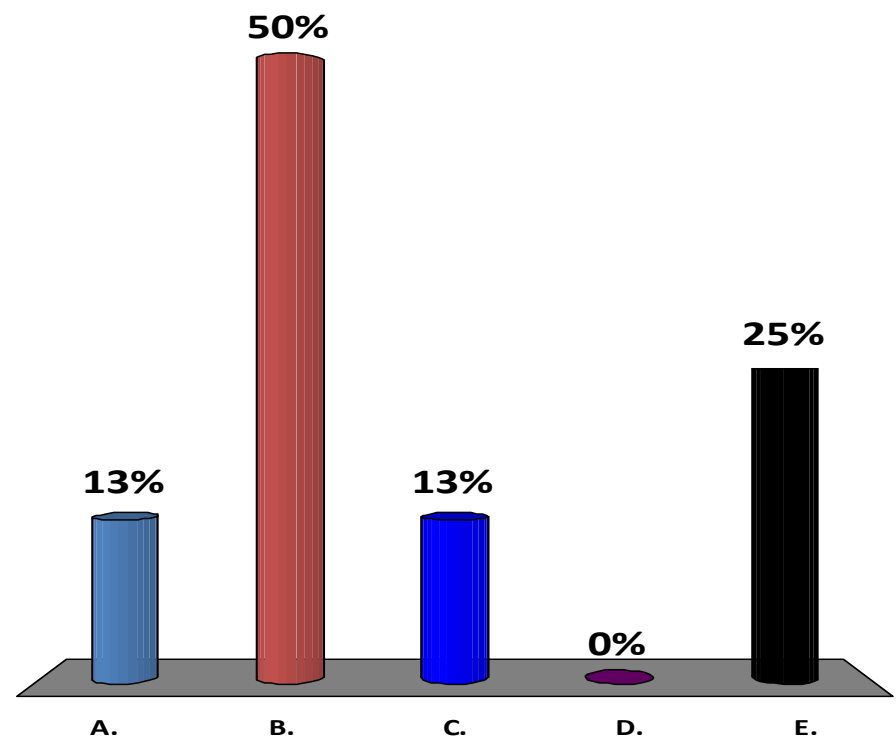
# *Increasing Returns through Collective Action*

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- **Coordination**
  - Potential for increased returns through coordination of supply, production, and marketing activities
  - Better communication between marketing and production units can reduce costs and improve product prices
  - Ensure quantity and quality of product needed to satisfy market demands
  - Transaction costs can be minimized or eliminated
- **Risk spreading**
  - Adverse market price or other conditions may be absorbed (averaged out) by pooling with other product lines that are not adversely affected

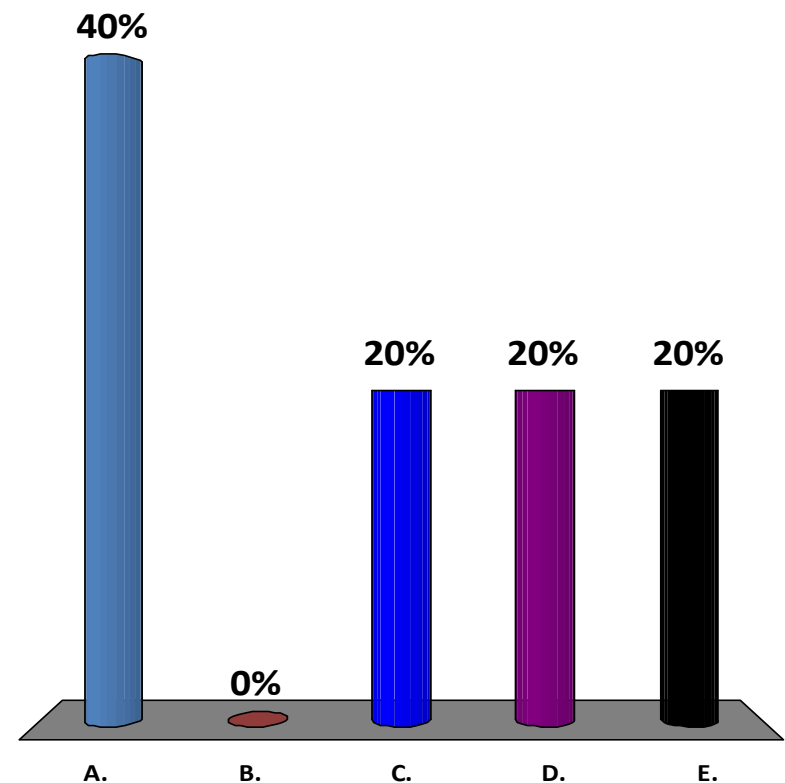
**Example:** A dairy cooperative that represents its members by bargaining for better milk prices at the first-handler level decides to buy a cheese manufacturing facility, creating a brand identity, and establishing a retail store. This is an example of increasing returns by \_\_\_\_\_.

