

# **Cooperative Benefits and Limitations**

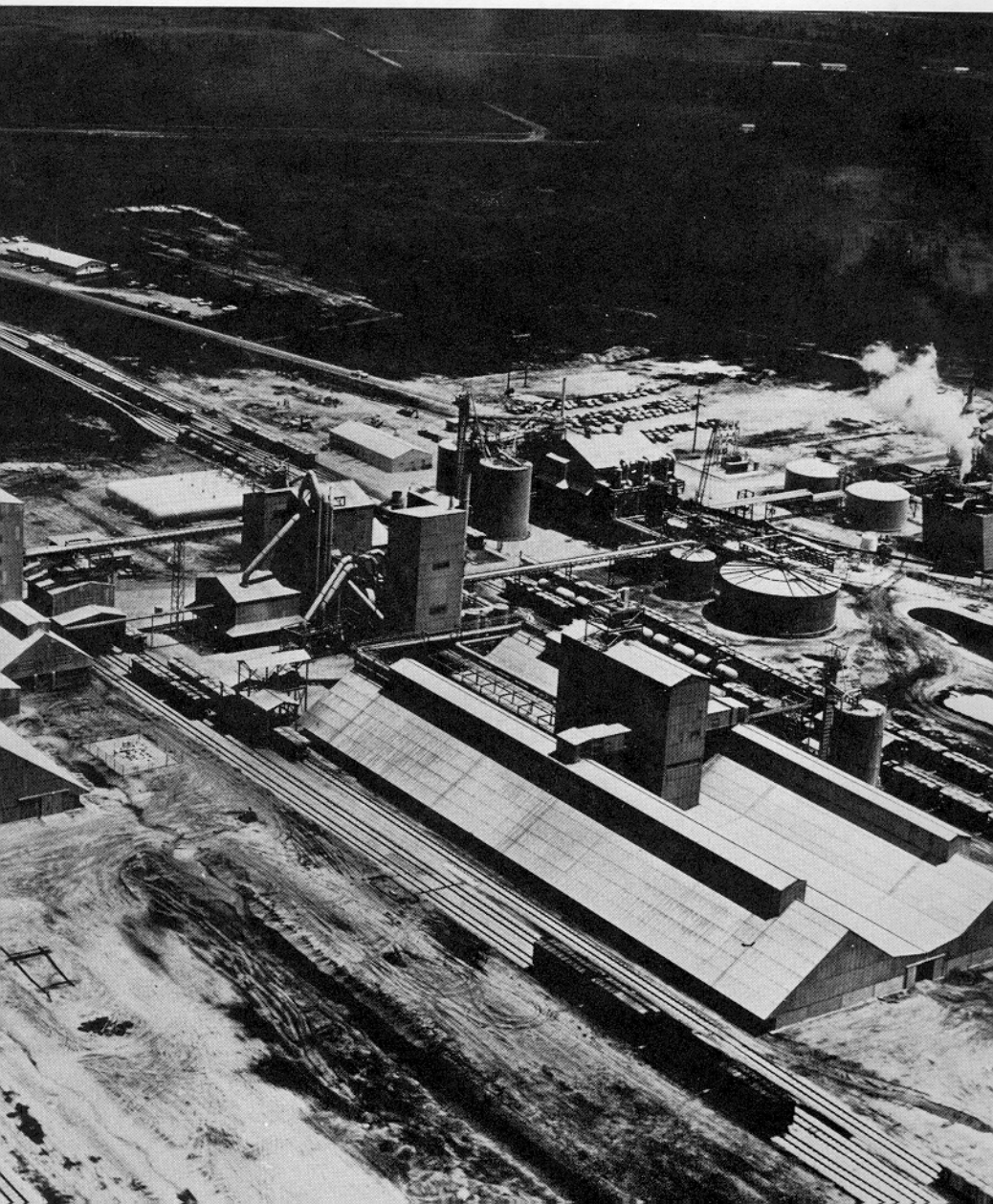
## **Farmer Cooperatives in the United States** **Cooperative Information Report 1 Section 3**

United States Department of Agriculture  
Rural Business – Cooperative Service

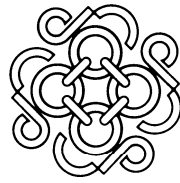
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*Farmers have found that a major benefit of a cooperative business is to give them an assured source of supplies and a market for their products. An example of building a source for phosphate fertilizer is the CF Industries, Inc., Plant City, Fla., complex. At the beginning of the 1980's, Farmers had invested \$17 billion in cooperatives, an average of about \$6,500 per farm.*



# Cooperative Benefits and Limitations



Successful cooperatives can benefit their farmer members and others in many ways. But even the most successful cannot be all things to all members. Understanding the more common benefits and limitations of cooperatives will help clarify their role in American agriculture.

## How Cooperatives Benefit Farmers and the Public

Cooperatives marketing farm products and providing farm supplies, credit, and other services vary widely in success. So their benefits and limitations also vary.

Benefits of cooperatives are difficult to measure. Some are tangible or direct as in the case of net margins or savings. Others are intangible or indirect such as cooperatives' effect on market price levels, quality, and service. Some are most evident at the time the cooperative is organized but become more obscure as the years pass. Benefits are greater for some types of cooperatives or in specific areas. Most benefits are evaluated in economic terms but some also may be social.

