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Rural Development
Business and Cooperative Programs
Cooperative Information Report 7

HOW TO START A COOPERATIVE

PREFACE

This guide outlines the process of organizing a cooperative business and provides information on the potential steps involved and some important aspects of cooperative development.

A cooperative business is briefly described, including its structure and basic principles. Twelve steps involved in most cooperative development projects are introduced and explained. Important considerations—such as practitioner principles, pitfalls to avoid, cooperative capitalization, legal aspects of cooperative development, and general rules for success—are presented. This information should provide a reader with a comprehensive understanding of the cooperative development process.

While this report focuses on agricultural cooperative development, it also contains information that is pertinent to non-agricultural applications. The cooperative business structure, shown to be successful in agriculture, has also been useful in helping others obtain benefits or provide needed services in areas such as housing, utilities, finance, healthcare, homecare, childcare, grocery retailing, manufacturing, business support services, and more.

How To Start a Cooperative

Cooperative Information Report 7

James J. Wadsworth completed this revision of How to Start a Cooperative. Its last complete revision was in September 1996 by Galen Rapp and Gerald Ely. Margaret Bau, a cooperative development specialist in the USDA Wisconsin State Rural Development Office, assisted with this revision.

Publications and information are also available on the USDA Cooperative Programs website: http://www.rd.usda.gov/programs-services/cooperatives

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HOW TO START A **COOPERATIVE**

INTRODUCTION

Cooperatives are unique businesses that operate in nearly every market segment of the economy. They are unique in that they are owned and controlled by members and operate to economically benefit those same members. In most circumstances, they are started by people seeking to fulfill an economic or service need.

This guide is intended to help people who develop a cooperative or who simply want to learn about the process of starting a cooperative. It is also intended as an educational resource for co-op development practitioners. It provides basic information on cooperatives, their structure and principles, why they are organized, the steps involved in the development process, and other pertinent information.

WHAT IS A COOPERATIVE BUSINESS?

A cooperative is a business owned and controlled by the people who use its services. They finance and operate the business for their mutual benefit. By working together, they can reach an objective that would be unattainable if acting alone.

A cooperative can help members increase their income or enhance their living standards by providing important services. A cooperative can help members gain marketing power and provide quality supplies or services otherwise unavailable or prohibitively expensive.

DISTINCTIVE FEATURES

In many respects, cooperatives resemble other businesses. They have similar physical facilities, perform similar functions, and must follow sound business practices. They usually incorporate under State laws and require bylaws and other necessary legal papers. Owners of cooperatives (members) elect a board of directors to represent their interests. The board sets policy and hires a manager to run the cooperative's day-to-day business.

Even though cooperatives are similar to many other businesses, they are distinctively different. The differences are explicitly identified in the cooperative's purpose, ownership, control, and distribution of benefits. Cooperatives follow three principles that define or identify their distinctive characteristics:

• user-owned,

• user-controlled, and
• user-benefited.

The user-owned principle means the people who own and finance the cooperative are those who use it. "Use" usually means buying supplies, marketing products, or using services of the cooperative business.

Members finance the cooperative and its operations through different methods: (1) by a direct contribution through membership equity or purchase of stock; (2) by an agreement to withhold a portion of net earnings (profit); or (3) by assessments based on units of product sold or purchased.

For instance, a member might be assessed a fee for every unit (box, bushel, etc.) marketed through the cooperative. These assessments are generally referred to as per-unit retains.

The user-controlled principle (also called democratic control) means that those who use the cooperative also control it by electing a board of directors and voting on major organizational issues. This is generally done on a one-member, one-vote basis, although some cooperatives use proportional voting based on use of the cooperative (hence, a member who markets 10,000 bushels of a crop through the cooperative would have a greater vote than one who markets 1,000 bushels).

The user-benefited principle says that the cooperative's sole purpose is to provide and distribute benefits to members on the basis of their use. Members unite in a cooperative to receive services otherwise not available, to purchase quality supplies, to increase market access, or for other mutually beneficial reasons. Members also benefit from distribution of net earnings or profit based on their use of the cooperative.

To operate under these distinctive principles, an important practice—particularly for new cooperatives—is to conduct continuing member education. This is especially critical for attracting and recruiting new members. It is also necessary because the cooperative's membership continually changes. Older members retire and new ones join.

Keeping owners informed is an important practice for any business, but vital in a cooperative for at least three reasons:

1. The democratic control principle, exercised through majority rule, requires that the entire ownership (members) be informed and involved to ensure that sound decisions are made;

2. Members must indicate their needs and accept the accompanying financial responsibilities before the cooperative can fulfill those needs; and

3. Some people are not familiar with the cooperative form of business. The educational system in the United States contains little, if any, information about cooperatives. So, the cooperative itself must become the educational institution.

There are also unique business practices that cooperatives follow. These practices include patronage refund systems, limited return on equity capital, and cooperation among cooperatives (see USDA CIR 55: Co-ops 101, under References).

Worldwide, cooperatives of all kinds recognize the International Cooperative Alliance (ICA) statements on cooperative identity, values, and principles. The ICA lists seven principles by which cooperatives operate (see Appendix A).

WHY COOPERATIVES ARE ORGANIZED

People organize cooperatives in response to a specific problem or opportunity. They develop them to improve their income or to provide a needed service. Cooperatives are formed as serious businesses that may undertake one or more of the functions of marketing, purchasing, or servicing.

If developed for conducting marketing activities, cooperatives work to:

- Improve bargaining power— by combining the volume of members, cooperatives leverage their position when dealing with other businesses.
- Reduce costs—volume purchasing reduces the purchase price of needed supplies. Earnings of the cooperative returned to individual members lower their net costs.
- Obtain market access—value is added to products by processing or offering larger quantities of an assured type and quality to attract more buyers.
- Improve product or service quality—when a cooperative is in a market, the quality of products or services is often improved because of enhanced competition.

If developed for conducting purchasing and servicing activities, cooperatives:

- Obtain products or services otherwise unavailable—cooperatives often provide products or services where the level of demand would not likely attract private businesses.
- Reduce costs/increase income—reducing the cooperative's operating costs through the cooperation of many members increases their earnings.

A study by the University of Wisconsin Center for Cooperatives found that there are more than 29,000 cooperatives of all types in the United States. These cooperatives have 350.8 million members (many people belong to more than one cooperative), assets of $3.1 trillion, and revenue of $514.6 billion.

The study divides the cooperatives into four major type categories: commercial sales and marketing; social and public services; financial services; and utilities.

Further breakdowns among these categories show numerous types of cooperatives that provide benefits to their members, including: farm supply and marketing, bio-fuels, grocery, arts and crafts, healthcare, childcare, housing, transportation, education, credit unions, farm credit, mutual insurance, rural electric, rural telephone, water, and other types in retail, service, and cooperative finance. (See University of Wisconsin Center for Cooperatives Research on the Economic Impact of Cooperatives, under References).

The cooperative business model should be explored whenever a group of people have identified a specific need that isn't being met by other businesses in the marketplace, and/or when they know that it is unlikely that another business will meet that need. Deciding whether to form a cooperative is not easy. However, by understanding the process, people can become more involved in activities that will ultimately clarify whether a cooperative will be a good fit for the need they face.

WHO SPARKS THE DEVELOPMENT OF A COOPERATIVE?

A compelling need and a few community leaders can spark the drive to form a cooperative. Usually, these leaders have identified an economic need or service they believe a cooperative can meet. They also know others who have similar interests and shared values.

These leaders can be small business owners, manufacturers, growers, artisans, or any citizens who lack (or are losing): a market for their products, satisfactory sources of production supplies, or services related to their occupation. Or, they may wish to secure some other needed service or reduce their current costs.

Depending on the situation, a new cooperative may be welcomed with enthusiasm or may be met with vigorous opposition, especially from a likely competitor.

If opposed, leaders must be prepared to react to various strategies of competitors, such as: price changes to retain potential cooperative members' business; better contract terms or canceled contracts; attempts to influence lenders against providing credit; and even publicity, misstatements, and rumors attacking the cooperative business concept.

Regardless of the business climate for the proposed cooperative, leaders must demonstrate a combination of expertise, enthusiasm, practicality, dedication, and determination to see that the project is correctly undertaken and objectively assessed.

The next section provides the steps typically followed in developing a cooperative. These should be closely studied.

ORGANIZING STEPS OF COOPERATIVE FORMATION

Starting a cooperative is a complex, time-consuming project. This guide provides a 12-step approach. In some cases, the steps may be followed in a different order than listed here. Nonetheless, it is important that organizers fully understand the potential steps. Ensuring that the development process is comprehensive is critical to creating a successful cooperative business, or deciding against one, if that's what the assessment recommends.

Figure 1 is an outline of the sequence of events leading to the formation of a cooperative. The table is broken down into four development phases: (1) Identify economic need, (2) Deliberate, (3) Implement, and (4) Execute. Within each of these phases, there are events/steps that take place. The 12 steps include some sub-steps.

PHASE I: IDENTIFY ECONOMIC NEED

The first two steps in cooperative development correspond to identifying the economic need that the proposed cooperative would fulfill. First, the group that sparked the cooperative idea must explicitly state the economic need and then hold an exploratory meeting of potential members. This meeting should serve to further flesh-out whether there is a consensus for the economic need, and if so, then provide the forum for the formation of a steering committee to lead the development process and fully explore how well a cooperative might meet the identified economic need.

STEP 1: DETERMINE THE ECONOMIC NEED

The cooperative development process begins with a small group of prospective members—those sparking the cooperative idea—meeting to discuss the economic need and the potential of a cooperative to meet that need.

Discussion topics at this meeting should include:

- What information about the perceived need is readily available?
- Could a cooperative effort address this need?
- What information about cooperatives is available?
- Who should be invited to a meeting of potential users?
- How should potential users be contacted?
- Where can an experienced co-op development advisor to help be found?

If a cooperative is deemed to offer a solution, a larger meeting of interested potential users should be planned. This is the exploratory meeting.

STEP 2: HOLD AN EXPLORATORY MEETING

Call a meeting of potential user-members to decide if interest is sufficient to support a cooperative. In other words, are there enough people who have the same economic need that is not being met? Announce the meeting date, time, and place via newspaper, social media Internet sites, radio, telephone, at other meetings, by letter, or word of mouth. Invite an outside advisor if one has been found and contacted.

The leadership group should develop an agenda and select a presiding officer who can conduct a business meeting. Also, the advisor (if one has been selected) can act as chair or facilitator and help answer questions. Primary agenda items might include the following questions/topics:

- What is the need? Do all the people present concur that the current market does not meet this need?
- Would a cooperative be the best solution to this need?
- Cooperative principles, terminology, and brief discussion on how they operate;
- Advantages and disadvantages of a cooperative;
- General scope of the project and preliminary estimates of capital needed; and
- Various forms of member-user commitment needed.

One approach is to have one member of the leadership group discuss the need and another summarize how the proposed cooperative might solve it. In addition, an invited representative from a successful cooperative might explain its operations, member practices, advantages, and limitations.

Allow plenty of time for discussion. Prospective members should be encouraged to express their views and ask questions. All issues raised should be addressed, although answers may be delayed until later meetings, when more information becomes available.

At this meeting, it's a good idea to hand out reports or bulletins about cooperatives to those in attendance. Answers to some of the frequently asked questions may be found in an array of cooperative bulletins published by USDA Rural Development (see References). Such questions might include:

- What is a cooperative and how is it different from other businesses?
- Who controls a cooperative? How is it governed?
- What responsibilities to the cooperative do members have?
- Can't we just find a grant to fund this?
- What does economic participation mean?
- What are net margins and net earnings?
- What are patronage refunds and retained patronage refunds?
- Can cooperative membership be restricted?

