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CONSIDERING COOPERATION: **A GUIDE FOR NEW COOPERATIVE DEVELOPMENT**

By

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Abstract

This publication reviews the key elements needed for successful formation and development of new cooperative businesses. The motivation for and process of forming cooperatives are discussed. Six phases of cooperative formation are presented including: 1) identifying the opportunity, 2) building consensus on the potential for a cooperative, 3) developing trust among potential members, 4) securing member commitment, 5) involving other stakeholders, and 6) starting up the cooperative enterprise. The roles and selection of qualified advisors are presented for each phase.

Potential obstacles to successful cooperative start-up are presented for each of the six phases of cooperative formation. Pitfalls in cooperative development can include: a lack of agreement on the economic problem to be addressed, a cooperative business approach that is not appropriate for addressing the identified problem, other organizational options are more viable than forming a cooperative, a limited understanding the of the responsibilities of directors and members, a lack of qualified leaders, poor feasibility analysis, unrealistic member expectations, the inability to discipline members who are not meeting responsibilities, a shortage of member business volume, inadequate business planning, insufficient member equity investment, ineffective pricing policies, a poorly designed governance structure, an underpaid or unqualified manager, ineffective board of directors, poor quality of products or services, and overall industry weaknesses.

Common causes of new cooperative failures are reviewed. Common causes of start-up business failures can apply to cooperatives as well, such as: economic factors, financial issues, lack of management experience, strategy causes, neglect, disaster and fraud. Some potential cases of failure more specific to cooperatives can include: starting from a defensive strategic position, a limited choice of goods and services to offer, accounts collection or payment issues with members, an inability to raise capital from members, or the ineffective of succession of leaders or managers.

Key ingredients for successful start-up are discussed. Two basic conditions must be present for successful formation. First, there must be a joint recognition of a common economic problem by the potential members and initial leaders. The second condition is that the proposed cooperative enterprise must be more effective at performing the hoped for services better than the prospective members can individually. The required leadership must spend the time exploring the potential for the new organization and providing the necessary vision. Leaders are the driving force in cooperative development. They achieve compromise among key stakeholders, overcome the potential barriers, and see the process through to completion. Consequently, it is essential that any cooperative effort have effective leadership.

Lessons from recent start-ups of so-called "New Generation Cooperation" are highlighted for each of the six phases of new cooperative development. Lists of cooperative development resources, websites, and publications are presented.

Keywords: new cooperative development, cooperative businesses, cooperative failures.

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INTRODUCTION

The social and economic history of the world records innumerable cases of individuals on all continents utilizing collective action to address common social and economic problems by forming cooperatives. There is an extensive literature on the economic justification of cooperatives, legal foundations, role of cooperatives around the world, as well as the structure and scope of cooperatives. This publication focuses on the process of new cooperative development and examines cases of recently formed cooperatives in the U.S. Before discussing the process of new cooperative development, it would be useful to present the range of organizational options available for groups considering cooperation.

Collaborative business groups can be organized in a variety of ways, linking companies together in a larger, overarching relationship for a common purpose. These organizations may range from informal information networks to legally incorporated cooperatives.

While such membership organizations are known by a variety of names, in general they may be logically classified as Networks, Alliances or Cooperatives.

Networks

A business network is a group of firms that collaborate to meet common needs, stimulate learning and combine complementary skills to achieve shared objectives and improve the long-term viability of the individual firms. The common bond may range from being in the same industry, to broader common interests such as sharing information about employee training or health insurance programs.

While they may or may not be formally organized, these networks are characterized by a lack of formal or legal business agreements among the individual member firms. The limitations of small firms such as under capitalization, a lack of management depth and marketing ability are well known. These problems are particularly acute in rural areas where many small firms are scattered throughout large geographical areas. In addition, problems of increasing costs and a lack of resources in many small municipalities are creating significant challenges for local governments and economic development officials.

Organizational Characteristics of Networks

- range from informal social groups to formal associations
- the common bond ranges from being in the same industry to a specific mutual interest
- tend to take a long-term view, because the common interest will continue
- medium number of entities involved due to industry, location and so on
- members are from very small to medium sized
- provides services, joint purchasing and/or combined marketing efforts
- anti-trust issues can be a concern

In a search for new approaches, collaborative networks that coalesce around common needs and opportunities are gaining increased attention. Groups of independent companies are sharing information and resources, participating in joint education programs, pooling expertise, and entering in shared purchasing and marketing endeavors. Such networks help enable small firms to access modern technologies, increase capacity, and may even blend complementary capabilities into production networks with innovative new products. Similarly, small towns are also beginning to recognize the savings which can be realized through joint purchasing of materials, and the sharing of expensive equipment and services. The bottom line is to achieve together what each cannot do alone.

Critical aspects of a network are the perception of a common benefit, developing a trust relationship among the participants, and the need for an active facilitator or "champion." In particular, the primary limitation of smaller networks may be a lack of full time staff support which makes the active participation of all members especially important. Among manufacturers, the potential unwillingness of competitors to work together may be a factor. It is important for these companies to understand they can successfully collaborate on common issues without divulging genuine proprietary information. Finally, as with the businesses themselves, a strategic plan for the direction and goals of the network is paramount to success.

Alliances

Structurally, alliances are a middle way between networks and cooperatives. Alliances are typically limited in size, having two or more entities linked through collaborative agreements for a specific purpose or service such as joint ventures or to provide education programs.

Alliances may range from agreements created for a single short-term purpose, to ongoing long-term relationships. Alliances are typically characterized by a more-or-less formal agreement which may range from a hand shake to a legal contract.

As with networks, the benefit of an alliance is essential to achieve shared objectives through the leveraging of combined resources and capabilities. Because alliances are organized to serve a specific purpose, they lack the flexibility of a broader network to address a variety of other business issues or opportunities which might arise. By the same token, this focus can provide impetus for the development of a strong and effective long-term relationship.

Organizational Characteristics of Alliances

- an understanding or at most a contractual agreement, but rarely a separate legal corporation
- involves two or a small number of entities
- entities are often corporations
- the partners may be in different industries but they have a common interest and their skills/talents/capabilities are complementary
- a short to medium to long term relationship
- organized to provide a very specific task, product or service

Cooperatives

Probably the most widely known and proven of collaborative business organizations are cooperatives. They are usually formed of many entities and are legally constituted, limited liability corporations controlled by their members.

Organizational Characteristics of Cooperatives

- a separate, legal, limited-liability corporation
- members are often in the same industry and have a common economic interest
- formed for perpetuity
- usually composed of many entities
- often used by individuals or proprietors
- involved in joint marketing of outputs, purchasing of supplies and/or providing services
- a wide variety of products and services provided

Cooperative members are often in the same industry and have common economic interests which may involve joint marketing, purchasing of supplies and/or the providing of services.

Most commonly known are large agricultural cooperatives, credit unions, and franchise business groups such as in insurance and hardware. Cooperatives have been formed among health care institutions. Although less common, cooperatives are not unknown to manufacturers of value added non-food products such as wood items and vehicle glass. Recently, several Fortune 500 companies found a cooperative to purchase a wide range of common goods and services.

There has been a growing interest in the cooperative form of business around the world as individuals struggle to improve their economic well being, gain access to markets, or acquire goods and services at a lower cost in an increasingly competitive global economy. To facilitate our discussion, we will use the term "individuals" to represent the spectrum of possible members (consumers, producers, workers, non-profits, businesses, governmental entities and other organizations) that might be involved in forming cooperative organizations.

Recent economic trends are driving a search for innovative, effective business alternatives including the formation of cooperative enterprises. Increasing economies of size are required to take advantage of new technologies and to remain cost competitive. Individuals, seeing increasing limitations to singular business strategies, are looking closely at innovative ways to pool resources while retaining their independence. Individuals acting as a group may be better able to gain access to markets, supplies or services otherwise unobtainable to them singularly. As governments around the world cut services and deregulate markets, cooperatives are being considered as a useful alternative to provide goods and services.

Other important features of cooperatives create benefits for member's and their communities. Cooperative businesses offer a unique link to communities in that the member-owners are typically concentrated in a specific geographic area or community. The social and economic benefits flowing from the cooperative to members can enhance community well being in unique ways. Both the return on investment in a cooperative as well as patronage benefits distributed to members can ultimately enhance the economy of the member's community. Investor-oriented firms (IOF's) tend to distribute economic returns to investors spread out across a large geographic area or around the world, not necessarily those located in a given community.

Over the last 15 years, the Upper Midwest has seen an increase in the number of new agricultural cooperatives formed to add value to and market member farm products. We will take a closer look at what have been called New Generation cooperatives later in this publication. Recently, there has been significant growth in the number of purchasing cooperatives organized in the U.S. Individuals such as electrical distributors, franchise owners, professionals, small business owners and non-profit institutions have formed cooperatives to gain buying power and lower member operating costs. For example, hospital-owned purchasing cooperatives have been formed on both regional and national levels to reduce costs of purchasing goods and deliver a wide range of services to member hospitals. Most recently, a number of new e-commerce cooperatives have been formed to effectively utilize Internet technology to benefit members.

