

IOWA STATE UNIVERSITY

Extension and Outreach / Department of Economics

How A Co-op is Different and Why It Matters

Employee Workshop - ALCECO / Ag
Partners, L.L.C.

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Objectives

- History & Legal Authorization
- Economic Justification
- Control and Governance
- Capitalization and Ownership
- Member Value



OUR HISTORY

The Problem

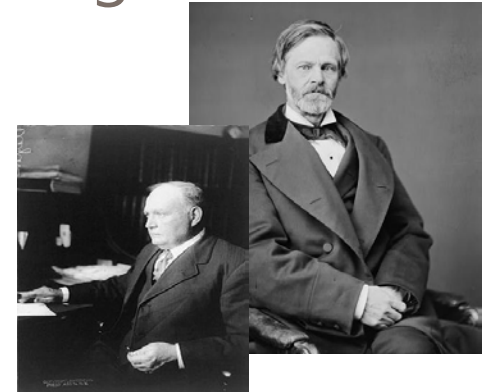
- Railroad movement (1840s – 1870s) led to rapid expansion and fueled the industrial revolution
- Farmers were largely left behind
 - little representation in Washington D.C.
 - no mechanism for organizing formally

Producers had no way to be on even footing with their trade partners, and no options.

The Solutions

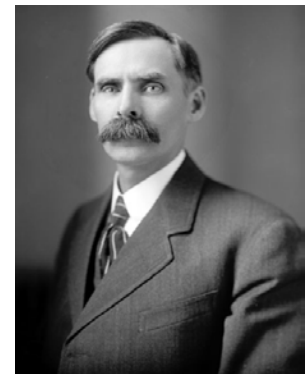
Beginning in 1850, farmer associations began to form, but these came under attack.

- Sherman Antitrust Legislation, 1890
- Clayton Act, 1914



It wasn't until 1922 that producers could form organizations to act collectively, legally.

- Capper-Volstead Act



Capper-Volstead Requirements

- One member one vote OR limit dividends on non-farmer equity to 8%
- Member business must be greater than non-member business
- All voting members must be agricultural producers
- Association must operate for the benefits of its members

Allows producers to organize voluntarily to produce, handle, and market farm products to improve their terms of trade.

In Iowa

- IA has had a cooperative associations statute since 1915, the current version dates back to 1935.
- **Chapter 499** is primarily used
- Gives producer organizations the authority to engage in “any lawful purpose” and to exercise any power “suitable or necessary, or incident to, accomplishing any of its powers”
- Can have voting and non-voting members
- Voting rights limited to persons “engaged in producing a product marketed by the co-op; or who use the supplies, services or commodities handled by the coop”.

