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Financing of Agricultural Cooperatives

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FINANCING OF AGRICULTURAL COOPERATIVES

by

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CHAPTER 1

THE STUDY

Problem

Cooperatives through the years have become important in marketing of farm products in the United States. The last few years in the United States, farm cooperatives have shown a tremendous growth in volume of business and in membership. From 1939 to 1949, the membership in marketing and purchasing cooperatives doubled and the volume of business increased four times. At the same time there has been a slight reduction in the number of cooperatives (Table 1).

Table 1. Farmers' Cooperative Marketing and Purchasing Association: Number, Membership, and Business, United States, 1939 and 1949

	Marketing Associations		Purchasing Associations		Total	
	1939	1949	1939	1949	1939	1949
Associations Listed	8,051	6,922	2,649	3,113	10,700	10,035
Estimated Membership in Thousands	2,300	4,075	900	2,509	3,200	6,584
Estimated Business in Millions of Dollars	1,729	7,083	358	1,643	2,087	8,726

Source: Agricultural Statistics, 1951, United States Department of Agriculture, Washington, D. C., 1951, Table 654, p. 568.

South Dakota cooperatives show a similar trend. From 1939 to 1950 the membership in marketing and purchasing cooperatives doubled and the volume of business increased four times. At the same time the number of cooperative associations has decreased (Table 2).

Table 2. Farmer's Cooperative Marketing and Purchasing Associations: Number, Membership, and Business, South Dakota, 1939 1/ and 1950 2/

	Marketing Associations		Purchasing Associations		Total	
	1939	1950 3/	1939	1950 3/	1939	1950 3/
Associations Listed	252	210	70	92	322	302
Estimated Membership in Thousands	58	97	17	40	75	137
Estimated Business in Millions of Dollars	23	111	4	18	27	129

1/ "Statistics of Farmers' Marketing and Purchasing Cooperatives, 1938-39 Marketing Season," Farm Credit Administration, Miscellaneous Report No. 21, June 1940, pp. 31-34.
2/ "Statistics of Farmers' Marketing and Purchasing Cooperatives, 1950-1951," Farm Credit Administration, Miscellaneous Report No. 169, March 1953, pp. 34-39.
3/ 1950 includes the percentage of business done in the state by regional cooperatives while in 1939 these figures were not included.

Handling such a great expansion in volume requires a considerable increase in capital. More fixed capital is needed when physical facilities are expanded to take care of the increased volume. Operating capital also has to be increased when more volume is handled.

If the membership increased proportionally to the volume increase, the per member investment could remain fairly constant. However, this was not the case. Therefore, each member needs to furnish more capital. How to obtain this additional capital from the members is a definite problem.

There are two main factors that have led to the increase in dollar volume which causes the increased need for capital. One factor is the rising level of prices. Since just before World War II up to the present, we have witnessed a general rising price level. The other factor is the expansion of cooperatives both vertically and horizontally. They have been handling more physical products as well as adding additional products and services. Also, there has been an expansion in cooperatives going into manufacturing and wholesaling, which means more financing of the regional cooperatives by local cooperatives.

It is difficult to tell which of the two factors, rising level of prices or business expansion, has had more influence. Chart 1 gives some indication of the relative importance by showing the actual volume of business as compared to the volume of business adjusted for price changes.

There are also other reasons for cooperative financing being important today. For example, farmers are having a more difficult time obtaining credit. This is causing the farmers to call upon marketing agencies such as cooperatives to extend credit, which puts an added load on capital resources.

The trend of increased volume per member raises several questions. What is the need for permanent and working capital now as compared to some previous time? What are the methods employed by cooperatives in obtaining capital? How efficient are these methods? What are the members' reactions and opinions as to financing of cooperatives? In an attempt to answer these questions, this study was made.