The six traditional organizations are:

Individual Proprietorship

- One person firm
- Owner provides labor, capital and management
- Objective: Earn income and be one's own boss
- Examples: Most small companies

Partnerships

- Two or more individual owners
- Owners share in providing the labor, capital and management
- Objectives: Earn money by specialization and small economies of size
- Examples: Professional and other types of small firms

Investor Oriented Corporations

- A way to raise large amounts of capital
- Owners only provide capital
- Objectives: Earn a return on invested capital
- Examples: Most medium and large businesses

Cooperative

- A way to provide "service at cost" to groups of individuals and/or firms
- Members/owners/patrons provide capital, patronage and oversight control
- Objectives: To provide services and a return on members' patronage
- Examples: Agriculture, credit unions, news, housing, food and hardware wholesaling

Not-For-Profit

- Provides services to members and non-members (the general public)
- Really has no owners; seeks funding from members and the general public
- Objective: To provide service with no direct financial return to any party
- Examples: Social, educational, charity, trade organizations (many types)

Government Provision

- Makes goods and services available to or paid by the general public
- No owners and difficult to determine real costs and benefits
- Objectives: To spread the cost over taxpayers and benefits to general public
- Examples: Federal, state and local government activities

MOTIVATION TO START A COOPERATIVE

The primary, underlying economic motivation to form a cooperative is basically the same as forming any new business. That is, the owners assess the feasibility and potential returns resulting from starting up a new business and agree that there are adequate returns to offset the risks taken and the costs incurred. However, the motivation of members for starting a cooperative can involve a more complex cost-benefit equation. In an investor oriented firm (IOF), an individual investor seeks out an investment opportunity yielding the greatest growth potential or highest return on investment possible. These investors are typically taking a proactive approach to seeking out business opportunities to meet their investment objectives often they will have little or no direct involvement in the business itself, other than as a shareholder. Indeed, the stockholder investment decision can be many steps removed from the decision to start the business or occur following start-up. Most stockholders are not involved with starting the business.

In the case of a cooperative, the prospective member-owners are frequently not simply seeking the highest possible return on their investment, but a set of returns associated with becoming a member which may include services, better prices, user control, access to markets, along with a return on capital invested. Cooperatives may also be formed to fight monopolies, corruption, exploitation, disenfranchisement or to achieve other objectives only possible through group action.

Distinctive features of a cooperative come into play right from the start. A group of potential members is not looking for just any possible business opportunity to provide the greatest return on investment. In fact there is often, but not always, a defensive nature to the reason for starting a cooperative. The group considering the new enterprise is typically responding to an economic problem which has a negative impact on them or to an opportunity requiring more resources or capital than they can individually supply. The problem itself is what catches the groups attention and motivates them to consider and develop a cooperative solution. The individuals involved are looking for the best opportunity as a group to own and operate a cooperative enterprise generating the highest total returns aimed at addressing the common economic problem.

PROCESS OF FORMING A NEW COOPERATIVE

The process of forming a new cooperative requires a step-wise approach to arriving at the group's ultimate decision to start the business. In the case of a start-up cooperative, all of the initial members have to be identified as part of the formation process. A critical number of member-owners must agree to move ahead with the decision to participate before the business can start. Unique financing and control features of cooperatives can make the start-up process a complex one.

The complexity involves developing agreement on the vision, mission, and feasibility of the proposed cooperative among a diverse set of stakeholders including: potential members, initial leaders, community members, lenders and suppliers or customers. In addition to the challenges any new business must face, new cooperatives must be built on a high level of trust and confidence in the initial leadership and advisors during the formation stage. Without an adequate level of trust among the potential members in the emerging cooperative organization, it is difficult to secure the needed member commitment required to finance and support the cooperative.

Typically, the process of forming a new cooperative is very time consuming and involves a number of leaders, advisors, and professionals, as well as organizational support from other entities. The process usually involves many informational and organizational meetings as well as coordination of the involvement of a mix of individuals and organizations.

Support for New Cooperatives

Most attempts at organizing a voluntary association involving many individuals requires some kind of external support. This support typically comes from individuals or organizations who have no direct financial interest in the new cooperative but are supportive of the goals of the group. This external support can provide an objective perspective during initial discussions. This support can include assistance in facilitating steering committee meetings, assisting the group in seeking out other resources or funding, and acting as a catalyst to pursue potential opportunities. Various aspects of more intensive advisory support during the process of forming a cooperative will be discussed later.

Along with a renewed interest in cooperatives, there has been increased support for new cooperative development in the U.S. at the national, regional and state levels. A number of national organizations and federal government agencies are providing support for new cooperative development including: the USDA Rural Business- Cooperative Service; the National Council of Farmer Cooperatives; the National Cooperative Bank; the CLUSA Institute; the Society of Accountants for Cooperatives, the Cooperative Works! network, and the National

Cooperative Business Association (see list of resources in the Appendix on Supporting Organizations).

There are a number of cooperative development resources available at the state and regional levels. Many states or regions have cooperative councils with staff who are knowledgeable about cooperatives. Land grant universities and Extension services may have faculty or staff who are available to advise those considering the formation of a cooperative. Numerous state offices of USDA, Rural Development have increased their activities in assisting new cooperative development.

Other sources of help may include state departments of agriculture or commerce, state cooperative councils, banks for cooperatives, or an established cooperative. Other federal agencies, such as the Small Business Administration and state and regional development agencies that provide assistance to business in general may also be helpful in developing business plans or conducting market research. Given the unique aspects of new cooperative development, it is preferable to work with advisors who possess a good working knowledge of cooperatives.

Role of Advisors and Consultants

Specialized help is usually needed throughout the various stages of forming a cooperative. Leaders need professionals familiar with the new cooperative development process to work with them step by step concerning organizational, legal, economic, business feasibility and financial aspects. Specialists with an understanding of cooperatives can be difficult to find.

Attorneys familiar with legal organizational options and state cooperative statutes as well as securities law should be retained to review and draw up the organization papers, to help develop capitalization plans, and to prepare agreements and contracts. Legal counsel is typically needed on a continuing basis after the cooperative is operating, to ensure that it is conforming to laws applied to businesses. References for such an attorney may be obtained through the supporting organizations mentioned in the preceding section.

In addition, organizers should seek financial counsel from an individual or firm familiar with cooperative accounting, finance, and options for member equity financing. It can be useful to consult a financial institution familiar with cooperatives to anticipate capital needs and alternative methods of financing. These institutions may provide valuable input into the design of the feasibility study to meet requirements of a lending agent, and they may have staff who are specialists in cooperative finance and accounting matters.

Cooperatives should also employ an independent accounting firm with cooperative accounting experience, if possible, prior to issuing any stock or collecting funds from potential members. The cooperative will need an accountant to assist in setting up the bookkeeping system, organizing records for tax purposes, and designing equity plans. An outside accounting firm should be retained by the board of directors to conduct an annual financial audit.

Finally, a variety of technical advisors may be needed, depending on the type of cooperative and business. For example, advice from an individual or firm with experience in marketing or market research would be important for producers organizing a marketing cooperative. New cooperatives investing in property or other assets as well as entering industries affected by government regulations typically need expert advice on property valuation or meeting regulatory requirements. Other consultants that do not necessarily require cooperative expertise but might be needed could include: engineers, architects, environmental specialists or plant designers. Typically the work of all of the needed consultants and advisors is incorporated into the relevant sections of the business plan and prospectus for the new cooperative.

Selecting Advisors

The level of professionalism and competence can vary greatly among those involved in advising any new start-up business, including new cooperatives. Attorneys and accountants may be fully qualified to work with various types of firms but have little or no knowledge about cooperative businesses. The high level of risk associated with starting a new enterprise demands that decisions be based on the best information obtainable. Steering committees need to select the best advisors possible. Although many groups are typically in a rush to make the decision to form a cooperative, adequate time should be taken to generate adequate funding to secure the most knowledgeable advisors available.

Criteria used for selecting advisors should include their: level of experience with new cooperatives, ability to work in a diverse team, understanding of issues related to start-up organizations, ability to insure confidentiality, and professional objectivity. Advisors should be aware of both the potential advantages of selecting a cooperative business structure as well as the potential disadvantages. The ability to work with a diverse group ranks high on the list of criteria, in that the steering committee can include a wide range of people, some with limited experience with new cooperative development. A comfortable working relationship with the steering committee is important for many reasons. Objectivity is of the utmost importance. For example, it would not be advisable to hire a firm to conduct a feasibility study who has a potential conflict of interest such as a potential major supplier, equipment manufacturer or lender.

Seeking the advice of other groups who have formed similar organizations can be very helpful for both getting referrals for good advisors as well as gaining a better understanding of what some of the pitfalls might be in starting a new cooperative . If a consulting firm is to be hired, identify at least three finalists, seek references from each of them and contact each reference. Request proposals from prospective firms detailing such information as experience, work with cooperatives, work with potential competitors, plan for back-up personnel support, and fee schedule. Be sure you know who will be assigned to do the actual work

PHASES OF NEW COOPERATIVE DEVELOPMENT

The phases of forming a cooperative are sequential in nature and occur along a critical path. That is, the activities associated with each phase must be completed before it is advisable to proceed to the next phase. The group needs to select and agree on what criteria constitute a green light at each phase before moving on to the following one or what criteria might constitute a red light meaning it is time to abandon the process and explore other options.