### Benefits to Farmers

In several major ways, cooperatives benefit farmer-members, and often nonmembers.

### Ownership and Democratic Control

Cooperatives enable farmers to own and control, on a democratic basis, business enterprises for procuring their supplies and services (inputs), and marketing their products (outputs).

They voluntarily organize to help themselves rather than rely on the Government. They can determine objectives, financing, operating policies, and methods of sharing the benefits.

Through cooperatives, farmers can own and operate a user- or service-oriented enterprise as contrasted to an investor- or dividend-oriented enterprise. Farmer ownership allows producers to determine services and operations that will maximize their own farming profits rather than profits for the cooperative itself.

## **Increased Farm Income**

Cooperatives increase farm income in a number of ways. These include: (1) Raising the general price level for products marketed or lowering the level for supplies purchased; (2) reducing per-unit handling or processing costs by assembling large volumes, i.e., economies of size or scale; **(3)** distributing to farmers any net savings made in handling, processing, and selling operations; (4) upgrading the quality of supplies or farm products handled; and (5) developing new markets for products.

By pooling supply purchases, sales, and handling and selling expenses, cooperatives can operate more efficiently-at lower costs per unit-than farmers can individually. This principle also can be applied to succeeding levels in terminal marketing of commodities and in wholesaling and manufacturing of supplies.

Farmers usually judge the benefit of belonging to a cooperative by its net margins or savings-a tangible measure. More specifically, they look at the amount currently paid to them in cash. Next is the amount allocated to them in noncash forms that may be revolved later. Many cooperatives annually make substantial cash payments of earlier deferred refunds from revolving funds.

The net margins realized by 5,900 marketing and supply cooperatives were about \$1.3 billion in 1976, after eliminating intercooperative distribution of patronage refunds and dividends on member capital. These savings were equal to about 21 percent of the \$6.14 billion investment members had in these cooperatives that year. Measured another way, such a savings constituted about 7.1 percent of the total \$18.8 billion net income U.S. farmers earned in 1976.

In addition, many cooperatives operating on a pool basis realize proceeds exceeding the average market prices in their trade area. Riceland Foods, Stuttgart, Ark., through combined superior marketing, processing, and exporting services, has for the past

three decades paid its members an average of 40 cents or more per hundredweight of rice above the average price received by all U.S. rice growers. Riceland's soybean grower members in the past decade have received 35 cents more a bushel than average. Similar benefits are substantial for fruit and vegetable, wool, and dairy farmers. A number of dairy, sugar, and fruit and vegetable associations bargain primarily for price, but also terms of sale, including terms for certain input items. These associations encourage members to produce quantities and quality of products needed to meet market requirements. Overall information on the influence of bargaining associations on prices received by members is not available.

Cooperatives also provide important indirect benefits through their effect on local prices for farm products, supplies, and services. The savings aspect usually becomes less tangible over a period of time.

Cooperatives inject competition into the system by providing services at cost to members. This leads to pricing adjustments by other organizations; thus the real benefit may be their day-to-day impact on market prices. Based on the competitive influence of cooperatives since they began operations, many leaders report that these economic benefits greatly exceeded the annual net margins of the cooperatives.

Also, a few large supply cooperatives have reduced prices and margins temporarily during periods of drought or unusual price-cost squeeze to provide direct benefits on a seasonal basis rather than at the end of the year.

Farm credit cooperatives, including Federal Land Bank Associations, Production Credit Associations, and the Federal Land Banks, Intermediate Credit Banks, and Banks for Cooperatives serving them, had net income of about \$369 million in fiscal 1978 and \$334 million in fiscal 1977. Data were not available on rural credit unions. Rural electric cooperatives had net margins totaling \$388 million in fiscal 1978 and \$340 million in fiscal 1977.

Most cooperatives have programs to retire equities farmers have built up over the years with their patronage. These amounts can be substantial, as exemplified by the \$19,992 check Bill Clifford of Plymouth, Neb., received on his 65th birthday. The check represented his equity built up between 1944 and 1976 from using his cooperative in support of his 80-acre hog farm.

In 1979, farmers had \$16.9 billion invested in cooperatives, an average of \$6,423 per farm.

## **Improved Service**

A basic objective of cooperatives is to serve their members' needs. They do this by providing services not available or by improving existing services. Rural electric cooperatives and artificial insemination associations are outstanding examples of making a new service available in rural areas. Production Credit Associations pioneered in making loans based on carefully planned budgets-still an important part of their services.

Providing a year-round grain marketing or processing service are meeting a need in some communities. Other new services are electronic auctions to encourage competitive pricing in livestock and cotton, bulk assembling and handling of citrus, use of bulk farm tanks and tank trucks for assembling milk, and further processing of a variety of raw farm products.

In the supply field, soil testing followed by bulk blending, delivery, and spreading of fertilizer are services first developed and now provided by many cooperatives. More recent services are application of liquid fertilizer and pesticides, "keep-full" services for gasoline and fuel oil, car care centers, and telephone-to-computer service for information on recommended types of fertilizer and feed for specific uses.

Cooperatives are supplying various custom services to help farmers meet labor shortages or to minimize individual investments in equipment.