FIGURE 1: SEQUENCE OF EVENTS IN COOPERATIVE DEVELOPMENT		
Events/Steps	**Description**	**Action**
Identify economic need*		
1. Determine the economic need.	Leaders meet to discuss issues and to determine the economic need that a cooperative might meet.	If a real economic need is identified, continue the process.
2. Hold an exploratory meeting. Sub-step: select a steering committee	Hold a meeting of potential member-users to decide if interest is sufficient to support a cooperative. Steering committee members should have a strong interest in the cooperative and sound business judgment.	If group votes to continue, collect a token investment and discuss steering committee. Select people who are leaders and excited about the potential cooperative.
Deliberate		
3. Conduct a member-use analysis and initial market analysis. Sub-step: hold a second member exploratory meeting.	Survey the potential member-users to explore prospective members' needs, anticipated business volume, location and business or service characteristics of prospective members, opinions of prospective members. Discuss the survey results and preliminary cost analysis with potential member-users, discuss all related issues.	Analyze survey results; steering committee votes whether to proceed; if yes, it conducts a preliminary market analysis. Group votes whether to continue. If yes, the steering committee goes forward with feasibility analysis.
4. Conduct a feasibility study. Sub-step: hold a third member exploratory meeting.	A comprehensive feasibility analysis, conducted by an experienced practitioner, will help the steering committee determine if the proposed cooperative is feasible, based on well-determined assumptions, researched information, and the member-use and initial market analysis. A feasibility study provides insights into the industry. The steering committee presents the feasibility study analysis findings to potential members and provides the committee's recommendation whether to proceed.	Steering committee reviews and prepares for presenting study to potential member-users. Group discusses the recommendation and decides whether to proceed.
5. Prepare a business plan.	The steering committee should arrange for the completion of an in-depth business plan prepared by a professional familiar with cooperative organization. The feasibility study will act as a foundation from which to base the plan. A business plan provides specifics of how the business will operate within the market.	Business plans act as an organizational map for the new cooperative to follow as it begins operations.

(continued next page)

- What is the risk investment (equity) and why is it needed?
- How much will members' initial investment (equity capital) be?
- Will members' investment (equity) requirement be determined by volume or by number of members?
- Can members simply cosign a bank note instead of providing a cash investment (equity)? What are the risks involved in cosigning?
- How much money can members lose if the cooperative fails?
- Can members sell their stock and other investments (equities) and get out of the cooperative whenever they want? Can they sell it to whomever they want?
- What are marketing or purchasing agreements and why are they needed? How long do they last? If members can't meet the terms of the agreement, do they have to pay a penalty?

These and many more questions about how cooperatives operate may be on the minds of potential members, especially if they have not had any prior experience with cooperatives. Providing accurate answers and making available sufficient materials on cooperatives are extremely important for building confidence in, and excitement around, the proposed cooperative business.

If the group of prospective members decides that a cooperative will meet their needs and it wants to continue toward creation of a cooperative, then the attendees can be asked to make a token investment in the concept. This money may be used to cover planning expenses and it also provides an indication of the sincerity of the participant's interest. Also, at this time, a steering committee should be formed as a sub-step of this second step.

Select a Steering Committee. A steering committee helps to streamline and expedite the development

FIGURE 1: SEQUENCE OF EVENTS IN COOPERATIVE DEVELOPMENT continued		
Events/Steps	**Description**	**Action**
Implement		
6. Employ legal counsel to draft and complete legal papers	The articles of incorporation state the purpose of the cooperative business and give the cooperative a distinct legal standing. The bylaws state how the cooperative will conduct business and must be consistent with both State statutes and the articles of incorporation.	Provide legal counsel with all pertinent information about the cooperative and work with them to develop all legal documents necessary.
Sub-step: hold fourth member exploratory meeting.	All the work and recommendations of the steering committee are reviewed, including changes to the business plan and the legal documents.	Hold another vote whether to legally form the cooperative. If affirmed, file the articles of incorporation.
7. Hold first meeting of the cooperative.	This meeting is for approving the bylaws, discussing the proposed business plan, and electing the first board of directors.	It is important to have a good turnout of members at this meeting.
Execute		
8. Convene first board of directors meeting.	At this meeting the new directors will elect officers per the bylaws, appoint committees, and discuss steps for carrying out the business plan. Other important business might include use of debt capital, membership drives, and development of manager qualifications..	The new board needs to hold an orderly meeting with a well-defined agenda.
9. Hold a membership drive.	A membership drive is held when a new cooperative needs more members than those who had taken part in early meetings and shown commitment.	Arrange informational meetings with prospective members. Communicate the vision and goals of the new cooperative.
10. Acquire capital.	The board of directors arranges for adequate capital. Capital may be raised by members purchasing stock (equity) and borrowing funds (debt) from a lending institution. Projected cash-flow analysis and financial statements from the business plan help determine capital needs.	Members must invest or pledge sufficient capital to demonstrate commitment to the cooperative.
11. Hire a manager.	The board of directors must hire a qualified manager who will be responsible for the day-to-day operations of the cooperative.	Form a search committee, review recommendations, interview candidates.
12. Acquire equipment and facilities, begin operations.	The manager and board together determine what facilities and equipment are needed and then acquires (or rents) them. The manager hires employees to operate the cooperative.	Follow the guidelines laid out in the business plan.

process. This committee will lead the effort to conduct a member-use analysis, feasibility study, and business plan (if the process goes that far). At the exploratory meetings with potential members, committee members will present information and findings, lead the discussions, answer questions, and provide feedback when appropriate.

Members of this committee should have a keen interest in assessing the potential of a cooperative, be well respected within the community, and have sound business judgment. Steering committee members often become the initial organizers and members of the cooperative's first board of directors.

The committee's first function is to select officers. Next, it should consider the required steps in the development process and establish an estimated timeline for conducting those steps. Figure 2 provides a diagram of the steps that most cooperative development steering committees need to take. The committee should establish "finish-by" dates for each of these steps. The diagram shows the decision nodes that determine if further steps will be forthcoming.

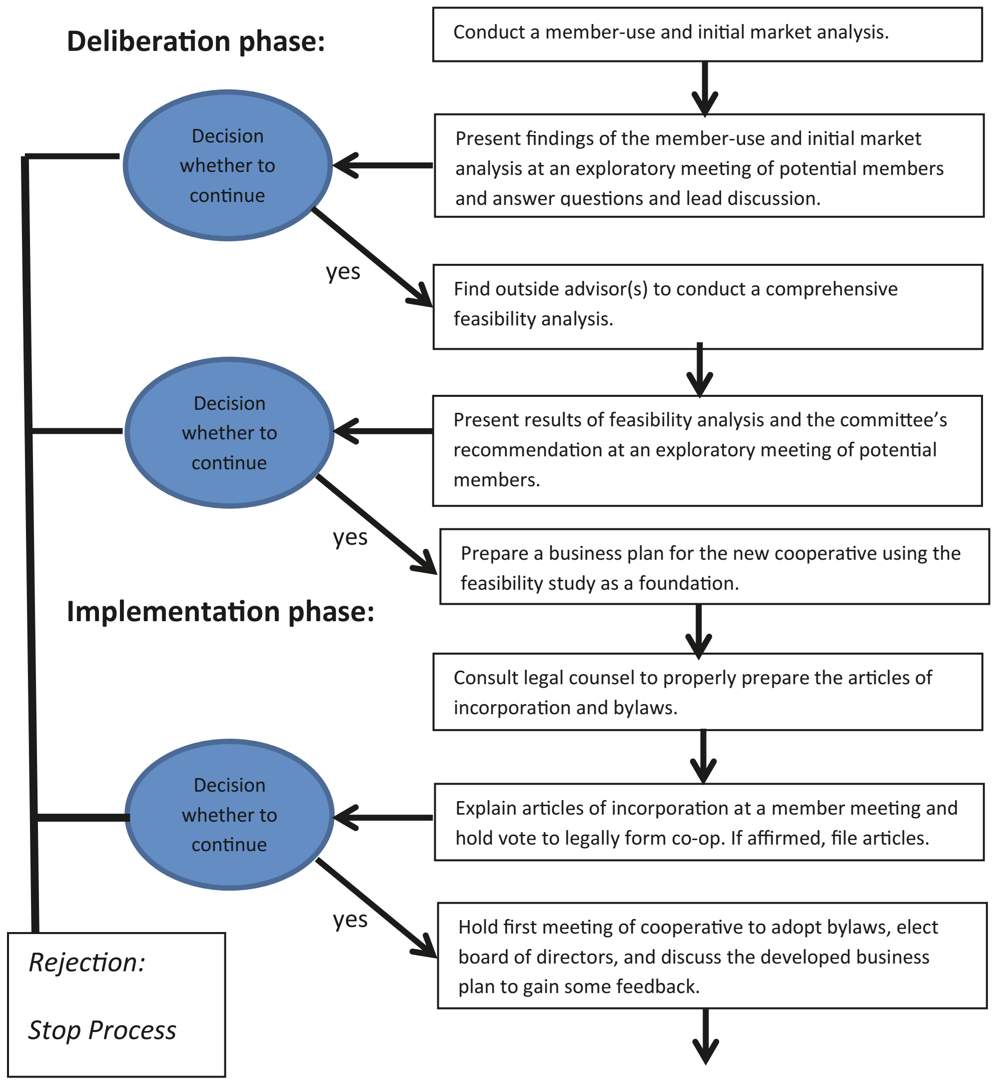
Throughout the cooperative's development, the steering committee should enlist an experienced advisor or practitioner to help with the necessary analysis during some of the steps. This specialized help should come from someone familiar with the intricacies of the cooperative-development process.

PHASE II: DELIBERATE

The steering committee takes the development project all the way through Phase II, which consists of Steps 3, 4, and 5. An experienced advisor/practitioner is often used for some of the activities in these steps.

FIGURE 2: STEERING COMMITTEE STEPS AND ACTIONS

Once the steering committee is formed, it carries out these development steps and actions:



New board of directors takes over from steering committee.
Often, the signatories to the articles of incorporation serve as the interim board.

STEP 3. CONDUCT A MEMBER-USE ANALYSIS AND INITIAL MARKET ANALYSIS

The steering committee must learn all it can about the cooperative's potential members and what the cooperative might do for them. It also needs to gain a more indepth understanding of the marketplace the cooperative will operate in.

Member-use analysis. To analyze potential member use of a cooperative, a survey should be conducted of prospective members. The survey should explore four areas:

1. Members' needs—the cooperative is formed and operated for the sole purpose of meeting members' needs. What are those needs? Where are members located? How experienced and capable are members? What is their familiarity with, and use of, other cooperatives? What is their willingness to join, finance, and use a new cooperative?

2. Anticipated business volume—the cooperative must have some assurance of sufficient volume to operate as a business and to plan for facilities and needed equipment. What are potential members' recent volume (production or purchasing) for the most recent, or a typical, year? What proportion of that volume will

members' market/buy through the cooperative?

3. Location and business or service characteristics of prospective members—where, how, and when the cooperative delivers its services is a prime consideration. Will the possible locations and methods of conducting business be well received by members? What variety of services will be offered, and what will members want?

4. Opinions of members—member participation in decisionmaking activities and sense of cooperative spirit are important for success. How do members feel about cooperatives and participating in one? Will they be excited about ownership and control?

Survey questions should be designed to gain information about these four areas. Formal survey techniques are best. The advisor usually drafts the survey questionnaire for the steering committee to review. Appendix B provides an example of a potential-member survey.