The ultimate goal of starting a cooperative can only be reached when six preliminary objectives are accomplished. The group must: 1) agree that a compelling problem or opportunity exists warranting their attention, 2) agree that by forming a new cooperative they can address the identified problem, 3) reach an adequate level of trust among potential members, 4) secure commitment from members, 5) secure commitment from other key stakeholders, and 6) assemble the staff and assets to start up the cooperative enterprise. Attaining each of these objectives typically involves a set of activities common to cooperative formation. However, each group's journey along the path of forming a cooperative can vary or take longer than another. Activities associated with these key objectives are discussed to provide insight into the start-up process. There is no hard and fast recipe for forming a cooperative or a list of steps which work for all situations. With that in mind, the six phases common to the formation of new cooperatives are presented.

The following table (Table 1) summarizes the six phases of new cooperative development. Each of the six phases will be discussed in more detail.

Table 1. Six Phases of New Cooperative Development

	Phase	Steps	Individuals Involved
I.	**Identifying an opportunity**	• Define critical questions • Explore relevant market/economic need • Discuss and agree on scope and nature of problem/opportunity • Research economic aspects of problem	Potential members Advisors Consultants Community
II.	**Building consensus on potential for cooperative**	• Study organizational alternatives • Hold initial meetings to review scope and nature of cooperative solution • Discuss and agree on cooperative approach • Create initial budget	Potential members Advisors Community members Consultants
III.	**Developing trust among potential members**	• Identify leadership to champion project • Establish steering committee • Agree on calendar and tasks • Assign tasks • Raise seed capital • Research market • Conduct feasibility study • Agree on feasibility and inform stakeholders	Steering Committee Potential members Consultants Advisors Lenders
IV.	**Securing member commitment**	• Develop detailed business plan • Establish legal identity • Create interim board • Set up books/accounting* • Conduct member equity drive and sign-up • Retain manager/ CEO* • Launch cooperative	Interim Board of Directors Advisors Consultants Members Manager/CEO Lenders Accountant Attorney
V.	**Involving other stakeholders**	• Secure necessary financing • Formalize relations with customers or suppliers	Interim Board of Directors Members Manager/CEO Lenders Customers/Suppliers
VI.	**Starting up the cooperative**	• Hold Annual Meeting • Elect Directors • Establish Committees • Secure necessary assets • Hire staff*	Manager Staff Accountant Advisors Board of Directors

* May occur in earlier or later phases

IDENTIFYING THE OPPORTUNITY

At first glance, identifying the opportunity might sound like the simplest step in forming a cooperative. In many cases, accomplishing the first step can be one of the more difficult and time consuming. Because the decision to form a cooperative involves a number of decision makers who must each support the decision, a good number of meetings and discussions will typically be needed. Cooperatives are formed for a wide range of reasons to enhance the economic and social well being of members. Early organizers may have differing opinions and views on exactly what the core problem to be addressed is, as well as how to solve it. They may possess varying degrees of understanding of the underlying nature of the problem and to what extent a new cooperative might actually remedy the situation.

An essential objective for this discovery phase of development is that the group of potential members must arrive at an agreement on the nature and importance of the problem to be addressed. Even though the discussion is typically initiated by one or a few individuals, the initiators must present a compelling enough argument to enlist the interest of the whole group in exploring organizational alternatives. In some situations where the group is beset by a resounding problem of major proportions, they may agree more quickly that something needs to be done than a group facing a less apparent problem. An example would be the exit of a firm from the individual's area which had played a key role in serving the economic needs of the group. For instance the exit of a processing plant which added value to individual producer products, creating a vacuum that a cooperative might be able to fill.

Initial Discussion

There are a number of activities common to this phase of cooperative formation which include:

- Initial open meetings are held to determine the scope and nature of the problem

- Closed meetings are used to discuss sensitive issues or proprietary business strategies

- A group of leaders emerges through the process of discussion

- The group agrees on the importance of the problem and that pursuing a cooperative solution is worthwhile.

- The leadership forms a steering committee to further study the problem and coordinate activities on behalf of the group throughout the remaining phases.

An experienced cooperative organizer in the Upper Midwest, Bill Patrie, calls the process of identifying the opportunity as "arriving at the central business proposition" which provides the underlying rationale for forming a cooperative. A smaller group of leaders usually surfaces to take the initiative in pursuing more information about the potential for cooperation. For the purpose of this discussion we call this group the *steering committee*.

Steering Committee Formation

Formation of a steering committee is a key step in starting a cooperative. The composition and qualifications of committee members should not be taken lightly. This group will assume a number of important responsibilities such as: selecting and evaluating advisors to the group, determining the initial feasibility of a cooperative, and building trust among potential members. In many cases, members of the steering committee will go on to serve as the interim board of directors for the cooperative. Those considering becoming a member of such a committee should realize that a significant time, energy, and sometimes financial commitment will be required. They need to be available to see the project through to fruition. They also will need an unselfish attitude with no expectation of immediate financial compensation for a lot of hard work. Committee members should be representative, as much as possible, of the geographic area and demographic cross-section of the potential membership to avoid implications of favoritism.

Steering committee members should have good business sense, an understanding of the problem to be addressed, as well as some knowledge of cooperative organizations. They should be respected members of the community and viewed as credible sources of information. As potential business opportunities are discussed, they will need to assume a fiduciary responsibility on behalf of potential members. That is, they should have the ability and reputation for putting the interests of the group before their own personal interest. They must not enter into arrangements unfairly benefiting relatives, associates, or use insider knowledge for personal gain. They must also be able to maintain strict confidentiality on sensitive information they discuss.

Many potential members will base their decision to join the new cooperative on the credibility of the steering committee. It will be next to impossible for each potential member to thoroughly examine all the ramifications of organizing a new cooperative as outlined in this chapter. That responsibility falls on the steering committee. Steering committee members are expected to be responsive and articulate in answering questions from potential members and other stakeholders. Once the problem is clearly identified and there is agreement that exploring the formation of a cooperative is an important, mutual priority, the group can then proceed to the next phase of development.

BUILDING CONSENSUS ON THE POTENTIAL FOR A COOPERATIVE

There are several pivotal questions that the group must answer at this point. Will forming a cooperative create the right organizational structure to solve the group's problem? How will a cooperative address the identified problem or seize the potential opportunity? How do the relative strengths and weaknesses of a cooperative compare with other available alternatives? The discussion at this point should begin with a review of what cooperatives can and cannot accomplish. In general, forming a cooperative cannot correct overall supply and demand imbalances. Creating a new cooperative of producers will not improve the prices they receive for products if there is a general oversupply of those very products. However, if the producers forming the cooperative have some unique product that allows them to capture a market niche in which they have a particular advantage, a new cooperative may be the solution they need. Another example would be a group of firms attempting to cut purchasing costs by pooling purchasing power to secure significant discounts from suppliers. Depending on the type of goods or services, there may already be a supplier willing to work directly with individual firms to achieve a discount. On the other hand, the group may be able to generate the aggregate volume of individual purchases necessary to achieve the buying power to negotiate a greater discount or gain access to markets otherwise unobtainable.

At this point, the group through the leadership of the steering committee will need to seek out information and advice on the details of the proposed cooperative operations. An in-depth feasibility study is usually needed to determine whether the proposed cooperative can become a viable enterprise. There are many factors unique to cooperatives which are associated with determining feasibility such as: member willingness to join and support the organization, expected returns to members from the cooperative, and group decision making capability. An in-depth analysis of the potential impact of the proposed cooperative's operations on members should be carried out.

The committee should evaluate whether there are opportunities to work with existing cooperatives to avoid duplication of efforts or building costly excess capacity when increased utilization of existing capacity would be the best approach. Alliances or joint ventures with other cooperatives or IOF's may provide the best economic alternative for potential members rather than having the proposed cooperative itself undertake costly operations or invest in new plants or assets which may duplicate existing alternatives.

Comparing the expected returns to members with the expected costs involved with becoming a member involves a complex analysis of the performance of the proposed cooperative business. Once the group agrees that the formation of a cooperative is the desired choice, then the process can move on to the next step, building trust among the key stakeholders.

DEVELOPING TRUST AMONG POTENTIAL MEMBERS

During this phase of cooperative development, the steering committee, having answered the basic questions on whether there is a need for a cooperative and that forming a new cooperative is the most desirable option available, now embarks on building trust among the potential members. This trust will be essential in laying the groundwork for securing member commitment to join and support the cooperative. The whole steering committee becomes the initial champions for the proposed cooperative. It is all the more important at this time that the members of the steering committee exhibit the ability to nurture trust among the prospective members and other stakeholders.

The steering committee may find it necessary to seek seed money to fund activities being carried out on behalf of the group. Funding may be required to: hire a firm to develop a feasibility study, conduct a member survey, pay legal fees or other preliminary costs. Prospective members could be contacted to contribute funds to help finance these types of activities. It should be made clear to the group that as the primary potential beneficiaries of the proposed cooperative, they need to assume the responsibility to fund activities to help determine the potential for the cooperative business. It should also be clear to those contributing funds, that they assume the risk of losing this contribution if the proposed cooperative business is proven to not be feasible or members do not make the necessary commitment to the new cooperative.