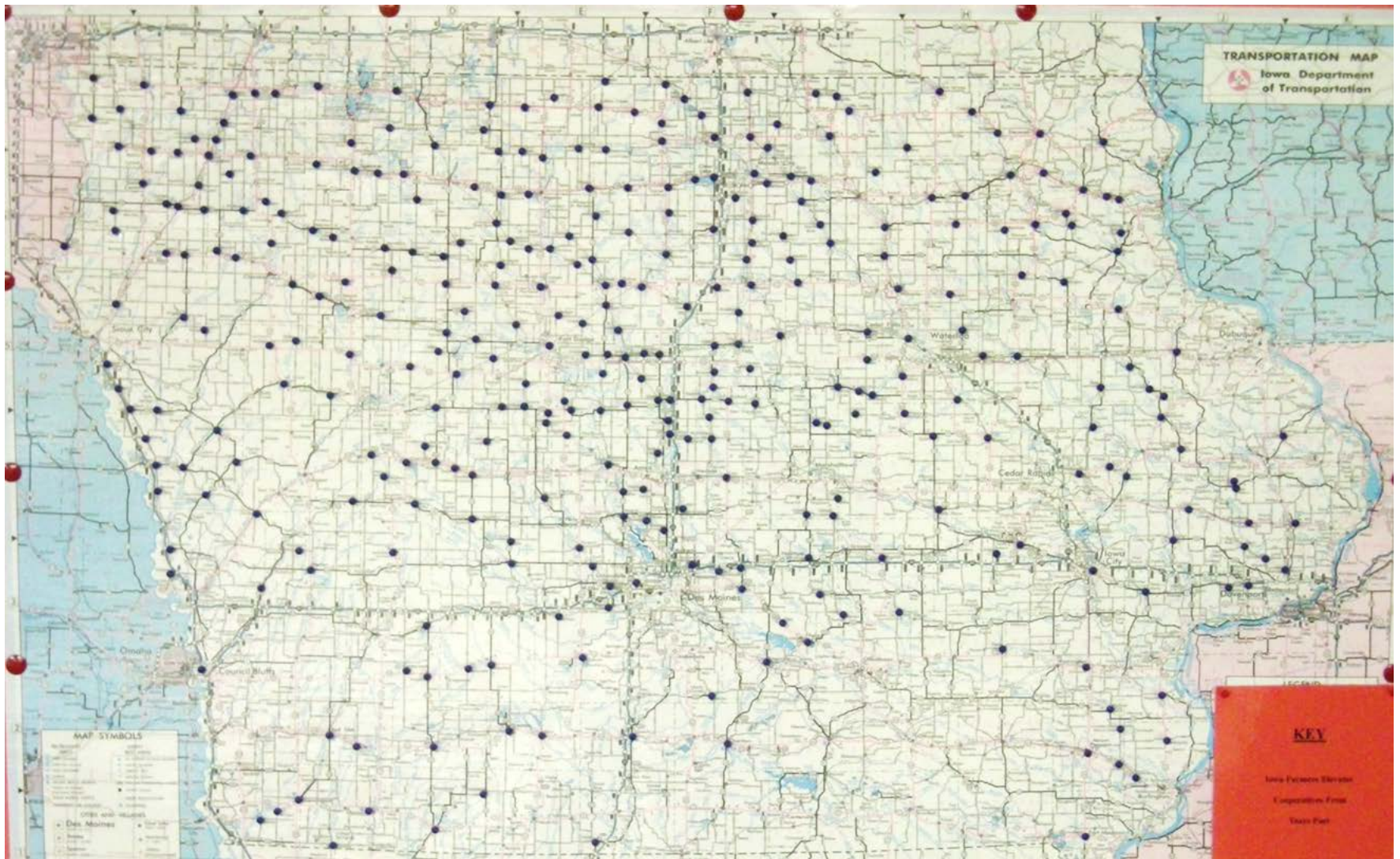
In Iowa – Other Statutes

Chapter 501 – “New Generation” cooperative

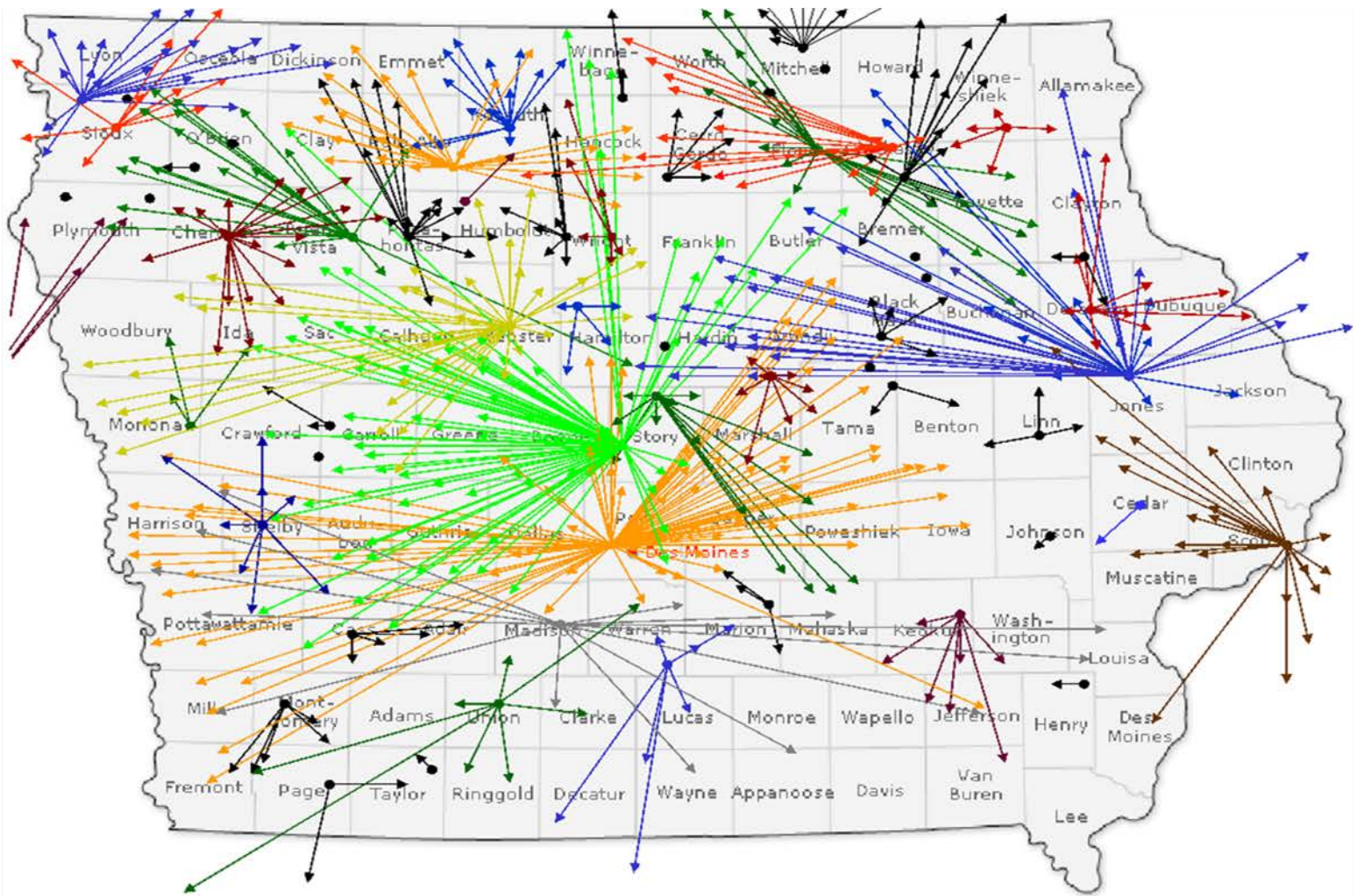
- “Closed membership” – members are only those that provide equity capital
- Often for value-added processing
- Members buy the right to delivery obligations – these are their equity shares (addresses undercapitalization problem)

Chapter 501a - combines LLC and co-op model

- Ability to raise capital from non-patron members and give them voting rights
- Addresses limiting capacity of traditional model



Iowa Grain and FS Co-ops 30+ Years Ago



Iowa Grain and FS Co-ops Today

ECONOMIC JUSTIFICATION

Business Structure Comparison

Feature	Sole Proprietorship / Partnership	LLC	IOF (Corp)	Co-op Corporation
Who Owns			Investors / Shareholders	Members
Who Controls			Board largely 'appointed'	Members Elect the Board and Serve on It
Who Benefits			Shareholders / Investors: dividends, stock price appreciation	Members: Patronage, Equity, Assets

A Fundamental Difference

“By construction, cooperatives put the economic interests of a particular class of patron in front of all other stakeholders and look to patron owners for risk capital and leadership...”

Principles of Cooperation

Benefits

- ✓ Income distributed to proportionally to patrons
- ✓ Limited dividends on equity capital

Control

- ✓ Voting by members
- ✓ Open membership

Ownership

- ✓ Equity is provided by patrons/members

Others

- ✓ Duty to educate, support
- ✓ Support community
- ✓ Political and religious neutrality

Economic Benefits to Members

Producers recognized the need for and benefits to acting collectively to:

- Get fair prices for their outputs
- Access products and inputs at market prices
- Reduce their joint costs of selling and buying through economies of coordination and size
- Pool risk
- Risk diversification
- Benefit from increased market power through profits