- A. Economies of size
- B. Vertical integration
- C. Market power
- D. Coordination
- E. Risk spreading



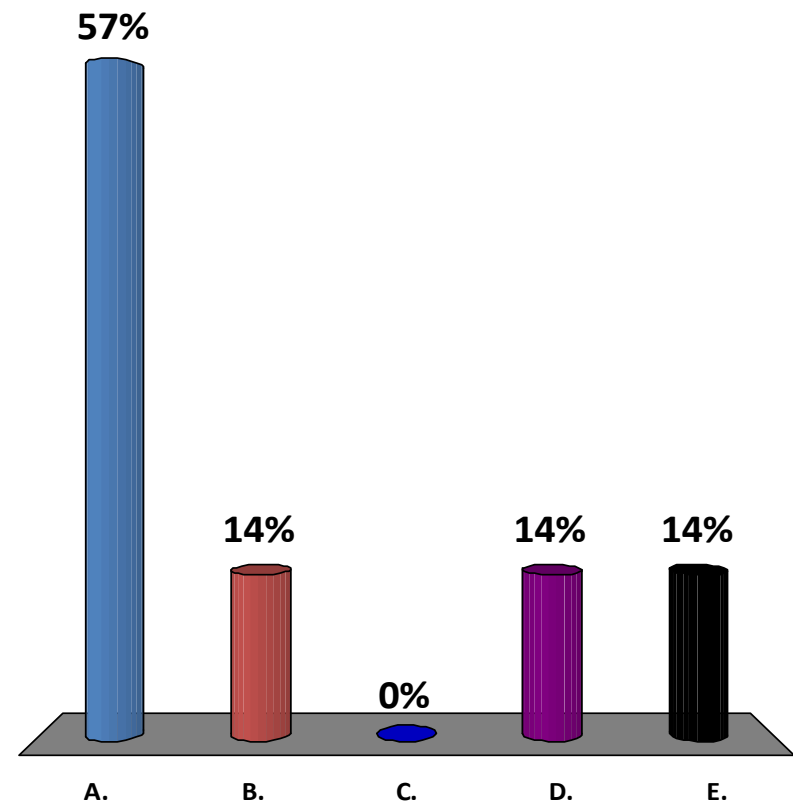
**Example:** A beef cooperative that represents its members by bargaining for better fed cattle prices decides to aggressively recruit beef producers to increase the number of its members and gain more control of the beef market. This is an example of increasing returns by \_\_\_\_\_.

- A. Economies of size
- B. Vertical integration
- C. Market power
- D. Coordination
- E. Risk spreading



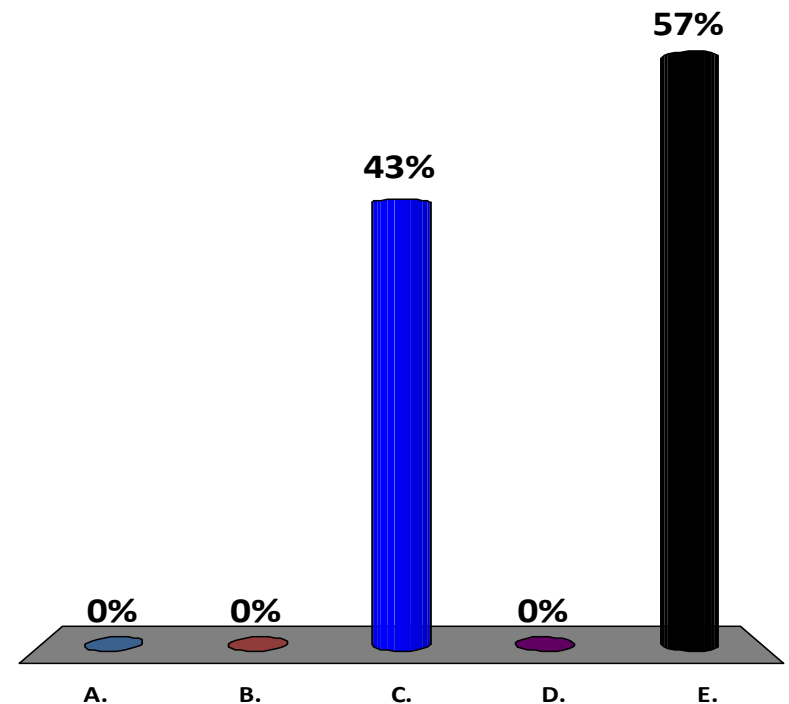
Example: A grain cooperative that stores grain for its members decides to build another elevator to decrease the per-unit cost of storing the grain. This is an example of increasing returns by \_\_\_\_\_.

