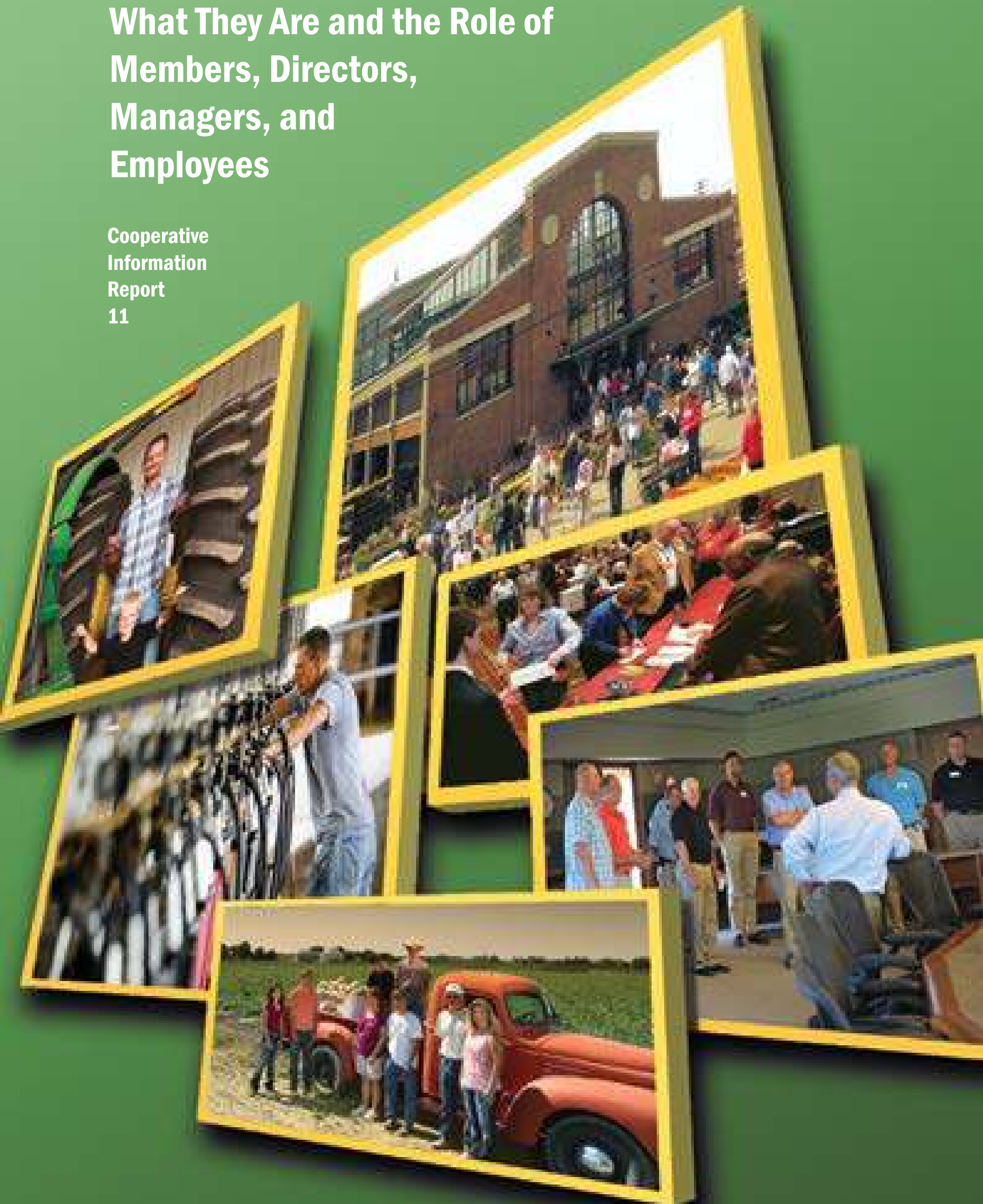
USDA

United States Department of Agriculture

Co-op Essentials

What They Are and the Role of Members, Directors, Managers, and Employees

Cooperative
Information
Report
11



USDA Rural Development

Abstract

This is an educational guide for teaching basic information about cooperatives. It explains what cooperatives are—their business, principle, and structural characterizations, and the responsibilities and roles of cooperative members, directors, managers, and employees.

Five chapters make up this guide. Chapter 1—What Are Cooperatives?, is the most extensive chapter and generally describes where and how cooperatives fit into the American system of business, their unique principles and practices, and their defining structural characteristics, and it introduces the roles of the major cooperative participants—members, directors, manager, and employees. Chapters 2-5 go into further detail about the participants. Chapter 2 gives an overview of cooperative members, Chapter 3 describes directors, Chapter 4 discusses the cooperative manager, and Chapter 5 explains employees.

Each chapter has a companion PowerPoint presentation with slides that coincide with and summarize the concepts and information provided in the text. These are available as a PowerPoint file from Rural Business-Cooperative Service for presentational use in educational/informational forums, at the following Web address: https://www.rd.usda.gov/files/publications/CIR11_CoopEssentialsPowerpoint.pdf.

Co-op Essentials: What They Are and the Role of Members, Directors, Managers, and Employees

This guide combines five earlier publications (CIR 10-18) on the same subject written by C.H. Kirkman, Galen Rapp, and Gene Ingalsbe while all were employed by USDA's Agricultural Cooperative Service. It was produced by Patrick Duffey and James Wadsworth in 2001 and revised by James Wadsworth in 2014.

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Publications and information are also available at:
https://www.rd.usda.gov/publications/publications-cooperatives
Email: coopinfo@wdc.usda.gov for more information.

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Chapter 1

What Cooperatives Are

This chapter focuses on what cooperatives are. It explains their business and structural characteristics and their unique principles. It introduces the major participants—members, directors, managers, and employees—whose roles are discussed in greater depth in chapters 2-5.

Business Characteristics

There are many ways of conducting a business in the United States. People buy, sell, trade, borrow, insure, and conduct all kinds of business transactions. Businesses are organized in different ways depending on: who owns and controls it, who buys from (patronizes) it, and who gets the profit (earnings) from it.

Businesses fall into one of three categories:

- Individually owned businesses (sole proprietorships), where one person owns, operates, manages, and receives the profits;

- Partnerships, which have two or more people who jointly own, control, and operate the business, sharing proportionately in the risks and profit;

- Corporations, which have multiple owners, called investors. An increasingly popular type of business ownership is the limited liability company (LLC). An LLC is a hybrid business structure that combines some of the characteristics of both a partnership and a corporation.

Cooperatives are a type of corporation; a State-chartered business organized and operating under its laws. Cooperatives resemble other businesses in that they have physical facilities, perform similar functions, and strive to follow sound business practices. They operate under bylaws and other necessary legal papers. However, cooperatives are different from general investor-owned corporations, which are operated to make a profit for investors.

The cooperative corporation is a business owned and controlled by the people who use its services. Cooperatives are controlled by a board of directors (elected by member-owners), derive equity from member-owners, operate for the benefit of member-owners, and allocate earnings to members based on use.