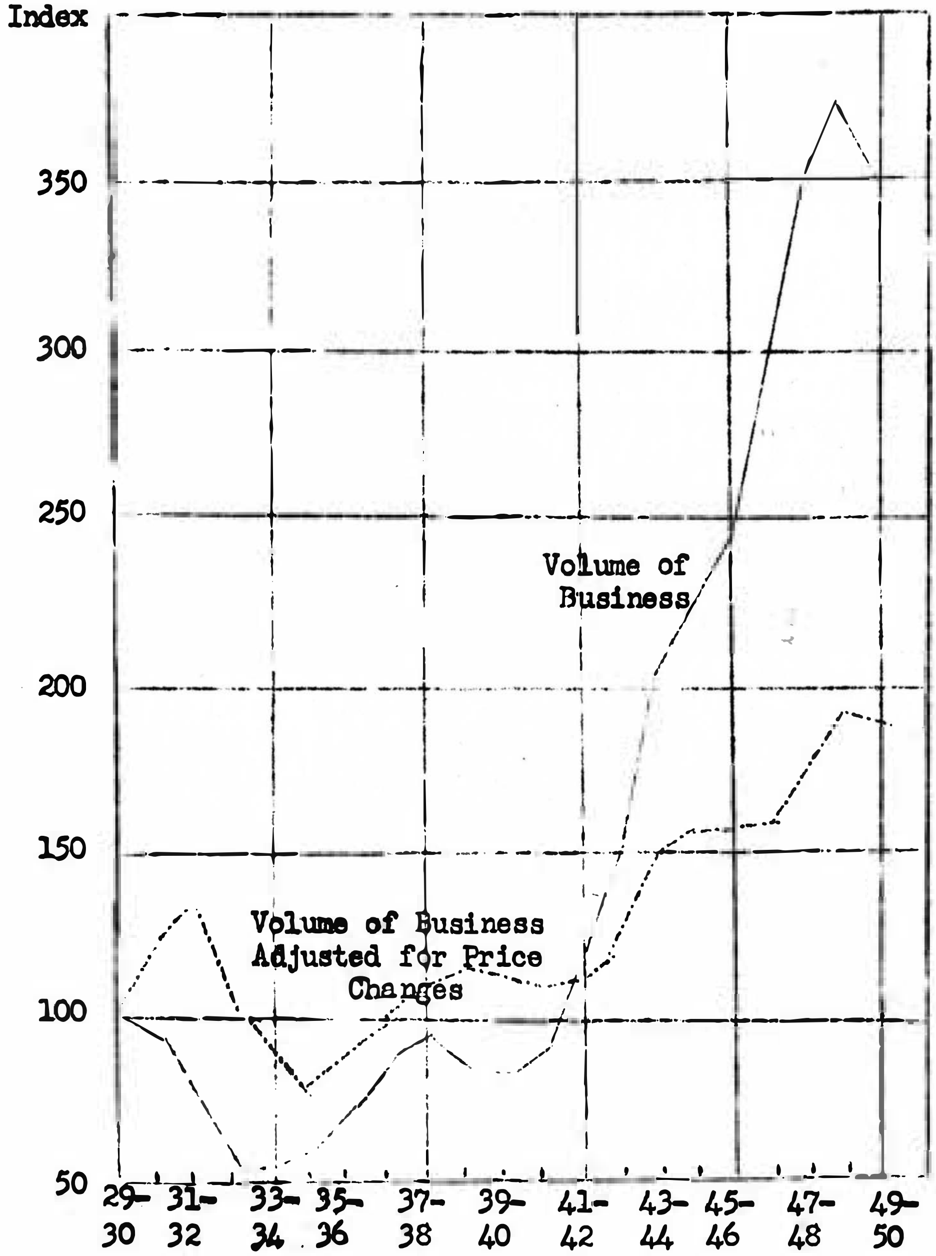
Purpose

The purpose of this study was to examine and evaluate the financing methods of South Dakota Cooperatives. There has been no previous work done on this in South Dakota. Three previous studies have been made on South Dakota cooperatives but very little was included about financing. 1/

1/ Brown, L. M. and Penn, R. J., "Cooperatives in South Dakota," South Dakota Experiment Station Bulletin No. 328, April 1939.
Brown, L. M. and Hedges, H., "Farmers' Elevator Operations in South Dakota," South Dakota Experiment Station Bulletin No. 351, June 1941.
Cotton, W. P., Lundy, G., and Brown, L. M., "Cooperative Creameries in South Dakota," South Dakota Experiment Station Bulletin No. 363, July 1942.

Chart 1. Growth of Farmers' Cooperative Marketing and Purchasing Associations, 1929-30 to 1949-50, United States

(1929-30 = 100)



Source: Annual Report of the Farm Credit Administration 1950-51, Figure 10, p. 54.

Minnesota conducted a study in 1950 on cooperatives in that state. 2/ Iowa conducted a study on farmers' opinions of cooperatives; however, this was mainly a sociological study. 3/

Procedure

To evaluate the financing methods properly, the opinions of the members are very important. Therefore, the study was divided into two parts: (1) the cooperative associations, and (2) the members of cooperatives. The field work was started in August 1952 and completed in March 1953.

Study of the Associations

The study includes 25 elevator, 25 oil, and 10 creamery associations. Other types of cooperatives were not considered. The cooperatives were selected by random samples from available lists of South Dakota cooperatives. Elevator associations were obtained from a directory published by the Farmers Elevator Association of South Dakota, oil associations were obtained from a list furnished by the South Dakota Association for Cooperatives, and creamery associations were obtained from a list prepared by the South Dakota Dairy Association. The cooperatives were listed in alphabetical order according to town. Separate lists were made for each type of cooperative. Random samples were taken from these three lists. Many associations had a combination of elevator and oil. These were included in the elevator list unless it was found later that the elevator department of the business was the minor department.

2/ Koller, E. F., Manning, T. W., and Jesness, O. B., "Statistics of Farmers' Cooperatives in Minnesota, 1950," University of Minnesota Agricultural Experiment Station Bulletin No. 412, June 1952.

3/ Beal, G. M., Fessler, D. R., and Wakeley, R. E., "Agricultural Cooperatives in Iowa; Farmers' Opinions and Community Relations," Iowa State College Agricultural Experiment Station Research Bulletin No. 379, February 1951.

The information on the individual cooperatives was obtained by personal interview with the manager and from the cooperative's records. Each cooperative was asked for a copy of its last annual statement. In some instances the manager did not have all the information available, but in the majority of the cooperatives the more important information was obtained.

The information to be gathered was divided into four large categories: (1) general information on the cooperative; (2) the need for and use of capital; (3) the capital structure; and (4) the cooperatives relations with regional cooperatives.

Membership Study

It was decided to include 150 members in the membership study. At the outset an attempt was made to select the members by random sample from the cooperative's membership list. This proved unsuccessful because many of the lists were out of date. In most cases, those making the last transaction on a certain day were selected. From elevator associations, 61 members were chosen, from oil associations, 59 members, and from creamery associations, 25 members. It should be brought out that the members were not selected from all the cooperatives. It should also be emphasized that although they were selected from a certain type of cooperative, the majority also belonged to other types. The data from each member was obtained by personal interview.

CHAPTER 2

NEED FOR AND USE OF CAPITAL

Size of South Dakota Cooperatives

Cooperatives in this study on an average show an increase in size when compared to cooperatives in South Dakota a few years ago. An increase is evident both in average volume handled and in average number of members and patrons.

Table 3 shows the relative size of the cooperatives included in the study. The largest number had a membership within the range of 200 to 500 members.

Table 3. Size of Cooperatives by Number of Members

Number of Members	Elevator	Oil	Creamery	Total
Less than 200	4	3	1	8
200 - 500	11	10	4	25
500 - 1000	8	7	3	18
Over 1000	2	5	2	9

A previous study made in South Dakota shows the average number of patrons and members in 1937. 4/ A decided increase may be seen when comparing these results with the results of this study (Table 4).

Table 4. Average Number of Members and Patrons of Cooperative Associations in South Dakota, 1937 and 1951

Type of Association	Average Number of Members		Average Number of Patrons	
	1937	1951	1937	1951
Elevator	137	428	261	487
Oil	276	588	458	632
Creamery	385	548	667	637

4/ Brown, L. M. and Penn, R. J., "Cooperatives in South Dakota," South Dakota Experiment Station Bulletin No. 328, April 1939; Tables 1 and 3, pp. 6 and 10.

Since the cooperatives in the study were chosen by random sample, they should be typical of South Dakota cooperatives. Therefore, they should be comparable to the previous study made by complete enumeration. By comparing the two studies, an increase is evident. This means there are more members now to finance cooperatives. At first this would appear to make the financing burden per member lighter, but first the dollar volume must be compared between the two studies.

Table 5 shows the size of cooperatives in the study by dollar volume handled. It can be seen that elevators and creameries had a larger volume than did the oil associations.