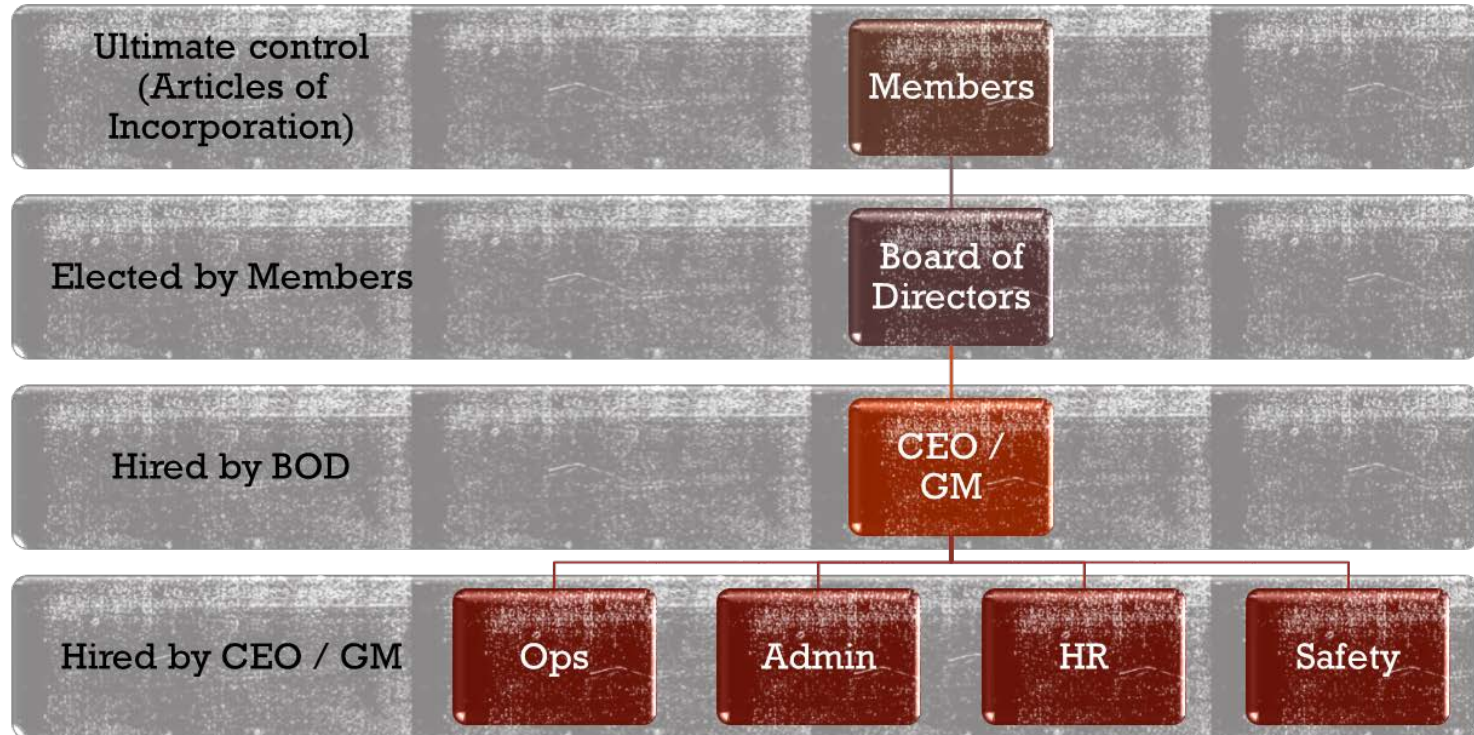
Cooperatives are the “competitive yardstick”

Other Benefits To Producers

- Improve or standardize product quality
- Form a community of like-minded producers
- Favorable tax treatment
- Pooled skills

GOVERNANCE & CONTROL

Chain of Command



Members are ultimately responsible

Members elect the board

- This happens on an annual basis
- Each member gets equal vote
- The board is responsible for creating the **strategic** vision and plan and overseeing its implementation.

The Board hires the GM / CEO

- The GM is responsible for **operational** vision and planning.

“Locals” and “Regionals”

Centralized (aka, “local”)

- members are individual, families or private businesses
- they elect the board
- usually one central office, 1 board of directors, can have many locations
- members receive patronage – mix of cash and equity

Federated (aka, “regional”)

- “co-op of co-ops”
- members are other cooperatives
- board is managers or board members of member co-ops
- Member receive patronage – mix of cash and equity

The decision to use a cooperative, is the decision to invest in one. The two cannot be separated.

