

Consumer Co-ops: Introduction to Consumer Food Cooperatives

Michael Cook

Department of Agricultural Economics

More people are becoming interested in establishing cooperatives to handle groceries. The interest stems in part from the tight economic situation faced by many families. The new National Consumer Cooperative Bank has also sparked interest in the cooperative way of doing business.

Cooperatives have proven to be valuable in providing supplies and markets for farmers. They have also been highly successful in providing insurance. Many cooperatives in other fields have failed, although there are examples of successful cooperatives providing groceries, housing, recreation, nursery care, automotive repair, and other goods and services. On the other hand, consumer cooperatives have been successful in Western Europe.

One reason for many cooperative failures has been the unavailability of loan capital. The new National Consumer Cooperative Bank proposes to serve this need.

What is a cooperative?

A cooperative is one way of doing business in a market economy. There are four unique and necessary characteristics of a cooperative.

Member/patron owned

The people who use the cooperative own the business. The major objective of the member/patron is to secure the goods or services desired at a reasonable price. Other forms of business organizations are owned by investors whose objective is making a return on the investment.

Some cooperatives do business only with members, but many will do some business with non-members. A true cooperative, however, will do the majority of its business with members.

How a person becomes a member is specified in the bylaws. The usual means is the purchase of a membership or a share of stock and by doing business with the cooperative. Membership may be open to anyone or limited as specified in the bylaws.

Operation at cost

A cooperative provides goods and services to members at cost. Two ways are open for following the principle. One way is to set prices at a level where operating costs are exactly covered. A second way is to set prices at a level that is expected to cover more than costs and then to give back to members at the end of the year the net returns (profits) in proportion to the volume of business each member does with the cooperative. Such payments are called patronage refunds. The refunds may be paid in cash or as equity capital certificates or a combination of the two. Retained patronage refunds are a major source of equity capital for many agricultural cooperatives.

Democratic control by members

Most cooperatives give one vote to each member, regardless of the volume of business a person does with the cooperative. In other forms of business the control is in proportion to the investment of the owners, usually one vote for each share of common stock.

A cooperative also needs to educate its members about its purposes and organization as well as the values of cooperation. In some cooperatives members learn primarily through participation. A cooperative that does not educate its members effectively cannot expect to last longer than a generation and a half.

Limited return on equity capital

Missouri statutes limit the payment on equity capital to 10 percent annually. Most cooperatives pay nothing on equity capital. Further, a member can sell the equity capital only to the cooperative and at its discretion and never for more than cost or book value. A member of a cooperative secures benefits through prices and services. In other forms of business, benefits accrue to the investor either as dividends or changes in the value of stock or both.

Except for the distinctive features just mentioned, cooperatives are identical with other forms of business. All must be economically feasible and all require capital, management and use of sound business practices. The economic and legal systems give no special advantages to cooperatives.

Types of food cooperatives

There are two types of cooperatives in Missouri providing groceries. They are called pre-order/buying clubs and stores.

Pre-order/buying clubs

In this type of cooperative, members pool orders, make the purchases from a supplier and arrange to distribute the food to the members who ordered it. Members usually perform the work involved in compiling orders, exchanging money and distributing goods. Most pre-order cooperatives are small, but they do not have to be. The small pre-order will probably not hire anyone or invest in much equipment. However, there will be a coordinator who voluntarily takes on a management role, and there will be some initial expenses and "capital" investments (such as a refrigerator) that are covered by a membership fee.

The pre-order organization makes it possible to secure items such as natural foods that may not be readily available. Prices are also usually lower because of selection of good rather than fancy quality, purchasing in bulk, and performance of the normal retailing functions by members. Many of the cooperative stores started as pre-order operations.

Stores

A store has goods and services similar to other types of grocery stores. They usually carry a limited line of merchandise, feature good rather than fancy quality and eliminate all "frills" that add to the cost of retailing. Most stores use members as volunteer workers who receive a break on prices in return for their labor.