Table 5. Size of Cooperatives by Dollar Volume Handled

Volume	Elevator	Oil	Creamery	Total
Less than 100,000	0	4	1	5
100 - 200,000	3	9	1	13
200 - 300,000	3	7	1	11
300 - 400,000	3	1	0	4
400 - 500,000	3	3	2	8
500 - 1,000,000	8	1	5	14
1,000 - 2,000,000	5	0	0	5

It is also possible to see the trend in dollar volume of business by comparing the results of this study, with those of the previous South Dakota study. 5/ (Table 6).

5/ Ibid., Table 4, p. 10

Table 6. Average Dollar Volume of Business Handled by South Dakota Cooperatives 1936 and 1951

Type of Association	Average Purchasing 1936	1951	Average Marketing 1936	1951	Average Total 1936	1951
Elevator	18,460	110,995 1/	44,592	554,108	63,052	638,464
Oil	49,624	218,801	36	0	49,660	218,801
Creamery 2/	1,669	---	139,087	—	140,756	496,719

1/ Were only nineteen elevators that indicated any purchasing.
2/ Only one reported any purchasing so not included in total.

A comparison of the average dollar volume of business in this study to volume reported in the previous study, shows a tremendous increase. A portion of the increase in elevator associations can be attributed to low crop production in 1936 which did not give elevator cooperatives volume. Generally, however, the increase can be attributed to an actual increase in dollar volume. It represents a much larger inorease than was evident in the increase seen in membership. This means that there is more dollar volume of business per member now than there was formerly. The individual member therefore must finance a larger volume of business.

Capital Requirements

The previous section brought out there would be additional capital required to finance the increased volume. However, it did not give any indication as to the additional amount needed.

In the study of the associations, an attempt was made to collect these data. The records were studied to determine the fixed assets, average working capital, and the inventory value at the end of the 1951 fiscal year. The same data was to be obtained for 1939. The reason for selecting this year was because it represented a year previous to the rising price level. However, it was difficult to find records for that year at many cooperatives. Many had not been organized at that time. To get a large enough sample it was necessary to include a combination of years in that period for comparison purposes. The increased need for capital can be seen in Table 7.

Table 7. Average Fixed Assets, Average Working Capital, and Average Inventories in South Dakota Cooperatives, 1939 and 1951

Type of Association	Average Fixed Assets (Depreciated Value) 1939	Average Fixed Assets (Depreciated Value) 1951	Average Working Capital 1939	Average Working Capital 1951	Average Inventories 1939	Average Inventories 1951
Elevator	10,930 1/	52,500	13,540 1/	49,610	20,380 1/	113,630
Oil	7,680 2/	40,420	15,460 2/	54,400	6,100 2/	32,000
Creamery	10,310 3/	33,700	11,790 3/	36,200	6,240 3/	17,860

1/ Includes five with 1939 figures, two with 1938, and two with 1941.
2/ Includes six with 1939 figures, two with 1940, two with 1941, and one with 1942.
3/ Includes two with 1939 figures, one with 1940, one with 1941, one with 1942, and two with 1943.

This indicates there is a definite increase in the need for capital. The average depreciated fixed assets increased in these cooperatives from three to five times their value in the previous period. Average working capital in all cases tripled. Inventory values showed a tremendous increase in all cases. Of course, some of this increase could be attributed to the cooperatives getting into a better financial condition. This could be true in the average working capital values. However, it seems that most of the increase can be attributed to an increased need.

The table also answers the questions of what the needed capital is used for. The increased inventory values take much of the capital. There is much more invested in fixed assets. The study also showed the accounts receivable on the average amounted to $18,443 for the elevators, $14,325 for the oil associations, and $4,598 for the creameries.

Inventories and Accounts Receivable

Many cooperatives in the study were in a difficult position due to inventories and accounts receivable. These two items were analyzed for the cooperatives which were able to furnish balance sheets. It should be emphasized that comparisons between types of cooperatives cannot be made when analyzing inventories and accounts receivable because their needs are different.

Accounts receivable were analyzed by calculating what percentage they were of sales. Generally, the standard percentage of accounts receivable to sales is 3 percent. 6/ When cooperatives in the study were compared to this percentage it can be seen that many cooperatives are not in a satisfactory condition as to accounts receivable (Table 8).

Table 8. Percentage of Accounts Receivable to Sales for Thirty-Three Cooperatives by Type of Cooperative

Accounts Receivable to Sales	Elevator Associations	Oil Associations	Creamery Associations
Percent	Number	Number	Number
0 - 3	4	5	6
3 - 6	4	6	0
6 - 9	1	1	1
9 - 12	0	3	0
12 and over	0	2	0

Inventories were analyzed by calculating how many times sales were greater than inventories. Generally, it is standard for sales to be eighteen times greater than inventories. 7/ When cooperatives in the study are compared to this figure it can be seen that many cooperatives again were not in a satisfactory position (Table 9).

6/ Consumers Cooperative Association Comparative Report -- Yardstick for your cooperative association, 1951-1952, Kansas City, Missouri.
7/ Ibid.

Table 9. Sales Times Inventories for Thirty-Three Cooperatives by Type of Cooperative

Sales Times Inventory	Elevator Associations	Oil Associations	Creamery Associations
45 and over	1	0	1
36 - 45	0	0	2
27 - 36	1	0	1
18 - 27	2	3	0
9 - 18	1	3	3
9 and under	4	11	0

The results of the examination of the accounts receivable and inventories indicates that there is not only a need for capital but there is also a need for better management practices to economize capital. At the same time the results show that accounts receivable and inventories are an important part in creating a need for capital.

CHAPTER 3

CAPITAL STRUCTURE

Methods of Financing Cooperatives

Cooperative membership is largely made up of individuals patronizing that particular business. The major portion of the capital must be furnished by these members because no one else can be expected to finance their business. The remainder may be borrowed. Within the two broad categories available for financing there are several methods open. Bakken and Schaars list as many as fifteen. 8/ Of the various methods there are only a few that are common and important.

Selling of capital stock is a common method of obtaining capital funds, especially for a newly organized cooperative. These may be in either voting or non-voting common stock or in preferred stock, which usually is non-voting. However, they must sell their capital stock to member-patrons who are usually limited in funds for investment purposes. This differs from corporations which are free to go to the national investment market for their funds. Capital stock in cooperatives is usually limited by law as to returns and amounts held by any one member. It can be seen that the sale of capital stock is limited.