Cooperative earnings from business conducted with members are taxed once, either as income of the corporation when earned or as income of the members when allocated to them. Cooperatives usually have a perpetual existence – members can routinely join or resign without disrupting ongoing operations.

There are more than 29,000 cooperatives of all types in the United States that serve more than 350 million members (many people belong to more than one cooperative). These cooperatives have about $3.1 trillion in total assets, generate revenue of more than $650 billion, and employ more than 2 million people. Financial, consumer service, and business cooperatives provide credit, transportation, facilities, recreational equipment, food, housing, health care, home care, child care, wholesale goods and supplies, electricity, telephone, and electronic services, farm

production supplies and service, and farm product marketing. (Source: University of WisconsinCenter for Cooperatives, Research on the Economic Impact of Cooperatives, 2009. http://reic.uwcc.wisc.edu/summary)

Unique Principles

Three principles distinguish cooperatives from general corporations: user-owner, user control, and user-benefits.

User-owner – the people who use the cooperative own it. Member-owners finance the cooperative's assets and have an obligation to provide financing in accordance with their use to keep the cooperative in business and permit it to grow.

User-control – as owners, members control the overall operations and activities of the cooperative. This control is exercised through voting at annual meetings and other membership meetings, and indirectly through co-op members elected to the board of directors. This is generally done on a one-member, one-vote basis. However, some cooperatives may use proportional voting based on members' use of the cooperative.

User-benefit – members use cooperatives for the benefits they provide. Because cooperatives strive for a goal of providing service at cost, distribution of earnings is a key benefit for members. Distribution of this financial benefit is based on members' use of the cooperative (that is, their patronage), not on their investment in the cooperative.

The third principle only partially explains the benefits members may derive from owning and controlling their cooperatives. Other benefits may include:

- Improved bargaining power – united in a cooperative, producers gain marketing clout, helping them sell their crops or other products for a fair price.
- Reduced costs – volume purchasing of production supplies and pooled marketing of products helps to lower the per-unit costs to members. Doing cooperative-to-cooperative business may further reduce overhead for necessary services.
- Filling a market void – cooperatives often provide services and/or products that are otherwise unavailable to members.
- Improved quality products and services – by providing members with quality products, facilities, equipment, and services, cooperatives not only help to increase the productivity of their members, but also to "raise the bar" for competitors to meet.

Additional benefits to members, beyond those provided by the cooperative's core operations, may include:

- Political action – cooperatives and associations of cooperatives provide a way to organize for effective political action. They can develop priorities and strategies on key issues for their members, then communicate these positions to legislators and regulators.

- Enhanced community strength – having a business owned and controlled on a cooperative basis helps the entire community. Cooperatives generate jobs and salaries for local residents. They pay taxes that help finance schools, hospitals, and other community services. Also, the additional income derived from the cooperative by members is often spent in the community, further helping other businesses and services that members use.

- Providing a competitive yardstick – studies have shown that cooperatives create an impact on competition that helps to keep prices lower for services and supplies, and improve the marketing of goods and products for both producers and consumers.

Cooperative Practices

These basic cooperatives practices differentiate them from other businesses:

Patronage refund system – cooperatives return earnings to members – after costs have been covered and needed operating capital obtained – on the basis of their use of the cooperative. This is most often done at the end of a co-op's fiscal year, based on earnings generated. Earnings are returned to patrons – as cash and/or equity allocations – on the basis of how much business each patron transacted with the cooperative during the year. These distributions are called "patronage refunds."

Limited returns on equity capital – members form a cooperative to obtain a service – such as a source of supplies, a market for their products, or to perform a special function – not necessarily for a monetary return on capital investment. Most cooperatives don't pay any dividends on capital while others pay a modest return. Limited

returns on equity supports the principle of distributing benefits proportional to use, rather than on investment.

Cooperation among cooperatives – many local associations are too small to gather the resources needed to provide all the services their members want, so cooperatives work together in many instances. Federated cooperative structures, joint ventures, marketing agencies in common, strategic alliances, and informal networks allow cooperatives to pool resources and assets to provide services and programs on a collaborative basis at lower cost.

Cooperative education – cooperatives provide education and training to members, directors, employees, and others in the community about the benefits of co-op businesses. They work to ensure that

members, directors, and employees are well apprised of their distinct, important roles in the cooperative and that others outside the cooperative understand the uniqueness of the organization and its benefits to the community.

Such education is carried out directly and indirectly. Directly, by advertisements, public forums, internal training programs, etc. Indirectly, by participation and funding of State cooperative councils and other like associations that carry out the important role of cooperative education.

The International Cooperative Alliance (ICA) recognizes seven cooperative principles. The principles they promote are in many ways similar to the principles and practices explained in this primer. The webpage of the ICA statements is here: http://ica.coop/en/what-co-op/co-operative-identity-values-principles. For a comparison of the USDA cooperative principles and the ICA principles, see: USDA Research Report 231, *Comparing Cooperative Principles of the USDA and the ICA*, https://www.rd.usda.gov/files/BCP_RR231.pdf.

Structural Characteristics

Cooperatives are characterized by the geographic territory they serve, their governance system, and the functions they perform. This provides an understanding of cooperative differences pertaining to scope of operations, member structure, and functional service.

Geographical – cooperatives are loosely categorized as "local" or "regional." These characterizations describe the cooperative's size and scope of operations in reference to serving members.

Local cooperatives typically operate within a single State, often within one or two counties. They usually have only one or two facilities from which to serve members. However, there are instances where local cooperatives have three or more facilities.

Regional cooperatives usually serve an entire State or a number of States. They can have operations that are nationwide or cover major portions of the United States. Some regional cooperatives also have international operations with sales and members in more than one country.

Governance system – based on membership structure, cooperatives are classified as centralized, federated, or mixed. These three classifications essentially define who the members are and how the cooperative is organized to serve them.

Centralized cooperatives have individuals and business entities as members. A centralized cooperative has one central office, one board of directors elected by its members, and a manager who supervises all day-to-day operations. Business may be conducted through branch offices or locations staffed by employees responsible to the central management team.

Federated cooperatives have other cooperatives as members. Each member of a federated cooperative is a separate cooperative that owns a membership share entitling it to voting rights in the affairs of the federated. Each member of a federated cooperative has its own board of directors, manager, employees, and facilities to serve its members.

The federated has its own hired management and staff and a board of directors elected by and representing the member cooperatives. It performs activities often too complex and expensive for them to do individually, such as manufacturing production supplies, tapping major financial markets, and marketing on a regional, national, or worldwide basis.

Mixed cooperatives have both individuals and other cooperatives as members. These cooperatives have features of both centralized and federated cooperatives.

Functions performed—cooperatives may perform one or more of three core functions: marketing products, purchasing supplies, and providing services. These functions further explain a cooperative's purpose and scope.

Marketing cooperatives assist members in maximizing the returns they receive for the goods they produce. They sometimes add value by developing raw member goods into desirable consumer products.

Marketing cooperatives help members to extend control of their products further up the marketing chain and realize additional margins through processing, distribution, and sale.