A store requires more investment and a more sophisticated organization. The members elect a board of directors to establish and monitor policies and management. The board employs individuals who are responsible for management and day-to-day operations. The store has the same operational concerns as any other grocery business and needs high quality management.

Both types of cooperatives must have a dependable source of supply for groceries. Small local units may find it desirable to work together to establish their own warehouse. A warehouse is a necessary feature in the food business. The members of a co-op warehouse are the local co-ops. This is known as the federated approach. It is the approach used by Missouri Farmers Association and Farmland Industries, large agricultural cooperatives. The warehouse should grow from the locals and not vice versa.

Incorporation

If the cooperative is intended to be a continuing organization and do a significant volume of business, it should be incorporated. Incorporation provides for perpetual life, limited liability for members, and a means of accumulating and managing capital. The only statute open to food cooperatives for incorporation in Missouri is Chapter 357 of the Missouri Statutes. While the statute appears complex, the provisions include essential features of a cooperative and prove to be quite manageable in practice.

Cooperatives are sometimes referred to as not-for-profit or non-profit organizations. This has led some groups to incorporate under Chapter 355, the not-for-profit corporation law. This chapter, however, expressly prohibits incorporation of an organization "on the cooperative plan."

Points to consider when starting a cooperative

Need and economic feasibility

The most basic concern is whether there is a need that can be served in an economically feasible manner. Some of the most successful co-ops were organized to provide goods or services that were not readily available. Goods at a lower price is an almost universal need or desire. A cooperative may be able to provide goods or services at a lower cost if there is inadequate competition in the local market or if it proposes to operate on a different and lower cost structure than the competition. Examples of how stores can operate at a lower cost are by using volunteers, limiting the line of merchandise, and working in "bare-bones" facilities. It will be difficult for a cooperative to operate like its competitors and show substantial savings.

Economic feasibility depends on more than an established need. The cooperative must address other questions, too, such as those relating to size, sources of supply, dependability of the market, capital requirements and supply, labor, management, facilities, health and safety requirements, and local licensing rules. These questions should all be resolved before organization proceeds.

Interest of potential members

A sufficient number of persons must have the interest to make the cooperative economically viable. An attitude of curiosity, "wait and see" or "if it gets started I will be a part of it" is not enough. The organizing group should determine the minimum number of persons necessary for a viable organization. The best test of true interest is to require either payment or a firm promise to pay some significant membership fee. The size of the fee will depend on the economic status of the prospective membership and the type of operation planned. It should be large enough that a person will not simply ignore the investment. Further, the co-op will need all the money it can get for capital.

The necessary equity capital can be raised

The most serious hurdle is likely to be securing equity capital. Some members will have limited resources. Most will have some reluctance to invest in a new enterprise. Another major problem is the regulations and restrictions relating to the sale of securities.

Agricultural cooperatives have certain exemptions from state security regulations, but such are not available at this time to consumer cooperatives. It is impossible to get a concise, easily understood statement about the evidences of equity capital invested in a consumer cooperative that are exempt from regulation. The intent is fully as important as the type of instrument. For example, the major purpose of a modest membership fee may be ascertaining interest of people and accumulating a list of people who want to be included in all activities. Even though such fees generate equity capital, the membership certificate would likely not be considered legally as a "security."

Retained patronage refunds have been the major source of equity capital for the agricultural cooperatives. The courts have consistently ruled that notices advising members of patronage refunds earned but retained are not to be treated as securities from the standpoint of regulation. The cooperative should maintain a record of the amount retained from each member.

Capital retains are another frequently used and good method of acquiring capital. This entails some modest mark-up (one or two percent) on purchases that are earmarked for a capital account. Records are maintained showing the retains collected from each member.

Stock, common and preferred, is an ordinary means of raising equity capital. Chapter 357 of the Missouri Statutes provides for common and preferred stock. Most agricultural cooperatives treat the common stock as a membership fee, issuing only one share with a modest face or par value per member. Solicit expert advice about security regulations before moving far in issuing any significant number of shares of stock and shares with a significant par or face value.

