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# **Do Yourself a Favor: JOIN a Cooperative**

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# Do Yourself a Favor: JOIN a Cooperative

Donald A. Frederick, Program Leader  
Law, Policy & Governance

Benjamin Franklin, at the signing of the Declaration of Independence, is credited with saying “We must all hang together, or assuredly we shall all hang separately.”

Mr. Franklin was an expert on the benefits of group action. Among his many accomplishments, he helped found the Philadelphia Contributionship for the Insurance of Houses from Loss by Fire, a cooperative fire insurance company established in 1752. The business has been conducted so efficiently over the years that it is still operating today.

For more than 200 years, Americans have worked together in cooperatives to meet challenges and solve problems that were too big for them to overcome as individuals. Today, farmers, independent business people, and other rural residents face many such challenges. National and international firms dominate their industries. Environmental and other regulations drive up business costs. At times, they compete against each other to the extent that they cannot earn a fair return on the capital, labor, and expertise they devote to their businesses.

Farmers, hardware retailers, independent grocers, and others have learned how to use cooperatives to deal with these situations. This pamphlet shows how you can use a cooperative to increase your income and control your future. It focuses on the unique aspects of doing business and providing services on a cooperative basis and the special benefits that cooperative members enjoy.

## **What Is a Cooperative?**

A cooperative is a business or service organization that has two unique characteristics. First, it is owned and democratically controlled by the people who use its services. Second, the benefits (services received and earnings allocations) are distributed to the user-owners on the basis of how much they use the cooperative. A business or service organization that operates as a cooperative can help you achieve longterm prosperity and a better quality of life.

## **User Ownership and Control**

The focus of noncooperative, investor-owned businesses is strictly on the “bottom line,” or the highest profit. The stockholder-owners may never use the products their company produces. Their primary concern is increasing the value of their stock and/or dividend payments.

A cooperative takes a different approach. A cooperative is not owned and controlled by outsiders, but rather by the people who use its services regularly, often daily. While a cooperative has to cover its costs to stay in business, it can focus its resources on meeting the needs of its user-owners, called members. Business decisions are made on the basis of what is in the overall best interests of the members. Each member maintains his or her status as an individual, and the cooperative becomes a means to realize business and personal goals. Here are some ways members exercise control.

**1. Elect directors.** The board of directors meets regularly to review business performance and set policy direction for the cooperative. The members elect this leadership group from among their fellow member-users. As regular customers of the cooperative, the directors have firsthand knowledge of its strengths and where improvement is needed. They have a personal stake in seeing that the business meets its goal of helping the members prosper.

The directors represent the members. If directors are not doing a good job, members have the authority to elect someone else or even recall and replace directors in the midst of a term.

**2. Approve articles and bylaws.** The articles of incorporation and the bylaws are legal documents that establish general rules for how a cooperative will be organized and operated. These include who can become a member, the number and method of electing directors, and how members will finance the cooperative. These legal documents are first adopted when the cooperative is organized and can be amended at any time by a vote of the members.

**3. Approve major changes in the business.** While directors oversee the general operation of a cooperative, the members usually must approve any change in its basic structure. This includes proposals to merge or consolidate, to form a joint venture with another cooperative or noncooperative firm, or to dissolve the cooperative. Members also usually vote on entering a major new line of business and on substantial investments, such as buying or constructing a new facility. Only the members can restructure a cooperative, sell it, or shut it down.

The way members of a cooperative vote is also different from an investor-owned firm. In a non-cooperative business, people usually have voting

power that reflects their equity investment. For example, shareholders in a noncooperative corporation have one vote for each share of common stock they own.

In a cooperative, each member generally has only one vote regardless of the amount of equity owned. This one-member, one-vote approach makes cooperatives very democratic organizations. Wealthy members can't buy control, and all members have equal say in how the business is conducted.

## **Benefits According to Use**

People buy stock in a noncooperative business to make money on their investment. The more of the company you own, the more benefits (stock appreciation and dividends) you will realize if the business succeeds.

The benefits of being a cooperative member differ in two ways. First, the advantages are more numerous. Second, they are distributed on the basis of how much use you make of the cooperative, rather than your equity stake. Here are some benefits of cooperative membership and how they relate to use.

**1. Access to quality supplies and services at reasonable cost.** By banding together and purchasing business supplies and services as a group, individuals offset the market power advantage of firms providing those supplies. You can gain access to volume discounts and negotiate from a position of greater strength for better delivery terms, credit terms, and other arrangements. Suppliers will be more willing to discuss customizing products and services to meet your specifications if the purchasing group provides them sufficient volume to justify the extra time and expense.

The larger the group purchasing supplies and services through the cooperative, the greater the potential for savings. And the more each individual member uses the supply operation, the more he or she may save over doing business elsewhere.

Another option for cooperative members is to manufacture their own supplies and hire experts directly to provide essential services. This gives members even more reliable sources of supply and greater control over the types of products available, the cost, and the quality of the services received.

2. Increased clout in the marketplace. Marketing on a cooperative basis, like purchasing supplies and services, gives members the ability to combine their strength while maintaining their status as independent business people. They can lower distribution costs, conduct joint product promotion, and develop the ability to deliver their products in the amounts and types that will attract better offers from purchasers.

A special Federal law, the Capper-Volstead Act, provides farmers with an extra incentive to market cooperatively, a limited exemption from antitrust liability for marketing agricultural products on a cooperative basis. Under this law, farmers can agree on the prices they will accept for their products and other terms of sale.