Purchasing cooperatives allow members to gain access to affordable production supplies and goods. By purchasing for numerous members in bulk, cooperatives reduce member costs and strengthen their purchasing power.

Many local purchasing cooperatives are affiliated with other such organizations, often through regional and national federated cooperatives. Such cooperative efforts further reduce member costs and strengthen their purchasing power through direct ownership of large-scale facilities, such as petroleum refineries, fertilizer and feed plants, research facilities, etc. Hardware stores, electronic component suppliers, independent grocery stores, school systems, and fast food restaurant franchises, among others, have also developed purchasing cooperatives.

Service cooperatives exist in a number of business sectors. Agricultural service cooperatives provide farm-specific services, such as animal feed processing, crop harvesting, and crop consultancy services. Utility co-ops provide electricity and telecommunication service, while other types of cooperatives provide credit, insurance, housing, and health care.

Roles of Cooperative Participants

Cooperative organizations operate through the participation of members, directors, manager, and employees. Each has a separate role to play in the life of the co-op, although they share the common interest of building a successful business.

Members – as owners of the business, they organize, incorporate, finance, and elect directors to set the cooperative's policy and govern. Members use the cooperative and are the reason for its existence.

Directors – members of the board are elected by, and serve at the will of, the membership. While some serve limited terms, others may serve multiple terms. They have two primary responsibilities: hire competent management and guide the direction of the business by providing policy and oversight to its operation.

Manager – the manager reports to and works closely with the board of directors. He or she is responsible for the day-to-day operations and performance of the cooperative.

Employees—hired by the manager, employees work for the member-owners in carrying out their responsibilities in the cooperative's operation. Their work and responsibilities are dictated by the manager.

It should be noted that the roles of members, directors, and managers are basically the same in all types of cooperatives. The role of employees, as described in this report, is also the same for most cooperative types. But an exception to the employee role occurs when it comes to worker cooperatives.

Summary

People and businesses use cooperatives to serve their common interests and for mutual benefit. Cooperatives are complex organizations with unique principles, practices, member benefits, and structural characteristics. Geographic area, governance system, and functions performed explain organizational structure and size and scope of member service.

Cooperatives exist in many segments of the American economy today, providing purchasing, marketing, and service for member-owners. Members use purchasing cooperatives to buy food, consumer goods, and business and production supplies. Cooperatives are used by members to market and process their farm-grown commodities, and co-ops often add value to the raw commodities. Some cooperatives provide members with transportation services, credit, housing, utilities, recreational equipment, building supplies, and other services and goods. Cooperatives often have branded products and some cooperatives perform two or all of the functions of purchasing, marketing, and service on behalf of their members.

Cooperatives consist of members, directors, management, and employees. All have important participation roles to play and responsibilities to fulfill.


Ballot Envelope

Chapter 2

Members Make Cooperatives Work

This chapter focuses on members: who they are and their responsibilities as owners, with particular emphasis on control, financing, and patronage.

Members are the foundation of the cooperative. They organized the cooperative and meeting their needs is the reason for its existence. Member support, through patronage and capital investment, keeps the cooperative economically healthy. Members' changing needs shape the cooperative's future.

Cooperative members can be individuals, businesses, or other organizations drawn together by a mutual interest. Members own and use the cooperative. They provide sufficient financial support so that the cooperative can operate. Through active participation in the cooperative, and the decisions of their elected representatives on the board of directors, members ensure that the cooperative has the right mix of good management and personnel, as well as the facilities and equipment required to meet their needs.

Commitment and Use

The success of a cooperative hinges on the commitment of its members. They must be committed to using it and financing it. A basic requirement of membership in a cooperative is to patronize and use its services. Benefits accrue to members through patronage of the co-op.

While member commitment to doing business with their cooperative should be a given, there are various methods used to compel this. Patronage is elicited by cooperatives through persuasion—exhorting members to support the cooperative for the common welfare of all, by legally binding membership agreements, and/or by substantial up-front capital contribution requirements.

Using the cooperative is the members' easiest responsibility to carry out, and by using it as much as they can, members help the cooperative succeed in several ways:

- A certain amount of business is needed just to cover the cost of operations each day, including maintaining buildings and equipment, utilities, and salaries. Greater volume reduces these costs per unit of sale and facilities can operate closer to capacity. Equipment and employees can be more productive. Overall, 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. (Or, covering basic operating overhead if the cooperative does not have physical assets.)

- Using the cooperative helps provide the financing to keep it operating and growing. Member financing is provided on the basis of member use of the cooperative.

- Using the cooperative is how members gain the benefits they sought when they first formed or joined the cooperative

- High amounts of member use provides the critical mass of business necessary to establish a secure market position.

Members must make a conscious decision to patronize their cooperative even when the short-term prices or services may be better elsewhere. If a large percentage of the members stop using the cooperative, the need for it must be re-examined.

Maximum use helps the cooperative and, ultimately, the members as well. The stronger the cooperative, the more competitive it can be in the marketplace. With more market clout, the cooperative will be better able to influence suppliers to provide products or services geared to members' needs. A prosperous cooperative with the solid support of its members is often recognized as a business leader in its community or industry.

Ownership and Control

As members use their cooperative, it is imperative that they recognize their special role as owners. As owners, members have certain legal responsibilities. They must:

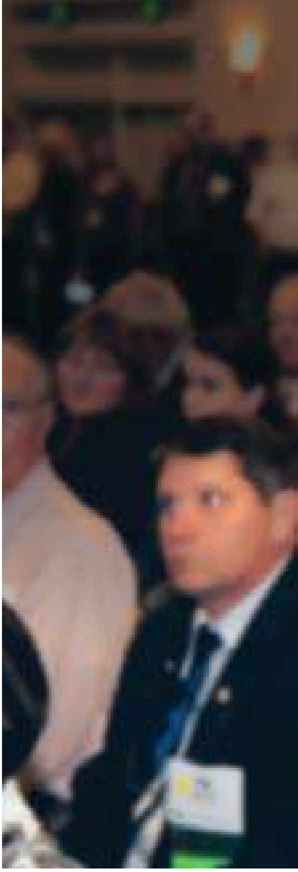
- Incorporate the cooperative; approve (and change) articles of incorporation, bylaws, and major policies;
- Sign marketing agreements and other binding contracts;
- Elect directors according to State statute and cooperative bylaws;
- Vote on significant actions affecting the cooperative's legal status such as mergers, acquisitions, or other asset changes, and if necessary, to dissolve the organization; and
- Ensure the cooperative follows general business laws and those unique to cooperatives such as taxation.

As incorporated businesses, cooperatives give members limited liability protection. Even though this means members' maximum loss is only the capital they've invested, inattention to ownership responsibilities often dilutes the value of the cooperative to them as users.

For example, capital used to defend the cooperative in a lawsuit or pay fines for violating regulations could have been used to enhance the cooperative's ability to serve its members.

Although members may have many ownership "partners," each has associated legal responsibilities, just as if he or she were a sole owner. Members make business decisions (directly or indirectly) through their elected representatives that benefit all member-users.