There are also non-stock cooperatives which get capital funds through membership fees. These usually bear no interest and for reasons similar to those stated for capital stock are rather limited for obtaining large amounts of capital funds.

8/ Bakken, Henry H. and Schaars, Marvin A., The Economics of Cooperative Marketing, McGraw-Hill Book Company, Inc., New York, 1937, p. 366-367.

The other direct method of obtaining funds from members is by borrowing from the member. This is done in many areas. The member is issued a certificate of indebtedness, or some similar certificate, which bears interest and has a due date. Many are for a short term and cannot be considered permanent capital. This also requires a cash investment by the member and is again limited because of the limited funds for investment purposes cooperative members have.

With the previously stated methods being limited, it means that cooperatives must frequently resort to an indirect method of obtaining adequate funds from members. To accomplish this, patronage refunds are deferred. The advantage of this method is that no direct cash outlay is required by the member and still the member is furnishing the capital. In the early 1930's this method became common and it is employed extensively today.

After the patronage refunds have been deferred, it is possible for them to be considered either member equities or liabilities to the cooperative. Many associations put the deferred refunds into capital stock, which are definitely member equities. However, many associations put them in certificates of indebtedness, or some similar certificate, which would ordinarily make them liabilities to the association.

The cooperative may elect to pay income tax on deferred refunds. If this is done the refunds do not have to be allocated to each member and they can be added to a permanent fund. However, if the cooperative does not pay income tax, deferred patronage refunds must be allocated to the patrons. If the cooperative is a tax exempt cooperative, it must allocate the refunds to the patrons. If the association is not tax exempt, it may or may not allocate the refunds, but it is required to pay income taxes if it does not allocate them to members.

Borrowing of funds from some outside source is the alternative other than member financing open to cooperatives. This is a secondary method because without sufficient member financing they would be unable to obtain loans. The more important private sources of credit are commercial banks, private marketing and supply firms, insurance firms, and other individuals. Some of these private lending agencies have not been sympathetic toward cooperatives. However, to offset this somewhat, the Bank for Cooperatives under the Farm Credit Administration was established to furnish needed capital to cooperatives which meet certain requirements. The banks offer complete credit services to cooperatives through three types of loans. They make short term commodity loans, which are secured by first liens on farm products or supplies, operating capital loans to supplement the cooperatives working capital, and facility loans for assisting in financing or in refinancing the cost of construction, purchase or lease of land, buildings, equipment, or other physical facilities. The regional cooperatives are also very important in furnishing credit to local cooperatives.

Cooperatives are also required by law in South Dakota to set aside reserves. Other states usually have similar laws.

Membership Capital

All except one of the associations in the study were capital stock cooperatives. One of the elevators, however, had a mixed stock and membership structure. The one clear exception was a creamery which had strictly a membership structure.

The oil cooperatives had a much larger percentage in capital stock than did the elevator and creamery associations. Largely responsible for this is the practice many oil associations follow in allocating their deferred refunds into stock credits. A very small percentage of the capital stock was in preferred stock. Elevator and creamery associations had larger percentages in deferred patronage refunds and in allocated reserves. Creameries also had a larger percentage in unallocated reserves and surpluses.

To see what the capital contributions were per member, each type of equity was divided by the total membership. The contributions are made by both cash investments and by retained patronage refunds, with the amount by retaining considerably larger.

The average investment per member in the oil associations was $226.21. The average member investment for elevators was $166.43, which is smaller than the oil association. Still smaller is the investment per member in creameries, which was $97.24. Table 10 shows the total equities in the associations broken down by type of equity. It also shows the average per member in each type of equity.

Table 10. Total Investment and Average Investment per Member by Type of Cooperative

	Common Stock	Preferred Stock	Part Paid Shares	Deferred Patronage Refunds	Allocated Reserves	Unallocated Reserves Surpluses	Total
Total All Investments							
Elevator 1/	643,678	30,335	186,339	690,436	348,858	433,225	2,368,891
Oil 2/	1,657,774	27,625	42,586	239,916	113,366	366,791	2,448,059
Creamery 3/	93,013	—	16,214	98,821	86,904	223,068	518,020
Average Per Member							
Elevator	61.47	2.90	17.79	65.93	36.75	41.37	226.21
Oil	112.70	1.88	2.90	16.31	7.71	24.94	166.43
Creamery	17.46	—	3.04	18.55	16.31	41.87	97.24

1/ Includes twenty-four associations and 10,472 members.
2/ Includes twenty-five associations and 14,709 members.
3/ Includes nine associations and 5,327 members.

Borrowed Capital

It has been previously stated that borrowing is the second alternative in financing cooperatives. Of the cooperatives studied, surprisingly few had borrowed funds at the end of the fiscal year. Twelve of the elevator associations, 13 of the oil associations, and 7 of the creamery associations reported no borrowed funds.

Borrowing from members was employed by some cooperatives in the study. At the end of the year, elevator associations showed borrowed funds from members of $122,595 and oil associations of $35,100.

The predominant source of credit from outside sources came from regional marketing and purchasing cooperatives. Credit from commercial banks, Banks for Cooperatives, and private marketing and supply companies were about the same (Table 11).

Table 11. Sources of Loan Funds by Percentage at the End of the Fiscal Year by Type of Cooperative 1/

Commercial Banks	Bank for Cooperatives	Private Marketing and Supply Companies	Regional Marketing & Purchasing Cooperatives	Certificates of Indebtedness to Members	Other
Elevators					
8	22	12	35	23	0
Oil					
16	0	19	32	28	5
Creameries					
5	0	0	0	0	95

1/ Thirteen elevator, twelve oil, and three creamery associations reported borrowed funds.

The maximum borrowed funds needed during the peak seasons of the year was considerably larger than those shown at the end of the fiscal year. This is especially true for elevator associations. Where oil and creamery associations witness a relatively even trend during the year in business volume, elevators have very definite seasonal changes in volume of business.

The normal amount of funds needed during the year is not much higher than those indicated at the end of the fiscal year. Table 12 gives the comparison of peak needs and normal needs with the amount shown at the end of the fiscal year.

Table 12. Total Amount of Loans Needed During the Fiscal Year by Type of Cooperative, Maximum and Normal 1/

Type of Association	Total Amount at End of Fiscal Year	Maximum Amount Needed During Peak Season	Normal Amount Needed During Year
Elevator	525,610.62	993,300.00	560,800.00
Oil	124,982.76	162,200.00	128,850.00
Creamery 2/	39,689.12	50,000.00	33,000.00

1/ Thirteen elevator, twelve oil, and three creamery associations reported borrowed funds.
2/ Does not include one creamery association which had a large loan at the end of the fiscal year, but did not indicate maximum and normal amounts.