Evaluating Feasibility

A key step in building trust among potential members is a thorough evaluation of the economic feasibility of the proposed cooperative enterprise. There are many generic aspects of a feasibility study that apply to any type of business such as determining demand for products to be marketed or estimating savings obtainable through alternative purchasing strategies, economies of size and logistical considerations. An effective feasibility study is designed to assess the specific situation and potential for the business that the cooperative would operate. The study should be conducted by a competent and well respected firm which is independent (not a supplier or promoter). The study should also help answer questions which address the unique operating features of a cooperative. Some of these questions include: What is the critical volume of member business needed to be profitable? Is there a critical volume of member patronage obtainable in the geographic area to be served? What will it take to attract the needed volume of business from members? Are there qualified leaders willing to commit to forming and directing the cooperative? What balance of meeting member needs and achieving cooperative profitability will be needed?

Prospective Member Survey

A survey of prospective members can be a useful activity in determining feasibility. The survey process can help determine the willingness of potential members to join and support the cooperative. Useful information which might be obtained includes:

- location of prospective members
- size or type of members businesses
- long-term product and service needs of members
- willingness to invest in the cooperative business
- willingness to patronize the proposed cooperative business
- willingness to abide by proposed membership restrictions and responsibilities
- attitudes towards cooperative businesses in general
- importance placed on forming a cooperative

Once an initial feasibility study is completed and the steering committee decides to proceed, a legal entity should be formed. Creating a legal identity limits personal liability for members and directors, can assure that funds are handled properly, and assists in building trust and confidence with potential members as well as prospective directors.

Incorporation

Forming any type of corporation limits the individual liability of those associated with the incorporated firm. Incorporation is advisable before the emerging cooperative handles a significant amount of funds or needs a legal identity to enter into legally binding agreements with members, consultants, or lenders. When a cooperative is incorporated, the personal liability of each member for losses suffered by the cooperative is limited to the member's equity in the cooperative. The group should seek legal counsel to determine when the appropriate time might be to incorporate. Sample legal documents for cooperatives are available from USDA, RB-CS (Fredrick).

Articles of Incorporation

In order to incorporate under state statues, a set of articles of incorporation or charter must be drafted. In this drafting process, the steering committee should carefully consider the special rules that distinguish cooperatives from other corporate businesses. Copies of state statutes applying to cooperatives can be obtained from the secretary of state or in some cases the state department of agriculture.

When the state accepts these articles, they become, along with the corporation statutes, the cooperative's charter. The cooperative is granted legal status as long as it continues to meet the statute's requirements and the rules it established in its own articles. Articles are legally binding; cooperatives can amend them only by following statutory procedures and filing the amendments following approval of the members.

A cooperative may choose to incorporate under general incorporation statutes, perhaps gaining potential advantages but assuming associated risks (Roy). Possible advantages include: no limitations to the amount of dividends paid on capital stock, greater freedom to do business with nonmembers, and more flexibility in transacting business with members. Associated risks can include: different treatment under antitrust and tax laws, and additional compliance with Federal Security Acts.

In some situations, cooperative organizers or attorneys advising the steering committee may be more familiar with laws applying to not-for-profit corporations and less familiar with the cooperative incorporation laws. The steering committee would need to be aware of the limitations of incorporating under the not-for-profit statutes such as the inability to distribute earnings, accumulate or redeem equity from members, or be involved in legislative activities.

It is usually expedient to organize under the laws of the state where the cooperative is headquartered. But if there are over-riding needs of the members for more flexibility than their state's laws provide, out of state incorporation is an option. Although it may be helpful to use the legal documents of another cooperative as a template when developing a charter and by-laws, it is dangerous to adopt them without a thorough review and legal counsel.

The articles of incorporation include provisions spelling out the following points:

- Purpose for forming the cooperative
- Activities the cooperative will be involved in
- Names of the incorporators
- Legal powers and limitations of the cooperative
- Membership requirements and voting rights
- Capital structure
- If stock, explanation of capital stock authorization (ie. stock classes, amount of stock issued, value, purchase requirements).
- Process for dissolution and distribution of assets upon dissolution

Bylaws

Bylaws are a set of written rules the cooperative uses to govern itself. The new cooperative must adhere to a set of rules defined in the charter, including state cooperative statutes and articles of incorporation filed. However, bylaws perform two additional functions. First, they implement charter rules by describing in more detail how cooperative affairs will be directed to ensure that laws and articles will not be violated. Second, bylaws address issues not specifically spelled out in laws or the articles of incorporation but necessary to make the cooperative an effective, well designed organization.

Bylaws, as the name suggests, are like laws with some provisions considered as contracts that define the rights and responsibilities of members, directors, and management. Directors, in particular, are responsible for ensuring that the cooperative adheres to the bylaws. Many states let the bylaws themselves establish penalties for violation. Examples will be cited later in this publication of other legal agreements between the members and the cooperative.

The committee should prepare these bylaws with the help of an attorney, making sure that the bylaws do not conflict with state statutes, articles of incorporation, or cooperative principles and meet the unique needs and situation of members. The bylaws must then be adopted and amended by members within 30 days after the cooperative comes into existence. Most states require adoption by either a majority of all members or a majority of members voting at a meeting. In a few states, the board of directors can adopt the initial bylaws, but these provisions normally allow members the opportunity to change them. As a cooperative grows and develops, there is typically a need to update and amend the bylaws to address new issues that arise.

Bylaws describe in more detail the specific qualifications for membership in the cooperative; the limitation on transferability of membership stock; and the reasons for suspension or termination of membership, such as breach of bylaws, loss of eligibility, or nonpatronage. They describe the notice of consent by members to treat patronage distributions as income for tax purposes. Bylaws usually specify the time and place of annual meetings and the procedures for special member meetings along with notice and quorum requirements. Bylaws contain any special voting rules, such as proxy and mail voting, ballot counting, and majority requirements.

In addition, bylaws mandate the appropriate number of directors, their qualifications, and their conduct. Bylaws describe terms of office (including staggered terms) and specify the number of times a director may be reelected or mandatory retirement ages. They describe director election procedures such as nominating, districting, voting as well as removal. They describe board actions to fill vacancies, to hold regular and special board meetings, and to give meeting notices. Bylaws may authorize the membership to set the amount of compensation for board members. Members may place special rules in bylaws to prevent conflicts of interest. Bylaws explain the duties of directors and all other officers. Finally, bylaws should describe the process to dissolve the cooperative and distribute remaining assets. All members should receive a copy of the bylaws when joining the cooperative.

Well crafted articles of incorporation and bylaws provide a solid legal organizational foundation upon which to build the cooperative business. In the haste to form a cooperative, some steering committees copy a charter or bylaws from some other cooperative which may not be applicable to the cooperative being formed. It is advisable to proceed with care in developing these important documents even though the process can be slow and tedious. A well written set of documents can help eliminate possible confusion among members and provide a good introduction to the cooperative for new members, directors, officers or management.

Some new generation cooperatives have utilized this approach to incorporating and preparing by-laws. In the interest of creating a legal identity and moving ahead with business planning, the steering committee acts as incorporators of the cooperative corporation and becomes the initial membership adopting a "trimmed down" version of by-laws which can later be amended to accommodate the organization's needs as the membership grows. This approach may avoid having the group get too bogged down in bylaws discussion and focus most of it's attention on determining the feasibility of the proposed cooperative business.

Other Legal Documents

Other legal documents may include membership applications, membership or stock certificates, marketing or purchasing agreements, meeting notices, notices of patronage allocations, and waivers of notice. In the case of a start-up cooperative, there may be agreements to organize the new cooperative spelling out the potential members rights and responsibilities as the process of forming the new cooperative unfolds. An initial equity commitment may be required but returned to potential members if sufficient equity is not raised or if the cooperative is not formed.

If a marketing cooperative does not have a marketing contract or a supply cooperative a purchasing agreement, its bylaws should specify the obligation, if any, of the members to market or purchase their products through the cooperative, the terms and conditions under which the products will be marketed or supplies purchased, and accounting procedures that should be used together with the amount of business done with members and nonmembers. These provisions are important factors for determining antitrust and tax treatment.

A membership application and/or marketing agreements will be needed. Depending on the competitive environment, a marketing agreement allows the cooperative to function effectively by ensuring sufficient control over the quantity, quality, and delivery conditions of products to be committed. This is especially helpful in the first few years of operation when the cooperative is establishing its reputation as a going, responsible, and successful business. See (Siebert) for more information on marketing contracts.

SECURING MEMBER COMMITMENT

The next phase of new cooperative development involves securing enough commitment from potential members to create a viable organization. Usually a number of activities take place to finalize member commitment including: analyzing potential risk, completing a detailed business plan, determining the required level of each member's investment, defining member's rights and responsibilities, assessing the need and skills for management/staff, and projecting the required level of and sources for financing. A sensitivity analysis should be utilized to determine how changes in key variables such as, availability of supplies, prices, interest rates, and government policy might effect the business plan between the time required to secure member commitment and the actual start-up of the cooperative business.

Analyzing Potential Risk

A key step in securing member commitment is describing and analyzing the potential risk associated with starting a new cooperative venture as well as presenting strategies that the proposed organization will utilize to manage those risks. The following example presents a set of risks which would be encountered by a group of producers considering the formation of a new value-added marketing cooperative (Estenson). The risks can be broken down into seven risk categories: market, technological, construction, operations, organization, financial and government policy. Each of these areas is discussed in more detail.