A cooperative's success depends largely on how well members understand what it is and how it operates. It is incumbent upon cooperatives to provide members with important cooperative documents (e.g., an "owners' manual") so that they clearly understand its business practices and its reason for being. Such materials may include:



- The definition of the cooperative (e.g., a mission statement or clause clearly identifying its major purpose) and an explanation of its unique principles and practices;
- The history of when and how the cooperative started;
- Articles of incorporation and bylaws;
- Information on organizational structure and staffing;
- Operational scope and products handled and services offered; and
- Operating policies.

Members who understand their cooperative are more likely to patronize it, reap benefits from it, and can offer constructive criticism and suggestions affecting its future.

Members carry the cooperative's image to the community and business environment. Although large cooperatives often hire professionals trained in communications, public relations, member relations, and governmental affairs, members are themselves often the best representatives. They promote the cooperative to potential members and explain it to others. Members also make sure it acts as a good community citizen by contributing funds, providing leadership, and participating in civic activities.

While cooperatives are politically neutral and avoid political affiliation, they often do attempt to influence legislation affecting their business environment. Members and directors may participate

in political activities, but the bylaws usually set conditions for managers, directors, and employees.

Control Guidelines – Members control their cooperatives by shaping its legal framework in the articles of incorporation and bylaws. The board of directors and hired management must legally abide by the provisions in these documents. Only the membership can change them.

The articles of incorporation list the cooperative's name, place of business, capital structure, and the incorporators. They also describe the type, purpose, operations, membership qualifications, duties of officers and directors, meeting and voting procedures, procedures/methods for raising and refunding of member capital, and procedures and rights in caseof dissolution. Other control documents include member applications and marketing agreements.

The policies reflect the operating philosophy and guide actions the cooperative will take to fulfill its mission. Members delegate the responsibility for development, review, and change of policies to the board of directors. Policies cover employee conduct and work rules, office hours, board/management relations, major asset purchasing, lines of business, and other topics related to successfully conducting the cooperative's business.

Governance – Members also control their cooperatives by casting votes on major business decisions (for example, a proposed merger with another cooperative or business) and by the authority they delegate to the board thorough a democratic election. The level of control is directly related to members' degree of participation in this important process.

Formal decisions are made by members at the annual meeting such as nominating and electing directors, amending the bylaws, accepting the audit report, voting on major actions or policies proposed by the board and management, and voting on resolutions and motions.

Informal participation covers involvement in cooperative activities such as:

- Serving on advisory committees and accepting special assignments;
- Expressing opinions in discussions with other members or directors;
- Providing feedback to employees and management;
- Responding to surveys about attitudes and assessments, product and service evaluations, buying and marketing intentions, and providing other opinions about changing conditions.

Active member participation provides additional information that helps the board and management better carry out their responsibilities. By active involvement in the governance process, members maintain control of the cooperative's scope, direction, and operation.

Members place the fiscal health of the cooperative in the hands of directors. Members reaffirm performance by re-electing directors or seek improvements by electing new directors.

Members must participate in governance activities of their cooperative or accept the decisions made by others.

Financial Responsibility

Members have a responsibility to finance their cooperative in proportion to their use of it. Members provide operating capital (equity) in three primary ways: direct investment, retained margins, and per-unit capital retains.

- Direct investment – refers to cash purchases of membership certificates, common and preferred stock, or other forms of equity.

- Retained margins – at fiscal year-end, when members receive a patronage refund based on their share of net income as determined by their use in the cooperative, they reinvest part of it as determined by the board of directors. Federal tax law requires that at least 20 percent of the refund be paid in cash. The rest is typically reinvested in the cooperative and later paid back to members according to a revolving cycle or other method, as determined by the board. Some cooperatives use a base-capital plan, whereby members are required to provide a base amount of capital that is determined by their proportion of use of the cooperative and the needs of the cooperative.

- Per-unit retains – members use this method to invest each time they conduct business with the cooperative. The cooperative retains a specific amount per physical unit (pounds, bushels, or cartons) involved in member transactions. Retains are accumulated and then revolved back to members over a period of years.

Cooperatives also acquire equity by retaining earnings on non-member, non-patronage business. (For more detailed information

about cooperative equity and the management of that equity, see CIR 55, *Co-ops 101*.)

Startup Capital – When cooperatives are organized and launched, they require an initial infusion of capital. For a proposed cooperative business to have a chance at succeeding, prospective members must invest in the venture. Their commitment must be large enough to compel a continuing concern about how their invested money is being managed. Such a commitment will also increase their motivation to seriously accept ownership responsibilities.

The amount of capital required is determined by economic feasibility studies and business plans. Some startup costs – legal fees, facilities, equipment, inventory, salaries, insurance, office furniture, and administrative supplies – will continue as operating expenses.

(See CIR 7, How to Start a Cooperative, and SR 58, Vital Steps: Feasibility Study Guide, for more information about cooperative start-ups.)

Control Follows Finance – Those three words explain the importance of members' responsibility to finance their cooperative. A desirable goal is to have members' contribution of equity capital amounting to at least a majority of the cooperative's total capital requirement. A high level of member equity capital provides for greater member control and commitment. It also usually makes it easier to access debt capital if necessary.

Financing should be 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. Being financed largely by current members results in a membership more likely to have common interests and objectives.

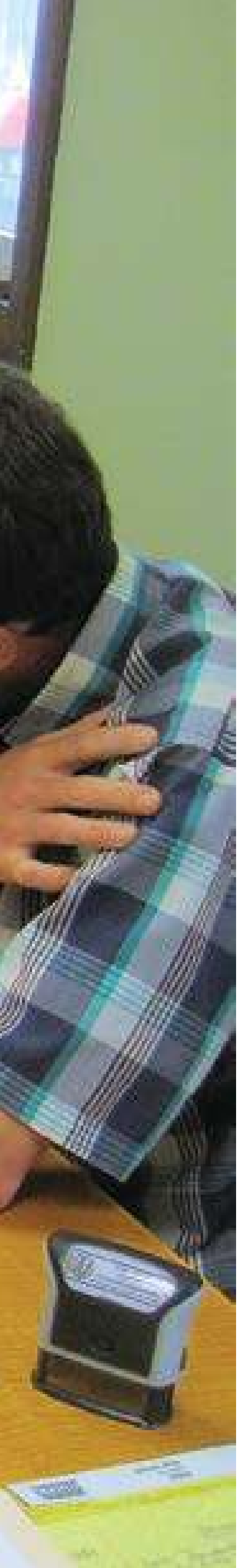
Summary

Members are owners of the cooperative and have associated responsibilities. They must use, control, and finance their cooperative to gain the economic benefits for which it operates.

In taking an active ownership role by patronizing and financing the cooperative, expressing their views and needs, participating in the governance process and decisionmaking, and evaluating how well the cooperative is performing, they gain other benefits as well.

They become educated in business practices and see first-hand the benefits derived from working together. They often gain valuable leadership training. The experience they gain from expressing their views in various meetings, participating on committees, serving on the board of directors, and speaking on behalf of the cooperative helps develop leadership traits that they transfer 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.