While the survey is being prepared, the steering committee should develop a list of potentially interested members. When the survey is completed and approved, the committee interviews potential members. In some cases, the survey may be given out at a meeting to be filled out by the potential members, or it may be mailed to them so they can fill it out at their convenience. Mailing the survey is likely best when there are a large number of potential members that the steering committee wants to reach. However, face-to-face interviews usually yield more thorough information and are thus best, if feasible.

For face-to-face interviews, steering committee members might travel with the advisor(s) to locate potential users or otherwise invite potential members to identified meeting locations. If confidentiality is important, the advisor should conduct the survey. The advisor should be prepared to discuss and answer questions about the proposed cooperative venture for the potential members.

Estimates of both membership and volume should be conservative. Not all persons interested will join initially, and some may wait to join later. Unfortunately, not all who join will make full use of the cooperative's services.

Once all the surveys are completed and collected, the advisor objectively analyzes the responses, prepares a report of the results, and presents it to the steering committee. The committee will then fully discuss the results, looking at the potential members' interest in joining the proposed cooperative, anticipated business volume, willingness to commit product (or use the cooperative for purchasing), and ability and willingness to provide capital. Depending on results, the steering committee then decides whether to proceed with the project. Following a decision to proceed, an initial market analysis is conducted to determine if the proposed cooperative has a feasible economic role in the marketplace.

Initial market analysis—this analysis, conducted prior to a more formal feasibility study, will identify how well the proposed cooperative's activities, given the economic need already identified earlier, will fit into the marketplace. Conducting this assessment will also help focus any additional services that the cooperative may be able to provide as a benefit to members.

This preliminary marketplace assessment doesn't need to be extensive, but it needs to identify suitable markets, given the economic need(s) to be fulfilled. It should also identify how the cooperative will fit in those markets, sources of supplies that will be needed, and likely service providers (and their requirements).

Here are a few methods for gaining this important information:

- Use previous market research and industry common knowledge.
- Do a survey of market, supply, or service providers. Contact users of the services, and potential buyers or suppliers, to learn about their experiences. Determine what their requirements are, and see if they can provide cost estimates.
- Ask State and/or Federal offices (such as USDA Rural Development offices, Extension Service, or community action agencies), universities, cooperative centers, commodity organizations, or private consulting firms to provide pertinent market information they have access to. Enlist them to conduct necessary research (e.g., provide useful data), if possible.
- Contact engineers, equipment dealers, real estate agents, and others to see if some cost estimates on establishing and operating the proposed cooperative's physical facilities can be obtained.

The advisor/practitioner analyzes information compiled and cost estimates gained and works with the steering committee to determine the best potential markets, supply sources, and service providers that fit the proposed cooperative's mission.

Once the analysis is completed, discussed, and approved by the steering committee, the second member exploratory meeting is called.

Hold a Second Member Exploratory Meeting. The steering committee should develop and follow a formal agenda for every potential-member meeting it holds as it goes forward. An example agenda is in Appendix C.

During this second meeting, the results from the member-use and initial-market analyses are presented. These results should be thoroughly discussed, and

potential members should feel free to offer ideas and information.

After the analyses are reviewed, results are discussed and, if accepted, the group should vote by secret ballot on whether to continue the organizational process. By now, the steering committee and advisor should have a good idea of the minimum volume of business, number of members, and amount of financing (and financial commitment by members) needed to justify starting the cooperative. Where support is questionable, the token investment made by potential members should be refunded.

Potential members should sign a pre-membership agreement (for the components of a pre-membership agreement, see Appendix D). This agreement helps determine the extent of serious interest in the proposed cooperative. The signer agrees to join, patronize, and furnish a specific amount of initial "risk capital."

Initial investment by members should be in proportion to their intended use of the cooperative. However, establish a minimal amount—perhaps 10 percent of potential risk capital (equity) needed to operate. This goal should be met before continuing organizational efforts.

Potential members should be given a written statement about how their investment will be used and procures for returning unused funds if the project is terminated or the individual later decides not to join. The money should be deposited in an interest-bearing account and records kept of investments and expenditures. Generally, this money is used for organizational costs, such as supplies, postage, phone bills, and attorney fees.

STEP 4. CONDUCT A FEASIBILITY STUDY

A comprehensive feasibility analysis, conducted by an experienced practitioner, will help the steering committee determine if the proposed cooperative is feasible, based on well-determined assumptions, researched information, and the member-use and initial market analysis. This study determines management, marketing, technical, economic, and financial feasibility and presents the entire concept in one document. It will provide the foundation of the business plan if a decision to proceed is made.

The emerging picture of the size and scope of the cooperative now permits the practitioner and the steering committee to develop basic operating and organizational assumptions. These assumptions must be taken seriously. Assumptions often include factors such as the technology used (the facilities, equipment, production process, etc.), financing (capital needs, volume, cost of goods, wages, etc.), marketing (prices, competition, etc.), and so on.

For indepth information on developing a feasibility study for a cooperative development project, see Vital Steps: A Cooperative Feasibility Study Guide (USDA Rural Development, Service Report 58) under References. This guide defines what a feasibility study is, explains why they are necessary and their limitations. It also lists lender considerations, defines the first steps of a feasibility study, and provides the key actions in completing a comprehensive study. The key actions include: (1) Deciding who will conduct the study; (2) Developing project assumptions; (3) Determining components to include in the study (i.e., executive summary, introduction, industry background, marketing, operational and technical characteristics, financial statements and projections, and summary and recommendations); (4) Accepting or rejecting the study; and (5) Group decisions going forward after accepting a study.

As stated earlier, the information gained from the initial market analysis is useful in the development of the feasibility study. Of course, the feasibility study will often go into much greater detail than the market analysis.

The feasibility study should include all the information available for making a decision as to whether—given the best of assumptions, data, and other pertinent information—the cooperative will succeed. It should include sensitivity analysis (i.e., changing assumption values to assess different numerical projections) to examine the impact of different business scenarios. It should also provide sound financial projections (pro forma cash flow, balance and income statements) and list all the resources (human, capital, physical) that will be needed for the cooperative to thrive.

A major portion of the feasibility analysis will include the capitalization of the cooperative. Part 2 of the Important Cooperative Development Considerations section of this report provides information on ways cooperatives are capitalized—including common stock and preferred stock, if the cooperative is organized as a stock cooperative—membership certificates and capital certificates if it is non-stock, and sources of debt capital if the cooperative will need to borrow funds to operate. It also provides information on the concept of member investment, which is critically important in a cooperative. Fledgling cooperatives often pursue grants to help with initial capitalization needs. Caution should be exercised in depending on grants. While grant funding may be used to enhance the new cooperative's capital, members must also invest in their cooperative. Member investment is a vital component for achieving sustainability and autonomy. Cooperatives with little or no member investment often fail.

Hold a Third Member Exploratory Meeting. The steering committee calls the third member exploratory meeting to fully present the results of the comprehensive feasibility study to potential members and provides the committee's recommendation on whether to proceed with the cooperative. The committee (the advisor often helps) answers questions on the feasibility study. If the group votes to proceed with forming the new cooperative, the process moves to Step 5.

STEP 5. PREPARE A BUSINESS PLAN

The steering committee, using the feasibility study as a foundation, should arrange for the completion of an indepth business plan for the new cooperative. A business plan is for actual cooperative implementation. It serves as a blueprint not only for the implementation, but also for what actions the cooperative will take during its operations. The business plan usually contains less emphasis on scenarios than did the feasibility study. Typically, it highlights only the scenario selected by the steering committee and advisor/practitioner. The business plan needs to focus on the actions necessary to launch the cooperative.

Standard business plans include such details as key management personnel to hire, employee positions to fill, business location (and needed facilities and equipment), the financial "package" to be implemented, product flow operations, customer relations, etc. It may also include steps to create a dynamic and involved membership, as well as the accounting, business, and cooperative practices that will be implemented.

PHASE III—IMPLEMENT

After completing Step 5, the cooperative becomes a reality in Steps 6 and 7. Now legal papers are created and formal cooperative meetings take place, including the first meeting of the new cooperative. (Note: incorporation, part of Step 6, is something that is often completed earlier in the process for some cooperative startups. For instance, groups forming food cooperatives are often advised to incorporate right after the potential members make their initial token investment.)

STEP 6. DRAFT AND COMPLETE LEGAL PAPERS

The steering committee should become acquainted with legal aspects of cooperatives by studying laws applicable to them and businesses generally. Every

State has one or more laws authorizing the formation of cooperative corporations, although a number of them are restricted to agricultural producers. The committee needs to study the laws in the State where the cooperative will be incorporated to ensure that the right procedures are followed. Legal counsel, experienced in cooperative law, should be employed to assist in the process.

The two main legal documents the cooperative needs to draft are the articles of incorporation and the bylaws. The articles of incorporation state the purpose and scope of the cooperative and give the cooperative a distinct legal standing. The bylaws state how the cooperative will conduct business and must be consistent with both the State statutes and the articles of incorporation. Other legal documents that the cooperative may need include the membership application, membership or stock certificate, marketing/purchasing agreements, meeting notices, and waivers of notice. (See USDA CIR 40, Sample Legal Documents of Cooperatives under References.)

Part 3 of the Important Cooperative Development Considerations section provides greater information and detail on legal considerations and documents.

Hold Fourth Member Exploratory Meeting. Hold another exploratory meeting of potential members to review all of the work and recommendations, to date, that the steering committee has presented. Discuss any changes to the original business plan, as well as the preparation of the necessary legal documents. The articles of incorporation and bylaws should be explained and discussed.

Support for the cooperative should again be evaluated by holding a vote on whether or not to form the cooperative. If the decision to form is affirmed, the incorporators should file the articles of incorporation.

STEP 7. HOLD FIRST MEETING OF THE NEW COOPERATIVE

After the cooperative has been incorporated, the new cooperative needs to hold its first official meeting. At this meeting, the bylaws need to be approved and the board of directors elected.

According to most statutes under which cooperatives are organized, articles and bylaws must be adopted by a majority vote of the members or stockholders. For convenience in organizing, only the persons named in the articles of incorporation, called the charter members, must vote to adopt the bylaws. These individuals are regarded as members, or stockholders, as soon as the articles of incorporation are filed. A good practice,

however, is to invite everyone who has signed a pre-membership agreement to this meeting to ratify the bylaws.

A temporary presiding officer conducts this first meeting and reports that the articles of incorporation have been filed. A draft of the proposed bylaws is presented, discussed, and adopted as read or amended.

Further action is usually needed to accept those members or stockholders who have subscribed for stock or agreed to become members (signed the premembership agreement) but are not named in the articles of incorporation.

If members of the first board of directors have not been named in the articles of incorporation, they need to be elected at this meeting.

Here are some suggestions for selecting the first board of directors:

- develop a panel of candidates for the board by calling for nominations;
- nominate only members as candidates;
- nominate at least one candidate for each position, possibly more; and
- vote by secret ballot.

Steering committee members are often board candidates, but other members may also be nominated. A vote for the board of directors by the members present is then held by secret ballot.

After the election, the new board addresses the membership by briefly discussing the next steps for the cooperative as identified in the business plan.

PHASE IV—EXECUTE

Steps 8 through 12 are the execution steps –they get the cooperative up and running. These are concrete "action steps" that bring the cooperative into operational existence.

STEP 8. CONVENE FIRST MEETING OF THE NEW BOARD OF DIRECTORS

Once the bylaws have been adopted, the board of directors should meet as soon as possible to avoid having to send out legal notices of a meeting to directors. At this meeting, directors approve various resolutions designed to make the cooperative an operational business and ready to serve members. If this meeting is to be held immediately, the board will need to sign a "Waiver of Notice of First Meeting of Board of Directors" (see Appendix E for a sample of a waiver). Another option is to include a phrase such as this in the bylaws: appearance at a meeting will constitute a waiver of notice, except when a director attends the meeting and objects to the transaction of business because the meeting was not lawfully convened.