- A. Economies of size
- B. Vertical integration
- C. Market power
- D. Coordination
- E. Risk spreading



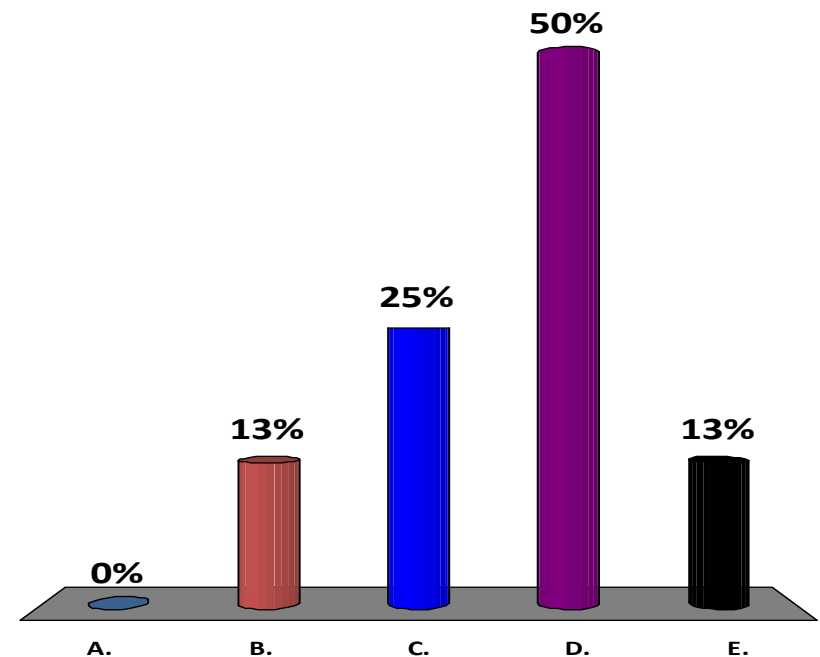
**Example:** A tomato cooperative decides to become a vegetable cooperative after observing its members may be able to offset losses from poor tomato prices by obtaining higher prices from other vegetables. This is an example of increasing returns by \_\_\_\_\_.

- A. Economies of size
- B. Vertical integration
- C. Market power
- D. Coordination
- E. Risk spreading



**Example:** Flower producers realize the success of their flowering business relies on having their products at the right time in the right place. Since transportation and transaction costs are major costs in the flowering business, flower producers decide to start a cooperative that will distribute the flowers for its members. This is an example of increasing returns by \_\_\_\_\_.

- A. Economies of size
- B. Vertical integration
- C. Market power
- D. Coordination
- E. Risk spreading



# *Cooperative Management Characteristics*

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- The management of a cooperative has changed over the years
- It has evolved from a typical one-person operation where the manager did everything
- Today, even small cooperatives often invest in a well-educated professional management team
- Emphasis on a high-quality management team



# *Reason for Failure*

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- In the past, cooperatives have failed due to
  - Overextension of credit
  - Unsound collection practices
  - Speculation in handling member commodities
  - Poor-quality products and services
  - Inadequate financial planning
  - Dominance by a single manager
  - Etc.
- Avoiding common management mistakes is critical for a cooperative's survival

# *The Role of Management*

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- Good cooperative management involves the successful combination of ideas, processes, materials, financial resources, and people
- Many of the decision-making techniques are the same as those used in other businesses
- Cooperative managers are in constant contact and direct communication with their member-owners
  - Members frequently criticize the performance of the business they own

# *Responsibilities of the Manager*

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- Select good personnel, train personnel, empower, and evaluate
- Plan, delegate, set performance standards, review job performance, establish grievance procedures, and provide leadership
- Motivate and reward or create a reward system
- Establish of goals for employees, inspire and recognize good performance, develop a sense of mission through teamwork, create an environment where employees are encouraged to be innovative
- Spend time with members, government agencies, and the general public
- Manage capital resources and maintain, upgrade, and replace assets to ensure maximum efficiency
- Concern for safety, health, and the environment