Market Risk

Introducing a new product into an untried market can be a risky proposition for any business. A number of questions arise which are specific to a marketing cooperative. In addition to the basic business planning required to initiate any new marketing effort, a cooperative needs to address additional questions such as:

- Does the board of directors have an appreciation of what will be required to support an effective marketing effort?

- How will producer members be required to deliver the highest quality products possible?

- Is management qualified to assess your market niche, develop an effective marketing plan and execute it?

- Will a product pooling approach be utilized to average revenues and marketing costs among members?

- What type of pricing and payment plans will be developed for member products?

- How will quality standards be enforced among members?

Potential members must be convinced that the potential benefits in joining this new marketing cooperative, such as better positioning their products in the marketplace or obtaining higher prices, outweigh the risks and cost of their commitment to this new venture.

Technological Risk

The group assumes a higher degree of technological risk when attempting to utilize new or cutting edge technologies for processing or adding value to products. Questions related to evaluating technological risk include the following:

- Will the plant use proven technologies and commercially accepted processes?
- Does current technology dictate a certain maximum or minimum plant size?
- Are members able to produce the optimal volume or will an oversupply develop?
- Will nonmember product be needed to reach optimal volume?
- If so, when and how much?
- Does the process provide end product flexibility or is it single purpose?
- Is management qualified to assess cutting edge technology and able to make informed decisions regarding processes and brands?

Construction Risk Assessment

If construction of a new plant is part of the business plan for the new cooperative enterprise, there are various risks associated with construction of building a new plant. Some of these risks include:

- Are there available engineers/contractors in the area who are experienced in building the proposed plant?

- Are the estimated construction costs reliable?

- Is the plant site environmentally acceptable?

- Have the design engineers designed adequate capacity to process projected member and non-member product volumes as well as allow for potential expansion?

- Do you have management qualified to evaluate contractors, bids, and oversee a complex construction project?

- Can construction and start-up plant operation be completed on schedule?

Operating Risk

Any new business venture incurs a certain level of risk associated with starting up operations. The following questions highlight some of the potential risks involved with new operations:

- Is the startup timetable reasonable including the ability of members to meet delivery requirements? Are the operating assumptions reasonable?

- Are full capacity expectations reasonable given the limitations associated with procuring most raw products from members?

- Do you have management qualified to run the plant efficiently and produce quality products?

- Are accounting procedures in place to identify operating strengths and weaknesses?

Financial Risk

There are a set of financial risks associated with starting new cooperatives including some of the following:

- How long can sales, prices, and/or production levels decline before debt servicing capacity is endangered?

- How high can expenses increase before debt servicing capacity is endangered?

- Under reasonable operating assumptions, does the project provide an adequate return on investment to members or other investors?

- Is the member equity level sufficient to maintain lender support through prolonged periods of financial stress?

- What strategic limitations may be imposed on the cooperative by lenders through loan covenants?

- Are there choices available in securing financing from a number of lenders?

- Are accounting and auditing procedures adequate to protect member's and other stakeholder's financial interests?

Organizational Risk

In a new cooperative, there are many organizational unknowns. It is wise for prospective members to ask some pertinent questions about the organization before making the decision to join such as:

- Are the key decision makers up to the task at hand (directors, manager, other)?

- Are there strategies in place to manage all of the rest of the risks associated with the new business?

- Is the board of directors comprised of the most qualified and effective individuals available?

- Is the organization incorporated and properly organized for tax purposes?

- Do the bylaws and member agreements clearly spell out the rights and responsibilities of members and the cooperative in relation to members?

- Were the books and financial record keeping systems set up by a qualified cooperative accountant?

- Does the board of directors insure that an annual audit is performed by an accounting firm familiar with cooperatives?

- Does the cooperative have a well thought out strategic plan which includes strategies for weathering both tougher and taking advantage of better than expected business conditions?

Government Policy Risk

Most new businesses involving agricultural production and marketing are affected by some level of government policy whether it be environmental regulations or price support programs. It is wise for any startup business to ask how will government policy affect market growth, market prices as well as operating permits and costs.

- What is the likelihood that government policy may change and what impact might that change have on plant profitability?

- What potential changes in policy might have an impact on the cooperative in regard to prices paid to members for their products?

A well designed business plan can be a useful tool in outlining what strategies the new cooperative will utilize to minimize the risks presented in this case of a new marketing cooperative.

Business Plan

The business plan describes what business strategies the cooperative will adopt to address the potential risks to be encountered in the industry the organization will operate in. Some of the risks associated with forming and operating a marketing cooperative have been described in the previous paragraphs.   The plan would include many of the components of a business plan developed for any type of firm, cooperative or otherwise. There are many good references available on how to write a business plan, (Allen, Zimmer and Scarborough). However, in the case of a cooperative, there are additional considerations which should be addressed in a well thought out plan.

A good business plan also provides a set of financial projections based on the best knowledge available by presenting pro forma financial statements including operating statements, balances sheets and cash flow statements for at least three years. These pro forma statements should utilize cooperative accounting and financing practices. Cooperative finance involves a number of unique aspects such as the variety of ways to raise or revolve member equity.

Financial projections should be built on several scenarios reflecting the impact of various member actions such as a given percentage members not meeting their patronage or investment obligations. What level of losses or prices might members be willing to tolerate? What happens if a significant member of members over produce or find more attractive alternatives?

A well-qualified advisor or consultant with experience both with cooperatives and the industry the organization will be operating in can be an invaluable resource in writing the plan. The manager, if hired at this point in the process, would play an active role in it’s creation. The plan should not just be an exercise that a lender might require the group to go through. The plan should be a useful tool for building confidence among prospective members and securing member equity commitment. The plan also sets benchmark for evaluating cooperative performance and making decisions.

The governance structure should be spelled out in the plan to insure that an effective decision making capacity is designed. The plan should identify what management skills will be required to implement the plan. The plan also can become the first manager's strategic "to do" list.

An appendix to the plan should include the adopted or proposed articles of incorporation and bylaws as well as other pertinent legal documents such as membership agreements or equity instruments. Manager and director position descriptions as well as resumes of key individuals such as directors and management can help attest to the quality of the key people involved.

Equity Drive

At this phase in the development of the new cooperative, it is essential that members commit to becoming actual owners of the proposed enterprise. The necessary level of member financing has already been determined. A high level of confidence in the success of the proposed cooperative has been established among potential members. A thorough feasibility analysis has indicated that the operation is economically feasible and a detailed business plan provides a clear picture of the strategies which will be adopted to operate a successful business. Potential members should have all of the information that they need to make an informed decision on making the commitment to join the cooperative.

And so, it is time for members to agree to invest their individual share of the total equity required to finance the start-up of the cooperative. The equity drive can be compared to an IOF firm rolling out a new stock issue by convincing prospective stockholders that the business will be able to generate the returns projected in the prospectus. The cooperative equity drive includes a description of the total expected benefits to members such as projected prices paid to or by members, new markets, patronage refunds or cost savings. Other projected benefits which might be presented to encourage potential members to join and invest in the cooperative are: market/supply security, increased bargaining power, or more control over their economic destiny.

It is critical that the steering committee members demonstrate a thorough understanding of the business plan by taking the primary responsibility for the equity drive. It might be beneficial, however, to involve key external stakeholders such as advisors, lenders, potential customers or management in designing and/or conducting the equity drive. Presentations from consultants involved in conducting the feasibility study or writing the business plan can add credibility to the equity drive. A separate presentation or meeting might be advisable to present plans to lenders who are being approached to provide financing to the cooperative and/or to potential members.

Members of the steering committee play a vital role in this process. They are addressing their peers and arguing the case for joining the cooperative. They build confidence in the proposed cooperative by taking the leap and being the first to sign on the dotted line. A manager may have been hired at this point. That individual can play an important role in building confidence or implementing the equity drive. In the end, prospective members must have enough trust in the individuals associated with the cooperative and confidence that the projected member benefits will be delivered to them, to write that check for their investment in the new cooperative and make the commitment to join.

INVOLVING OTHER STAKEHOLDERS

Any successful start-up cooperative relies on many stakeholders other than members. Management, employees, lenders, suppliers and customers are some of the non-member stakeholders who must commit their support to the cooperative for it to succeed.

Manager or Chief Executive Officer

A key stakeholder in the start-up organization is the manager or chief executive officer. New businesses, in general, take a particular style of manager to get operations off the ground. New cooperatives, usually take a uniquely qualified individual to balance the needs of the cooperative business with the needs of individual members. The new manager should be astute in the workings of the business world that the cooperative will compete in as well as be sensitive to the workings of a membership organization. More information on effective cooperative management can be found.

Role of Lenders

Any new business needs to be adequately capitalized. Typically, the amount of capital provided by members is not adequate to fully finance the new cooperative business. Depending on the level of risk associated with the start-up cooperative and the amount of member equity raised, lenders may be interested in providing debt capital as an additional source of financing.

There are two basic approaches to utilizing debt financing for starting up the cooperative. Loans are normally secured at the cooperative level and are paid back out of the cooperative’s cash flow. Members may also seek individual loans to purchase equity in the cooperative and be individually responsible for paying off their individual loans. This approach may be effective in situations where members have significant business assets of their own to use as collateral and interest expenses can be absorbed by members.

OPENING UP FOR BUSINESS

After all of the preliminary phases of the development process have been accomplished, the cooperative can open it’s doors for business. Several remaining activities occur at this point.