Through cooperative marketing, members can share information and negotiate with buyers from a position of greater strength and security. They can also develop processing facilities by themselves or as part of a joint venture with other cooperative or noncooperative firms.

A cooperative can also serve as a vehicle for people selling goods and services to work with their customers to promote industry research, reduce

regulatory burdens, and develop markets for their products. The cooperative can thus help create a “win-win” situation for the entire industry, a business environment where both producers and buyers have more income to divide.

3. Share in the earnings. Some people talk about noncooperative firms operating “for profit” while cooperatives operate “at cost.” This isn’t totally accurate. Most cooperatives generate earnings. Where they differ from noncooperative firms is how they allocate and distribute their earnings.

A noncooperative firm retains its earnings for its own account, or perhaps pays part of them out to shareholders as dividends, based on the amount of stock each investor owns. In a cooperative, earnings are usually allocated among the members on the basis of the amount of business each did with the cooperative during the year. For example, if a cooperative has net earnings of \$20,000 during the year and 2 percent of its business was with Ms. Jones, then Ms. Jones would be allocated \$400 of those earnings ( $\$20,000 \times .02$ ).

Typically, Ms. Jones would receive her allocation, called a patronage refund, partly in cash and the remainder as an addition to her equity account in the cooperative. Permitting their cooperative to accumulate retained patronage refunds is a relatively easy and painless way for members to help finance cooperative activities and growth. Also, if certain rules in the Internal Revenue Code are followed, the cooperative is permitted to deduct both the cash payouts and the retained patronage refunds from its taxable income. This makes cooperative earnings particularly valuable.

4. Political action. Growers, small business owners, and other rural residents have to realize that no one gives you a favorable law or regulatory ruling just because you think you deserve it. You

have to build your case and argue your point convincingly.

A cooperative gives people a means to organize for effective political action. They can meet to develop priorities and strategies. They can send representatives to meet with legislators and regulators. These persons will have more influence because they will be speaking for many, not just for themselves.

They can also form coalitions with other groups having similar views on issues. The larger the voice calling for a specific action, the more likely that the system will respond with the policy you desire.

5. Local economy enhanced and protected. Having its businesses owned and controlled on a cooperative basis helps your entire community. Cooperatives generate jobs and salaries for local residents. They pay taxes that help pay for schools, hospitals, and other community services.

When a business is a cooperative, your town is less likely to lose those jobs and taxes. A business owned by one person, or a subsidiary of a big company, can easily be moved to another community. When many local people share the ownership of a cooperative, no individual or company can take it from your area or simply close it. Only the membership as a whole can make such decisions.

### **Why Not a Nonprofit?**

Sometimes people confuse cooperatives with nonprofit associations. Or they think organizing as a nonprofit sounds appealing because they have heard that nonprofits are totally exempt from taxation and have easier access to grant funding.



Clear distinctions exist between nonprofit groups and businesses. Nonprofit laws and tax treatment are designed for charitable and civic organizations, such as the Red Cross and the Rotary Club. They are not appropriate for business ventures.

For example, one of the main characteristics of a cooperative is that earnings are returned to patrons on the basis of use. But in a nonprofit, all earnings must be retained in the organization and, upon dissolution, all assets usually must go to another nonprofit. Thus, operating as a nonprofit keeps members from sharing in the earnings of their business.

## **The Real Bottom Line**

Cooperatives are not solutions in and of themselves. They are a means for people to achieve an honest day's income for an honest day's work or to meet other social and economic needs. To succeed, they require capital, commitment, patience, and a membership willing to work together even if it means giving up a little individuality in the process. But the rewards — respect, a higher income, new friends and acquaintances, the satisfaction of having solved problems — are well worth the effort.

Other publications to help you learn about cooperatives:

*Cooperative Financing and Taxation*, Robert C. Rathbone, USDA/RBCDS, Cooperative Information Report 1, section 9 (Revised 1995) 26 pp.

*Cooperative Principles and Legal Foundations*, Martin A. Abrahamsen, et. al., USDA/ACS, Cooperative Information Report 1, section 1 (Reviewed 1993) 26 pp.

*Sample Legal Documents for Cooperatives*, Donald A. Frederick, USDA/RBS, Cooperative Information Report 40 (1990) 65 pp.

*Tax Treatment of Cooperatives*, Donald A. Frederick, USDA/RBCDS, Cooperative Information Report 23 (Revised 1995) 10 pp.

*Understanding Cooperatives: Education Series*, USDA/RBCDS, Cooperative Information Report 45, sections 1-14 (1994-95), 4 pp. each.

*What is a Cooperative? Why Cooperatives are Organized*, USDA/RBCDS, Cooperative Information Report 50 (1995), 4 pp.

*What Are Cooperatives?* Galen W. Rapp, USDA/RBCDS, Cooperative Information Report 10 (Revised 1995) 23 pp.

To order these publications, or for general information on cooperatives, write:

USDA/RBS/Cooperative Services  
Ag Box 3255  
Washington, DC 20250-3255

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## U.S. Department of Agriculture Rural Business-Cooperative Service

1400 Independence Ave., SW, Stop 3257  
Washington, D.C. 20250-3250

Rural Business-Cooperative Service (RBS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The cooperative segment of RBS (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs. RBS also publishes research and educational materials and issues *Rural Cooperatives* magazine.

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