All in all, cooperative ownership can give a member a well-earned sense of personal and business achievement along with the numerous economic and service benefits the cooperative's existence provides.



Chapter 3

What Cooperative Directors Do

This chapter focuses on the board of directors. It covers characteristics members should consider in choosing a director to represent them, alternatives for nominating and electing directors, and functions and responsibilities of directors.

The cooperative board of directors – the key link between members and hired management – determines cooperative policy. As such, it is a vitally important body in the make-up of a cooperative. Elected by members, directors are charged with fulfilling responsibilities within the parameters of the cooperative's policies and the law. They must set up overall objectives and chart the course the cooperative will follow to achieve those objectives.

Being a director is an extremely important function in a cooperative and the role must be taken seriously. To effectively carry out their duties, directors have to be well versed in many critical areas and able to provide sufficient time and energy to their duties. Serving on a cooperative's board of directors can be time consuming in carrying out both formal and informal duties. While attending board and committee meetings may take only a couple of days each month, informal duties – such as listening to, informing, and providing advice to members; writing letters, and reading various materials to stay informed and prepared for meetings – can consume a considerable amount of additional time.

Directors are also asked to represent the cooperative at community functions and take leadership roles in community organizations on behalf of the cooperative. In larger cooperatives, directors are periodically asked to visit State and Federal legislators and officials.

Selecting Directors

In considering director candidates, members should look for people who are good conversationalists, can clearly express their views, and are good listeners. This is because a good director must also be able to establish two-way communications with the manager, other directors, and members. People who have been active in other organizations are often good director.

A director can be a powerful force for strengthening member support, promoting the cooperative in the community, and in other ways influencing the business environment in which the cooperative operates. Thus, a good potential director has the ability to get along with others, uses the cooperative fully, is interested in its performance, and will actively participate in making decisions.

Because cooperative directors are often involved in complex business decisions, they need to be able to exercise good judgment. Potential directors are often people already experienced in business matters, either gained from running their own business (e.g., farm), or from other business-related experiences or jobs (members with college degrees or other relevant experience can bring special expertise to the board).

A good candidate can also be a person who makes the most of available educational resources, so members need to consider people who aren't afraid to research and seek answers to questions and problems if they don't already have knowledge in a specific area.

Selection Methods – Smaller cooperatives generally elect their directors "at-large," meaning the entire membership can vote directly to fill each director position, and each director represents the entire membership. As a cooperative grows, or the composition of its membership changes or it combines with one or more other cooperatives, the "at-large" method may become impractical. In these cases, cooperatives turn to other methods to produce equitable representation of the membership.

Other selection methods include dividing the cooperative's territory into geographic districts with nearly equal membership numbers. Others establish roughly equal territories based on volume of member business. Still other co-ops establish districts by the type of commodity members produce. Some cooperatives have provisions for a public "at-large" director who can contribute a special expertise, such as an agricultural economist, a lawyer, or a financial or governmental affairs specialist.

Cooperatives' democratic control principle has been interpreted to mean equal voting rights, yet this does not preclude using proportional voting to achieve equitable voting rights. State statutes offer guidance on how the cooperative can elect directors.

A nominating committee is often used to select candidates, although candidates may also be nominated "from the floor" during a cooperative meeting. The committee may be appointed by the board chairperson or elected by the membership. Former directors are often named to the nominating committee, although existing directors, hired management, or staff should not serve.

A biographical sketch of candidates should be developed and given to members before the election. An ideal slate offers at least two candidates for each position. Some large cooperatives with large or scattered membership may use district caucuses or mail balloting to nominate candidates. Directors are elected at the annual meeting.

Regardless of the method used, the members need to be familiar with director qualifications, the articles and bylaws, and who – among the membership – might be qualified to be a director candidate.

Director Responsibilities

Understanding the differences between the manager and director roles is a key requirement for board effectiveness and harmony. Their roles in a cooperative are unique among businesses. The uniqueness centers on the employee-only status of the cooperative's manager as compared with the manager of other businesses, where they typically share in ownership. A cooperative manager should not be a member of the board, but must attend and contribute to board meetings.

More distinct differences exist between the director and manager roles and responsibilities. Directors have primary control and use a strategic perspective in determining how to best serve members' needs and in deriving the organizational and operating policies required to do that. Directors delegate to the manager but should take counsel from the manager when it is appropriate. Conversely, the manager controls operations and uses a more tactical perspective – delegated by the board – in running the day-to-day operations of the cooperative. Decisions made by the manager must be in line with the cooperative objectives and general direction set by the board. The manager also advises the board when asked on policies and programs.

Just as it is important that the manager understand that he/she is not a board member and must defer to the board of directors on major decisions, directors must also recognize the manager's responsibility for day-to-day operations.

Directors are responsible for:

- Preserving the co-op's character;
- Safeguarding assets;
- Hiring the manager;
- Setting cooperative policy;
- Distributing year-end financial benefits;
- Strategic planning;
- Self-evaluating their performance;
- Electing board officers; and
- Appointing board committees.

These major responsibilities are explained in greater detail in the following sections.

Preserving Co-op Character – Directors are responsible for preserving the cooperative's character. Character refers to laws, regulations, policies, and practices that distinctly apply to the cooperative. Each State has at least one statute related to cooperatives. Federal laws have specific requirements for cooperatives related to Government programs, antitrust, and taxation. Also, the cooperative's bylaws and articles of incorporation state what the cooperative is and how it must operate. Directors can be held legally liable as individuals if there are violations by the cooperative to these laws and regulations.

However, over time, a subtle but very real threat to the organization's cooperative character may develop. Management

and board philosophy can drift from the cooperative's formally adopted mission or the cooperative's operational practices may no longer coincide with members' changing needs. Without continual education of the key participants (managers and staff, directors, and members) and without careful strategic planning for meeting members' needs, the cooperative character (except those aspects defined by law) can slip away, making the cooperative less oriented and focused on servicing members.

Safeguard Assets – Members who invest in the cooperative expect some kind of beneficial return. They entrust the board to make sound business decisions to protect their investment and increase value in terms of producing benefits. Directors are accountable for both their actions and those of hired management. The board equitably distributes benefits by weighing the cooperative's business needs and those of member owners. Each year the board hires an individual or firm to audit the cooperative's financial records and presents results in an annual report to the members.

Hire Manager – The board's most important decision, and one that often determines the success (or failure) of the cooperative, is hiring (or firing) the manager. The board must objectively appraise candidates' qualifications, including hisor her leadership skills, business acumen, ability to manage personnel, potential skills in working with a board of directors, and knowledge of the uniqueness of cooperatives.

The board delegates day-to-day control and guidance to the manager through bylaw provisions, written policies, budgeting, strategic planning, reporting requirements, and performance accountability. The board also annually reviews the manager's performance and seeks ways to improve problem areas.

Set Policies – The board originates and approves general policies that relate to the cooperative's functions and how it conducts business. The policies cover internal and external activities and serve as a basis for making consistent decisions that minimize conflict among the participants in the cooperative. They also determine the accountability of those same participants.

