

BULLETIN

A GLOSSARY FOR COOPERATIVES

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Business terminology is not always clear, and different terms are often used to describe the same business concept. This glossary defines and explains common business terms associated with cooperatives, and can help members, employees, and newly elected directors better understand the financial reports, as well as other business reports, of their cooperative. The terms are divided into six sections: (1) Types of cooperatives; (2) Cooperative structure; (3) Legal terms; (4) Governance; (5) Financial statements and terms; and (6) Equity redemption plans.

Types of cooperatives:

Cooperative – We may define “cooperative” several different ways. Perhaps a short definition best captures the meaning of a true cooperative: a user-owned and user-controlled business that distributes benefits on the basis of use. The user is the member of the cooperative who has a financial investment in the cooperative, controls the cooperative by exercising a one-member, one-vote policy, and receives benefits (better prices, improved goods and services, a share of the net profits) in proportion to use (patronage). A cooperative is usually incorporated under a state incorporation law, and therefore is a special corporation, giving member-owners limited liability protection.

Bargaining cooperative – A cooperative whose sole or principal function is to bargain for terms of sales. It does not handle the actual products as would a marketing cooperative.

Marketing cooperative – A cooperative that physically handles a commodity or product and may store, process, and package the commodity or product for sale to wholesalers and/or retailers.

New generation cooperative – Also referred to as a new wave or value-added cooperative, this refers to a number of new cooperatives organized by farmers during the past decade to add value to the commodities they produce. They meet the full definition of a cooperative but differ from traditional cooperatives in three ways: (1) closed or restricted membership rather than open membership; (2) members provide a substantial amount of equity capital up front with the purchase of shares that give them the right and obligation to sell a certain quantity of product to the cooperative; and (3) these equity shares can be transferred, when the member no longer uses the cooperative, at their market value; that is, at the appreciated or depreciated value.

Service cooperative – A cooperative that solely or primarily renders services (such as housing, financing, insurance, artificial breeding, electricity, or telephone) as distinguished from handling commodities.

Supply and purchasing cooperative – Two types of cooperative through which member-patrons obtain the supplies and services needed for their own business or personal use at competitive prices. Examples include: farm supply co-ops purchasing fertilizer, feed, seed, and other inputs for farmers; municipalities purchasing police and fire protection; rural hospitals purchasing medical supplies

and medical services; and fast food firms purchasing supplies and food products.

Worker-owned cooperative – A cooperative owned and controlled by the workers (employees). Most worker-owned cooperatives are in the processing or service sectors.

Cooperative structure:

Acquisition – When a cooperative purchases another cooperative or other type of business.

Centralized – Cooperatives that are owned and controlled *directly* by their members. These are typically local cooperatives with a single branch. Regional, interregional, and national cooperatives may also be centralized, having one corporate office but operating several branches or retail outlets, although this is not common.

Consolidation – A merger of two or more cooperatives in which a new cooperative is organized to replace the original cooperatives.

Federated – A cooperative in which the members are individual cooperatives. For example, local farm supply cooperatives are members of Land O'Lakes, Inc., and CHS, Inc., two regional cooperatives, via their purchases of feed, seed, agronomy, and petroleum products.

Horizontal integration – The act of combining two or more similar production units or marketing agencies under central control and management, e.g., two fertilizer plants or two retail stores.

International cooperative – A cooperative that serves members and operates in more than one country.

Interregional and national cooperatives – Large cooperatives that serve a major portion of the United States.

Local cooperative – Usually refers to a cooperative that operates in a relatively small geographic area. Often it has

one facility only, although mergers and acquisitions have enlarged the operating size of local cooperatives. Some farm supply cooperatives and grain local cooperatives today are now as large as regional cooperatives were in the 1950s, covering a multi-county area and often having several locations. An example is Landmark Services Cooperative, headquartered in Cottage Grove, Wisconsin.