3fficers of the board are elected, and directors are assigned to individual or committee assignments to implement the business plan. Other members may also be assigned to committees, but at least one board member should be on each committee for leadership and to enhance communications. Target dates are established for important events such as groundbreaking, construction completion, dedication or open house, and full capacity operations.

The board needs to act immediately to implement key actions in the business plan. Some of these activities might be:

- conduct a membership drive;
- adopt a form of membership application or stock subscription;
- adopt the forms of contractual agreements;
- acquire business liability and board insurance;
- acquire capital;
- select a bank in which to deposit funds (if one hasn't been already chosen);
- initiate steps to hire a manager;
- authorize officers or employees to handle cooperative funds and issue checks;
- design and install an accounting system;
- provide for bookkeeping and auditing services;
- print the articles of incorporation, bylaws, and other member documents for distribution to all members;
- secure bonds for officers and employees in accordance with bylaws; and
- pick a business location and seek bids for facilities and equipment.

The board should hold additional training meetings for directors to hone their knowledge on topics such as legal liability, cooperative finance, management relationship and supervision, and member relations. An outside expert can be brought in to discuss these topics. Educational topics for the entire membership should include member responsibilities, cooperative operating policies, and tax treatment of patronage refunds. A membership review meeting can be held for this purpose, or newsletters and other informational materials can be distributed that discuss members' role and responsibilities in the cooperative.

STEP 9. HOLD A MEMBERSHIP DRIVE

A new cooperative must have enough members to start operations and justify its existence. Additional members may be needed to financially strengthen the association or increase its volume.

Cooperatives that provide supplies and services normally have an open membership. Those that process and market, bargain for price, have contractual agreements, or offer limited services, may have a selective

membership policy. Members should feel a responsibility to recommend other possible members who they believe to be qualified users of the cooperative. That's why it's important for members to understand what their cooperative is, how it operates, its benefits, and its limitations.

People join cooperatives primarily for economic benefits—better services and increased income. Most people will appreciate being told about the advantages of cooperative membership. If those benefits are not evident, few prospects will join; even if they do, they probably won't regularly patronize the cooperative.

The cooperative should arrange and promote informational meetings with prospective members. In some cases, these prospects will have to be specifically invited. At these meetings, the board of directors should communicate the vision and goals of the new cooperative and key aspects of the business plan that are likely to be of interest. Information about what a cooperative is should be provided if it is felt that some in attendance may not have a solid understanding of cooperatives. All questions, both general and specific, should be answered forthrightly and transparently.

New members are then usually asked to join by purchasing stock or paying membership equity and signing an application. The applicant should get a receipt for funds collected. The cooperative must follow up with membership and stock certificates and related material.

Accurate accounting of money is an extremely sensitive issue. The cooperative should retain an independent accounting firm to assist in recording funds prior to any sale of stock or the collection of substantial amounts of money.

STEP 10. ACQUIRE CAPITAL

Starting a new cooperative can create a need for substantial capital. A problem develops when trying to operate with limited membership equity capital and sizable total capital requirements to launch, or expand, a business. Therefore, member equity must be carefully weighed against projected cooperative capital needs. The board of directors is responsible for arranging adequate capital.

While the best source of financing for a cooperative is from members, financing a new cooperative with member equity alone is usually impossible. Therefore, additional sources for funds are needed. Local area banks are good possibilities. Others include CoBank, the cooperative banks of the Farm Credit System, NCB (formerly National Cooperative Bank), USDA Rural Development (for guaranteed loans or other loans), and Federal or State governmental funds. Another option may be to sell preferred stock to members and others in the community.

The more financing members provide, the less the cooperative will need to borrow or attain from other sources. Usually, cooperatives sell common or preferred stock to members to raise capital. The common stock is usually tied to voting rights, but there are several types of stock plans. For example, class A stock could be designated as voting stock and limited to one share per member, while class B stock could be non-voting stock that members could purchase based on their anticipated volume of business with the cooperative.

Preferred stock can also be sold to members and outside investors. Although owners of preferred stock have no, or very limited, voting rights, this stock carries less risk than common stock. Members, as well as other people in the community, may want to further support the new cooperative through the purchase of preferred stock.

The steering committee and the advisor should conservatively estimate the amount of capital raised from preferred stock sales. Some States limit dividends that can be paid on both common and preferred stock, thereby making preferred stock unattractive to outside investors. Stock sale programs should be carefully reviewed by an attorney to ensure conformance with State and Federal laws and to consider whether they have a place in the capital structure of the new cooperative.

(Part 2 of the Important Cooperative Development Considerations section of this report covers the methods for acquiring capital and the classification of financial instruments.)

STEP 11. HIRE A MANAGER

Selecting and hiring the manager is one of the most critical tasks for the board of directors. The success of the cooperative depends more on the manager than any other individual. The manager directs day-to-day operations, hires and fires employees, and allocates resources for greatest efficiency and effectiveness.

The steering committee begins the task of manager selection by developing a position description. A supplemental statement should describe the responsibilities of the manager and the roles and responsibilities this person will have with the board of directors of the cooperative.

Long and varied lists of desired qualities to seek in a manager have been compiled, but three areas of focus are suggested—education, experience, and ability to work with people. Manager candidates need to be judged in these areas: commodity or product expertise, business and basic financial acumen, knowledge of cooperatives (because of their unique characteristics), leadership abilities, and "people skills."

Finding a manager with both education and experience with cooperatives is important for several reasons. Unlike investor-owned corporations, a cooperative manager should not participate in cooperative ownership. Career decisions could conflict with ownership interests. Cooperatives do not offer managers stock options or profit sharing, although some cooperatives have incentive plans. The candidate needs to understand the special nature of the cooperative's patrons because they are both customers and owners. This dual relationship adds a unique dimension to a candidate's requirements to work with people.

Good managers are hard to find, especially for cooperatives. The best source is often other cooperatives. Leads may be obtained by contacting the managers of other cooperatives, directors of State or regional cooperative councils, national cooperative organizations, the advisors who helped form the cooperative, and employment agencies. Advertise the opening in publications that likely have a cooperative- and industry-related readership.

STEP 12. ACQUIRE EQUIPMENT AND FACILITIES, BEGIN OPERATIONS

Acquiring a business site, facilities, machinery, equipment and other supplies is a job that takes foresight, analysis, judgment, and timing. The new cooperative's business plan is the blueprint. The newly selected manager should participate in these discussions.

Facilities should be located conveniently for members and facilitate the establishment of good distribution links with suppliers, markets, and other business services.

Directors need to study facility requirements thoroughly. Their decisions will influence the cooperative's operations for many years. It's important to avoid using so much capital for fixed facilities and startup that other budgeted items and/or cash flow are jeopardized.

A useful planning tool is an acquisition schedule and budget. To develop this, list items in the logical order they should be acquired, based on need, delivery time, loan requirements, funds available, and other factors. The data from the schedule should be built into the cash-flow projection for the startup period. Changes to this plan should be analyzed before enactment.

IMPORTANT COOPERATIVE DEVELOPMENT CONSIDERATIONS

This section provides information in four parts. The first part provides some principles for development practitioners to follow and pitfalls that can undermine a cooperative formation. The second part is about member investment in a cooperative business and methods of cooperative capitalization; the third is the legal aspects of cooperative development consisting of the important legal documents that come into play, and the fourth part concludes with some general rules for success in cooperative development.

PART 1—PRACTITIONER PRINCIPLES AND PITFALLS

Professionals and others involved in cooperative development should follow tried and true principles throughout the process and know of the pitfalls to avoid for the best possible outcome in forming a cooperative.

THE MADISON PRINCIPLES

Cooperation Works! (http://www.cooperationworks.coop), a network of cooperative developers, created the Madison Principles in Madison, WI., in 1995. These 12 principles are professional standards for cooperative developers and are a creed to follow in any cooperative development project.

1. Declare Conflicts of Interest: Cooperative developers subscribe to the highest level of ethics and shall declare any conflict of interest, real or perceived, so that they can be a credible source of objective feedback and an articulate advocate of the project as needed.
2. Develop Co-ops Using Proven Models: There are essential development steps that must be taken in a critical path to success.
3. Facilitate the Goals of the Steering Committee: An enthusiastic group of local, trustworthy leaders is a prerequisite for providing technical assistance. The effective cooperative developer nurtures that leadership by helping them shape a vision that will unite members and provide ongoing training.
4. Use a Market-Driven Approach: Cooperatives only work when they are market driven; the cooperative developer works to ensure that accurate market projections precede other development steps.
5. Acknowledge the Importance of Member Involvement: Member control through a democratic process is essential for success. Success also depends on the commitment of the members' time, financial resources and loyalty to the cooperative.
6. Seek Tangible Benefits: There must be tangible benefits for members.
7. Steer Toward Revenue Generation: The cooperative's products and services must generate sufficient revenue so the effort can be financially self-sustaining. Provisions must be made to share any surplus equitably.
8. Honor Diversity: Each cooperative responds to its unique economic, social and cultural context; as a consequence, each cooperative is different.
9. Make Co-op to Co-op Connections: Cooperative

developers link emerging cooperatives with established cooperatives to facilitate mutual communication and learning.

10. Promote Social and Economic Empowerment: Cooperatives are tools for development and promote social empowerment and economic goals.

11. Understand That Cooperatives Work Everywhere: Applied appropriately, cooperatives have value to all population groups and for all businesses and services in the public and private sectors.

12. Our Vision of the Cooperative Community Is Global: Opportunities for human cooperation exist throughout the world. Cooperative development transcends national boundaries.

PITFALLS TO AVOID

Cooperative development projects and newly formed cooperative organizations are often vulnerable to certain pitfalls. The following list contains some of the inadequacies that may arise to derail a project.

1. Lack of clearly identified mission. A new cooperative shouldn't be formed just for the sake of forming one. The cooperative must develop a clear mission statement with defined goals, based on the economic need.

2. Inadequate planning. Detailed plans for reaching the mission and goals are extremely important. Indepth surveys that identify member-user needs, coupled with a feasibility study, are necessary. Stop the organizational process if there is not sufficient interest in the cooperative by potential member-users, or if the feasibility study indicates that is would not be a sound business venture. The human cost in time and organizational expense will then be saved. If the process proceeds, be sure to develop and follow a realistic and comprehensive business plan.

3. Failure to use experienced advisors and consultants. Most people interested in becoming member-users of a new cooperative haven't had cooperative business development experience. Using advisors experienced in cooperative development can save wasted effort and expense.

4. Lack of member leadership. Calling on the services of experienced advisors will not replace the need for leadership from the organizational group. Decisions must come from the potential member-user group and its selected leadership on the steering committee. Professional advisors should never part of decisionmaking.

5. Lack of member commitment. To be successful, the new cooperative must have the broad-based support of the potential member-users. The support of lenders, attorneys, accountants, cooperative specialists, and a few leaders won't make the cooperative a business success. It must have commitment from a critical mass of members who will support and use the cooperative.

6. Lack of competent management. Most cooperative members are busy operating and managing their own businesses or have fulltime jobs and lack experience in cooperative management. The directors must hire experienced, qualified management to increase the chances of business success.

7. Failure to identify and minimize risks. The risk of starting a new business can be reduced if identified early in the organizational process. Careful study of the competition, Federal, State, and local government regulations, industry trends, environmental issues, and alternative practices helps to reduce risk.