Policies identify: director and manager functions and relationships; member, employee, and public relations; organizational requirements; and operational activities such as credit, pricing functions performed, and purchasing, marketing, and services provided. These written policies should be periodically reviewed and updated.

These policies are discussed, finalized in writing, approved, and reviewed at least annually by the board. A policy manual is developed and distributed to each director and the manager.

General policy statements reflect the board's philosophy of what kind of business the cooperative should be, such as being a civic and business leader in the community. Hence, the manager can make minor commitments to participate in community events without first getting board approval.

Policies may also be specific, such as: "No additional credit shall be extended to any patron whose account is 120 days past due." Such a policy gives the manager authority to refuse extending additional credit even to a director. Here are some other specific examples:

- Policy – An independent Certified Public Accountant shall audit the financial records at the end of the fiscal year. Implementation—the manager keeps appropriate records and provides other information needed for the audit.

- Policy – The manager shall prepare an annual business plan for approval and make progress reports at monthly board meetings. Implementation – Without further specifics, the manager prepares a budget for approval, then compares it to actual business transacted, and reports any other information that would help the board understand the cooperative's operational and financial status.

- Policy – Employee pay raises will be based on job performance.

- Implementation – Job descriptions and performance standards are written for each employee and performance is reviewed annually. Amount of pay raise depends on performance evaluation results.

- Policy – An annual membership meeting shall be conducted. The president of the board of directors shall address the membership. Implementation – Management plans, organizes, and conducts the annual meeting. The president presents a report at this meeting focusing on the cooperative's major accomplishments of the year and broad strategic plans going forward.

Distribute Year-End Financial Benefits – The cooperative's performance is recorded on a fiscal year-end statement of operations and balance

sheet. The board determines how the net income (or loss) will be distributed. With net income, it decides how much patronage refund to pay members in cash (Federal law requires at least 20 percent), how much to place in allocated equity, and how much to retain (unallocated equity). The latter is necessary to help operate the cooperative and provide for its capital needs. Allocated equity refunds are members' equity (ownership) in the cooperative and are periodically returned to the members on a revolving schedule, as determined by the board.

Strategic Planning – The board provides leadership in developing cooperative plans to meet members' needs as time goes on. The process starts with an assessment of the general and changing business climate that affects both members and the cooperative. In long-range planning, the board – with input from management – considers challenges relating to internal and external organizational growth, business volume, membership, territory served, assets, etc. The board develops objectives and strategies for management to implement to achieve the objectives. They monitor plan progress on an ongoing basis and make necessary adjustments.

Self-Evaluate – The board should conduct an internal assessment to assess how well it is fulfilling responsibilities. Directors should assess: (1) themselves individually, (2) the board's performance, and (3) board meeting effectiveness. Conducting such assessments identifies weaknesses and allows for the development of corrective actions. Education should be provided to address weaknesses. An effective board improves the likelihood of positive cooperative performance.

Elect Board Officers – The board usually elects the cooperative's officers shortly after the annual meeting. Each officer has specific duties as detailed in the cooperative's bylaws. The most common officer makeup of cooperatives includes a president, a vice-president, a secretary, and a treasurer.

- The president presides at all meetings, watches over the association's affairs, and serves as the main communication link between hired management and the other directors and members.

- The vice president, in the absence or disability of the president, performs the duties of the president.

- The secretary keeps a complete record of all meetings of the board of directors and general membership and is also the official custodian of the cooperative's seal, bylaws, and membership records.

- The treasurer oversees the bookkeeping and business accounts to ensure accuracy and proper handling. The treasurer also presents periodic financial reports.

Appoint Board Committees – The board's work may be divided among special or permanent committees, each dealing with a phase of the association's operations,. These may include finance, purchasing, feasibility, marketing, membership, nominating, and others.

Committees study the problems or issues in their particular field and make recommendations to the board of directors. In some instances, committees may be given certain powers to act for the board, subject to later review by the entire board.

Summary

The board of directors is the cooperative's leading governing body. In carrying out this overall responsibility, the board performs several important supporting roles. It is a listening post, hearing from management and membership. It is a communications hub, imparting information between members and management. It is an advisory body to members and management, providing recommendations and guidance. It is a decisionmaking group, deciding on cooperative policies, approving major operational changes, and developing strategic plans. But in every role and action, the board is accountable to members.

Members choose director candidates and elect them to office. From their peers, members select individuals with the best judgment and business management skills to represent them and conduct affairs on the cooperative's board of directors. Loyalty, integrity, the ability to make wise business decisions, and willingness to serve are some of the necessary characteristics for board members.

Acting as a group, directors set the objectives for the cooperative and make decisions that set the course the cooperative will follow in achieving those objectives.

In carrying out their responsibilities, directors serve much like trustees, charged with legal obligation to protect the assets of the members. Directors must fulfill their responsibilities while exercising due care to act within the parameters of the cooperative's policies and the law.

Chapter 4

What the Cooperative Manager Does

This chapter focuses on managers and their responsibilities, with particular emphasis on differences between managing a cooperative versus other forms of business.

All businesses are managed to provide a return on the investment of stockholder-owners. The manager of an investor-owned corporation basically needs to satisfy stockholders with the yield they're earning on their investment. The manager of a cooperative, likewise, needs to satisfy its member-owners, but he or she needs help from them, including information and input on decisions. Because of the active participation of members, there must be considerable communication between them and the manager.

The success of a cooperative largely depends on the relationship between the board of directors and management. The working relationship between board and manager requires respect and an understanding of each other's responsibilities.

Like any other business, cooperatives attempt to hire the best manager, offering competitive wages and benefits, performance incentives, and retirement programs. Managers are hired to operate the business, focusing their efforts on everyday operations to serve members. When interviewing manager candidates, the board must make the ownership issue clear and further stress that the manager is accountable to the board.

The board of directors decides what the cooperative will do; the manager and immediate staff decide how it can best be done – subject to board review – in achieving the primary objective of serving members effectively.

Manager Responsibilities

Cooperative, managers have responsibilities that differ from those of directors. Understanding the differences in a cooperative is a key requirement for an effective and harmonious relationship between directors and the manager. In a cooperative, the manager does not share in ownership and should not be a member of the board. This produces a clear separation between manager and director responsibilities.

The major responsibilities of a cooperative manager are to:

Implement Board Policy – Policies are set by the board of directors and implemented by the manager. All business operations of the cooperative must be managed within the boundaries of the policies that are set by the board.

Advise the Board – While members and their elected directors often operate their own farm business, the operations of a cooperative usually greatly differ. The manager therefore has a responsibility to advise the board on how the cooperative can be operated more effectively, offering direct technical advice in areas such as:

- Competitive strategy – cost cutting, pricing policy, service packages, cooperative benefits, etc.;
- Financial management – credit control, debt load, cash-flow, and member equity.
- Operational efficiency – product storage and handling, pickup and delivery schedules, administrative procedures, facility organization, purchasing and marketing strategies, and staffing;
- New technology and equipment – industry innovations, improved machinery, computer systems, and research results;
- New products and services – additions or replacements and product information;
- Policy changes – made necessary because of problems with

implementation or by changes in business environment;

- Regulatory changes – chemical use, worker safety, environmental laws and standards;

- Governmental affairs – new or changed legislation, governmental assistance programs, and involvement in public policy.