Cooperatives have led in improving services to farmers because their objectives have been to meet members' needs even though little or no net margins are made for the cooperative in every operation.

## **Quality of Supplies and Products**

Farm supply cooperatives have been noted for providing supplies giving the greatest value-in-use to the farmer. Their objectives have been to provide the feed, seed, and fertilizer that gave the farmer maximum gains or yields rather than those that returned the largest net margins to the cooperatives.

Cooperatives long have relied heavily on State experiment stations for advice as to variety of seed, analysis of fertilizer, and formulation of feed that would best meet the needs of their farmer-members.

In marketing farm products, cooperatives' pricing practices have been based on differentials for quality. And they have provided information and advice on ways to produce quality products and to maintain that quality in the marketing process. Basically, cooperatives encourage production oriented to market requirements by developing producer payment plans based upon meeting grade, size, time, and other market specifications.

Marketing cooperatives have led in demanding industry grade standards, then using them in offering top quality products to buyers. Their efforts to improve quality, reliability, and integrity of exports can increase the cooperatives' share of the export market.

## **Assured Sources of Supplies**

Cooperatives provide members with a dependable source of reasonably priced supplies, especially during shortages or emergencies. This service may require cooperatives to forego larger net margins from other domestic or foreign business to meet the needs of their member-owners.

Cooperatives operated as pacesetters in the public interest in supplying petroleum and fertilizer to farmers during the shortages of the early 1970's. Specifically, cooperatives (1) confined sale of supplies to member-patrons to enable farmers to expand production; **(2)** made special purchases at extra costs; **(3)** added storage and transport equipment to acquire or store products when they were available; (4) expanded refining and manufacturing capacity; and (5) formed an international petroleum trading and purchasing cooperative to acquire foreign sources of supplies.

In 1975 during a period of fertilizer shortages and skyrocketing prices, cooperatives held the line by charging an average of \$31 per ton less than noncooperative suppliers, resulting in a cost saving to farmers of nearly \$200 million.

Cooperatives worked closely with congressional committees and Government agencies to obtain priorities for fuels and plant foods needed to meet food and fiber production goals. Also, they offered various suggestions to members for conserving fuel and fertilizer supplies. Furthermore, cooperatives began extensive long-range planning for strengthening the supply position of members in the years ahead. For example, petroleum refinery facilities were purchased to improve cooperatives' fuel sources.



## Enhanced Competition

Strong successful cooperatives introduce desirable competition that raises the going market prices for farm products, the type of services provided, and the quality of supplies farmers purchase. Individual farmers have little bargaining or purchasing power, but by joining in cooperatives they can acquire “muscle in the marketplace.” Farmers in many areas are forced to deal with fewer product buyers or supply sellers. In some industries, only a few large companies control a substantial share of the market at various integrated levels in the marketing process.

Cooperative competition can have a salutary or regulative influence on the daily operating practices of business firms. Local prices for farm products often advance when cooperatives enter the market, and the prices of purchased farm inputs frequently declines. After Tri-Parish Cooperative, Slaughter, La., opened in 1960, other feed companies dropped prices \$20 a ton within the first year. In 1975, Moroni Feed Company, a turkey cooperative in the Sanpete Valley of Utah secured a \$7.50 ton reduction in Midwest shipments of soybeans, a benefit producing \$125,000 in savings to members.

The basic cooperative principle of providing services at cost injects a highly competitive force in the marketplace even though there are a small number of large firms. Cooperatives provide a “yardstick” by which members can measure the performance of other firms that serve farmers. This can help cooperative officials decide whether to integrate operations on a more intensive scale.

Cooperatives, due to their nonprofit and service-at-cost nature, tend to push performance closer to the competitive norm. The reason is that they bring more to market at a higher producer price than would be the case if all firms were profit-seeking. This assumes open membership in the cooperatives.

When cooperatives enhance competition in the marketplace, usually nonmembers as well as members benefit. They may gain from increased price levels for farm products or lower price levels for supplies; from upgrading of quality or improvement of services; or from development of new markets.

## Expanded Markets

Through pooling products of specified grade or quality, many marketing cooperatives can meet the needs of large-scale buyers better than can individual farmers. A number of cooperatives have developed markets in other countries and their exports

provide outlets for more production than members otherwise could sell.

In many cases, cooperatives have expanded-or acted to retain markets by processing members' products into different forms or foods. Major cooperatives have been organized to preserve farmers' link to a market and to protect their production investment. Examples are: Pacific Coast Producers, formed to process growers' fruits and vegetables after a large cannery closed; and American Crystal Sugar Company, purchased by sugar beet growers and converted to a cooperative after previous owners began closing plants that refined beets into sugar. Some associations have pioneered in developing new types of processed food products. These approaches simply use members' production in different combinations. In some instances additional markets are created by improved storage techniques such as controlled atmosphere for fresh products.

Farmers have used cooperatives to capture a greater share of the value added to a product as it moves to the consumer. By the mid-1970's, more than 80 cooperatives were marketing farmers' products under nearly 300 cooperative-owned processed food brands.