An initial annual meeting of members is scheduled where an election of directors occurs replacing the interim board of directors or steering committee. The board typically selects its own officers and assigns directors to serve on any individual committees which are needed.

The results of the equity drive are announced and any remaining financial commitment needed from members or lenders is secured. All of the assets needed to run the business are obtained. If a manager has not been hired yet, that hire is made as early as is practical. This person needs to be involved in or better yet carry out all other activities such as hiring additional staff and acquiring necessary plant or equipment.

The new cooperative will need to obtain any permits or licenses required to conduct business in it's respective industry. If employees are hired, employer requirements must be met for the hiring process as well as complying with payroll taxes and deduction requirements. Membership records need to be established to document the volume of business for each member and the amount of equity investment or credits. The board must select a bank to handle the cooperative's accounts as well as an auditor. Any state or federal security regulations affecting the new organization must be adhered to.

ACHIEVING SUCCESSFUL START-UP

What can directors, members, and managers of start-up cooperatives do to enhance the chances of success?   An effective board of directors teamed up with qualified management are certainly key ingredients.   A solid financial footing is essential with significant equity investment from members. Executing effective marketing or purchasing strategies are another key element.

Potential Obstacles

One of the biggest obstacles to achieving the full potential of a cooperative is overcoming the natural instinct of independence among potential members. Market economies encourage independence. There is even inherent competition between various municipalities and local governments which can discourage productive cooperation.

One of the best ways to overcome independence and encourage cooperation is to objectively determine and publicize the potential dollars and cents savings and other benefits that can be generated by cooperating. For potential members unwilling to join, that becomes "the cost of independence". When individuals better understand the various "costs of independence", they may develop a clearer understanding of the potential benefits of cooperation.

There is often a tendency for the initial members to try capturing only the benefits but avoid bearing the costs of belonging to a new of cooperatives. It must be made clear that in order to achieve the benefits from group activity, there will also be costs. One cost is giving up some independence and abiding by group decisions. This is usually achieved through binding membership agreements that clearly spell out the level of participation each individual will commit to.

Another obstacle can be the cost of financing the cooperative activity. History suggests that the higher the level of investment that members have in the cooperative (and consequently, the more they have to lose if it fails), the more likely it will succeed. Finally, it is essential that the costs and benefits of operations be distributed in a manner that is considered "fair" by most participants.

Leaders Involvement

The role and level of involvement of various leaders changes through the new cooperative development cycle. Leaders promoting the concept and forming the advisory committee assume a high degree of involvement during the early phases of development. Once a manager is hired the role of the manager increases as a number of responsibilities are shifted from the steering committee to the manager. Although many organizations delay the hiring of a manager until the cooperative is up and running, it may be advantageous to hire a manager earlier in the process to assist in member recruitment, equity raising, and construction, etc. Following formation of the cooperative and election of a board of directors, the role of the manager increases to an even higher level. At that point the level of involvement of directors and members tapers off a bit. However, it can be difficult for loyal and active directors to delegate responsibilities that they were intimately involved in. That is not to say that these groups step back totally from cooperative affairs but do delegate more to management as operations begin.

Figure 1 summarizes the changes in the degrees of involvement for the steering committee, members, and management through the pre-startup and post- startup phases of new cooperative development.

Problems may arise when members of the steering committee (and later, the board of directors), do not adjust the degree of involvement in operations downward following the hiring of management. The founders of the cooperative may have trouble turning over the reins to the manager and the new board of directors. They have typically worked very hard, volunteering a significant amount of time, and want to do everything necessary to make the project succeed. They may be reluctant to turn "their baby" over to a new player on the scene.

For the new cooperative to function most effectively, the various key players; leaders, management and members must change the level of involvement to meet the current situation. The steering committee must also be aware of what their role really is, as the cooperative shifts

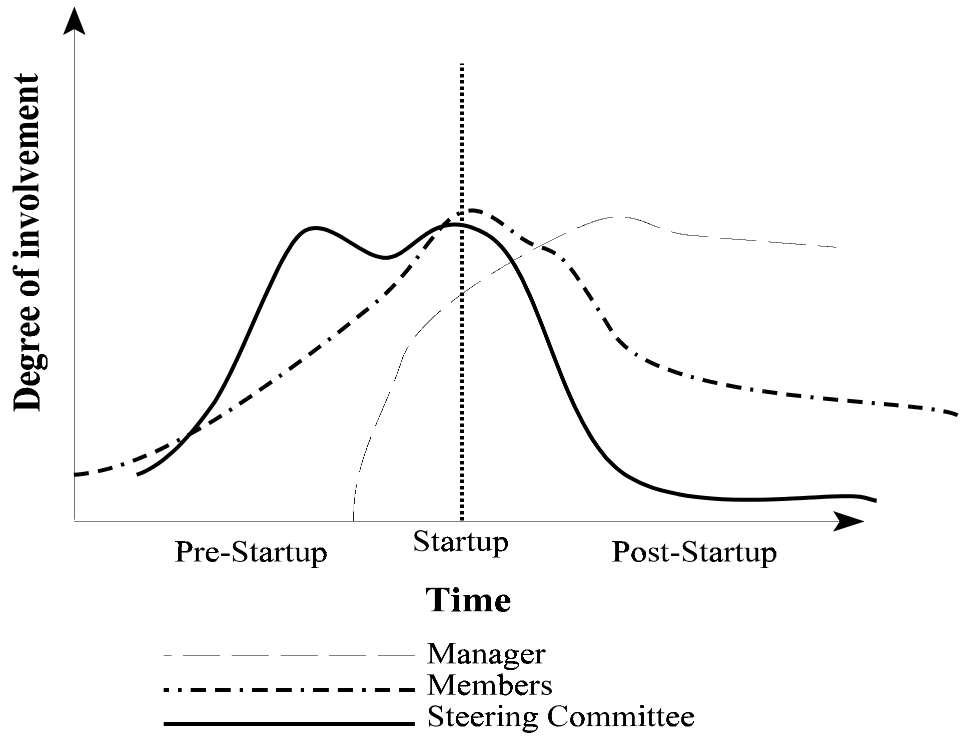

Figure 1. Leadership Involvement During New Cooperative Start-Up

from being a concept into becoming an actual business. Basically, it changes from doing everything to handing over all operational issues to management. The degree of member involvement increases significantly during the pre-startup phase and peaks at the startup when

the degree of involvement by management increases. The degree of management involvement increases steadily after hiring through the startup into the post startup phase.

Member Capital and Risk Through Startup

Newly formed cooperative businesses usually require a significant infusion of capital supplied by members who expect a financial return on that investment as a reward for their risk taking. One potential challenge in a start-up cooperative, is that the expected financial returns can only be generated once the cooperative is up and running and achieves profitability. Until that point, which may take three to five years or more to reach, members are postponing their returns on their investment which becomes part of their risk-taking.

Figure 2 describes the amount of capital investment, risk associated with the investment and returns from that investment over time in a startup.

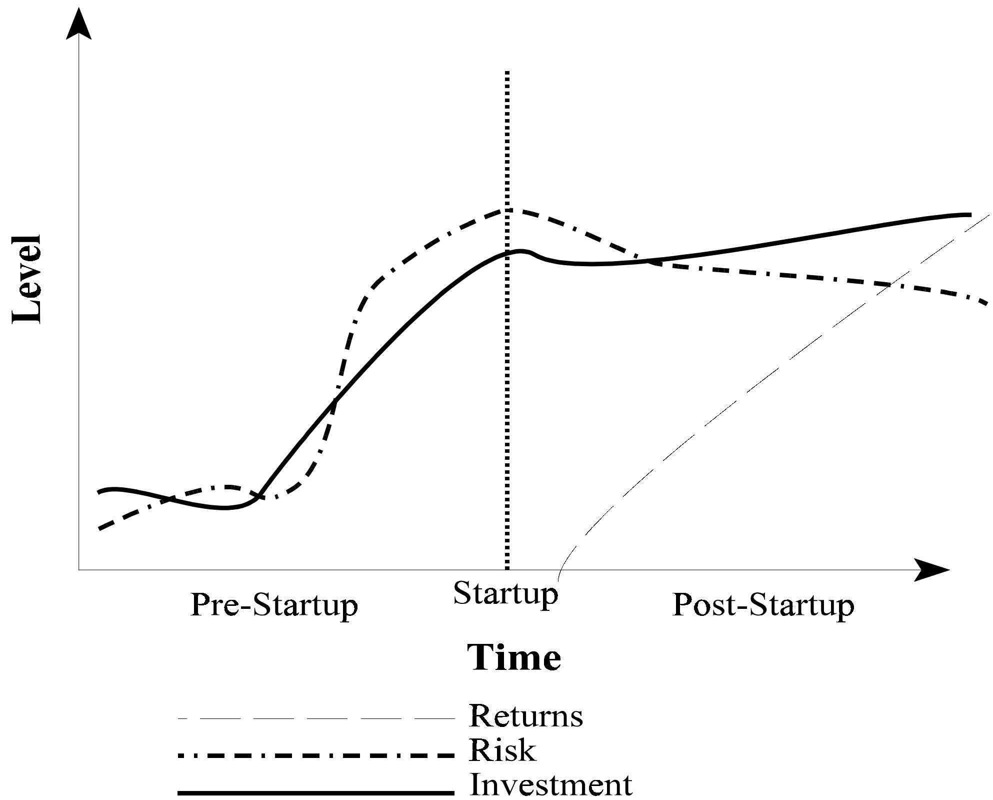

Figure 2. Investment, Risk, and Returns During New Cooperative Startup

This scenario assumes that the initial capital investment must be made before the cooperative can open its doors for business and financial returns can only be generated after the cooperative business generates earnings. This scenario is typical of many new cooperatives. Members must be willing to make short term financial sacrifices to be able to achieve longer term financial returns as the cooperative achieves profitability. Members often need the ability and willingness to be patient in regards to waiting for the returns expected from their initial investment. The delayed return on member investment can create a unique challenge for leaders organizing new cooperatives.