CAPITALIZATION, OWNERSHIP & PROFITS

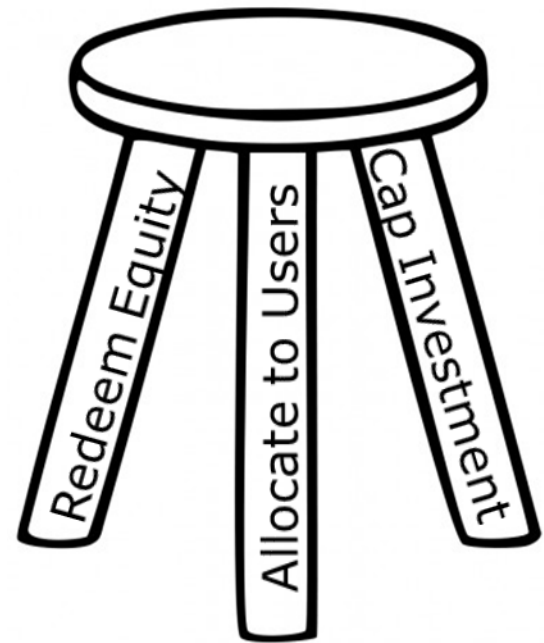
What is the co-op's objective?

- Co-op profit maximization?
- Member profit maximization?
- Minimize selling price of inputs to farmers?
- Maximize purchase price of farmers' outputs?
- Maximize total system benefits?
- Maximize the total amount of business conducted?