The interest rates that cooperatives had to pay generally ranged from 3 to 6 percent. One cooperative had a loan at 8 percent interest, but this was a large loan with greater than average risk. Thus, cooperatives are able to borrow funds at reasonable rates of interest.

By comparing the capital furnished by members, with borrowed capital, it can be seen that cooperatives in the study are largely financed by members. This is true especially for the oil and creamery associations. Elevator associations, however, depended more on borrowing, especially at the peak seasons when they indicated their need for borrowed funds was close to one million dollars while their total members' investment was 2.3 million dollars.

CHAPTER 4

PERMANENT AND SHORT-TERM CAPITAL

The Nature of Capital in Cooperatives

Businesses have two types of capital, permanent and short-term. Permanent capital is needed for fixed assets and for the minimum amount of working capital needed over a period of years. Short-term capital is needed to cover the fluctuations above the minimum amount of working capital needed. It is important that there be a clear distinction between permanent and short-term capital. To be able to operate cooperatives efficiently, managers should have a clear idea of the amounts in each of the two types. Members should also have a clear idea of what is permanent and short-term capital in order that good membership relations may exist. However, in most cooperatives it is difficult to distinguish between permanent and short-term capital.

The major cause of this difficulty in distinguishing between the two types of capital is the interpretation of deferred patronage refunds. When a cooperative defers patronage refunds, it may put a due date on the refunds. Then it is relatively easy to determine whether the deferred patronage refunds are permanent or short-term capital by the period of years the deferred patronage refunds are to remain in the cooperative. Many cooperatives, however, have no due date on their deferred patronage refunds. If this is the case, it is indefinite as to which type of capital the deferred patronage refunds are because it is up to the members how long the refunds shall remain in the cooperative. Since members may at any time vote to pay the deferred patronage refunds, the refunds cannot be considered permanent capital.

If deferred patronage refunds are to be considered short-term capital, it is still difficult to tell what is the amount in each of the two types of capital by examining the balance sheet of cooperatives. The cooperative may allocate the refunds to a revolving fund or some similar fund which shows up on the balance sheet but some of this could have a long revolving period so it wouldn't be short-term capital. Other cooperatives may allocate deferred patronage refunds to capital stock and it will then show up on the balance sheet as capital stock with no indication of the amounts in permanent and short-term capital. If the deferred refunds are allocated to stock permanently there is no question that all the capital stock is permanent capital. However, the cooperatives which follow the practice of revolving capital stock or paying a percentage of the stock out each year cannot consider their entire amount of capital stock permanent capital.

Results of Study as to Permanent and Short-Term Capital

In the study an attempt was made to separate the capital into permanent and short-term capital. This had to be an arbitrary breakdown because there was no clear distinction in the cooperatives as to the amounts in each type. Since deferred patronage refunds are of a temporary nature it was decided to consider them as short-term capital, with capital stock, reserves, and surpluses considered permanent capital. Fifty percent of the oil associations had deferred patronage refunds included in their capital stock. Since the majority of these associations had the amount deferred in the past five years available, it was decided to consider this amount short-term capital. By subtracting the amount deferred in the last five years from the total amount of capital stock, the permanent capital was derived.

There was a great variation among individual cooperatives in the study as to the percentages in permanent and short-term capital. Some cooperatives had practically no permanent capital while other associations had practically all their funds in permanent capital. Creamery associations on an average had a higher percentage in permanent capital than did the other two types of cooperatives (Table 13). A partial explanation for this is that creamery associations have been in existence longer than oil or elevator cooperatives.

Table 13. Percentage of Permanent and Short-Term Capital by Type of Cooperative

Type of Cooperative	Percent Permanent	Percent Short-Term
Elevator	71	29
Oil 1/	61	39
Creamery	81	19

1/ Includes ten associations with complete data and ten associations with data adjusted by subtracting the deferred patronage refunds for the last five years from the total capital stock. Data for five associations was unavailable.

After making this breakdown, the amount of permanent capital in relation to the amount of fixed assets was examined. It is normal good business practice for any business to have at least sufficient permanent capital to cover the fixed assets. One of the better known authorities on cooperative financing pointed this out: "In my opinion, the long-term capital, - and by long-term capital I mean with not less than a twenty-five year due date, and preferably with no due date such as capital stock, - should be related very closely to the value of the physical facilities." 9/

In the study there were fourteen associations which had insufficient permanent capital to cover the value of their fixed assets while other cooperatives had permanent capital which exceeded the value of their fixed assets (Table 14).

9/ Wallrich, Matthew M., "Transfer From Revolving Fund Capital to Permanent Capital Financing," American Cooperation 1949, American Institute of Cooperation, Washington, D. C., 1949, p. 647.

Table 14. Number of Cooperatives Which Had Sufficient Permanent Capital to Cover Fixed Assets by Type of Cooperative

Type of Cooperative	Number with Sufficient Permanent Capital	Number Without Sufficient Permanent Capital
Elevator	17	8
Oil 1/	20	0
Creamery	4	6

1/ Includes ten associations with complete data and ten associations with data adjusted by subtracting the deferred patronage refunds for the last five years from the total capital stock. Data for five associations was unavailable.

The amount of permanent capital can be further examined by comparing it to a cooperative's total assets. There were only three cooperatives in the study whose permanent capital was 75 percent or over of their total assets. Many associations fell as low as 15 to 30 percent (Table 15).

Table 15. Permanent Capital as a Percentage of Total Assets by Groupings

Permanent Capital To Total Assets Percentage	Elevator No.	Oil No.	Creamery No.
Over 90	0	0	2
75 - 90	0	0	1
60 - 75	4	6	0
45 - 60	7	6	0
30 - 45	5	5	5
15 - 30	7	3	2
Under 15	2	0	0

1/ Includes ten associations with complete data and ten associations with data adjusted by subtracting the deferred patronage refunds for the last five years from the total capital stock. Data for five associations was unavailable.