8. Poor assumptions. Often, potential member-users and cooperative leaders overestimate the volume of business and underestimate the costs of operations. Anticipated business success must be based on sound and conservative assumptions. A dose of pessimism often proves to be judicious.

9. Lack of financing. Regardless of the amount of time spent on financial projections, most new businesses are underfinanced. Inefficiencies in startup operations, competition, complying with regulations, and delays often cause financial shortfalls. Often, the first months of business operations, and even the first years, are not profitable, so adequate financing is important to survive this period.

10. Inadequate communications. Keeping the membership, suppliers, and financiers informed is critical during the organization and early life of the cooperative. Lack of correct information can create apathy or suspicion. The directors and management must decide to whom, and how, communications are to be directed. In addition, member-users not familiar to cooperatives must be fully educated in how cooperatives function and how their benefits will accrue.

Considerable time and effort are spent in starting a new cooperative. Knowing and avoiding the potential pitfalls, and completing all the necessary steps for development as identified for the project, helps to increase the odds of success for a new cooperative.

PART 2—CAPITALIZING THE COOPERATIVE

THE MEMBER INVESTMENT

Investing risk capital in a cooperative is a basic member responsibility. The initial investment required (equity capital) from each member will be determined by the projected cost of facilities, estimated business volume, cash-flow requirements, projected number of members, and their use of the business.

Members' initial risk capital investment should be large enough for them to realize they have a financial stake in the business to protect. If the investment requirement is based on volume, rather than the number of members, the investment should be in proportion to their expected use. Those who wish to contribute more than their share may purchase preferred stock, or capital certificates that earn fixed dividends, but carry no additional voting privileges. Members may also provide short-term debt capital in the form of certificates of investment or member loans.

Members provide additional amounts of risk (equity) capital as they use their cooperative. One method is through per-unit retains. The cooperative deducts from transactions an amount based on the value or quantity of services provided or products marketed. Another method is to retain part of the cooperative's net earnings at the end of each business year. Under both of these methods, the risk capital (equity) investments are credited to members' equity account in the cooperative's accounting system.

Like other businesses, cooperatives must build financial reserves. These can be used both to carry them through times when operating expenses exceed income and for growth of the business. Sometimes, part of these reserves is dedicated to a specific purpose, such as covering uncollectible accounts (bad debts). Another portion may be set aside to fund a new facility or the startup of a new member service.

Accumulated reserves relieve the pressure on the cooperative to borrow money or reduce important services during tough times. And they reduce the likelihood the cooperative will have to ask the members for a direct investment of additional risk capital to meet unexpected needs.

When planning for the capitalization of the new cooperative, the steering committee and advisor estimate the amount of reserves that will be needed and the best method of obtaining this capital. State law should be checked for rules on reserve levels or methods of accumulation.

Membership equity or payment for a share of stock is usually retained by the cooperative, at least until the membership is terminated. However, another element to planning capitalization entails a strategy for revolving member equity capital (related to business done with the cooperative), retained patronage refunds, and per-unit retains back to members. When the cooperative's equity is sufficient to meet its needs, a portion of each year's income should be used to redeem the oldest patronage-based equity.

This equity is replaced by funds retained from the current year's patrons. The schedule for revolving equity is set by the board of directors. A systematic equity-redemption program keeps the cooperative financed by current users, in proportion to their use of the cooperative.

CAPITALIZATION METHODS

Capitalization is the amount and source of money needed to start and operate the cooperative. Indeed, a key part of the feasibility study will be fully determining the cooperative's capital needs and sources to meet those needs. The cooperative's capital structure needs to be determined, including these considerations: (1) Will it be a stock or non-stock cooperative? (2) How much member investment is necessary (estimate)? and (3) What is the amount of borrowed (debt) money needed, and where will it be sourced?

While many State incorporation statutes permit organizing as either a stock or non-stock cooperative, a number limit them to agricultural producers. In a stock cooperative, members are issued stock certificates as evidence of their membership and capital investment. More than one type of stock may be issued.

Common Stock—Stock cooperatives issue shares of common stock to document membership and voting rights. Common stock may be divided into classes. Each class may have different par values and carry different voting privileges. Usually, cooperatives don't pay interest on common stock.

Preferred Stock—Preferred, non-voting stock may be issued to both non-members and members for additional capital investment. This stock may be divided into classes. Each has different par value and/or other conditions. Interest paid on preferred stock may be limited by State or Federal statute or redemption determined by the board of directors. If the cooperative is changing structure or going out of business, preferred stock is paid before the common stock.

Member Loans—Some cooperative startups make use of an additional member investment, a member loan, for raising equity. The individual member and cooperative set mutually agreed upon terms and a loan is then made to the cooperative by the member. However, member loans are less flexible than preferred stock, and they must be prepaid prior to preferred and common stock in the event of dissolution.

Membership Certificates—If the cooperative is organized as a non-stock organization, a membership certificate is usually issued. This certificate is issued when membership equity is paid and establishes voting rights in the cooperative. The amount of capital collected from membership equity is usually considered as incidental to capitalizing of the cooperative. Membership certificates are generally non-interest bearing. To obtain more capital, in this case, the cooperative will also issue capital certificates.

Capital Certificates—Capital certificates of a non-stock cooperative are the equivalent of preferred stock issued by a stock cooperative. They are sold in various denominations, may bear interest, and may or may not have a due date. They convey no voting privileges and may be owned by non-members.

The combination of membership fees, sale of capital certificates, and capital certificates issued for retained patronage are all sources of risk capital (equity) for non-stock cooperatives. Note that certificates issued for retained patronage may carry a due date to implement systematic rotation.

Debt Capital and Sources—How much debt capital the cooperative can, or should, borrow depends on the how much risk (equity) capital members initially invest, cash flow, quality of management, and the degree of risk acceptable to members. Members should contribute at least half of the equity capital needed. But, it usually takes several years of operations to reach this goal. Also, the type and scale of the cooperative will determine how soon members will reach the 50-percent goal.

Long-term credit is the usual way of acquiring part of the money to finance land, buildings, and equipment. The period of the fixed-asset loan depends on a number of factors, but it is usually related to the facility's projected life.

The steering committee should explore various sources of long-term loans and recommend the source that can supply the financing best suited to the proposed cooperative. Among sources of facility loans are USDA Rural Development, CoBank, NCB, commercial banks, credit unions, and insurance companies. Other financial arrangements may be available that are temporary or unique to the new cooperative venture.

Operating capital may be obtained through short-term loans (1 year or less) and/or a line of credit after the cooperative becomes established. A new cooperative, however, can obtain only part of its operating funds from short-term loans. Member equity must make up the balance.

Sources of short-term credit include credit unions, commercial banks, banks for cooperatives in the Farm Credit System, and NCB. The committee should explore all sources and recommend the lender that best meets the requirements of the proposed cooperative.

Commercial banks, particularly those in the area where the cooperative will operate, are an important source for loans. Personnel of these banks already are familiar with the economy in the area and probably know many of the cooperative's prospective members. These banks also offer a variety of banking services the cooperative will need once it begins operations. New cooperatives often get loans or loan guarantees from government agencies.

Farm Credit System banks, particularly CoBank, that are nationally chartered are a major source of credit for newly organized and established agricultural and rural utility cooperatives and their members. Farm Credit System banks make loans to cooperatives to purchase fixed assets and for operations. Individual farmers borrow funds to purchase land and to finance farm operations. The system is used also to finance members' share of equity capital for a new or expanding marketing, purchasing, or service cooperative.

NCB is another source for loans and startup financing. It primarily finances non-agricultural cooperatives, including consumer, worker, retailer-owned, health, housing, and other types of cooperatives, both urban and in rural communities.

Preparing a Loan Application—Cooperative leaders need to carefully develop the loan application to make a good first impression on the potential lender. Lenders will insist on seeing certain key documents before considering a loan request. Special expertise is important in helping prepare these documents, including that of an economist, marketing specialist, attorney, certified public accountant, and perhaps others with expertise related to the proposed cooperative's business.

The lender will carefully review the business plan of the proposed cooperative. It will want to know the projected volume of business and seasonal changes in it, current market conditions, and how the cooperative will fit into that market. The lender will also want to see evidence for the proposed facility and equipment needs, the projected cash flow, operational aspects, etc. Cash flow will be a focal point as it provides the lender with a continuous, month-by-month cash income and expense prediction. Lenders are particularly concerned with the net ending cash balance, which provides evidence that the cooperative will have sufficient funds to operate, pay bills, and repay loans, especially during adverse market swings. Most lenders want 3-year projections. (See Appendixes F through J for examples of cash flow, income, balance sheet, ratio analysis, and sources and uses of funds, statements.)

The lender will carefully examine the projected operating statement and balance sheet. The income statement provides a projected picture of operations for 1 or more years. It contains information on sources of income and expenses. The key figure is the "bottom line," which indicates whether net margins (profits) are anticipated. A monthly operating statement provides information to lenders and assists the board in making major policy and management decisions.

The balance sheet will project the future value of the cooperative and indicate its solvency and ability to satisfy creditors' claims when due. It lists the cooperative's assets, liabilities, and net worth.

To provide the lender with further condensed information, a schedule of Fixed Assets Costs and Depreciation (see Appendix K for a sample) should be developed. A condensed listing quickly conveys what the cooperative needs to purchase or lease. To assure the lender that depreciation has been accurately noted, it is also desirable to outline in table form the classes of assets, cost, life expectancy of equipment, and annual depreciation.

Another helpful document for lenders is a Financing Needs and Sources Schedule (see Appendix L for a sample schedule). This listing will save the lender time in assembling the various pieces of data for analysis. It should show major items for which loans and member equity will be spent. These items are extracted from the projected cash-flow data.

PART 3—LEGAL ASPECTS OF COOPERATIVE DEVELOPMENT

Several Federal laws are especially important for cooperatives. The Capper-Volstead Act of 1922, sometimes called the "Magna Carta" of farmer marketing cooperatives, recognizes the rights of producers to act together in handling, processing, and marketing their production without violating antitrust law. Producers may also form a marketing agency in common. But even though cooperatives have this organizational protection, their operations are subject to the same antitrust laws as other businesses. (See USDA CIR 35, Understanding Capper-Volstead, under References.)

The Farm Credit Act of 1971 defines a cooperative that is eligible to borrow from the banks for cooperatives in the Farm Credit System and the conditions the cooperative must meet. The National Consumer Cooperative Bank Act created a similar financial institution, the National Cooperative Bank (now called NCB), to serve non-farm cooperatives.

The Internal Revenue Code describes the tax treatment of cooperatives and their patrons and tax reporting requirements. (See USDA CIR 44, Parts 1-5, Income Tax Treatment of Cooperatives, under References.)

ARTICLES OF INCORPORATION

Incorporation is usually the best method of organizing. Each State has special enabling laws under which cooperatives may incorporate. It may be preferable to incorporate under the State's general corporation enabling act, but structure its bylaws to operate as a cooperative.

Incorporation gives the cooperative a distinct legal standing. Members generally are not personally liable for the debts of an incorporated organization beyond the amount of their investment. The articles indicate the nature of the cooperative business and should specify rather broad operating authority when incorporating, even though services may be limited at the beginning.

These articles of incorporation usually contain the name of the cooperative, principal place of business, purposes and powers of the association, proposed duration of the association, names of the incorporators (in most States), information about the capital structure, and how assets will be distributed upon dissolution. In some States, the names of the first officers of the association must be included. (See Appendix M for a sample format of cooperative articles of incorporation.)

Filing the articles of incorporation (usually with the State's secretary of state) activates the cooperative corporation. After the organizing committee approves the articles, the attorney files for the corporation charter and pays the recording fees. Once chartered by the State, the cooperative should promptly adopt bylaws.