# *Management's Role in Strategic Planning*

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- To be effective, six elements must be present in strategic planning
  - Develop a mission statement
  - Assess the cooperative's operating environment
  - Establish objectives and goals
  - Identify an strategy to meet those objectives and goals
  - Combine resources to implement the strategy
  - Obtain feedback and improve

# *Who Are the Board of Directors?*

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- The board of directors are elected at the annual membership meeting
- They are usually members of the cooperative
- The cooperative's bylaws specify director eligibility, method of selection, term of office, and board organization

# *Responsibilities of the Board of Directors*

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- Provide leadership and guide the cooperative's affairs
- Get involved in strategic planning
- Participate in listening and communicating with both management and member-owners
- Provide sound recommendations and guidance
- Problems typically arise when directors slip too far into the day-to-day management role
- Communicate policies to the members, including board's decision on distribution of year-end earnings to patrons

## *Responsibilities of the Board of Directors (Cont.)*

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- Protect member's financial assets
- Hire the general manager and review his or her performance on at least an annual basis
  - A written job description, achievable business objectives, and clear performance criteria are necessary for an effective review
- Self-evaluate needs to be done by the board
- Be aware of current events that might affect the cooperative
- Be receptive to new ideas that may enhance the benefits or lessen the limitations
- Represent the cooperative at public functions, and communicate with legislators and regulators

# *Responsibilities of the Members*

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- Elect the board of directors
- Buy/use the cooperative services
- Actively participate in overseeing its organization, sound management, and operation
- Make your wishes known
- Understand the nature of their cooperative
  - Its purpose of existence, benefits and limitations, operating structures, finances, and long-run planning processes
  - Its articles of incorporation and bylaws, the legal limitations on their operations and directors, and requirements for member participation and quality control
- Stay informed about the cooperative
- Recruit new members
  - In a marketing co-op recruit those who can meet the standards for high quality and consistent volume



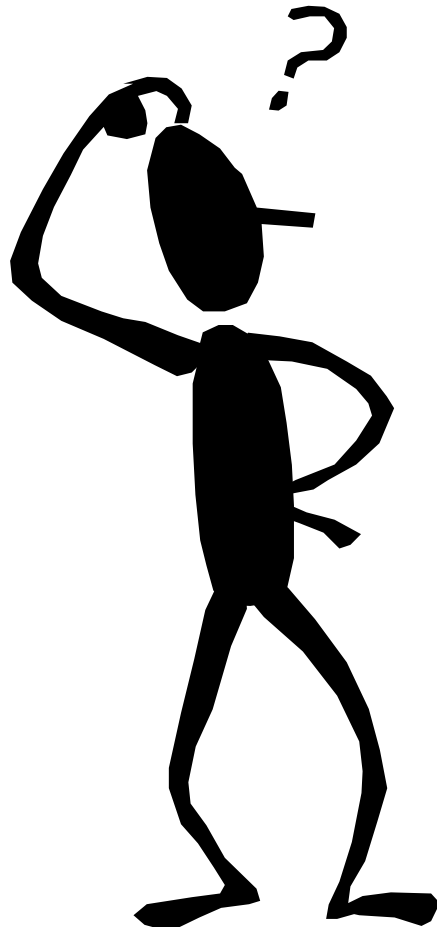
# *Strategic Alliances*

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- A cooperative's need for growth may go beyond its internal abilities to increase volume and services
- Strategic alliances may capture economies of size, gain market stability, or stabilize seasonal patterns
- An alliance may be a cheaper, faster, and less risky way to acquire geographic territory, add new services, or expand facilities
- Small, independent cooperatives may form joint ventures with one another that allow them to combine resources for certain business objectives
- Individual cooperatives may also form federated cooperatives
  - Member cooperatives maintain their identity as individual businesses while holding membership in the federated cooperative
- Individual cooperatives may also consolidate into a newly created cooperative (a centralized cooperative)

*Questions?*

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# *Next Seminar*

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Saturday, March 23rd, 2013, 9:30 – 3:30 p.m.

## **Product and Service Improvement Strategies for Small-Acreage Producers**

Ag Workshop Room, Room 149  
Agricultural Sciences Building  
Texas A&M University – Commerce  
2600 South Neal St, Commerce, TX 7548



Thanks!