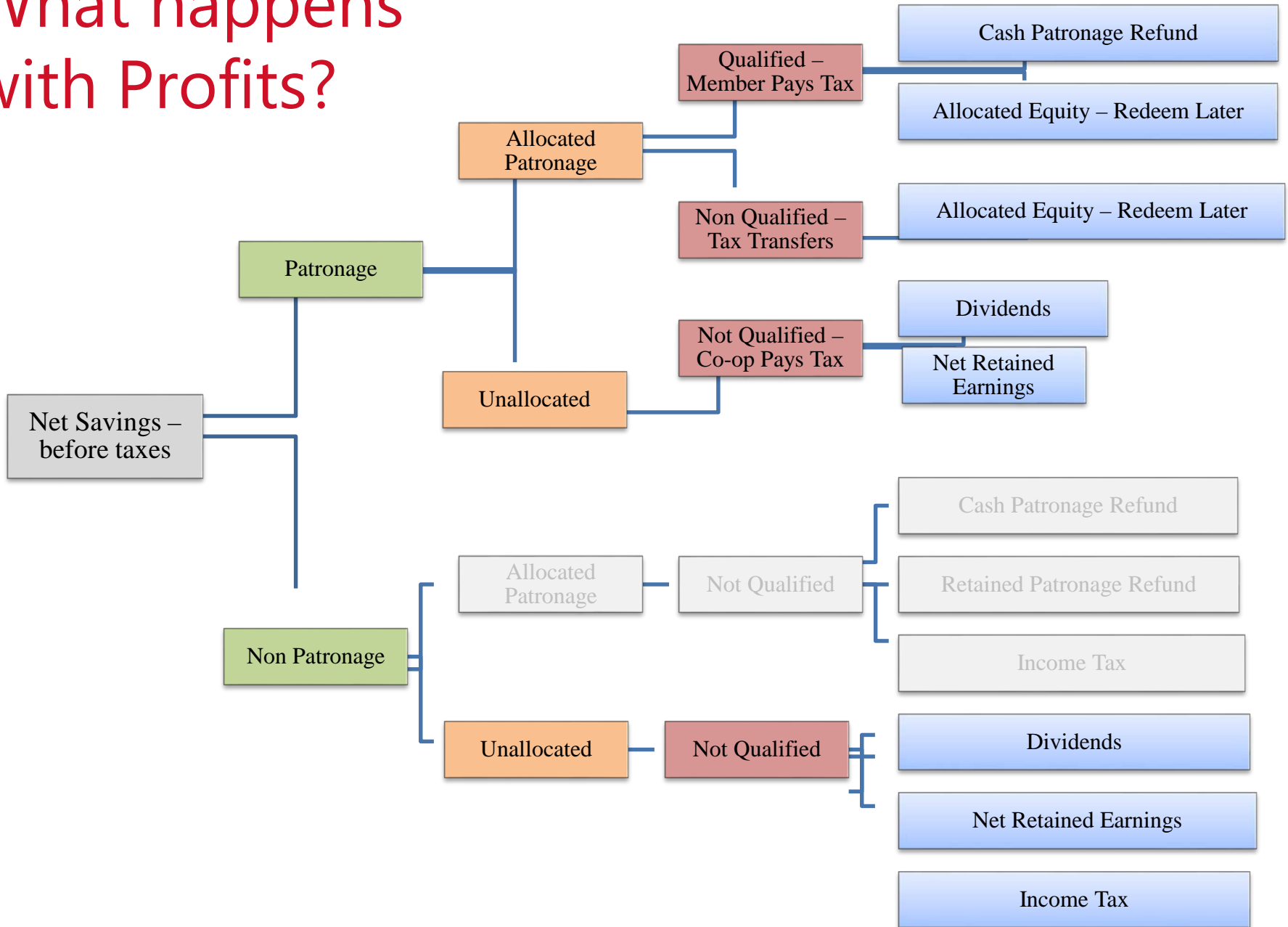
Cooperatives MUST be profitable

Profitability is necessary for...

- Financial sustainability of the cooperative
- Ability to reinvest in assets and productive resources
- Ability to revolve equity
- Funds for growth



What happens with Profits?



Profits Become Patronage to Members

Patronage is...

- ...a cooperatives adherence to the “service at cost” principle, and
