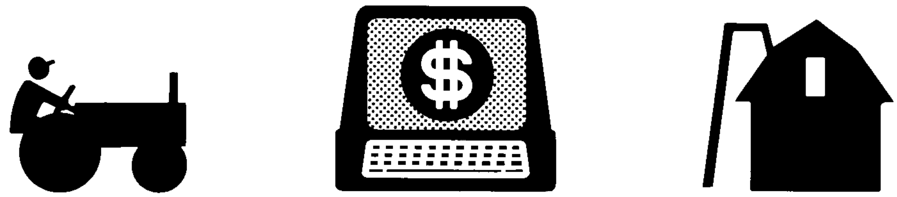
AEC-42

COOPERATIVE EXTENSION SERVICE
UNIVERSITY OF KENTUCKY • COLLEGE OF AGRICULTURE



The Farmers' Cooperative Yardstick

Agricultural Cooperatives— How They Fit In The American Free Enterprise System

Lionel Williamson

In the American free enterprise system businesses are classified into three broad categories: individually owned, partnerships, and corporations. Corporations are further divided into two categories: investor-oriented and member-oriented. Member-oriented corporations include agricultural cooperatives.

Agricultural cooperatives are a unique and separate form of business organization. They are unique because they adhere to cooperative principles and concepts often different from the other forms of business. An agricultural cooperative enterprise is one belonging to the people who use its services. Its control rests with all the members, and its gains are distributed to members in proportion to the use they make of its services.

Individually Owned Business

Individually owned businesses are more dominant in farming than in any other segment of our economy. The most common type of farming structure is the one where the owner-operator makes the decisions and assumes the risk. As entrepreneurs, they usually provide the labor. This form of business organization has several advantages: **(1)** it is a very flexible method which may be employed in almost any field of human activity; **(2)** it offers great opportunities for personal initiative and ingenuity; and **(3)** usually, no special legal formalities are required to form an individual enterprise. Individually owned businesses also have these disadvantages: **(1)** any losses are borne by the owner—they cannot be shared and **(2)** capital limits the size of the business.

Partnership

A partnership is a business jointly owned by two or more people who have agreed to operate on a partnership basis. Together, they provide or borrow the capital, reach decisions by mutual agreement, and are mutually responsible for repayment of debts. They divide the income or share the losses among themselves according to the original agreement.

The partnership arrangement is advantageous when partners do not have enough capital or skill to operate individually and labor is performed largely by the partners themselves.

Limited Partnership

A limited partnership is formed by two or more people, having as members one or more general partners and one or more limited partners. It differs from the partnership in that it generally requires filing a certificate with a designated official, showing the name, character, and location of the business; names and addresses of the partners; contributions to be made by limited partners; the term for which the partnership is to exist, and how profits or losses are to be shared among the partners. Limited partners are not liable for the partnership's debts except to the extent of the investment that they agreed to make in the partnership as stated in the certificate required by the statutes.

Partnerships have two major advantages over the individually owned business: **(1)** the amount of capital available is usually greater and **(2)** several partners may bring special skills and training into the firm.

Corporation

Corporations have several advantages over partnerships. For example, a corporation is treated by law as a "legal person" distinct from its human members. Individual shareholders have limited liability and shares are transferable. There are two major kinds of corporations: the investor-oriented corporation and the cooperative. Both are state-chartered businesses and are usually organized under the laws of the states where they have their main office.

Investor-oriented Corporation

The investor-oriented corporation, also called the "Profit-type Corporation," aims to make a profit for its investor-owners. Its capital funds come from shares of stock which investors buy for their profit-making potential. Supplemental capital is obtained by borrowing from banks, other financial institutions, and individuals. The corporation owners, called stockholders, elect directors at their annual meeting. The board of directors manages the affairs of the corporation. Corporations have several advantages over a partnership. They have continuity of existence, limited liability of individual share holders, and transferability of shares.