Potential Pitfalls

There are a number of potential pitfalls to new cooperative development. Table 2 offers a summary of key potential pitfalls for cooperative development for each of the six phases of new cooperative development.

Table 2: Potential Pitfalls in New Cooperative Development

Phase		Potential Pitfall
I.	**Identifying an opportunity**	• Lack of agreement on the problem to be addressed
II.	**Building consensus on potential for cooperative**	• Cooperative approach not appropriate for addressing problem • Other options more viable than forming a cooperative
III.	**Developing trust among potential members**	• Limited understanding of member's responsibility • Lack of confidence in leadership • Poor feasibility analysis
IV.	**Securing commitment from members**	• Unrealistic member expectations • Inability to discipline members not meeting responsibilities • Lack of member business volume • Inadequate business planning • Insufficient member equity • Ineffective pricing policies • Poorly designed governance structure
V.	**Securing commitment from lenders and other stakeholders**	• Under invest in manager compensation • Low level of equity financing • Lack of strategic plan
VI.	**Starting up cooperative enterprise**	• Unstable leadership transition • Poor marketing plan • Unqualified manager • Ineffective board of directors • Undercapitalized • Poor quality of products or services • Weak industry

. A major pitfall in Phase I of cooperative development is the inability to reach an agreement on the economic problem to be addressed which usually stalls the process at that point or results in a misunderstanding of some of the group involved about the potential for a cooperative in Phase II. A number of the potential pitfalls in starting new cooperatives can be connected to the limited resources available to new members for forming a cooperative. Along with a tendency towards being undercapitalized, pitfalls can arise from under-investment in management and resources needed for high quality planning. None of these pitfalls need to be fatal. Once a steering committee or organization becomes aware of a given pitfall, there are numerous strategies which might be used to remedy the problem. However, success is not guaranteed. The next section addresses some of the issues related to new cooperative failure.

NEW COOPERATIVE FAILURE

There are limited data available on the failure rate for new cooperatives, but starting any new business is a high risk proposition. New cooperatives fail for many of the same reasons other new businesses fail. However, we will discuss some of the unique dynamics which may create additional stress on new cooperative startups and possibly cause new cooperatives to fail.

Causes of Business Failures

First we will take a look at some of the causes of business failure in a specific industry sector - agriculture, forestry and fishing. The Economic Analysis Department of the Dun and Bradstreet Corporation collects and analyzes data on business failures. Table 3 categorizes the common causes of business failure including: economic factors, finance, experience, neglect, disaster, fraud, and strategy.

A relatively small number of factors account for a high percentage of failures. Industry weakness (27%), insufficient profits (31.8%), insufficient capital (14%), lack of business knowledge (4.9%), and disaster (2.9%) account for a total of 80.6% of business failures in these industry sectors. Many new cooperatives formed operate in these business sectors; it is safe to say that these same factors contribute to cooperative business failures.

Causes of New Cooperative Failures

New cooperatives can be prone to a number of unique business problems. The primary goal of new cooperatives is to help address the economic problems of members or seize new opportunities. If these problems are due to overall weaknesses in the industry that members operate in, the new cooperative may begin it's life in a more hostile economic environment than other firms that have the luxury of choosing their markets. The new cooperative can have little or no choice of products or services to offer, the primary focus is on the well-being of members. This can be particularly challenging when these products or services offer little or no growth opportunity and thin profit margins.

Table 3: Causes of Business Failures: Agriculture, Forestry, and Fishing

Economic Factors Causes	(in percent)	
High interest rates	0.0	
Inadequate sales	0.0	
Industry weakness	27.0	
Insufficient profits	31.8	
Inventory difficulties	0.5	
Not competitive	1.0	
Poor growth prospects	0.0	
Poor location	0.0	
Subtotal	60.3%	
Finance Causes		
Burdensome institutional debt	6.9	
Heavy operating expenses	8.3	
Insufficient capital	14.2	
Subtotal	29.4%	
Experience Causes		
Lack of business knowledge	4.9	
Lack of line experience	0.5	
Lack of managerial experience	0.5	
Subtotal	5.9%	
Strategy Causes		
Excessive fixed assets	0.5	
Over expansion	0.0	
Receivables difficulties	0.0	
Subtotal	0.5%	
Neglect Causes		
Business conflicts		0.5
Family problems	0.5	
Lack of commitment	0.0	
Poor work habits	0.0	
Subtotal	1.0%	
Disaster	2.9%	
Fraud	0.0%	
TOTAL	100.0%	

Results based on primary reason for failure.

Source: *The Business Failure Record*. Economic Analysis Department, The Dun and Bradstreet Corp., 1998.

Accounts receivable difficulties can be more problematic when your customers are your member-owners. There can be a tendency, particularly in agricultural cooperatives, to invest in excessive fixed assets when the fluctuations of member production due to weather, more attractive alternatives or government policy can result in under-utilized plants. Cooperatives tend to be undercapitalized given that the primary source of equity is members and members may not be in a financial position to invest the necessary capital. A lack of capital may translate into inadequate compensation of managers.

The basic economic or social premises for forming the cooperative may be flawed to begin with. Eastern Europe or the former Soviet Union states are filled with failed "pseudo-cooperatives" formed by government bureaucrats with a top down vision of what a cooperative should be, not a bottom up focus on member needs and control. Some producer cooperatives have been formed as "captive" sources of supply by buyers of product to increase returns to buyers returns not necessarily members. Government funding or grants can provide a needed initial infusion of capital for some cooperatives, but if the actual cooperative business cannot generate the cash flows needed over the long term, failure is only a matter of time.

Founder Burnout

The process of developing and forming the new cooperative can be very time consuming and exhausting which can be a factor of new cooperative failure. During the first few years of start-up, the original organizers may experience founder burnout. An infusion of new energetic leadership is essential in assuring sustained cooperative growth. Any successful cooperative develops strategies to replenish the supply of effective leaders filling key positions in the organization.

INGREDIENTS FOR SUCCESS

Let us begin by reviewing the two necessary conditions for the successful establishment of any cooperative organization. First, there must be joint recognition of a common economic problem. Two or more individuals must face a common, real economic problem. The problem could be the lack of sufficient market outlets of firms in an industry, common recognition of inadequate buying muscle in the purchase of supplies or services, or financial pressures that force entities to explore the sharing of equipment, personnel or services.

It is extremely important to identify the real economic problem, and not just the symptoms of the problem. Also, all parties that will be involved should have a rather uniform understanding of the problem.

The second condition is that the proposed cooperative should be more efficient in performing the service collectively than individuals can. In economic terms, the new organization can achieve economies of scale. Economies of scale can arise through better utilization of personnel, equipment or other resources as well as by the sharing of financing or risk management. It can be difficult and risky for a single producer to finance, organize and operate a business, but collectively it may be accomplished very efficiently.

It is important to identify effective leaders at an early stage, encourage them and reward them for their efforts, even if merely with a few supportive comments. Leaders are the driving force in cooperative endeavors. They achieve compromise among participants. They overcome barriers and obstacles. They see worthwhile efforts through to completion. Consequently, it is imperative that any cooperative effort have the required leadership.

An effective board of directors teamed up with qualified management are certainly key ingredients. A solid financial footing is essential, and effective marketing or purchasing strategies are other key elements.

Lessons from New Generation Cooperatives

Observations of the new cooperative development process taking place in the upper Midwest in the 1990's will be presented as a summary of key ingredients for successful new cooperative development. The phenomenon of "Coop Fever", a term used to describe a wave of interest in developing new value-added marketing cooperatives serving farmers in the Northern Plains states, swept through the Dakotas and Minnesota (Torgerson). The development of a significant number of new cooperatives in the upper Midwest with new member investment in the hundreds of millions of dollars has created great interest around the world among those interested in agricultural and rural economic development. Much has been written about these "New Generation " cooperatives (Stefanson), (Gerber). Directories of “New Generation” cooperatives listing organizations by commodity and state have been developed (Gerber), (Merrett).

Cooperative organizers such as William Patrie, Rural Development Director, North Dakota Association of Rural Electric and Telephone Cooperatives have been directly involved in organizing some of the “New Generation” cooperatives and have developed novel approaches to guiding groups of producers through the six phases of cooperative development (Patrie). We will include some of those strategies along with other key ingredients for success in Table 4.

