

An Introduction to Cooperatives: History, Economics, & Principles

*Kentucky Center for Agriculture & Rural
Development (KCARD)*



What is a Cooperative?

■ Simple Definitions:

“An enterprise or organization owned by and operated for the benefit of those using its services” (Merriam-Webster Dictionary)

“A cooperative is a business owned and controlled by the people that it services.”
(Larry Snell, KCARD)



Economic Principles of Cooperatives

- **User-Owned:** The people who own and finance the co-op are those who use it
- **User-Controlled:** The people who use the co-op control it via “One Member-One Vote” on major organization decisions and electing board of directors
- **User-Benefited:** The sole purpose of the cooperative is to provide and distribute benefits to members on the basis of their use of the services of the cooperative. (Operation (Service) at Cost, Patronage Refunds, Improved Pricing, Market Access to Goods and Services otherwise not available)



Cooperative History

- **Early Origins:** Group Hunting and Shelter Building; Evidence in Greece, Egypt, Rome, Babylon, African, and Native American Tribes
- **Industrial Revolution:** changing living conditions sparked interest in cooperatives in Europe during late 18th and early 19th century
- **Rochdale Equitable Pioneers Society (England):** co-op formed in 1844 by 28 workers in textile mills to open own food store; 1st successful cooperative; serve as model for modern cooperatives



Rochdale Principles

- The store is open to all
- The store charges ordinary market prices
- The store receives only ready money and gives no credit
- The store gives dividends in proportion to purchases
- Every member must have a share or shares and receive good interest on them
- All are equal in voting powers
- The store sells genuine articles
- The store has an honest manager and active committee
- The Society insists on an efficient and intelligent audit and stock offering



Cooperatives in the United States

- **Philadelphia Contributionship for the Insurance of Houses from the Loss of Fire:** 1st successful cooperative organization; initiated by Benjamin Franklin in 1752; still serves members in PA and NJ today
- **Emergence of Agricultural Cooperatives:** Most early American cooperatives were formed for benefit of farmers (supply and marketing cooperatives)
- **Failure of Early Cooperatives:** Insufficient capital, poor management, and lack of understanding of cooperative principles by members are reasons for lack of success
- **Role of Federal Government:** By the early 1900s, passed laws that improved environment for co-op development



Changing Environment for Co-ops

- **Sherman Antitrust Act (1890):** Welcomed by farmers b/c of monopoly practices of large business organizations; But ironically it threatened cooperatives
- **Clayton Antitrust Act (1914):** formally excluded cooperatives from Sherman Antitrust Act
- **Capper-Volstead Act (1922):** authorizes producers of agricultural products to “act together in association, corporate, or otherwise, with or without capital stock”
- **Cooperative Marketing Act of 1926:** created a Division of Cooperative Marketing within USDA (now contained within Rural Business-Cooperative Service of USDA)



Capper-Volstead Act

- Established statutory requirements under which cooperatives must be organized, which harken back to the Rochdale principles:
 1. It must be operated for the mutual benefit of its members;
 2. Either it must limit each member to one vote or if it pays dividends on the basis of members' stock it must limit these dividends to a maximum of 8 per centum per annum; and
 3. It can not handle a greater amount of products from nonmembers than it does from members



Cooperative Development in 1930s

- **Farm Credit Act (1933):** created 12 regional and one central bank to loan to agricultural cooperatives; Production Credit Associations were established to make production loans to farmers
- **Federal Credit Union Act (1934):** credit unions organized as alternatives to banks, which rarely offered services to working people
- **Rural Electrification Act (1936):** created REA within USDA to help form cooperatives and provide them with loans needed to build rural electric infrastructure; electric co-ops brought electricity to rural areas at a time that investor-owned utilities were not declining to extend service due to costs



Co-ops Today by the Numbers

- More than 400,000 cooperatives in the US
- Serve more than 130.5 million members
- Nation's 100 largest co-ops, representing agriculture, finance, housing, energy, and hardware sectors reported over \$150 billion in sales in 2006



Cooperative Theory: What is the role of Cooperatives?

- Sapiro Theory: the role of co-ops is to achieve market power for members through large scale legal monopolies
- Nourse Theory: the role of co-ops is to force non-cooperatives to behave more competitively (co-op yardstick)
- J.S. Mills: the co-op model provides a “socially advanced” way of doing business



Cooperative Principles

- Voluntary and Open Membership
- Democratic Member Control
- Member Economic Participation
- Autonomy and Independence
- Education, Training, and Information
- Cooperation among Cooperatives
- Concern for Community



Voluntary and Open Membership

- “Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political or religious discrimination.”
- Members participation should be based upon clear understanding of cooperative’s vision and acceptance of responsibilities of membership
- May close membership based on ability to use or on a limit that it can effectively serve
- Obligates leadership to elicit information from entire membership



Democratic Member Control

- “Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary, cooperatives members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.”
- Assumes members will participate in setting policy and giving broad direction
- Democratic control involves electing representatives to serve on the board of directors, attending membership meetings, and voting for structural changes as requested by the board of directors



Member Economic Participation

- “Members contribute equitably to the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.”
- Outlines the use of surpluses which illustrates the purpose of cooperative is to meet needs of its members not accumulate capitals in the hands of a few investors
- Important to have “Skin in the Game”



Autonomy and Independence

- “Cooperatives are autonomous, self-help organizations controlled by their members. If they enter into agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.”
- Must be free from government intervention and other sources so members can control their destiny
- Capitalization and financial pressures can make difficult for cooperative to adhere to this principle
- When the co-op begins following the “free money” path, it risks losing its autonomous nature



Education, Training, and Information

- “Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public - particularly young people and opinion leaders - about the nature and benefits of cooperation.”
- Communication is vital in a cooperative because of democratic control by members, meeting members needs, and rarity of cooperative business model
- Manager training is one of the best investments a cooperative can make
- Financial pressures and time demands can make difficult



Cooperation among Cooperatives

- “Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional and international structures”
- Cooperatives often lack necessary resources to meet all the needs of its members; can meet at lower cost by working with other co-ops
- Cooperatives should not view other co-ops as competitors; very difficult for many to adhere to this principle



Concern for Community

- “Cooperatives work for the sustainable development of their communities through policies approved by their members.”
- Cooperatives recognize that healthy communities are important to the strengths of their business
- Cooperatives have a vested interest in the community because the owners/members are members of the community