BYLAWS

Bylaws state how the cooperative will conduct business and must be consistent with both State statutes and the articles of incorporation. Bylaws are like the owners' manual of the cooperative business. Bylaws are not filed with the State, but are considered legally binding among members.

Bylaws usually have:

- membership requirements and a list of the rights and responsibilities of members;
- grounds and procedures for member expulsion;
- procedures for how to call and conduct meetings; methods of voting; processes for electing or removing directors and officers, and number, duties, terms of office, and compensation;
- time and place of director meetings;
- dates of the fiscal year;
- requirement to conduct business on a cooperative basis;
- process for how net margins will be distributed;
- process for redemption of members' equity;
- a consent provision that members will include the face value of written notices of allocation and per-unit retain certificates as income in the year they are received;
- distribution process for non-patronage income;
- procedures for handling of losses;
- guidelines for how non-member business will be treated;
- process for dissolution of the cooperative;
- provisions for indemnification of directors; and
- the process for amending bylaws.

Also covered is how the board is structured to represent the membership, given geographical distribution and size of the membership and the scope of business and function of the cooperative. Directors may be selected to represent districts based on membership density, to reflect commodities or services to be handled, or some other basis that provides equitable representation. The steering committee's recommended management structure should include the basis for director representation, voting methods, and board officers and their terms.

For marketing cooperatives that lack a marketing agreement, the bylaws specify the extent of members' obligation to market through the cooperative. They outline the terms and conditions under which the products will be marketed and accounting procedures.

The steering committee prepares the articles and bylaws with the help of an attorney to ensure that provisions comply with the laws of the State in which the cooperative is incorporated. The committee's role is to ensure the bylaw provisions will not conflict with operating procedures. (See Appendix N for a sample outline of cooperative bylaws.)

MEMBERSHIP APPLICATION

The membership application form usually has five main parts: applicant's statement asking to become a member of the cooperative; signature of the applicant; statement of cooperative acceptance of applicant; signatures of the president and secretary, and a statement of the duty and intent of the member.

The application, signed by the member and approved by the board of directors, is the legal proof that the patron is a member. A cooperative should have a completed membership application on file from every member. Membership and amount of business done with members and non-members are important factors for certain antitrust and taxation provisions.

A membership certificate may be issued to each member as evidence of entitlement to all of the rights, benefits, and privileges of the association (see Appendix O for a sample membership certificate).

MARKETING AND PURCHASING AGREEMENTS

Marketing and purchasing agreements ensure that the cooperative has sufficient control over products or services to keep the cooperative viable. This is especially helpful in the first few years of operation when the cooperative is establishing its reputation as a responsible business. Marketing and purchasing agreements have also helped some cooperatives get needed outside financial help.

In some cases, cooperatives that use contractual agreements must file them with the State government.

In a marketing agreement, the association agrees to accept specified products of stated or better quality, to market them to the best of its ability, and to return to members all marketing proceeds, less deductions for expenses and continuing capital needs. A similar contract with members can be structured for service and supply cooperatives.

Marketing agreements are continuing, or self-renewing, agreements that usually specify that after it has been in force for some initial period, it should continue indefinitely unless the member (or the cooperative) states in writing a desire to cancel or modify it. A cancellation request must be made during a specified annual period, as noted in the contract. (See Appendix P for a sample membership/marketing agreement.)

REVOLVING FUND CERTIFICATES

When a cooperative retains funds from business with, or for, patrons as capital investments, it issues a written patronage refund certificate (or similar document) to the member as a receipt for capital investments that will be eventually revolved or redeemed. Meanwhile, the retain is used to finance the business. Member investments may be deductions based on per-unit of product handled or services used, reinvested patronage refunds, or original capital subscriptions, if a non-stock cooperative.

PART 4. GENERAL RULES FOR SUCCESS

Several basic rules for successful development of a cooperative apply to the process itself and the continuing operations of the new cooperative. Some rules are unique to the cooperative form of business. They include effective use of advisors and committees, keeping members informed and involved, maintaining good board/manager relations, following sound business practices, conducting businesslike meetings, and forging links with other cooperatives.

USE COMMITTEES EFFECTIVELY

Organizing human resources and effectively using their expertise is central to any successful business. Maximum participation by members is crucial to the success of the cooperative.

The first committee is the steering committee. Selecting potential members with experience with cooperatives and/or development is important in setting up the general steering committee. Finding true specialists may not be possible among the leaders interested in being on the committee. However, there are likely people who have an interest or experience in certain areas that enable them to better understand the "language" of technical advisors or of complex cooperative concepts, and they should be sought to serve.

Subcommittees can be used in the cooperative formation process, especially if there is a large group of interested members. Areas for subcommittees to focus on might include: membership, facilities, site selection, finance, legal documents, and communications. In some cases, one or more of these areas can be combined.

Committees are also useful in the ongoing management of the cooperative. Temporary or permanent committees might include advisory groups for youth and young member activities, education and training, long-term planning, commodities and services, member and public relations, board recruitment, annual review of the manager, and legislative affairs. Only the board of directors can name a committee, and all committees serve at the discretion of the board.

KEEP MEMBERS INFORMED AND INVOLVED

Member responsibilities start with the conception of the cooperative and remain vital throughout the life of the business. Member loyalty and commitment are critical to creating a successful cooperative. Communication is key to developing this loyalty and commitment.

The communication and education functions need to be an integral activity of the management team. They require the assistance, knowledge, and involvement of the cooperative staff and member leadership groups. Effective communications and education programs require financial support and must be backed by specific board and management policies.

When members are involved and informed about the cooperative, they measure their needs in terms of dollars and are more willing to invest in and patronize the cooperative. Members should be intimately familiar with the cooperative and assume a positive, broad role in its management and direction. Important member responsibilities:

- understand its purpose, objectives, benefits, limitations, operations, finances, and long-term plans;
- read and understand the articles of incorporation and bylaws;
- know that laws limit their rights or powers and those of their board of directors;
- understand that bylaws or policies of the elected directors may further limit their operations by establishing member obligations, regulations, and quality controls exceeding those prescribed by legal statutes

and provide equity (risk) capital for the cooperative business;
- understand that education on cooperative principles and practices, as well as related issues, is a lifelong membership expectation; and
- understand that both profits and losses belong to members.

In summary, members' participation in affairs of their cooperative increases their feeling of ownership and responsibility for its success.

MAINTAIN GOOD BOARD-TO-MANAGER RELATIONS

The differing responsibilities of the board of directors and the manager must be clearly understood and carried out.

Directors represent members and are legally responsible for the performance and conduct of the cooperative. All corporate powers of the cooperative, other than those specifically conferred on members, are vested in its directors and outlined in the bylaws and in State and Federal legal statutes.

Directors' three major responsibilities are to set policies (see USDA CIR 39 Sample Policies for Cooperatives, under References), employ and evaluate the general manager, and provide sound oversight on the financial foundation of the cooperative.

The board also has some specific responsibilities such as:
- functioning as trustees for the members in safeguarding their assets in the cooperative;
- setting goals, objectives, and general policies;
- adopting long-range strategic plans;
- employing a competent manager and evaluating performance;
- preserving the cooperative character of the organization;
- establishing an accurate accounting system;
- adopting an annual operating budget;
- appointing an outside firm to perform an annual audit;
- controlling the total operation; and
- authorizing the distribution of cooperative net earnings and redemption of members' equities.

The board, in turn, delegates responsibility for daily operations to a hired general manager or chief executive officer. The general manager hires or discharges employees, including department heads.
Responsibilities of hired management include:
- managing or directing daily business activities;
- carrying out policies set by the board;
- setting goals and making short-term plans that coincide with the board's long-range plan;
- employing, training, and discharging employees;
- organizing and coordinating internal activities in compliance with cooperative goals and objectives and board policies;
- keeping complete accounts and records;
- developing an annual budget; and
- providing the board with periodic reports.

Questions often arise as to the division of responsibilities between the board and hired management—sometimes they overlap and an exact division of responsibility is difficult to make. Some factors to consider are: the time period—long-term decisions are the responsibility of the board of directors while management makes short-term decisions; "idea decisions" are usually introduced by the board and actual decisions implemented by management; decisions involving policy are the responsibility of the board, and cooperative functions are handled by management; broad primary control activities usually concern the board, while secondary controls pertaining to short-run operations are the responsibility of management. When it comes to staffing , the board hires the manager who, in turn, selects the staff of the cooperative and also supervises that staff.

Use of policy and procedure manuals and job descriptions along with frank discussions of questions when they arise can help maintain an understanding of the division of responsibility.

CONDUCT BUSINESSLIKE MEETINGS

A cooperative's meetings must be well planned and conducted in a businesslike manner.

Policy should be established for determining a reasonable quorum for membership and board meetings. A quorum is the minimum percentage of members required to be present to conduct official business. Quorum requirements are sometimes written into State statutes, but should be discussed in the bylaws. As membership expands, the percentage quorum increases the actual number needed. Setting the quorum too high increases the risk of not getting enough member participants to deal with business matters needing attention.

Parliamentary procedure is appropriate for orderly democratic group action. It enables the chair to lead a group smoothly and efficiently in determining the wishes of the majority while protecting the rights of the minority.

A good meeting just doesn't happen. It is achieved by carrying out several successive steps:
- planning ahead;
- involving directors/members;
- following a published agenda; and
- following through on meeting actions.

FOLLOW SOUND BUSINESS PRACTICES

The major challenge to cooperative members, the board of directors, and management occurs after business operations begin. To get a good start, the cooperative needs to develop and install a systematic accounting system, properly organize and employ human and financial resources, prepare financial reports—including operating and capital improvement budgets—and conduct short- and long-range planning, among other business duties.

Beyond complete and accurate documentation of income and expenses, a cooperative must keep exact member records. Such records need to account for members' initial and subsequent investments and member purchasing, marketing, and/or services used. This information determines patronage allocations from net earnings. Members also need these records for their own personal accounts, particularly for income tax purposes.

The management staff prepares periodic operating statements and balance sheets to inform the board and members how the cooperative is performing and its financial condition. A full report is typically issued annually, with abbreviated monthly or quarterly reports for board use. Reports should be compiled often enough for the board so that it can monitor business activities, take appropriate actions, and keep members informed on how their cooperative is progressing. An annual, independent audit of the cooperative's financial condition, including a look at the business and accounting procedures and how the cooperative has conformed with tax and other legal requirements, should be performed.

Once the cooperative is organized and operating, members need to consider how they want it to grow. This requires both short- and long-range strategic planning. Long-range planning, which looks 3-5 years ahead, usually gets inadequate attention. But this is becoming more important because of rapid technological, economic, and social changes. Planning involves developing a vision and mission statement, assessing likely future business trends and the external and internal business environments, defining desired goals and objectives, and developing a course of action to reach them.

FORGE LINKS WITH OTHER COOPERATIVES

New cooperatives should search for potential beneficial links with existing cooperatives as a strategy for strengthening their operations. Alliances with other cooperatives may be valuable sources for supplies, marketing outlets, and related services. Membership in State and national cooperative associations can keep the new cooperative abreast of what others around the country are doing. These associations can be sources of education and training and legislative and public relations support, and can help identify sources of special expertise.

CONCLUSION

Developing a cooperative is not an easy endeavor. It takes more than just the completion of the steps outlined in this report. A cooperative must have at its core a very real economic need it will meet. The process of assessing the potential of a cooperative to fulfill that need must include strong local leadership, use of skilled advisors/development practitioners, full transparency and sound judgment, and a critical mass of potential members for sufficient business volume. Also needed is a thorough understanding of what a cooperative is and how it functions, a realistic market analysis, a comprehensive feasibility study, and a realistic business plan. Full capitalization with sufficient member investment, proper legal documents, a committed and transparent elected board of directors, skilled management, and proper facilities and equipment will also be critical to success.