## **Improved Farm Management**

Progressive managers and field staffs of cooperatives provide valuable information to members on farm production and management practices. Advice may be offered on the quality of seeds, fertilizers, and pesticides, and on feeding and cropping practices. Also, many cooperatives provide market and economic information about various products or enterprises. Many cooperatives assist county extension agents in implementing the recommendations of State experiment stations. Many farmers are looking to their cooperatives for more complete purchasing and marketing services.

## **Legislative Support**

Another financial benefit, not easily measured, is the legislative support cooperatives provide for their members. This is supplied by the large centralized cooperatives, the federations of locals, State cooperative councils, and National cooperative organizations such as the National Council of Farmer Cooper-

atives, the National Milk Producers Federation, and the Cooperative League of the USA.

An example is the passage in 1978 of the Tax Reduction Act, which increases the investment tax credit for cooperatives. Directors and employees of many cooperatives devoted much time and experience to help get this change through Congress. Officials estimate that this bill will mean added annual savings of \$1 to \$2 million just for members of the Land O'Lakes cooperative system.

## **Local Leadership Development**

Successful, growing cooperatives often develop leaders among directors, managers, and other employees. And members, by participating in business decisions on a democratic basis, become more self-reliant and informed citizens in their communities. The practical business experience acquired as directors or committee members is often supplemented by specialized formal training. This experience of working with the cooperative contributes to improved rural leadership.

In July 1976, Secretary of Agriculture Earl L. Butz, speaking at the 50th anniversary of the Cooperative Marketing Act and Farmer Cooperative Service of USDA, stated: "I think there is no better training ground for democracy in this country than in the self-management and operation in these cooperatives. That, to me, has been the great contribution that cooperatives have made in the past 50 years and I think it will be the great contribution they will make in the next 50 years."

## **Family Farmer Control of Agriculture**

These benefits, which vary among cooperatives, all indicate ways cooperative enterprises help the family farm stay in business and thus keep control of production.

The credit and supply cooperatives help the family farmer enlarge and operate his production units more efficiently on an independent basis. The marketing and processing cooperatives provide members market access and help them sell their products to **advantage**—either in the original state at harvest or later following storage, or in a processed form. These cooperatives help him (1) remain an entrepreneur rather than a contract producer or piece-worker, and (2) retain control of his products further up the marketing chain on the way to consumers.

Many leaders believe that marketing cooperatives have three basic alternative strategies or approaches in the future: maintain the open market, offer cooperative contracts, and forward integrate into advanced markets.

There are increasing indications that input requirements (credit, supplies, and equipment) and product marketing (assembling, processing, and selling) will need to be in one cooperative system to be most effective. It could offer farmers supplies on a for-sale or custom basis and provide each of the three marketing alternatives mentioned above.

Dr. Ronald D. Knutson, Texas A&M University, recently expressed this view to an audience of young farmer couples: "In the future every farmer will be a part of a system. The only question is whether it will be a corporate system controlled by someone else or a cooperative system controlled by producers. . . . Family farmers can survive only if cooperatives survive. . . . If cooperatives fail to relate, accept, and perform to meet the challenge, the family farm system of agriculture is finished."

Some cooperatives have become full-service, integrated enterprises. They now provide an alternative business system in which farmers can compete with the large industrialized corporations that are increasingly important in agriculture.

A new type of cooperative approach also is being used in some areas of the United States to combine features of the traditional marketing cooperatives with some aspects of production cooperatives. Briefly, individuals, often migrant farm workers, have combined their financial resources into equity capital. Using this as a corporate fund base, the cooperative arranges financing to either purchase or lease a tract of land. The cooperative then proceeds in the following manner: The board of directors, elected by the members, allocates the land to each family member. The member then assumes the production responsibility. To date, this type of cooperative has been involved primarily in intensive agriculture such as strawberry and vegetable production.

Some special features of these cooperatives need emphasis. Membership is on a family basis because production requires considerable labor. Family members become deeply involved in the operation by their total commitment of labor and all available capital resources. It is important to point out that the individual farm family member is the operator. His decisions determine how effectively he produces and, therefore, his annual returns.

The cooperative is the central focus for the entire operation.

The board of directors is exceptionally active and establishes guaranty and quality performance standards. These standards can be used as criteria for accepting or retaining the family member as a producer. The basic decision of land allocation becomes the critical decision made by the Board. The marketing is done by the cooperative. Thus, the operation of the organization ensures that fully responsive production patterns are developed through the land allocation power and the exclusive marketing arrangement.

These new types of cooperatives are another adaptation of the highly integrated cooperative operation. The production enterprises require a total family labor commitment, in contrast to the high capital requirement of other integrated efforts. Considerable progress has been made by these cooperatives as an organizational means for assisting migrant workers achieve economic and community status.