Marketing-agency-in-common – A federated cooperative with membership of two or more cooperatives, created for the purpose of negotiating terms of trade on behalf of the membership. The cooperative does not take title to product and leaves the actual marketing up to the members. Some agencies establish and market under a brand name. An example is the Central Milk Producers Cooperative that represents dairy cooperatives in the bargaining process for premiums with milk bottlers that serve the Chicago market.

Merger – Two or more cooperatives are brought together under one name. The acquiring cooperative continues but the acquired cooperative is liquidated.

Regional cooperatives – Large cooperatives that serve one or more states. An example is CHS, Inc., headquartered in Inver Grove Heights, Minnesota.

Vertical integration – The act of combining two or more units in the marketing channel, e.g., a dairy cooperative making cheese expands into wholesaling and retailing activities. An example is Land O'Lakes, Inc., a cooperative that manufactures and markets butter, cheese, and other dairy products to the food service industry, to food wholesalers, and to food retail stores.

Legal terms:

Articles of incorporation – A legal document filed with the appropriate state agency showing the purpose, capitalization, address, and names of the incorporators of a cooperative.

Bylaw – A standing rule, not included in the articles of incorporation, which specifies operational practice and policy of the cooperative.

Charter – The articles of incorporation under which a corporation (including cooperatives) is legally organized. It is the authority to proceed as a corporation subject to the constitution and laws of the state in which the incorporation took place. In Wisconsin most cooperatives are incorporated under Wisconsin Statute Chapter 185.

Incorporating – The act of setting up a corporation by filing incorporation papers with the appropriate state agency. In Wisconsin this agency is the Department of Financial Institutions.

Governance:

Director – One of several members of the cooperative who is elected by the membership to a board of directors to govern or control the affairs of the cooperative.

Hired management – An individual hired by the board of directors to manage the day-to-day activities of the cooperative. This person is accountable to the board.

Member – A person who joins a cooperative organization. The bylaws of a cooperative define the requirements of membership, such as purchasing one share of common stock, paying a membership fee, conducting a minimum annual dollar amount of business with the cooperative, or simply using the services of the cooperative.

Officers – The board of directors elect amongst themselves, usually shortly after the annual meeting, a president (or

chairperson), vice president (or vice-chair), a secretary, and a treasurer.

Outside director – An individual who is not a member of the cooperative but sits with the board of directors, and is elected by the cooperative membership. Outside directors are usually selected and approved by the board of directors and have no votes on the board, instead serving in an advisory capacity. An exception is the federal requirement that those cooperatives that are part of the Farm Credit System have an outside director with voting rights.

Patron – A person who purchases products or services from the cooperative, including members and non-members. Cooperatives may have patrons who do not meet the membership requirements. The business from non-member-patrons is often simply referred to as “non-member business.”

Financial statements and terms:

Allocated equity – The share of net margin (savings) from member business that has been allocated to individual member-patrons based on their patronage but retained by the cooperative for operating purposes. There is an obligation to redeem this equity to members or past members at some point in the future.

Assets – The capital resources of a cooperative or everything that the cooperative owns.

Current assets – Assets which are expected to be converted into cash or to be used up within one year of the balance sheet.

Fixed assets – Physical items not readily convertible to cash; includes items such as land, buildings, and equipment.

Other assets – Assets on the balance sheet such as investments in other cooperatives (e.g., regionals, CoBank) or other types of investments.

Balance sheet – A statement showing the assets, liabilities, and equity (net worth) of a cooperative on a specified date, which is usually the end of the fiscal year.

Capital – Money, or the dollar value of plant and equipment used in the cooperative; may be supplied by members as owners and/or borrowed.

Equity capital – Capital usually supplied by members (preferred stock, which is equity capital, may be sold to non-members, and net profits from non-member business may also be included). Equity capital has no fixed repayment period nor annual fixed interest or dividend payment. On the balance sheet it is equal to total assets minus total liabilities.

Debt capital – Capital that is borrowed. It has a fixed repayment period and fixed annual interest payments.