The most common source of capital for all types of business firms is profit generated from internal operations. Cooperatives, while making no profits, can accumulate surpluses or net savings, other names for profits. Income taxes must be paid on such surpluses. It is not sound for a cooperative to use such a method extensively for securing capital, as it violates a basic cooperative principle. Many cooperatives use the approach of tax paid surplus as one method of getting some capital. If the earnings (profits, surplus) are quite small, it may often be more practical to place them in a tax paid surplus account rather than to allocate patronage refunds to many members.

Some cooperatives keep no earnings derived from member business but strive to make a profit on non-member business, pay taxes on the earnings and allocate the remainder to the capital account. Be careful to always have member business as the primary goal, or again it becomes something less than a true cooperative.

Some food cooperatives use the "direct charge" approach. An estimate is made of operating costs for some future period which is then prorated equally among all members. It is not a solution to long-term equity capital, but it does help build operating capital.

Steps in organizing a co-op

Do not rush organization. Consider all eventualities and alternatives. The organizational process can have a vital effect on the eventual outcome. Hence, a process with wide involvement is best. It is not the only way and it is slow, but it is probably the soundest approach.

Exploratory meetings

- Hold exploratory meetings to discuss and formulate tentative answers to the following questions:
- How many persons in the community are interested in organizing a cooperative?
- What kinds of services should the proposed cooperative perform?
- What are the problems with respect to the desired services? Are they already available and, if so, can they be improved through a cooperative?
- What has been the experience in the community with other kinds of cooperatives?
- What are the available community assets in terms of potential members, leaders, financial resources, facilities and potential productivity capacity?
- Who wants a cooperative — the people who will use it or someone else?

Establish working committees

- If a cooperative looks promising after the exploratory meetings, establish working committees. Address the following issues; a separate group for each will broaden participation and spread the work load.

General survey

- This group would gather and develop firm data on the services to be provided, costs, benefits and whether or not a co-op is the only or best way to secure the services.

Membership

- This group would evaluate realistic size of potential membership and volume of business.

Facilities

- Even a simple pre-order cooperative needs some place to operate. This group should match the size and type of cooperative with facilities and equipment needed and available.

Finance

- This group should determine capital requirements for facilities, equipment, and operations and determine possible means of securing the capital.

Legal documents

- This committee should consider articles of incorporation, bylaws and any necessary licenses or permits.

The chairperson of the working groups might serve as the steering or coordinating committee.

Additional information

The best source of advice is some successful cooperative in the same line of business. Most are happy to share expenses. Staff in your local MU Extension center may not always have the answers, but often they can get them.

The new National Consumer Cooperative Bank is a source of information. The Bank's Washington address is 2001 S Street, N.W., Washington D.C., 20009.

The Cooperative league of the USA, located at 1828 L Street, N.W., Washington, D.C., 20036, has a great deal of general information on cooperatives.

The original authors of this publication were C. Brice Ratchford, John Noller and Bernadette Mahfood.

Related MU Extension publications

- EC942, Consumer Co-ops: Steps in Organizing a New Pre-Order Food Cooperative
<http://extension.missouri.edu/p/EC942>
- EC943, Consumer Co-ops: Managing a Pre-Order Food Cooperative
<http://extension.missouri.edu/p/EC943>
- EC944, Consumer Co-ops: Essential Elements of Managing a Food Cooperative
<http://extension.missouri.edu/p/EC944>
- EC945, Consumer Co-ops: Orienting New Members
<http://extension.missouri.edu/p/EC945>

Order publications online at <http://extension.missouri.edu/explore/shop/> or call toll-free 800-292-0969.



■ Issued in furtherance of the Cooperative Extension Work Acts of May 8 and June 30, 1914, in cooperation with the United States Department of Agriculture. Director, Cooperative Extension, University of Missouri, Columbia, MO 65211
■ an equal opportunity/ADA institution ■ 573-882-7216 ■ extension.missouri.edu