Cooperatives

Cooperatives are state-chartered "businesses voluntarily organized, operating at cost, owned, capitalized, and controlled by member-patrons as users, sharing risks and benefits proportional to their participation." Cooperatives in agriculture are divided into three broad categories: marketing, supply, and related services.

How Cooperatives Differ from Other Types of Businesses

The primary difference between cooperatives and other types of businesses is an objective. A cooperative seeks economic benefits for its members from cost-reducing services and seeks to increase members' income, improve quality, provide an improved service, and develop the best use of members' resources.

While the profit-type corporation's primary objective is to make a profit for investor-owners, cooperatives exist to meet members' needs economically and efficiently. Looking at who receives the net margins in each form of business makes the difference between them evident. In an individually owned business, it is the owner; in a partnership, the partners; in an investor-oriented corporation, the stockholder; in cooperatives, the member-patrons.

Several operating principles distinguish cooperatives from noncooperative businesses: open membership, democratic control, limited or no interest on equity capital, patronage refund, and continuous education. These principles are as important today as they were to the Rochdale Society some 50 to 75 years ago.

Open Membership

Open membership allows anyone who wants to join a cooperative and who can use its services to do so. By the same token, membership is never compulsory. Cooperative members do not automatically buy from their cooperatives forever. Rather, cooperatives earn their members' loyalty day by day and product by product.

Democratic Control

Cooperatives are owned and controlled by their member-patrons rather than by the investing public. Most cooperatives follow a one-person-one-vote principle, usually referred to as democratic control. At the annual meeting, each member business is entitled to one vote regardless of its size or volume of business. Members elect a board of directors to act for them in setting cooperative policies and goals.

Limited Return on Equity Capital

Cooperatives are permitted under law to pay limited dividends, but very few do. Their priority is to provide economic benefits for their members. Co-op members are interested primarily in advantages they derive as patrons of the organization. They are not so much interested in an outlet or a place to invest capital at a high rate of return. Limitations by cooperatives of returns on capital are recognized in both federal and state laws. These laws specify the maximum returns that may be paid on invested capital. In most state statutes the limit is fixed at 8 percent.

Continuous Education

Cooperatives must educate their members. Members must understand how their cooperative works and the importance of their patronage and support. Cooperatives should make provisions to educate members and employees and the general public in the principles and techniques of cooperation.

Service at Cost

Cooperatives generally do not retain net margins on excess of gross proceeds over expenses. When the cooperative returns its net margins to its patrons, it is in effect reducing its gross income, thus implementing the service-at-cost feature. Cooperatives that return all net margins to members are exempt from paying federal income tax at the corporate level.

Summary

Cooperatives continue to play a very important role in the American Private Enterprise system. Today's agricultural cooperatives are responsible for providing farmers with about one-third of their production inputs and credit needs for both short-term and long-term purchases. Marketing cooperatives are responsible for marketing more than 70 percent of milk and nearly 30 percent of all other commodities.

What Are the Features of the Methods of Doing Business?

	Types of Business			
			Corporation	
Features Compared	**Individual**	**Partnership**	**Investor-oriented**	**Cooperative**
1. Who uses the services?	Nonowner customers	Generally nonowner customers	Generally nonowner customers	Chiefly the owner patron
2. Who owns the business?	The individual	The partners	The stockholders	The member-patrons
3. Who votes?	None necessary	The partners	Common stockholders	The member-patrons
4. How is voting done?	None necessary	Usually by partners' share in capital	By shares of common stock	Usually one-member one-vote
5. Who determines policies?	The individual	The partners	Common stockholders and directors	The member-patrons and directors
6. Are returns on ownership capital limited?	No	No	No	Usually 8 percent
7. Who gets the operating proceeds?	The individual	The partners in proportion to interest in business	The stockholders in proportion to stock held	The patrons on a patronage basis

See your County Extension Office for the entire series of publications on agricultural cooperatives.