Capital credits – The term used by electric cooperatives for retained patronage.

Certificate of equity, of investment; revolving fund certificate – Usually a certificate without a maturity date issued as evidence of retained patronage refunds or per unit retains.

Common stock – Ownership capital in a cooperative, divided into shares or stock certificates that carry voting rights (unless otherwise indicated) and are eligible for dividends. Common stock may be split into Class A common stock with voting rights and Class B common stock without voting rights. Often as a condition for membership, a member must purchase one share of common stock.

Direct investment – Cash investment in the cooperative via the purchase of membership certificates, shares of common or preferred stock, or other forms of equity.

Dividend – A return paid to investors on preferred stock or other invested capital. Most state cooperative incorporation laws limit dividends to an annual 8% return.

Gross margin – Total sales minus cost of goods sold.

Liabilities – Everything a cooperative owes to someone.

Current liabilities – Liabilities that are due within one year of the balance sheet.

Long-term liabilities – Liabilities that are due beyond one year of the balance sheet, such as a long-term loan on land and buildings.

Local margin – All income minus all expenses from the cooperative’s own operation. It may also be referred to as local savings.

Operating statement – An itemization of business income and expenses with net income (net savings, net margin, net profit) for a given period such as a month, quarter, or year. It may be referred to also as a statement of operations, income statement, or profit and loss statement.

Patronage refund – An allocation of net margin (savings) distributed to patrons on the basis of patronage (use of the cooperative).

Per unit retain – Funds held from patrons, or a check-off applied on the basis of per unit of commodity marketed through the cooperative (e.g., 5 cents per bushel of wheat), as a means of building equity capital in the cooperative. Also referred to as per unit capital retains.

Preferred stock – Capital stock that has a stated dividend rate and takes preference over dividends paid on other stock and/or patronage refunds to members. It is equity capital, since any dividends paid are at the discretion of the board of directors. Preferred stock may be sold to members and non-members alike.

Retained patronage – The share of net margin (savings) retained by the cooperative for the purpose of operating the cooperative.

Statement of cash flow – A statement showing all gross cash flows of the cooperative over an accounting period, usually twelve months. It records cash provided by sources and cash consumed. It contains three components: (1) cash flow from operating activities; (2) cash flow from investing activities, and (3) cash flow from financing activities.

Statement of changes in financial position – A statement showing all sources of funds and all uses of funds, with the change in working capital, for an accounting period.

Total net margin – Local net margin plus patronage refunds from regionals or other cooperatives.

Unallocated equity – The share of net margin (savings) from member and/or non-member business retained by the cooperative for operating purposes. This is considered permanent capital in that there is no obligation to redeem this equity to current or past members unless the cooperative is dissolved.

Working capital – Total current assets minus total current liabilities.

Equity redemption plans:

Equity redemption – Returning to current or past members retained allocated equity.

Equity redemption plan – A plan detailing how the cooperative will redeem equity to current and past members.

Base capital plan – A financing plan in which the cooperative obtains capital by focusing directly on the current proportion of capital that a member-patron should have invested in the cooperative at a particular time. It is based on the degree of member-patron use of the cooperative during a base period, such as the average of the past three years.

Percentage of all equities plan – A financing plan that redeems a specified percentage of the designated equity pool, without regard for the age of the equity or age of the member or past member. For example, all members or past members receive a redemption of 10 percent of their allocated equity account.

Revolving fund plan – A financing plan in which capital funds are obtained from member-patrons through retaining patronage refunds or per unit retains, are used for a period of time by the cooperative, and are later (e.g., 10 years) repaid to the member-patrons or past members.

Special or unsystematic plan – Plans that redeem equity by age of member, when settling estates, for hardships and the like.

Targeted base capital plan – A base capital plan that sets a targeted equity capital investment for each member-patron (such as \$2.00 for each bushel of corn normally marketed annually through the cooperative), and then allows member-patrons to either invest their amount up front or to build up this amount up over time through annual retained patronage refunds.

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