APPENDIX A INTERNATIONAL COOPERATIVE ALLIANCE: COOPERATIVE IDENTITY, VALUES AND PRINCIPLES

(http://ica.coop/en/what-co-op/co-operative-identity-values-principles)

Definition: A cooperative is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

Values: Cooperatives are based on the values of self-help, self-responsibility, democracy, equality, equity and solidarity. In the tradition of their founders, cooperative members believe in the ethical values of honesty, openness, social responsibility and caring for others.

Principles: The cooperative principles are guidelines by which cooperatives put their values into practice.

1. Voluntary and Open Membership. Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.

2. Democratic Member Control. Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. Cooperatives are organized in a democratic manner; members have equal voting rights (one member, one vote).

3. Member Economic Participation. Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their co-operative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4. Autonomy and Independence. Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5. Education, Training and Information. Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefits of cooperation.

6. Cooperation among Cooperatives. Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures.

7. Concern for Community. Cooperatives work for the sustainable development of their communities through policies approved by their members.

APPENDIX B

SAMPLE MEMBER–USER QUESTIONNAIRE

Prepare an introductory letter to accompany the survey and state the purpose. Stress that the data will be kept confidential and used only for the stated purpose.

PRODUCER SURVEY: XYZ VEGETABLE COOPERATIVE

While you are not required to respond, your help is needed to provide data for a new vegetable marketing cooperative. All answers will be treated confidentially.

1. Contact person for the farm ____
   Address _______________________________________ Phone _________

2. Farm location—see attached map – County ______________ Grid No. ___

3. How much of your vegetable acreage is irrigated? ___________ acres.

4. Give type and capacity for any of the following facilities and equipment you own.

   type and capacity

   Cooling facilities ____
   Packing equipment ____
   Refrigerated truck ____
   Nonrefrigerated truck ____
   (over 1 ton) ____
   Mechanical harvester ____

5. Check the following supplies or services you are interested in obtaining from the proposed cooperative if a competitive fee is established.

_____ Packing containers
_____ Vegetable marketing
_____ Vegetable packing
_____ Seeds
_____ Plants
_____ Other (specify)

6. Are you willing to follow the proposed cooperative's recommendations on varieties to plant and cultural and harvesting practices?
   Yes ___ No ___

7. Banks generally require cooperative owners to raise 35 to 50 percent of the needed capital. Assuming the cooperative appears feasible, are you willing to make an initial cash investment in it in proportion to your intended use?
   Yes ___ No ___

   What is the maximum amount you are willing to invest?

8. Per-unit retains are a capital investment that is deducted from patron's sales proceeds in proportion to the volume of products they market through the cooperative. Are you willing to finance the cooperative with per-unit retains?
   Yes ___ No ___

9. A delayed producer payment is one way of reducing equity for operating capital. Are you willing to accept a delayed crop payment in lieu of a larger initial cash equity investment?
   Yes ___ No ___

   If yes, for how long? ___ days

10. In a pool, producers are grouped by type and grade over a selected period of time (week, month, or season). Producers are paid the average price the cooperative receives for the pooled products less packing and marketing fees. Are you willing to market your vegetables on a pooled basis?
    Yes ___ No ___

11. Are you willing to sign a marketing agreement to sell all or a fixed quantity (acreage) of your vegetables through the proposed cooperative?
    Yes ___ No ___

12. Where do you plan to market your vegetables in the current year (by percentage of production)?
    a. Roadside stands ___ percent
    b. Farmers' markets ___ percent
    c. Other markets (specify) ____________________ ___ percent

13. Please record production and marketing data in the accompanying table.

Crop	Months usually harvested	Major markets this year*	Harvested or to be planted					Volume sold		Acreage you plan to sell through cooperative next year	Acreage you plan to contract with cooperative next year
			2 years prior	1 year prior	This year	Next year	In 2 years	2 years prior	1 year prior		
Asparagus											
Broccoli											
Cabbage											
Cauliflower											
Eggplant											
Greens											
Peppers											
String beans											
Summer squash											
Sweet corn											
Tomatoes											
Winter squash											

(Vegetable cooperative example. If another type of cooperative, tailor table to reflect member potential use of cooperative.)

*A—roadside stands, B-farmer's markets, C—Other markets (as detailed in question 12)

Continued next page

14. Do you feel a cooperative is needed to help you with marketing your vegetables?

    ____

    Very much ___ Some ___ Not at all ___

15. How well do you understand cooperatives, how they are structured, how they are controlled and governed, and how they operate? Very well ___ Some ___ Not at all ___

16. Would you be willing to help with the development of a cooperative designed to meet your needs in marketing vegetables? Yes ___ Maybe ___ No ___

17. What skills do you have that could be useful in the study of a potential vegetable marketing cooperative?

    ____
    ____

18. Can the steering committee use your name in its contact with other potential members of the proposed cooperative? Yes ___ No ____

19. Provide any thoughts you have about studying the idea of a new cooperative.

    ____
    ____
    ____

Thank you!

APPENDIX C EXAMPLE STEERING COMMITTEE MEMBER-MEETING AGENDA OUTLINE

I. Call meeting to order

II. Introductions (who is involved, steering committee members, and other key people leading effort)

III. Review on how the project started

IV. Recap on how far along project is and what has happened so far

V. What this meeting needs to accomplish

VI. Activity reports (call on steering committee members to provide reports on their activities if necessary)

VII. Review study findings (producer survey, initial market analysis, feasibility study, business plan, etc.)
   A. Summary of key findings
   B. Detailed report of most important components of study
   C. What the findings mean
   D. Answer questions from participants
   E. Further discussion on study

VIII. Steering committee recommendation

IX. Hold vote on whether to adopt recommendation

X. Next steps

XI. Final discussion/thoughts

XII. Adjourn

APPENDIX D

PRE-MEMBERSHIP AGREEMENT COMPONENTS

A pre-membership agreement assesses the potential membership commitment. It usually includes these components.

1. Statement of purposes for which new cooperative is to be formed.

2. Description of steering committee and its organizational powers.

3. Statement of what the new cooperative's bylaws will provide when formed.

4. Notice that steering committee may call meetings of prospective members.

5. Duties of steering committee to keep records and make accounting to cooperative when formed.

6. Subscription agreement for membership certificate or stock.

7. Agreement to sign marketing agreement if cooperative is to have one.

8. Agreement to become a member of the cooperative if formed.

APPENDIX E

SAMPLE OF WAIVER OF NOTICE OF FIRST MEETING OF BOARD OF DIRECTORS

Waiver of Notice of First Meeting of Board of Directors

We, the undersigned, being all the directors of

____

(Name of association)

____ ,

(Town) *(State)*

hereby waive notice of a meeting of such directors at ___________o'clock am./pm. on _______ the _______ day of ______________ , 20__ , at _____________________________ in ___________________ , __________

(Place of meeting) *(Town)* *(State)*

for the purpose of electing officers of the association to serve during the ensuing year, adopting the form of marketing contract, and hereunto subscribed our names, this _____________________ day of ___________________ , 20__ .

____

____

____

____

APPENDIX F SAMPLE PRO FORMA CASH FLOW STATEMENT

Pro forma cash flow statement, FY 20XX*

Item	Mth 1	Mth 2	Mth 3	Mth 4	Mth 5	Mth 6	Mth 7	Mth 8	Mth 9	Mth 10	Mth 11	Mth 12
Totals												
CASH RECEIPTS												
Cash sales**												
Credit Collections												
Commission fees												
Interest income												
Loans												
Equity (e.g. capital retain)												
TOTAL RECEIPTS												
CASH PAID OUT												
Purchases**												
Salaries												
Employee wages												
Payroll expense												
Bad debts												
Outside services												
Supplies												
Repairs & maintenance												
Advertising/promotion												
Car/travel												
Accounting & legal												
Rent												
Telephone												
Utilities												
Insurance												
Property taxes												
Other taxes												
Interest on loans***												
Depreciation												
Miscellaneous												
Subtotal												
Principal payment***												
Capital purchases												
Income taxes												
Other withdrawal												
TOTAL CASH PAID												
CHANGE IN CASH												
Beginning balance												
Ending balance												

*May have multiple statements for different years.

**May have more than one cash sale and purchases line (more commodities/products).

***May have more loan (e.g., operating, facility) and interest payment lines if more loans are obtained.

APPENDIX G SAMPLE PRO FORMA INCOME STATEMENTS

Pro forma income statements, FY 20XX – FY 20XX*

Item	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**
INCOME	$	$	$	$	$
Cash sales					
Commission fees					
Total sales					
Cost of goods sold					
GROSS MARGIN					
EXPENSES					
Salaries					
Employee wages					
Payroll expense					
Bad debts					
Payroll expense					
Outside services					
Supplies					
Repairs & maintenance					
Advertising/promotion					
Car/travel					
Accounting & legal					
Rent					
Telephone					
Utilities					
Insurance					
Property taxes					
Other taxes					
Depreciation					
Miscellaneous					
TOTAL OPERATING EXPENSES					
Operating income					
Interest expense					
NET MARGIN					
Unallocated earnings					
Allocated earnings					

*This example shows 5-year projections but many projects focus on just 3 years. Operating statement line items will vary in description and inclusion depending on project.

APPENDIX H SAMPLE PRO FORMA BALANCE SHEETS

Pro forma balance sheets, FY 20XX – FY 20XX*					
Item	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**
ASSETS	$	$	$	$	$
Current assets					
Cash					
Accounts receivable					
Inventory					
Prepaids (e.g., insurance)					
Other					
Total current assets					
Fixed assets					
Machinery & equipment					
Buildings					
Land					
Less: accumulated depreciation					
Total fixed assets					
TOTAL ASSETS					
LIABILITIES AND MEMBER EQUITY					
Current liabilities					
Accounts payable					
Taxes payable					
Patronage refunds payable					
Line of credit					
Interest payable					
Total current liabilities					
Long term liabilities					
Machinery and equipment note					
Real estate and building					
Total long term liabilities					
Total liabilities					
Member Equity					
Common stock					
Preferred stock					
Allocated earnings					
Unallocated earnings					
Per unit capital retains					
Total member equity					
TOTAL LIABILITIES & MEMBER EQUITY					

*This example shows 5-year projections but many projects focus on just 3 years. Balance sheet line items will vary in descriptions and inclusion depending on project.

APPENDIX I SAMPLE PRO FORMA RATIO ANALYSIS

Pro forma financial ratio analysis, FY 20XX ! FY 20XX*					
Item	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**	**FY 20XX**
Current ratio (current assets/current liabilities)					
Debt ratios					
(total debt/total assets)					
(total debt/member equity)					
Average collection period					
(receivables/sales per day)					
Total assets turnover					
(sales/total assets)					
Profitability ratios					
Return on equity					
(net margins/total equity)					
Return on investment					
(net margins/investment)					
Return on sales					
(net margins/sales)					
TOTAL LIABILITIES & MEMBER EQUITY					

*This example shows 5-year projections but many projects focus on just 3 years. Balance sheet line items will vary in descriptions and inclusion depending on project.