Table 4. Lessons from New Generation Cooperative Development

I.	**Identifying an opportunity**	• Reports developed such as North Dakota 2000 identifying economic development opportunities for value-added processing • Consortium of state leaders surface to promote further pursuit of opportunities and set priority for development of ag. value-added businesses • Good facilitators to help group focus on nature of the problem and opportunities
II.	**Building consensus on potential for cooperative**	•Intensive support is provided through rural electric cooperatives in North Dakota to assist groups in assessing the potential for forming new cooperatives. •Initial project planning includes use of premier consulting resources •Projects are market-driven, starting with demand analysis
III.	**Developing trust among potential members**	•Experienced cooperative development advisors are available and utilized •Well-respected, effective farmer leaders to champion the project •High degree of feasibility determined for proposed cooperative business •Experienced and top quality consulting firms are involved with matching state funds available to fund feasibility studies.
IV.	**Securing commitment from members**	• Detailed, quality business plan was developed as member prospectus • Well planned and executed equity drive • Legally binding membership and marketing agreements • Visionary farmers take lead on equity drives
V.	**Securing commitment from lenders and other stakeholders**	• Strong member commitment required both in equity and product delivery • Well qualified manager hired early in development phase • Lenders who understood cooperatives • Well qualified attorneys, accountants and cooperative bank staff involved • Detailed, quality business plan to take to the bank
VI.	**Starting up cooperative enterprise**	• Effective execution of business plan • Anticipate startup challenges (cash flow, management, construction, etc.) • Board with a long term vision • High level of equity financing • Business able to generate strong earnings

Use of Advisors

Many of the steering committees providing the leadership for developing "New Generation Cooperatives" actively sought out qualified advisors and consultants throughout the development process. Fortunately there is a pool of qualified advisors in the Upper Midwest who were available as well as consulting firms with staff loyal to the communities involved. Advisors were sponsored to work with steering committees through support from cooperative trade associations, state cooperative councils, other cooperatives in the region, state governments, Land-Grant Universities, federal government funding, and other "New Generation" cooperatives. These advisors and consultants provided valuable information and advice to leaders of new cooperatives. This does not diminish the qualifications or capabilities of the farm leaders involved who were talented in their own right. But they also knew when it was desirable to seek advice or consultation.

Although this list offers only a brief sketch of the development process and resources for "New Generation" cooperatives, it highlights a number of important lessons which those interested in new cooperative development can benefit from.

SUMMARY

There is increased interest in economic alternatives as individuals try to adopt needed technology and compete in today's dynamic global markets. The cooperative organizational structure may offer a viable alternative. New cooperative development requires strong commitment and leadership from the potential members and a number of other stakeholders to result in the creation of an effective, sustainable cooperative. There is no single path which those must take to develop new cooperatives - but there is a wealth of common experiences to draw upon. The recent development of "New Generation" cooperatives adds to the better understanding of what it takes to successfully create and nurture a new cooperative. There are a significant number of resources and supporting organizations available to those interested in new cooperative development. It is not an easy task to create a new cooperative, but the end result benefits the economic and social well-being of members if the organization is well designed and built on a solid foundation.

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REGIONAL AND U.S. COOPERATIVE DEVELOPMENT RESOURCES

Northeast

Cooperative Councils

New York and the New England states

Northeast Cooperative Council
203 Warren Hall
Cornell University
Ithaca, NY 14853-7801
607-255-8800

New Jersey Council of Farmer Cooperatives
c/o Swedesboro Auction, Inc.
Anderson And Leahy Avenues
Swedesboro, NJ 08085
609-467-0313

Pennsylvania Council of Cooperatives
P.O. Box 299
State College, Pa 16804
814-231-3010

Cooperative Accounting

Northeast Chapter, National Society of Accountants for Cooperatives

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Agri-Mark, Inc.
P.O. Box 5800
Lawrence, MA 01842
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Buffalo, NY 14202
716-854-1830

Government Agencies

NE State Departments of Agriculture

Connecticut Department of Agriculture
State Office Building
165 Capitol Avenue
Hartford, CT 06106-1630
860-566-4667

Maine Department of Agriculture, Food and Natural Resources
28 State House Station
Augusta, ME 01333
207-287-3871

Maryland Department of Agriculture
50 Harry S. Truman Parkway
Annapolis, MD 21401
410-841-5882

Massachusetts Department of Food & Ag.
100 Cambridge Street
Boston, MA 02202
617-727-3000

New Hampshire Department of Agriculture, Markets and Food
P.O. Box 2042
Concord, NH 03302
603-271-3551

New Jersey Department of Agriculture
P.O. Box 330
Trenton, NJ 08625
609-292-3976

New York State Dept. of Ag. & Markets
1 Winners Circle
Albany, NY 12235
518-457-3800

Pennsylvania Department of Agriculture
2301 North Cameron St.
Harrisburg, PA 17110-9408
717-787-4737

Rhode Island Division of Agriculture
235 Promenade St.
Providence, RI 02908
401-222-2781

Vermont Dept. of Agriculture, Food & Markets
116 State Street, Drawer 20
Montpelier, VT 05620-2901
802-828-2430

Northeast USDA Rural Development Offices

Cooperative Development Contacts

USDA Rural Development
451 West Street
Amherst, MA 01002-2999
413-253-4319

USDA Rural Development
Community Facilities, Rural Utilities, &
Cooperative Development
99 Fort Fairfield Road
Presque Isle, ME 04769
207-764-4155

USDA Rural Development
Community and Business Program
P.O. Box 405
Bangor, ME 04402-0405
207-990-9168

USDA Rural Development
Community Outreach
10 Ferry Street, Suite 218
Box 317, Concord Center
Concord, NH 03301
603-223-6037

USDA Rural Development
Cooperative Development
The Galleries of Syracuse
441 South Salina Street, Suite 357
Syracuse, NY 13202
315-477-6425

USDA Rural Development
Rural Business and Cooperative
Development
RR #3, Box 27 F
Montrose, PA 18801
717-278-2542

USDA Rural Development
Community, Business and
Cooperative Programs
3rd Floor, City Center, 89 Main Street
Montpelier, VT 05602
802-828-6010

Northeast Non-Profit Cooperative Development Organizations

Cooperative Development Institute
Lynn Benander, Director
277 Federal Street
Greenfield, MA 01301
413-774-7599

National

Professional

Cooperative Communicators Association
5307 43rd Street
Lubbock, TX 79414-1315
806-795-2783

National Society of Accountants for Cooperatives
6320 Augusta Drive
Suite 800
Springfield, VA 22150
703-569-3088

Non-Profit Organizations

Cooperative Development Foundation
1401 New York Ave., NW
Suite 1100
Washington, DC 20005
202-638-6222

Cooperative Development Services
30 West Mifflin Street
Suite 401
Madison, WI 53703
608-258-4396

Cooperative Housing Foundation
P.O. Box 91280
Washington, DC 20090-1280
301-587-4700

Credit Union National Association
Box 431
Madison, WI 53701-0431
608-231-4000

Farm Credit Council
50 F Street, NW, Suite 900
Washington, Dc 20001
202-626-8710

Trade Associations

National Association of Housing Cooperatives
1401 New York Ave., N.W., Suite 1100
Washington, DC 20005-2160
202-737-0797

National Council of Farmer Cooperatives
50 F Street, NW, Suite 900
Washington, DC 20001
202-626-8700

National Cooperative Business Association

1401 New York Avenue, NW, Suite 1100
Washington, DC 20005
202-638-6222

National Rural Electric Cooperative
Association
1800 Massachusetts Avenue, NW
Washington, DC 20036
202-857-9500

National Telephone Cooperative
Association
2626 Pennsylvania Avenue, NW
Washington, DC 20037-1695
202-298-2300

North American Students of Cooperation
Box 7715
Ann Arbor, MI 48107
313-663-0889

Cooperative Finance

National Cooperative Bank
1725 Eye Street NW
Suite 600
Washington, DC 20005
202-336-7700

National Rural Utilities Cooperative
Finance Corporation
Woodland Park
2201 Cooperative Way
Herndon, VA 22071-3025
703-709-6700

COBANK
P.O. Box 5110
Denver, CO 80217
303-740-4000

U.S. Government Agencies

USDA, Rural Development
Rural Business - Cooperative Service
Stop 3201
1400 Independence Ave., S.W.
Washington, DC 20250-3201
202-690-4730

National Agricultural Library
10301 Baltimore Avenue
Beltsville, MD 20705
301-504-5755

Appropriate Technology Transfer to
Rural Areas (ATTRA)
P.O. Box 3657
Fayetteville, AR 72702
800-346-9140

Websites

International

The International Co-operative Alliance (ICA)
http://www.coop.org

National

The National Cooperative Bank (NCB)
http://www.ncb.com

The National Cooperative Business Association (NCBA)
http://www.ncba.org/

The National Council of Farmer Cooperatives (NCFC)
http://www.ncfc.org

State

New York State Consolidated Laws - Cooperative Corporations
http://assembly.state.ny.us/leg/?cl=21&a=1

University

University of California Center for Cooperatives
http://cooperatives.ucdavis.edu

Cornell Cooperative Enterprise Program
http://www.cals.cornell.edu/dept/arme/cooperatives/

Arthur Capper Cooperative Center at Kansas State University
http://www.agecon.ksu.edu/accc/

Quentin Burdick Center for Cooperatives at North Dakota State University
http://www.ag.ndsu.nodak.edu/qbcc/

University of Wisconsin Center for Cooperatives
http://www.wisc.edu/uwcc

Government

USDA, Rural Development, Rural Business-Cooperative Services
http://www.rurdev.usda.gov/rbs

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