CHAPTER 5

MEMBERSHIP STRUCTURE

The ideal membership situation of a cooperative is one where all members are patrons and all patrons are members or becoming members. It is not a healthy situation when there are considerably more members than patrons or vice versa. E. A. Stokdyk brings this out when he said, "However, when members cease to patronize cooperatives, their point of view changes and they become more concerned about dividends on invested capital than about returns on products or refunds on purchases. If, therefore, some provision is not made to return the withdrawing members' investment, as time goes on and more members cease farming, a sharp conflict may arise between the present patrons and the expatrons." 10/

The cooperatives in the study were asked how many members and how many patrons they had. By looking at the total numbers, it appears that these cooperatives had nearly a corresponding membership, because the total number of members and the total number of patrons were nearly equal (Table 16).

Table 16. Total Number of Members and Patrons by Type of Cooperative

Type of Cooperative	Number of Members	Number of Patrons
Elevator	10,697	12,180
Oil	14,709	15,788
Creamery	5,477	5,930

However, the total members and total patrons do not give a true picture because some cooperatives have an excess of members over patrons while others have an excess of patrons over members and the two balance

10/ Stokdyk, E. A., "Financial Structure and Policies of Cooperatives," American Institute of Cooperation, Philadelphia, October 1945, p. 4.

each other. For example, one oil association had 455 members and 1,179 patrons while another oil association had 600 members and 200 patrons. Several cooperatives do not have a corresponding membership as the totals would indicate.

Much of this discrepancy between number of members and number of patrons can stem from the practices followed by cooperatives in their handling of members' equities in case of death, retirement, or leaving the community. If the associations have no plans for retiring these equities, they will soon be carrying numerous members on the books who are not patrons. Some may be dead while others may live hundreds of miles away. Also there is the problem of prospective members not joining a cooperative because they will never be able to get their investment back when they no longer are able to patronize the cooperative.

The majority of the cooperatives in the study pay out cash in case of death. All except three cooperatives buy in capital stock, but some of these cooperatives do not pay out patronage refunds and other member equities. When a member leaves the community the majority also pays out cash but not to the same extent as in the case of death. There are more cooperatives again which retire capital stock than pay out patronage refunds or other member equities. Fewer cooperatives pay out capital stock, patronage refunds and other equities when a member retires from farming (Table 17).

Table 17. Handling of Member Equities in
Case of Death, Retirement or Departure

	Capital Stock Pay Out	Capital Stock Retain	Patronage Refunds Pay Out	Patronage Refunds Retain	Other Equities Pay Out	Other Equities Retain
			Death			
Elevators 1/	24	1	20	4	20	4
Oil 2/	22	2	19	5	18	6
Creameries 3/	9	0	8	2	7	3
Total	55	3	47	11	44	14
			Departure			
Elevators 1/	22	2	17	6	17	6
Oil 4/	17	6	14	9	13	10
Creameries 2/	9	0	9	1	8	2
Total	48	8	40	16	38	18
			Retirement			
Elevators 1/	19	5	15	8	15	8
Oil 4/	9	14	7	16	6	17
Creameries 2/	9	0	9	1	8	2
Total	37	19	31	25	29	27

1/ One association retains all if member owns land in the community except in case of death. One association pays out capital stock in all three cases but only 15 percent of patronage refunds and other equities.
2/ Includes twenty-four associations. One cooperative leaves all to the discretion of the board of directors.
3/ One association has no capital stock.
4/ Includes twenty-three associations. Two cooperatives leave all to the discretion of the board of directors.

There is a basic conflict between the ideal of keeping membership current and cooperative finances. Many of the cooperatives are probably in such a financial position that they feel it is impossible to pay out capital for stock, patronage refunds, and other equities.

CHAPTER 6

PATRONAGE REFUNDS

It has been brought out that if sufficient capital cannot be raised from members by direct methods of financing, the cooperatives can rely on the indirect method of deferring patronage refunds. The prevalence of this type of financing can have a bearing on the capital structure of a cooperative. How the deferred patronage refunds are handled can determine the amount of permanent capital the cooperative has. It is the purpose of this chapter to determine the prevalence of this type of financing and to examine methods of handling deferred patronage refunds by cooperatives in the study.

Use of Deferred Patronage Refunds as a Method of Financing

Cooperatives in the study relied heavily on deferring patronage refunds as a method of financing. A major portion of the elevator and oil associations deferred at least a portion of the current year's savings in 1951. Creamery associations, however, did not use this method to as large an extent. It should be pointed out that 50 percent of the associations that deferred all the current earnings paid out some cash refunds from a previous year (Table 18).

Table 18. Distribution of Patronage Refunds by Type of Cooperative, 1951

Type of Cooperative	Pay Entire Amount in Cash Currently	Defer a Portion and Pay a Portion In Cash Currently	Defer Entire Amount
Elevator 1/	6	2	15
Oil 2/	6	3	14
Creamery 3/	5	1	2

1/ Two reported a loss for the year's operations.
2/ Two could not find the data.
3/ One had no patronage refunds and one paid on a pool basis every month.

To further point out the useage of deferred patronage refunds, two elevator and nine oil associations reported they never had paid out any cash on a current basis. Seven elevator, five oil, and two creamery associations did not know when their last current cash payment had been made. However, nineteen elevator, eighteen oil, and all creamery associations reported they had paid cash refunds either currently or for a previous year at least once in the past five years.

Cooperatives differ as to the amount they will defer. Some associations will defer the total refunds, some only a percentage of the total refunds, and some will defer none of the total savings. When the disposition of total patronage refunds as to amount deferred and amount paid out in cash is studied for the cooperatives in the study, a still better picture as to the prevalence of this type of financing may be seen. In the elevator and oil associations, over 50 percent of the current refunds were deferred in 1951. Deferred refunds in creamery cooperatives were not nearly as high (Table 19).

Table 19. Distribution of Total Patronage Refunds by Type of Cooperative, 1951

	Total Refunds	Amount Deferred	Current Cash Refund	Cash Paid Out For Previous Year
Elevator 1/	411,706	209,630	202,076	58,854
Oil 2/	401,017	208,998	192,020	21,689
Creamery 3/	183,053	37,748	145,305	10,189

1/ Includes twenty-three associations. Two cooperatives reported a loss for the year's operations.
2/ Includes twenty-three associations. Two cooperatives could not find the data.
3/ Includes eight associations. One cooperative had no patronage refunds and one cooperative paid on a pool basis every month.

It can be seen that deferring patronage refunds is being employed extensively as a method of financing cooperatives. Undoubtedly the reason for this is that members are not making sufficient direct investments to adequately finance their cooperatives. In many instances it probably means that members are financing cooperatives against their wishes. However, the majority must want this method or otherwise it would not be used as extensively as it is.