## **Benefits to Rural Communities**

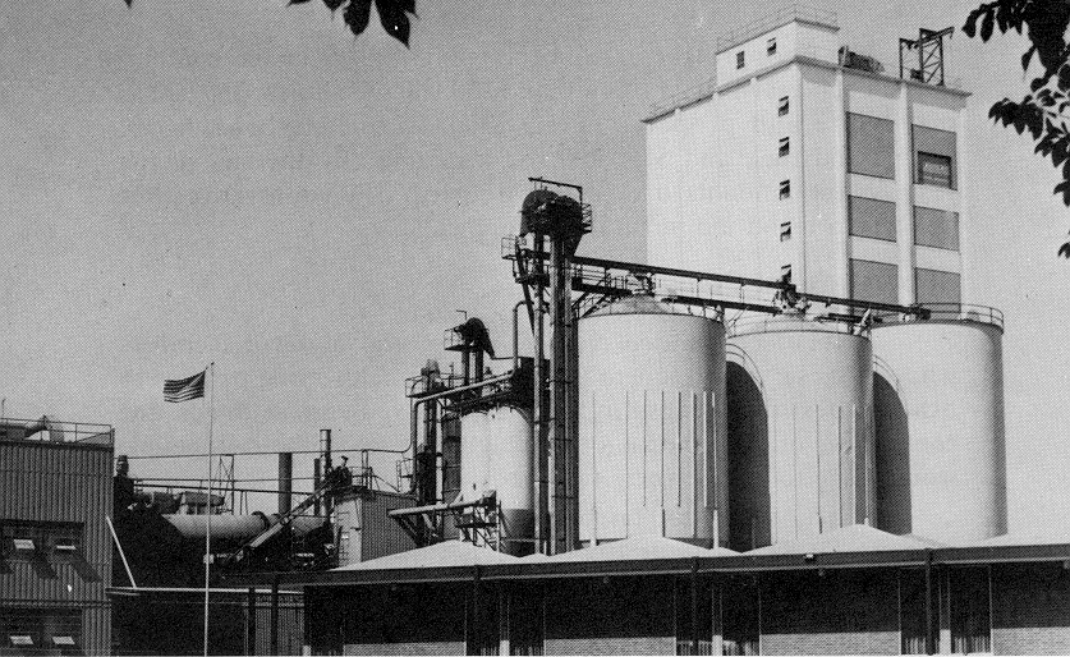
Cooperatives benefit the economy of rural areas in a number of ways.

### **Added Community Income**

Most of the additional income farmers get through cooperatives is spent with hometown firms for goods and services. Successful cooperatives also have substantial payrolls and their employees' patronage of local businesses adds to the economic well-being of the community. The cooperatives also spend money for supplies, utilities, insurance, and local taxes.

As an example, a cooperative in the Midwest for many years provided grain storage and marketing; petroleum, feed, and fertilizer distribution; and the handling of general supplies. Later it added feed manufacturing and seed cleaning services. As the rural population declined, some businesses closed in the small town where the cooperative was headquartered. The cooperative took over or added lumber, furniture, carpet, and appliances to serve the remaining farmers and rural residents. And it acquired or built elevators in two adjoining towns.

In a typical year in the early 1970's the cooperative had net margins of \$300,000 of which \$200,000 was paid in cash dividends and cash patronage refunds. The remainder was retained for capital reserves and income taxes. The savings realized from its operations were returned locally, not sent to stockholders in distant cities.



*An underlying benefit of a farmer-owned cooperative system is that benefits flow back to rural communities. Cooperatives in 1976 produced net savings for farmers amounting to \$1.3 billion. Cooperatives are often the economic backbone of rural communities. Above is the Dawson Mills soybean processing plant, Dawson, Minn.; below is the Blount Farmers Cooperative, Maryville, Tenn.*



The cooperative also spent many dollars in the communities. Each year it paid more than \$200,000 in salaries; \$30,000 as real estate and property taxes; \$200,000 for telephone, lights, water, and fuel; and \$100,000 for insurance. By the end of the 1970's these amounts had almost doubled. The cooperative thus has been a major aid in rural development.

### **Stronger Rural Communities**

A local cooperative usually has several hundred members who use its services frequently. This in turn helps bring patrons to other types of business in the community. In small towns, the cooperative often is the major or only business. Without it, people would have to go elsewhere for goods and services.

A majority of the farmer cooperative plants and other facilities are located in rural areas-a plus value in stimulating home ownership and retaining rural industry. Participation in cooperatives often encourages participation in other community projects and in State and local government. Cooperatives often provide funds for community fairs, health centers, fund drives, and the like. As a result of working together in cooperatives, members better understand how to unite in solving community problems. And leaders developed in cooperatives also become leaders in other community organizations.

### **Goods and Services to Nonfarmers**

Rural electric cooperatives serve many rural nonfarm residents. Likewise, diversified supply cooperatives supply gasoline, fuel oil, car care, fertilizers, pesticides, lawn and garden, and various home supplies and equipment to nonfarmers. Some cooperatives also provide custom services related to these supplies and distribute patronage refunds to these customers.

Good performance by farmer-owned cooperatives promotes their image with the public and helps obtain outside support in case adverse legislation or regulations are proposed.

### **Benefits to Consumers**

Although farmer cooperatives are organized to serve their members, they also operate in the public interest. Five ways they contribute to consumers were discussed by former Assistant Secretary of Agriculture George B. Mehren several years ago. They are still valid today.

## **Quality Products**

Producers in many cooperatives hire trained people to help them produce quality farm products—all the way from the seed to fertilizing, cultivating, harvesting, and transporting products to the cooperative packing or processing plant.

Many cooperatives have been leaders in searching for better varieties and handling methods; in establishing uniform grades and standards; in using quality testing laboratories; and in identifying quality by use of brands and labels. As a result, millions of consumers can buy with confidence products bearing cooperative brands such as Land O'Lakes, Sunkist, Ocean Spray, Diamond, Sun-Maid, Seald-Sweet, and Welch.