- ...a distribution of co-op profits (aka “savings”) to those who did business with the cooperative.

How?

- Cash
- Allocated equity (retained by co-op temporarily)

Example: A Member...

...with 500 acres in corn, is the poster-child member, buying all her inputs and selling all grain through the co-op.

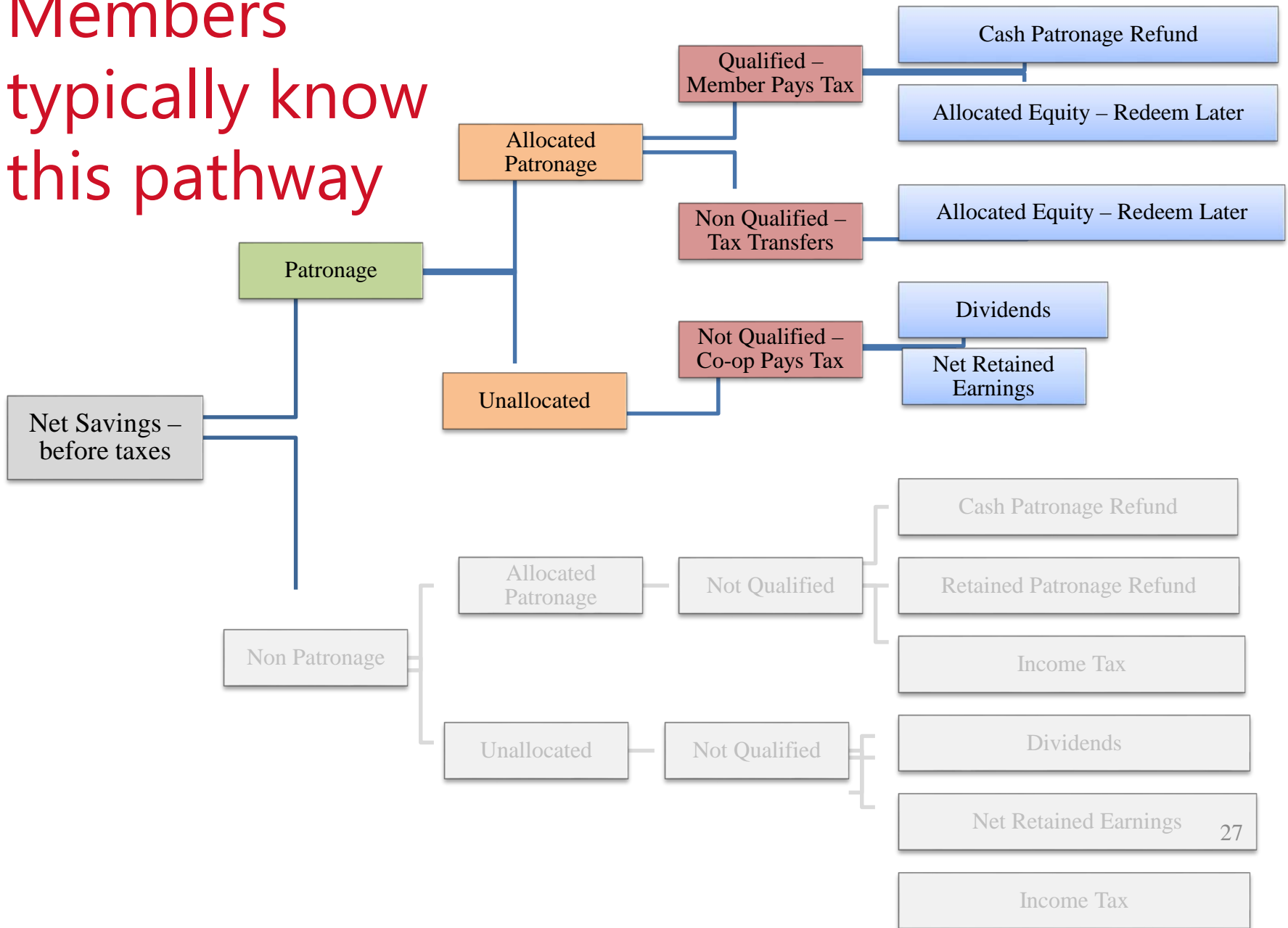
- Bushels marketed: 200 bu/acre
- Inputs purchased: \$308.35/acre