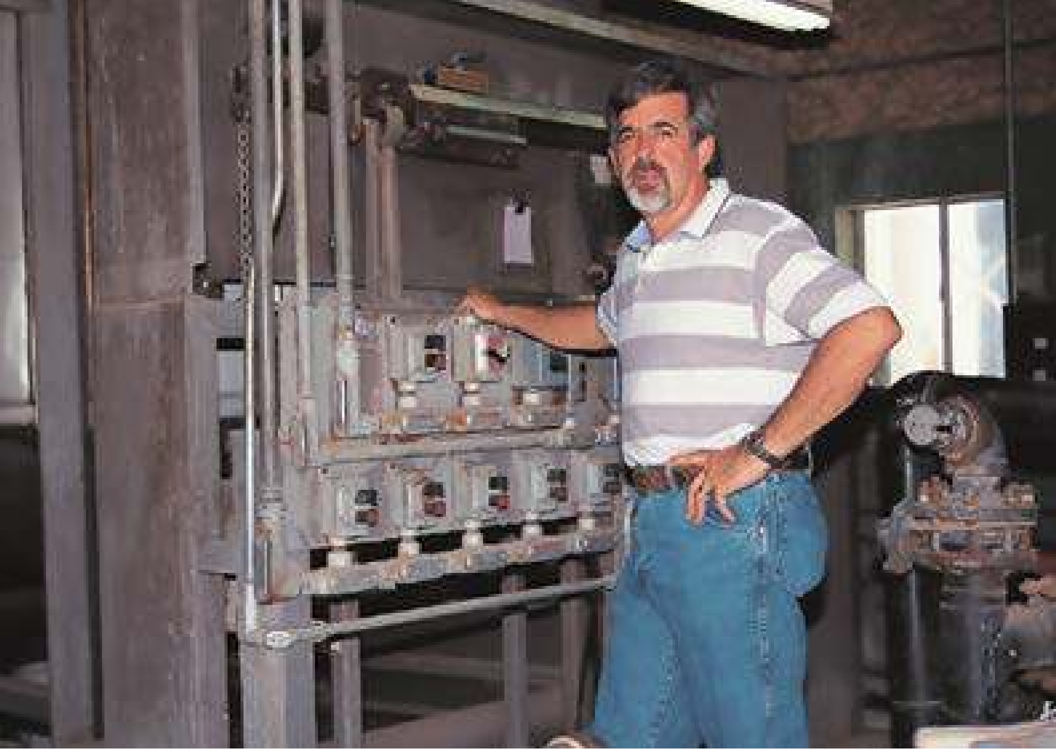
Manage Daily Operations – Supervises and coordinates – under board direction – the business activities of the cooperative by managing the people, capital, and physical resources.

Hire Staff – Maintaining a competent staff is a very important job for a manager. How well the manager selects, trains, and supervises employees has a direct bearing on how well the cooperative performs. The board provides the manager with tools to assemble an effective staff, including a wage and salary plan, attractive benefits, and safe working conditions. Employees make the cooperative work, but the manager provides leadership, direction, motivation, and appraises their performance.

Set Tactical Goals and Implements Action Plans – Significant operational planning occurs as managers direct the daily affairs of the cooperative. The manager develops tactical goals in line with the cooperative's major long-term objectives, as set by the board of directors. The manager develops and implements action plans to reach the shorter-term tactical goals.

Report to the Board – The manager must be an active, but non-voting , participant at board meetings. Managers keep their boards informed of issues and circumstances that affect cooperative operations.

Formal reporting occurs at monthly board meetings. The manager sends financial statements and information on major issues to directors in advance of board meetings so they can review the material. Accurate reports to the board are necessary for good business management and help build mutual respect and trust between the manager and board. Major items include:



- Information on special issues and circumstances;
- Statement of operations with budget comparisons;
- Balance sheet with comparisons to one or more previous years;
- Accounts receivable status that notes delinquent accounts';
- Progress toward objectives set as part of planning;
- Summary of operations activity during the most recent period; and
- Proposals for immediate or longer term consideration.

Managers also need to be able to contact their boards at any given time. Outside of board meetings, managers must keep the board president and other officers apprised of significant events that may call for immediate action.

Report to Members – Cooperative bylaws require a formal annual report be distributed to members and an annual meeting to be held. The manager distributes the full annual report to the board and creates an abbreviated form to be given out to all members at the annual meeting. In more abbreviated form, the report contains much of the same information already provided to the board. The manager then gives a report to the membership discussing operational highlights, issues and problems encountered, special activities, and outlook for the coming year.

The manager also writes letters to members, and typically writes a column in the cooperative's newsletter and/or on the Web site, and may send out messages via social media. District or regional meetings and one-on-one member visits are often used. Periodic cooperative publications cover a wide range of information about cooperative operations. In addition, the manager will often have daily informal contact with some members as they visit or transact business at the cooperative.

Representing the Cooperative

As the person in charge on a day-to-day basis, the manager represents the cooperative in many ways. His or her representation

is often guided by the cooperative's policies and specific board directives. The manager's own interests may also influence the type and extent of his or her representation on behalf of the cooperative. The manager represents the cooperative in at least four areas: community, cooperatives, industry, and government.

Community – As a business leader, the manager may be called upon to participate in a variety of community activities, such as helping raise funds for charities, speaking at business and social events, and becoming a member of the chamber of commerce or community service organizations.

Other Cooperatives – The board of directors may select the manager to be the cooperative's voting delegate or official representative to other cooperatives or cooperative organizations. At the board's discretion, the manager may serve on the boards of other cooperatives, such as a federated cooperative it belongs to.

Industry – Most industries have professional or trade associations to protect or enhance their business interests. The manager may get involved in one or more of the key organizations closely related to the cooperative's functions.

Government – Managers who are particularly convincing speakers are often called upon to speak to regulatory officials and policymakers on issues affecting the cooperative or its members.

Even in personal actions and activities, many people see the manager – sometimes indirectly – as representing the cooperative. That responsibility requires constant and careful attention.

Summary

A cooperative manager wears many hats and fulfills a unique position between members, employees, and the board of directors. In meeting responsibilities, a manager essentially simultaneously serves as coach and player, leader and follower, educator and motivator, diplomat and dictator, mediator and magician, judge and jury, and analyst and activist.


Thomas

Chapter 5

What the Employees Do

This chapter focuses on employees: what they do, and the characteristics of quality employees.

Cooperative employees work for a unique organization because the owners of the business are its day-to-day customers. This close contact with owners requires certain sensitivity by cooperative employees in serving members' needs. Members want, and expect, good service and fair treatment from the employees of their cooperative business.

Cooperative employees deal with both the member-owners and the cooperative's business associates (i.e., venders, marketers, transporters, suppliers, advertisers, etc.) on a day-to-day basis. This unique business relationship places added emphasis on people skills when dealing with the member-owners and those that the cooperative deals with to carry out its services for members. Employee attitudes are judged whenever they have direct contact with members and business associates.