Cooperatives led the way in working with the U.S. Department of Agriculture on grading and standardization programs that help assure quality products. For example, **Norbest** Turkey Growers, Salt Lake City, Utah, was the first commercial firm to adopt U.S. grades and standards for turkeys. The Turtle Lake (Wis.) Cooperative Creamery Association became the first dairy manufacturing firm to receive a permit to label its dried skim milk products as Grade A quality. And the Lake to Lake Dairy Cooperative, Manitowoc, Wis., was the first firm USDA authorized to label consumer packages of cheese with its U.S. Grade AA shield.

Plains Cooperative Association, Lubbock, Tex., tests producers' cotton to measure staple length and ability to take and retain dyes. And it has developed techniques to classify fineness and color. These tests assure buyers of product **quality and help** growers produce the type and variety of cotton to meet consumer demands.

## **Varied Services**

Cooperatives have been alert and responsive to the changing demand for convenience foods, good packaging, and effective merchandising. Some conduct dealer and consumer education programs on proper care and handling of their products and ways to use them. A number use another merchandising device, the test kitchen, where they develop recipes for consumer use.

Cooperatives developed the system of classified pricing, later formally adopted in Federal milk marketing orders. These and other marketing orders and agreements stabilize the market, identify quality, shift low-quality products to byproduct use, and provide a more stable supply of products.



## **New Products and Processes**

Cooperatives have introduced new products and processes, including: (1) Tree Top, Inc., Cashmere, Wash., was the first to produce on a commercial scale, a frozen apple juice concentrate that USDA research had developed; (2) National Grape Cooperative Association, Westfield, N.Y., has developed many new products such as apple-grape drink under its Welch brand; (3) Sun-Maid Raisin Growers of Fresno, Calif., was responsible for much of the early work in developing machinery for cleaning and destemming raisins as they come from the growers' trays; and (4) Skookum Growers, Wenatchee, Wash., helped make Golden Delicious apples popular by helping breed better varieties and find better handling and holding procedures.

Land O'Lakes is an example of a cooperative that has striven to market foods that meet the needs and desires of consumers. Shortly after organizing in 1921, it pioneered quality control in butter production and was the moving force behind the establishment of Federal and State inspection and grading.

Land O'Lakes has continually diversified until its products now are found in about 400 different forms-in the grocer's dairy, meat, and frozen foods cases, and on shelves displaying dry and canned foods with Land O'Lakes products as ingredients. The basis of this diversification is its Research and Technology Division that comprises a Research and Product Development Department, an Analytical Laboratory, a Quality Assurance Department, and a Consumer Affairs Department. The Land O'Lakes Kitchens, located in Marketing Services, works closely with the Research and Development unit.

## **Lower Production and Marketing Costs**

Lowered production costs on the farm and marketing efficiencies brought about by cooperatives help hold down food costs to consumers. Farm credit associations and rural electric cooperatives make credit and electricity available to farmers at reasonable rates. Farm supply cooperatives make important contributions in controlling production costs.

By eliminating transfer of ownership and some of the stages of marketing and by keeping marketing and processing costs per unit at minimum levels, cooperatives influence the performance and margins of other firms. Some benefits of these more efficient distribution systems accrue to consumers.

Moreover, to the extent that agricultural cooperatives achieve increased returns for farmer-members, farm production and supplies may increase and prices become lower. Thus, for a period consumers indirectly may benefit as much or more than producers.

The question often arises as to whether increasing marketing and bargaining power of cooperatives will mean higher prices to consumers.

First, increased bargaining power often means more than bargaining for higher prices. It means bargaining for other terms of sale and results in more orderly marketing and market stability-thus providing ultimate benefits to consumers as well as farmers.

Second, the cost of farm products is only a small part of the total cost of many foods to consumers; hence, any price increase to the farmer has a relatively small effect on the consumer price. Further, if prices become too high on an item, consumers have a wide range of choices they can substitute and thus bring the price back down.

Third, farmers' increased bargaining power through cooperatives may interject a countervailing force on any excessive margins being taken by other handlers of food products. And increased efficiency resulting from strengthened cooperative operations or mergers could give the farmer added income without increasing consumer costs.

Fourth, in specific products, areas, or years a reasonable increase in costs to consumers may be justified to attain a more equitable balance between returns to producers and costs to consumers, or to assure more adequate supplies of the product.

## **Improved the General Welfare**

The additional income farmers receive through ownership in cooperatives is spread among thousands of farmers in communities throughout the country.

Cooperatives help reduce members' costs for supplies and services by distributing most of their net savings above costs of operation back to member-patrons on a patronage basis.

Cooperatives also employ thousands of employees who largely reside in rural communities. The cooperatives' substantial payrolls are spent for consumer goods and services in small towns and cities.

In addition, cooperatives are good customers of many other businesses that provide supplies, building, equipment, fuels, utilities, advertising, and the like.

The economic literacy and leadership qualities of rural people are also improved, thus making for stronger communities and citizens.

All of these contributions to farmers, rural communities, small towns, and consumers promote the general welfare of our country.