The co-op has released their annual report and announced patronage rates for the year:

- 3.70 cents per bushel of grain
- 3% of agronomy business

The co-op announces they will pay 60% as cash and the rest (40%) as retained allocated equity (this is the capitalization function).

Members typically know this pathway



Member Equity – Revolving Ownership

EQUITY

Common Stock	\$156,500	\$156,500
Deferred Patronage Refunds	\$24,046,010	\$23,980,270
Retained Earnings	\$8,780,160	\$9,072,520
Total Equity	<u>\$32,982,670</u>	<u>\$33,209,290</u>

Retained earnings are **permanent equity**.

Deferred patronage refunds (aka allocated equity) are NOT permanent – they are eventually paid back.

Equity is Paid Back?

Equity is not marketable, not recallable, and requires a board decision to be redeemed.

When? (Depends...)

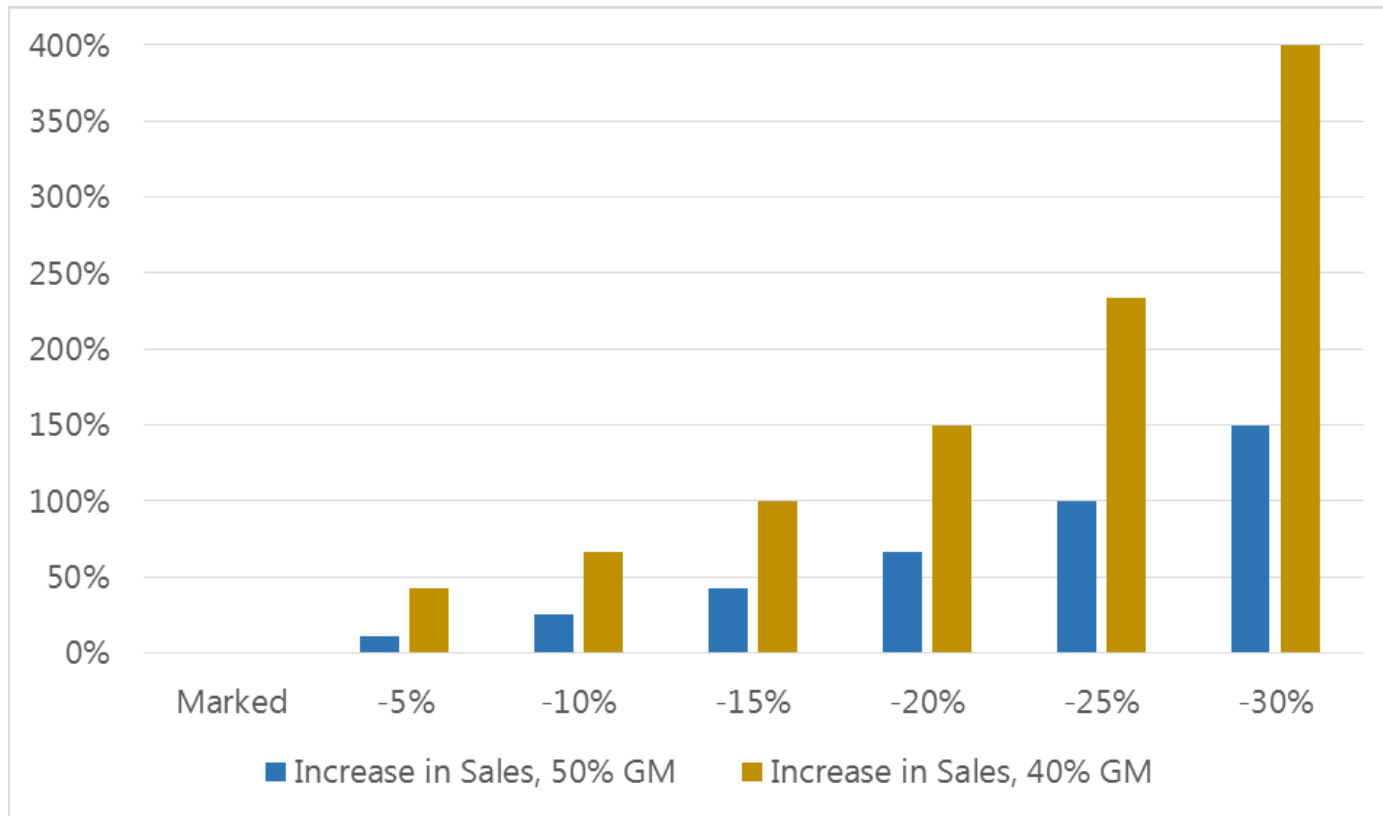
- If good profitability, the co-op can redeem old equity faster (10-12 years on average in Iowa)
- If not profitable enough: hopefully before the member dies (yikes, but it's true)

How?

- Age of patron
- Age of equity (revolving equity)

Margins Are KEY.

There are **severe** penalties to profitability when prices are cut or margins otherwise depleted!



Other Profitability Impacts

- Poor quality control – grain and supplies
- Theft
- Inventory mismanagement
- Employees – 40% of total expenses, on average
- Safety – soft dollar costs especially

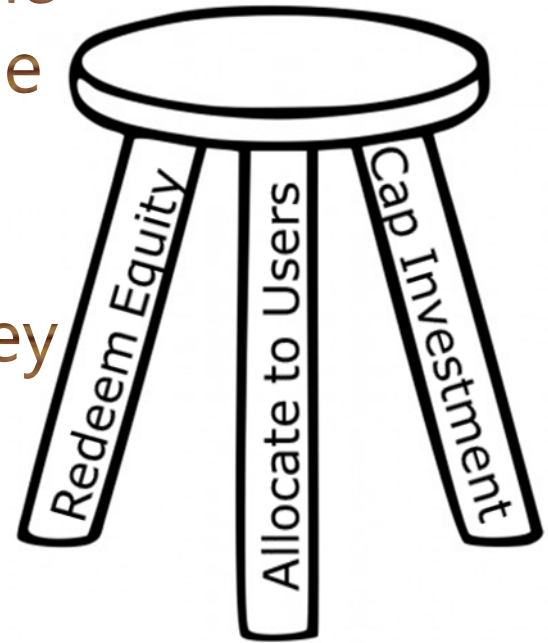
Who Owns the “Stuff?”

MEMBERS jointly own the assets entrusted to the employees!

- Grain bins, dryers, feed mills
- Fertilizer, seeds, tanks, all inventory
- Equipment, Vehicles, Computers, Buildings, Land

As an employee or intern, what is your responsibility for these?

Each and every decision made by employees, management, and the board has an impact on the value members' derive from the cooperative: patronage, asset efficiency, new investments – they all tie together into the **value proposition**.



MEMBER VALUE