APPENDIX J SAMPLE PROJECTED SOURCES AND USES OF FUNDS STATEMENT

Projected Sources and Uses of Funds Statement, Month, 31, 20XX	
Item	**Dollars**
SOURCE OF FUNDS	
Operations:	
Net margin	
Depreciation	
Per unit capital retains	
Facility loan	
Operating loan	
Inventory loan	
Total sources	
USE OF FUNDS	
Patronage refunds payable in cash	
Additions to fixed assets	
Additions to investments	
Deferred charges	
Loan principal paid	
Net increase in working capital	
Total uses	
Changes in working capital:	
Change in current assets:	
Cash and certificates of deposit	
Accounts receivable	
Accrued interest payable	
Operating loan payable	
Term loan payable	
Net change in current liabilities	
Net change in working capital	

APPENDIX K SAMPLE SCHEDULE OF FIXED ASSET COSTS AND DEPRECIATION

Schedule of fixed asset costs and depreciation		
Item	**Cost**	**Annual Depreciation**
Land	x	NA
Less timber sale	x	NA
Total land, net	X	NA
Buildings and equipment		
Buildings (18-year life):	x	x
Erected building, site preparation	x	x
Engineering	x	x
Equipment installed (12-year life)	x	x
Total buildings and equipment	x	x
Organizational expense (5-year life)	x	x
Total fixed assets	x	x

NA = Not applicable.
x = dollars

APPENDIX L SCHEDULE OF FINANCING NEEDS AND SOURCES

Schedule of financing needs and sources				
Item	Fixed assets	Inventory capital	Operating capital	Total provided
Total capital	x	x	x	x
Equity	x	x	x	x
Borrowed funds:				
Bank loan	x	x	x	x
Long-term note	x	x	x	x

x = dollars.

APPENDIX M

SAMPLE FORMAT OF COOPERATIVE ARTICLES OF INCORPORATION

This outline provides an example of how Cooperative Articles of Incorporation might be set up.*

Articles of Incorporation

____
(Name of Cooperative)

We, the undersigned, all of whom are residents and citizens of the State of __________________________, engaged in the production of agricultural products, do hereby voluntarily associate ourselves for the purpose of forming a cooperative association, (with/without) capital stock, under the provisions of the ______________________ Act of the State of __________________________.

Article I— Name
Article II— Principal Place of Business
Article III—Purposes
Article IV— Powers; Limitations
    Section 1. Powers
    Section 2. Limitations
Article V— Period of Duration
Article VI— Directors
Article VII— Membership (for nonstock cooperative) or
Article VII— Capital Stock (for stock cooperative)
    Section 1. Authorized Amounts; Classes
    Section 2. Common Stock
    Section 3. Preferred Stock
Article VIII—Amendment

In testimony whereof, we have hereunto set our hands this _____ day of __________ ,
20__ . State of _________________________. County of________________________.
Before me, a notary public, within and for said county and State, on this ___ day of _______ , 20__ , personally appeared _____ , known to me to be one of the identical persons who executed the within and foregoing instrument, and acknowledged to me that he/she had executed the same as a free and voluntary act and deed for the uses and purposes therein set forth.

Witness my hand and official seal the day and year set forth.

Notary Public ____
In and for the County of ______________________ , State of ____________________________
My Commission expires ______________________________

____

*Steering committee should hire legal counsel to help prepare legal documents.

See USDA CIR 40, **Sample Legal Documents for Cooperatives** for more detailed information on what is contained in the Articles of Incorporation for a cooperative.

APPENDIX N **SAMPLE OUTLINE OF COOPERATIVE BYLAWS**

This outline provides an example of how Cooperative Bylaws might be set up.*

Article I — Membership
- Section 1. Qualifications
- Section 2. Suspension or Termination

Article II — Meetings of Members
- Section 1. Annual Meetings
- Section 2. Special Meetings
- Section 3. Notice of Meetings
- Section 4. Voting
- Section 5. Quorum
- Section 6. Order of Business
  - Determination of quorum
  - Proof of due notice of meeting
  - Reading and disposition of minutes
  - Annual reports of officers and committees
  - Unfinished business
  - New business
  - Election of directors
  - Adjournment

Article III — Directors and Officers
- Section 1. Number and Qualifications of Directors
- Section 2. Election of Directors
- Section 3. Election of Officers
- Section 4. Vacancies
- Section 5. Regular Board Meetings
- Section 6. Special Board Meetings
- Section 7. Notice of Board Meetings
- Section 8. Quorum
- Section 9. Reimbursement and Compensation
- Section 10. Removal of Directors

Article IV — Duties of Directors
- Section 1. Management of Business
- Section 2. Employment of Manager
- Section 3. Bonds and Insurance
- Section 4. Accounting System and Audits
- Section 5. Depository

Article V — Duties of Officers
- Section 1. Duties of President
- Section 2. Duties of Vice President
- Section 3. Duties of Secretary
- Section 4. Duties of Treasurer

Article VI — Operation at Cost and Members' Capital
- Section 1. Operation at Cost
- Section 2. Margin Allocation
- Section 3. Per-Unit Retains
- Section 4. Dividends
- Section 5. Records and Documentation
- Section 6. Fiscal Year

Continued next page

APPENDIX N
Continued

Article VII – Equity Redemption
    Section 1. Regular Redemption
    Section 2. Discretionary Special Redemptions
Article VIII – Consent
Article IX – Nonpatronage Income
Article X – Losses
    Section 1. Patronage Losses
    Section 2. Nonpatronage Losses
    Section 3. General Provisions
Article XII – Dissolution and Property Interest of Members
Article XIII – Indemnification
Article XIV – Amendments

We, the undersigned, being all of the incorporators and members of the _______________ association, do hereby assent to the foregoing bylaws and do adopt the same as the bylaws of said association; and in witness whereof, we have hereunto subscribed our names, this ________ day of ______ , 20__ .

____

*Steering committee should hire legal counsel to help prepare legal documents.

See USDA CIR 40, **Sample Legal Documents for Cooperatives** for more detailed information on what is contained in the Bylaws of a cooperative.

Other Articles sometimes included in cooperative bylaws include: executive committee and other committees, membership certificates, stock certificates, etc.

APPENDIX O SAMPLE MEMBERSHIP CERTIFICATE

Membership Certificate

This certifies that ____________________________________ of _____________________________
is a member of ____________________________________ Association and is entitled to all of the rights, benefits, and privileges of the Association.

Date ____________________________________ .

____
(President)

SAMPLE MEMBER AGREEMENT/MARKETING CONTRACT

THIS AGREEMENT between the ____________________________ , Inc., hereinafter referred to as the Association, and the undersigned Producer, witnesseth:

The Producer
1. Applies for membership in the Association, and if accepted as a member, agrees to be bound by its articles of incorporation, bylaws, rules, and regulations as now or hereafter adopted.
2. Appoints the Association as agent to sell all the __________________ of marketable quality produced an any farm in control of or operated by the Producer, except that required for consumption on the farm.
3. Will deliver such products at such times and to such places in unadulterated form under such conditions as may be prescribed by proper authorities.
4. Will notify the Association of any lien on the products delivered hereunder, and authorizes the Association to pay the holder of said lien from the net proceeds derived from the sale of such products before any payment is made to the Producer hereunder.
5. Will provide capital in such amounts and in such a manner as may be provided in the bylaws.

The Association:
1. Accepts the application of Producer for membership in the Association.
2. Agrees to act as agent for the marketing of products of Producer as herein provided.
3. Will dispose of Producer's products in a manner deemed to be most advantageous for its members.
4. Will account to the Producer in accordance with this contract for all amounts received from the sale of products as herein provided.
5. Will reflect in an appropriate capital account the capital received from each patron.

The *Producer and the Association* mutually agree that the Association shall have the power:
1. To establish various plans for making returns to the Producer.
2. To blend or pool proceeds from sales of products of the Producer with the proceeds of the sales of products of other Producers, and to account to or settle with Producer therefore in accordance with established plans.
3. To process or cause to be processed products of the Producer and dispose of the same in the manner deemed most advantageous to its members.
4. To collect from buyers of products the purchase price therefore and to remit the same to Producer under a plan authorized by this contract after making uniform deductions deemed adequate for all necessary expenses and for capital purposes.

In case of a breach of this contract by the Producer, the actual damage to the Association and other producers cannot be determined. Therefore, Producer agrees to pay to the Association as liquidated damages for such breach, the sum of _________ dollars (_________) per ____________ on all products that would have been delivered had the Producer not breached the said contract.

And the Association shall further be entitled to equitable relief by injunction or otherwise to prevent any such breach or threatened breach thereof and the payment

Continued next page

of all costs of litigation in connection with the exercise of any or all of the remedies available to the Association.

This contract shall remain in effect for an initial term of (______) years from the date hereof. Following the initial term, the contract may be cancelled by notice given in writing by either party to the other within ten (10) days after any yearly anniversary date, and such cancellation shall become effective on the last day of the second calendar month following the month during which such notice is given.

Date ______________

Producer's signature ________________________ (________________________)

Print name here

Address

____

(R.F.D. or Street No.) *(Town)* *(State and Zip Code)*

Social Security No. _____________________ County____________________________

Accepted this day of _________. 20__ .

______________________________ , Inc.

By ______________________________ , Pres.

By ______________________________ , Secy.

(Some State laws provide for filling or recording cooperative marketing contracts in a county recorder's office to give notice to third parties that the contract exists. And acknowledgment if the contract is to be filed or recorded.)

REFERENCES

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Frederick, Donald, A., **"Co-ops 101, An Introduction to Cooperatives,"** Cooperative Information Report 55, Rural Development, U.S. Department of Agriculture, Washington, DC, April 1997 (revised by James J. Wadsworth and E. Eldon Eversull, November 2012). http://www.rd.usda.gov/files/cir55.pdf

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Reynolds, Bruce and James Wadsworth, "**A Guide for the Development of Purchasing Cooperatives,"** Cooperative Information Report 64, Rural Development, U.S. Department of Agriculture, Washington, DC, April 2009. http://www.rd.usda.gov/files/cir64.pdf

USDA Rural Development, **"Understanding Capper-Volstead,"** Cooperative Information Report 35, Revised April 2009. http://www.rd.usda.gov/files/cir35.pdf

USDA WEBSITES

U.S. Department of Agriculture: http://www.usda.gov/

USDA Cooperative Programs: http://www.rd.usda.gov/programs-services/cooperatives

Cooperative publications: http://www.rd.usda.gov/publications/publications-cooperatives

USDA Rural Development: http://www.rd.usda.gov

USDA Rural Development can also assist you from its State Offices. Please look up and contact the Rural Development State Office within your State: http://www.rd.usda.gov/contact-us/state-offices

To order USDA publications email: coopinfo@wdc.usda.gov

OTHER WEBSITES/RESOURCES

International Cooperative Alliance (ICA) Statement of the Cooperative Identity: http://ica.coop/en/whats-co-op/co-operative-identity-values-principles

University of Wisconsin Center for Cooperatives, Research on the Economic Impact of Cooperatives: http://reic.uwcc.wisc.edu/default.htm.

The Agricultural Marketing Resource Center (AgMRC) has extensive information on value-added businesses available at www.agmrc.org. This site also provides links to resources for feasibility studies and business planning.

Outside advisors can assist in the development

process as well as be providers of other sources of background information. There are cooperative development centers located throughout the United States with the sole purpose of being practitioners of cooperative development. Those interested in developing cooperatives can benefit from contacting a cooperative development center in their State or region (if there is one) for assistance.
http://www.rd.usda.gov/files/RD Cooperative Development Centers 20150121.pdf

Cooperation Works!
http://www.cooperationworks.coop/
eXtension.org Cooperative Community of Practice:
http://www.extension.org/cooperatives

Agricultural Marketing Resource Center (AgMRC):
http://agmrc.org/
University of Wisconsin Center for Cooperatives:
http://www.uwcc.wisc.edu/
Quentin Burdick Center for Cooperatives:
http://www.ag.ndsu.nodak.edu/qbcc/