Handling of Deferred Patronage Refunds

After the patronage refunds have been deferred, they may be handled in various ways. The refunds may be put into a revolving fund or some similar fund where the deferred patronage refunds are revolved out or a percentage of the total amount is paid yearly. Some associations may put a definite period on the deferred patronage refunds, but the majority usually have no due date. Usually it is assumed that the refunds will be paid out in a short period of time regardless of a due date.

Some cooperatives allocate the deferred patronage refunds into capital stock and then revolve or pay a percentage of the capital stock. This has the same features as the revolving funds or similar funds mentioned previously.

Other cooperatives have made a practice of allocating deferred patronage refunds to capital stock permanently. When this is done there is no need for further handling of the deferred patronage refunds.

There are also cooperatives which have deferred patronage refunds and have no definite plan for handling them. This makes it difficult to explain to the members what is happening to the deferred refunds.

Of the various methods used in handling of deferred refunds, the revolving fund was employed the most. The oil associations had a common practice of allocating refunds to stock credits and then revolving the stock. The other two types did not employ this method. A few made a practice of paying a percentage of the entire amount of deferred refunds out instead of using a revolving basis. There were 14 that had no plan (Table 20).

Table 20. Number of Cooperatives Using Various Methods of Handling Deferred Patronage Refunds

Type of Cooperative	Revolving Fund	Revolving Capital Stock	Percentage Paid of Total Deferred Refunds	No Plan	Allocate to Capital Stock Permanently	Do Not Defer Patronage Refunds
Elevator	12	0	2	5	0	6
Oil	5	10	3	4	1	2
Creamery	1	0	0	5	0	4

With the exception of two cooperatives, all the cooperatives which withheld patronage refunds notified members about the amounts deferred by means of letters. One oil association notified the members by issuing revolving fund certificates and one creamery issued certificates of indebtedness.

The one association issuing revolving fund certificates had a due date on the certificates. The majority of the cooperatives using the revolving fund method had no fixed period of revolving. Two elevators and one oil association had definite periods of one, four, and five years. However, the associations which had a definite period to the revolving fund were not obligated to retire the deferred patronage refunds in that period of time.

The oil association that issued revolving fund certificates and the creamery association that issued certificates of indebtedness paid interest on the deferred refunds. Only one association paid interest on the amount in the revolving fund.

Deferred patronage refunds may be carried in either the members' equity or the liability section of the balance sheet. It is misleading when a cooperative carries deferred patronage refunds of a comparatively short-term nature in the equity section. In the study, forty associations carried the deferred patronage refunds in the equity section while eight associations carried them in the liability section. Twelve associations did not have any deferred patronage refunds.

There was an indication that a few of the cooperatives were looking for better methods of handling deferred patronage refunds than the revolving fund method. Two elevators and two oil associations had changed from the revolving fund method. A few other cooperatives indicated they were thinking of going to a different method. The trend of those changing was to recapitalize and put the amount in the revolving fund into capital stock, with the feeling that much of the revolving fund was invested in fixed assets.

CHAPTER 7

MEMBERSHIP RELATIONS AND OPINIONS

Frequently within cooperatives conflicts arise between members, boards of directors, and managers. Managers, for example, are responsible for day to day business transactions. Because of this, they often want to take over policy making. Actually it is the job of the manager and the board of directors to formulate policies, but they should make it a point to let the members have a voice by giving the members a chance to vote on important policies. The manager and the board of directors should especially do this when determining methods of financing, because it is the members' capital that is going into the cooperative. The major portion of the membership study was set up to find out the members' opinions about financing and to get their feelings as to the opportunity of participating in policy decisions. Some of the questions were set up to find out the members' opinions by the action the member has taken, such as the investments made in cooperatives.

Investments in Cooperatives

Cooperatives are a part of the farm enterprise. By joining cooperatives, the members have taken over the function of the middleman and vertically integrated their farm enterprise one or more steps closer to the final market. Since cooperatives are a part of the farm enterprise, members should invest in their cooperatives as willingly as they invest in the rest of the farm enterprise.

To better see the average member's investment in cooperatives, the study attempted to find the investments in cooperatives and the investments in the rest of the farm enterprise. Many of the members had no idea of their investments but sufficient data was collected to give some indication as to the relative amounts in the cooperatives and in the farm enterprise.

It was found that the average cooperative member in this study belonged to two cooperatives. In these two cooperatives he had an average investment of $350. The same average member had an investment in land, buildings and machinery of $38,500. Thus the average member's investment in cooperatives totaled less than 1 percent of the investment in his farm enterprise, with only an average investment of $175 in each cooperative. This investment seems relatively small in view of the tremendous increase in volume of business the last few years.

Members' Willingness to Invest in Cooperatives

An attempt was made to find out what is the members' willingness to invest in cooperatives. Two approaches were made to this question.

First, the members were asked whether cooperatives are of enough importance to farmers that they should invest some of their operating capital in cooperatives in the same manner that they invest money in land and equipment. Eighty-six percent answered "yes," 13 percent "no," and 1 percent had no opinion. This indicates that members consider cooperatives of enough importance to invest some of their operating capital in cooperatives.

Secondly, an attempt was made to find out how much they would be willing to invest in local cooperatives. Forty-two percent indicated that they would not invest any and 15 percent gave no answer. However, of the 42 percent that said they would not invest any, many felt they had invested sufficient funds previously or they did not have sufficient funds to invest any. Of the remaining 43 percent, most were willing to invest $100, some indicated $200 and a few indicated $500 or over.

In summary, the members generally think cooperatives are of sufficient importance to invest some of their operating capital in cooperatives, but when asked as to how much, about one-half said they would not or could not invest any. It may be that they had invested enough of their farm capital in cooperatives as compared to the remainder of their farm enterprise.

Members' Preference of Methods of Financing

In order to find the members' preference as to how their local cooperative should be financed, they were asked how they felt their local cooperative should obtain needed additional funds. They were then given four choices which were to be ranked in order of preference (Table 21).

Table 21. Members' Preferences in Financing Local Cooperatives

Methods of Financing Cooperatives	Ranking 1/ 1	2	3	4
Retaining patronage refunds until capital is built up	98	18	14	12
Asking members to buy more shares of stock	20	66	35	16
Sale of certificates of indebtedness to the members	10	32	70	24
Borrowing capital	13	22	19	84

1/ Some members gave no opinion or partial answers.