## **Benefits to People Overseas**

Several regional cooperatives have helped cooperatives develop in other lands. U.S. cooperatives organized the Cooperative Fertilizer International, headquartered in Chicago, to help farmers in India build a large cooperative nitrogen plant. They also contributed \$1 million to get the project started.

Many cooperative employees and leaders have gone abroad on specific assignments to help build cooperatives, or strengthen existing ones, in emerging countries.

Hundreds of trainees and representatives of cooperatives and governments in other countries come to the United States each year to learn about our cooperatives. Leaders and managers here hold conferences and conduct tours to explain the operations and services provided. For many years, visitors took courses and special training at the former International Cooperative Training Center at Madison, Wis. Officials of our cooperatives lectured and participated in seminars at these sessions. The center's activities were taken over by the University of Wisconsin in the early 1970's.

## **Limitations of Cooperatives**

Cooperatives are subject to the same economic forces, laws, and human relationships that contribute to the success or failure of other types of businesses. Cooperatives, however, have various intrinsic limitations. Some relate to the agricultural industry and others pertain to their objectives and the inherent nature of cooperative organizations.

### **Production Control**

Agricultural surpluses have plagued farmers from time to time since the Civil War, stimulating cooperatives to attempt production controls. They have found through bitter experience,

however, especially during the commodity marketing activities in the 1920's and the Federal Farm Board era a decade later, that they could not control production to any substantial degree.

It became increasingly clear that if production control programs were to be effective they would require the help of the Federal government with its power to allocate output, to offer incentives for restricting production, and to secure compliance with such programs.

Furthermore, at the present time, it is not legal for cooperatives to control members' production. The basic role of cooperatives is to market the available supply in the most effective manner possible, not to limit production.

## **Farming Based on Labor Input**

Cooperative farming usually refers to a cooperative enterprise where a number of farmer-members pool their land, capital, equipment, and labor, and share in the returns on the basis of their labor input.<sup>1</sup> Although this type of cooperative generally has not been successful in this country,<sup>2</sup> a few church groups operate farms on this basis or a modification of it. Frequently incentives are lacking, problems occur in decisionmaking, and dissatisfaction results from the distribution of net income. Another major problem has been the transfer of equities from one generation to another.

In the 1930's and 1960's, encouraged or assisted by Government agencies, low resource farmers formed a number of farm machinery-use cooperatives, sometimes called machinery pools. These did not last long because some members did not take proper care of the equipment or problems arose in scheduling its use among the members. Others were dissolved when members became able to purchase their own machinery. Much informal cooperation, however, still exists among groups of two or more

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Some statutes pertaining to agricultural marketing and purchasing cooperatives authorize the production of farm products. Other State statutes do not. Farmers, however, can form cooperative farms under the general cooperative or general corporation statutes of most States.

<sup>2</sup>Canada reported 16 farming cooperatives in 1975, with no change in recent years, and 23 farm machinery-use cooperatives. Also, Canada reported 304 other production cooperatives, including grazing, feeder, fodder, artificial insemination, woodcutting, and other types. In 1974 the 343 total production cooperatives had assets of \$36.1 million; sales of livestock, lumber, pulpwood and other, of \$36.1 million; and service and other income of \$8.3 million.

farmers in using specialized equipment such as that for terracing, combining, draining, and cutting ensilage.

Interest is developing in the modified type of cooperative farming discussed earlier wherein the cooperative leases or buys land and the members assume production responsibility for the acreage allocated to them. Experience will determine whether this type of activity will grow.

When diversified marketing/ supply cooperatives attempt to engage in agricultural production to guarantee a supply of products for their processing plants, or to attain capacity operation of their feed mills, inherent difficulties arise. If cooperatives operate farms, they may in effect compete directly with many of their members. They would compete in the farm labor market, and during periods of surpluses many members might believe that cooperative farming contributes to reduced farm prices. Also, the question might arise as to how much resources should be used and how many risks should be assumed by the entire membership for the benefit of one group of producers or type of product.

The basic question of risk-taking by the cooperative becomes apparent. Any gains made through production efforts are, of course, returned to the members. But, if substantial losses are incurred, members may not be willing to accept them.

## Price Fixing

In the 1920's, Aaron Sapiro espoused the philosophy that through large, strong cooperatives, farmers could tell buyers what the **price** of farm products were to be. Experience demonstrated that cooperatives could not fix prices because of their inability to control production. While cooperatives often could influence demand for the particular product they marketed through emphasizing improved production, better merchandising, and more effective bargaining, they were unable to substantially influence the overall demand for farm products.

Some question whether cooperatives handling a large share of a commodity's total production, such as cranberries, citrus fruits, or milk, could fix prices. This, however, does not take into account the basically inelastic nature of most agricultural consumption and the fact that consumers usually have a wide variety of food choices available to them, including those resulting from competition among cooperatives. Further, some farmers may choose to market independently and take advantage of the coop-

erative price umbrella rather than be a part of the cooperative. Should prices for any of these products increase too much, consumers may substitute other products.

## **Middlemen Functions**

Cooperatives generally cannot short-circuit the marketing system or functions within it. The usual steps are necessary in serving buyers although cooperatives may influence market structure and where and how marketing functions are performed. While not eliminating functions, they may improve or change inefficient marketing practices and replace middlemen who perform them. These changes can reduce marketing margins.