Employees promote the cooperative and carry out the cooperative's business: delivering supplies, handing members' products, conducting marketing and sales activities, ordering and maintaining supplies and inventories and keeping accurate accounting records. Their role also includes recommending products and services to members; handling complaints; representing the cooperative in the business and civic communities; educating members and the public about what the cooperative offers; and adequately maintaining facilities to serve members.

Characteristics of Quality Employees

Like all businesses, cooperatives need quality employees. To be effective and serve the cooperative well, employees have obligations and responsibilities.

Understand the Cooperative – Quality cooperative employees understand the uniqueness of their organization. They understand what a cooperative is and understand the cooperative principles that are the foundation of the organization.

It's hard for employees to deliver quality services if they don't understand the business that employs them. Ownership entitles members to certain information that they would not expect from privately held businesses. Cooperative employees are often asked questions about internal operations, governance, and earnings of the business. A well-informed employee knows how to handle these questions in a way that satisfies members.

For non-members, employees must be careful not to reveal information that could be useful to the competition. All employees must be kept well informed of the cooperative's distinctive traits and operations.

Know and Follow Policy – Well-informed employees keep abreast of current cooperative policies and rules. The purpose and application of any policy or rule should be discussed with a supervisor or explained in an employee meeting. Policies and rules are implemented to safeguard the member-owner interests, set good business standards, and ensure the cooperative's success.

An employee's supervisor and the manager are responsible for handling and resolving any conflict with the cooperative's policy.

Well-informed employees avoid evaluating policy or rules to fit a particular situation or circumstance. They should implement policy and rules in a fair and equitable manner toward all fellow employees and customers.

Respect All Members and Treat Them Fairly – Cooperative members (the customers) want to be treated fairly and honestly by the business they own. Special treatment for one customer may generate short-term results, but cause ill will and dissatisfaction among most customers.

Indeed, special concessions shared with selected members or other customers soon bring dissatisfaction among all members/customers. Employees must be polite and professional and offer services or products in an equitable way to all members, regardless of their status in the cooperative.

Are Well Trained – Employees must be able to explain technical information about service areas in which the cooperative operates. Customers rely on employees to recommend products or services. The ability to respond to member questions and resolve their problems plays a role in determining how loyal members will be to the cooperative for their future needs.

Because of the fast pace of today's business and changes in technological product and environmental regulations, employees must understand the operations and methods the cooperative uses to provide products and services.

Are Team Players – Team success, whether in sports or business, demands that all players cooperate to reach predetermined objectives. Each employee of the cooperative organization should

know the objectives of the cooperative and understand their role in achieving them. They must work together toward overall achievement of objectives.

Employees working in service organizations, such as cooperatives, must be aware of the service level required to meet the organization's objectives and their expected contributions to the team effort.

Communicate Well – Strong communication is the key to any successful business operation. Employees are the eyes and ears of a cooperative and some are in positions where they constantly interact with members and the public. That interaction is important as a communication and feedback system can help shape future procedure and policy changes necessary for increasing member appreciation and satisfaction.

Employee communication with supervisors leads to implementing desired changes. Unsafe working conditions or damaged facilities and broken equipment should be reported to supervisors for correction or repair. Irregularities in cooperative business operations or planned absences from the job must be communicated to keep the cooperative operating efficiently. Issues with member relations of any kind should be brought to a supervisor's attention.

Effective communication means not only talking, but also listening carefully to comments and suggestions from members, other customers, instruction from supervisors, and recommendations from other employees.

Maintain Assets – Employees are responsible for keeping members' assets – facilities, equipment, inventory, and supplies – in good condition. Dirty or poorly arranged merchandise, malfunctioning equipment, unkempt facilities, and lower or poor-quality products can be a deterrent from reaching a cooperative's goals, just as overpricing or poor selection of merchandise would be. Malfunctioning equipment and poorly maintained facilities suggest that employees don't take member satisfaction seriously.

Participate in Community Activities – Employees carry the image of the cooperative to the community by participating in civic or service organizations, school activities, professional and youth groups, or the chamber of commerce. If possible, employees should strive to be involved in some aspect of a community's activities.

Volunteering not only contributes to the employee as an individual, but also shows the cooperative is interested in the needs and welfare of the community. However, it is important to note that because they represent the cooperative, employees must be cautious about taking a particular stand or participating in an activity which has special social, political, or religious orientation. Most cooperatives maintain religious and political neutrality.

Maintain Professionalism – Employees present the cooperative's image during their day-to-day contacts and the work they conduct. Therefore, it is important that they maintain a professional attitude while carrying out their duties. A professional attitude means that employees are polite, positive, courteous, well educated, articulate, and enthusiastic about the cooperative's mission.

Summary

Cooperative employees play an important role is carrying out the cooperative's business for members. Given the unique principles that cooperatives operate under, it's imperative that employees fully understand the uniqueness of a cooperative, compared to an investor-owned-firm.

Many employees interact with the member-owners of the business every day and with management as well. They have responsibilities to fulfill like all business employees, but the relationships they forge with members further define their unique position in the business world. Employees – together with members, directors, and the manager – run the cooperative business to serve and benefit members.

Appendix: USDA Cooperative Information

Cooperative Programs within USDA's Rural Development mission area, conducts research, collects statistics, develops educational materials, and provides technical assistance to farmers and other rural residents interested in organizing cooperatives. See the website: https://www.rd.usda.gov/programs-services/all-programs/cooperative-programs.

General and specific cooperative educational materials are available from USDA. These can be found online at: https://www.rd.usda.gov/publications/publications-cooperatives.

Here is a snapshot of materials that complement and expand upon the information in this report:

- CIR 55 – Co-ops 101: An Introduction to Cooperatives
- CIR 5 – Cooperatives in Agribusiness
- CIR 7 – How to Start a Cooperative
- SR 58 – Vital Steps: Cooperative Feasibility Study Guide
- CIR 61 – The Circle of Responsibilities for Co-op Boards
- CIR 62 – Cooperative Directors: Asking Necessary Questions
- CIR 63 – Nominating, Electing and Compensating Co-op Directors
- CIR 45 Section 1 – Understanding Cooperatives: The American System of Business
- CIR 45 Section 2 – Cooperative Business Principles
- CIR 45 Section 3 – The Structure of Cooperatives
- CIR 45 Section 4 – Who Runs the Cooperative Business: Members

- CIR 45 Section 5 – Who Runs the Cooperative Business:
- CIR 45 Section 6 – Who Runs the Cooperative Business: General Manager and Employees
- CIR 58 – Assessing Performance and Needs of Cooperative Boards of Directors
- CIR 39 – Sample Policies for Cooperatives
- RR 231 – Comparing Cooperative Principles of the U.S. Department of Agriculture and the International Cooperative Alliance
- Cooperative Curriculum for Instructors – Understanding Cooperatives: 7 Lesson Units on CD ROM

For questions or requests email: coopinfo@wdc.usda.gov

United States Department of Agriculture