At the same time cooperatives cannot do the impossible in the marketplace. For example, they cannot always market members' surplus or poor quality products to advantage. Neither can they provide the highest quality nor the most complete services and still have the lowest prices for the supplies they sell.

## **Market Power**

Not all cooperatives acquire the leadership and financial abilities to deal effectively with other firms in the marketplace. Leaders of some local cooperatives want only to do an efficient job at the assembly and storage stage of the marketing process. They may acquire sufficient size and strength to influence the level of service and margins and thus return higher proceeds to members, but have little or no influence on the basic price level for a farm product or supply item. The heavy dependence on member-patron equity capital is a critical limiting factor in acquiring size and diversification.

Because of a lack of vision, leadership, managerial ability, capital, or for other reasons, some cooperatives do not or cannot vertically integrate their operations, either individually or jointly with other cooperatives in federated associations. They do not acquire strength at the processing or manufacturing level where the real market power may be found in the industry.

Furthermore, should large regional supply cooperatives acquire substantial market power, the likelihood of their abusing it with members is limited. Members would not permit them to charge exploitative prices, and if the cooperatives realize unusually large net margins, these usually must be distributed back to member patrons on the basis of their patronage.

## **Influence on Prices and Services**

When a cooperative is first organized, the general tendency is for gross margins of all firms serving the area to narrow. Prices for farm products increase and prices for supplies or services decrease to varying degrees. The cooperative's influence is clearly evident but after a few years it becomes obscure. Members tend to forget the situation prompting formation of the cooperative and young farmers never experienced it. Thus, cooperative leaders cannot state with certainty what the level of market prices, margins, or services currently would be if the cooperative did not exist.

## **Reserves Accumulation**

Where cooperatives operate fully on a cost basis by distributing to patrons any net margins remaining over operating expense, management sometimes feels this limits the cooperatives' ability to accumulate capital reserves similar to those in other businesses. This method of operation also may limit the use of carry-back and carry-forward provisions concerning any losses that might occur.

## **Restrictions by Inherent Characteristics**

Although such features as ownership by farmer-users and operating at or near a cost basis give cooperatives some advantages, they also present limitations. Some are self-imposed. Some have been alluded to earlier.

## **Frailties of Human Nature**

Cooperatives are subject to the same "people problems" as any business, but have additional problems stemming from being owned by those who use them. Some of their members and directors are misinformed; some have little realistic knowledge about business activities or how effectively their cooperative is operating or what it can be expected to accomplish. And directors and managers at times can neglect their responsibilities or take advantage of their positions, resulting in poor performance or failure of the cooperative.

Not all farmers in an area believe alike and thus not all will join or trade at a given cooperative. Likewise, leaders among

farmers and cooperatives do not always agree on objectives, policies, and approaches, often leading to intense competition and duplication of services and facilities between cooperatives serving the same area. This situation can limit their efficiency, market power, and members benefits.

Directors of cooperatives frequently are faced with the difficult choice between building financial strength of the cooperative through retained patronage refunds, or increasing returns to farmer members. The frailties of human nature may result in decisions that do not build cooperatives to their full potential.

### **Limited Objectives**

Members may organize a cooperative to market only one specific product or to handle only specified kinds of farm supplies. Also, their objectives may preclude handling supplies used by both farmers and nonfarmers, distributing patronage refunds to nonfarmers, or handling unrelated products on which a net income could be realized. These restrictions may limit the cooperative's volume and opportunities to reduce per-unit costs or to serve all farmers or all rural residents in the area.

### **Decisions by Large Numbers**

While boards of directors may have authority to make major decisions, they may first wish to discuss them with the membership. This sometimes requires time or delays action. Also, hired management has a more difficult job than the comparable chief executive in other types of businesses. He must give attention to member relations as well as strictly business activities. He must try to keep members satisfied as patrons and also informed of their responsibilities as member-owners.

### **Member Attention and Support**

Their voluntary nature is a weakness of some cooperatives, especially those not using annual marketing or purchasing agreements with members. Farmer-members thus may not always participate in annual meetings, provide adequate capital, or fully support the cooperative with their patronage. A lack of commitment by members may greatly limit a cooperative's ability to fully develop its potential for serving farmers.

Local cooperatives handling most farm products have formed federated regional cooperatives to sell their commodities



or buy supplies. But in some cases these member locals do not fully capitalize and use the regionals and thus limit their ability to be most effective. Perhaps more basic is their failure to analyze the services of the regionals against the real needs of the locals and make adjustments accordingly.

### **Member Competing Needs for Capital**

At the same time a cooperative needs capital for some purpose, members may need additional capital for their farming operations. Or two divisions within a cooperative may need funds at the same time. Thus major expansion in one of the cooperative services may be limited and occur at a much slower rate than management or some of the members desire.

### **Patronage Refund Policy**

While it is understandable that some members may need considerable cash for payment of income taxes, they often do not understand their cooperative's needs for retaining patronage refunds to finance additional facilities, and how such actions could improve services or income to members.

***Authors/J. Warren Mather and Homer J. Preston/Directors of Cooperative Management Division and Cooperative Development Division, respectively/ Dr. Preston retired in December 1978.***