The results of this question indicate that members prefer to do the financing of their cooperatives. However, they would rather have it done indirectly by withholding patronage refunds rather than by a cash investment.

The members were further asked whether they should (1) finance their cooperatives according to the amount of business they do with their cooperatives, or (2) all members should have an equal investment, or (3) they should invest as much as they want. Forty-three percent indicated preference for number (3), 29 percent indicated number (2), and 25 percent indicated number (1). Although members preferred to finance by withholding patronage refunds, they felt it should be left open for members to invest more if they so desired.

There is a contradiction in the answers to the two questions. When the members say they prefer to finance by withholding patronage refunds, they are indicating that they should finance their cooperatives according to the amount of business they do with their cooperatives. However, only 25 percent said they should finance according to the amount of business they do. Part of the conflict may arise from the cooperative principle of members having equal investment. Members may have had this principle in mind when they answered the second question. In other cases the member giving the opinions were willing to invest only the amount that was retained from him, but if other members were willing to invest more than the amount deferred, it should be left open for them to do so.

If cooperatives want to obtain additional capital by direct investment of members, it would help in their financing program if they knew the type of investment farmers prefer. To find the members' preference, members were asked whether they prefer to invest surplus funds in securities with fixed values or securities with fluctuating values. The members definitely preferred securities with a fixed value with 84 percent preferring that type as compared to 13 percent favoring securities with a fluctuating value. Three percent had no opinion. These results indicate that cooperatives would be wise to offer members securities with a fixed value rather than fluctuating value when financing by a direct method.

Members' Opinions About Deferred Patronage Refunds

Since members prefer to finance their cooperatives by the indirect method of retaining patronage refunds, it is important to get members' opinions about handling deferred patronage refunds. The study indicated that there was a general lack of communication between the cooperative and the members on this subject. This has led to some resentment by the members to this type of financing.

Part of this resentment stems from the fact that cooperatives are not giving out complete information. Although 79 percent said they received notification of patronage refunds withheld, 109 members out of 150 interviewed did not know their total investment in deferred refunds. Many indicated that they would like to receive an accrued statement of total investments each year from their cooperative as well as a statement of amount withheld during the current year. There were also many who were ignorant as to what the deferred patronage refunds were used for.

Another part of the dislike for deferred patronage refunds comes from the fact that many cooperatives fail to pay out any cash refunds for years at a time. Although only 11 percent had any objections to methods used by cooperatives to which they belong in getting funds from members, the majority indicated they would like some cash refunds each year. The members must pay federal income tax on these refunds whether they are paid in cash or deferred. Therefore, if all the refunds are deferred, members have to reach into their own funds to pay the tax. Resentment arising from this source could probably be cured by paying at least enough cash refunds each year to pay the income tax.

It is also very important to get the members' opinions as to how deferred patronage refunds should be handled. To obtain these opinions, the members were asked how they thought the deferring of refunds should be done. Twenty-eight percent indicated that stock should be issued for the funds, 7 percent preferred revolving fund certificates, 7 percent preferred certificates of indebtedness, and 23 percent felt letters of advice as to net amount retained was sufficient.

Forty-five percent indicated that these certificates should have a due date, 27 percent indicated there should be no due date, and 28 percent had no opinion. Of those who felt there should be a due date, 56 percent preferred five years, 30 percent preferred ten years, and 14 percent less than five years.

Whether to put a due date on the deferred patronage refunds is a difficult problem facing the cooperatives. From the cooperative's viewpoint, it is not advisable to have due dates on deferred refunds. If the cooperative has a few poor business years, it may jeopardize the cooperative's financial position when the deferred refunds start coming due. On the other hand, members look in favor upon due dates because they are then assured of receiving the refunds in cash at a certain time. The members are putting their own interests over that of the cooperative when they say deferred refunds should have a due date.

Members' Opinions about Extending Credit

One of the factors that has contributed to increased need for funds of cooperatives has been the demand upon cooperatives by their members for credit.

When the members were asked whether their cooperative should extend credit to their members, 75 percent said they should. The majority felt that the cooperative needed to extend credit in order to meet competition. However, the majority who indicated that credit should be extended said that a definite credit policy should be followed by having a limitation on amount and/or time.

If membership relations are to be favorably maintained, members' opinions as to extension of credit should be considered. The young farmers who usually have insufficient operating capital need credit from some source. However, the older farmers, who are established and have no need for credit, and the cooperative leaders, who are watching out for the welfare of the cooperative, feel that extension of credit is not one of the cooperative's functions. If the cooperatives hope to maintain relations with their members and hope to bring in new members, they must consider the farmer who needs credit. The cooperatives could assist the members in giving information about existing credit agencies. If existing credit agencies do not adequately serve this function, cooperatives could take positive action in seeing that such credit is made available. Until cooperatives have carried out the necessary program, they may have to finance a credit program.

Participation by Members

It is important that members have the feeling that they have a part in decisions taken by their cooperatives. Cooperatives will have much better relations with their members if members are given a voice in policy making. Answers to several of the questions in the membership study seemed to bring out whether the members felt they had a voice in making decisions.

The members were asked whether they had an opportunity to vote on the distribution of savings at the annual meetings of the cooperatives of which they were a member. In answering this question, 59 percent felt they had an opportunity, 24 percent felt they did not, while 17 percent did not know.

Members were then asked whether they actually did vote on the distribution of savings at the annual meetings of the cooperatives where they were a member. Thirty-four percent said they did vote while 66 percent indicated they did not vote on the distribution of savings.

The members also were asked whether they felt that members participated in decisions taken by cooperatives about the distribution of savings. Over 50 percent felt that members did not participate in these decisions.

When asked who made the decisions regarding the distribution of savings, 49 percent said the board of directors, 27 percent said the members, and 24 percent had no idea. One member felt the regional cooperatives did the deciding. This point was checked further by asking the cooperatives in the study who made the decisions whether to defer patronage refunds or pay them in cash currently. Nineteen elevator associations, nineteen oil associations, and six creamery associations said the board of directors did the deciding. Only six elevator associations, six oil associations, and three creamery associations reported that the members decided. One creamery operated on a pool basis and refunds were paid monthly.

There is a conflict between board of directors, managers, and members on policy making. The board of directors and managers feel that they are in a better position to actually know what is happening in their association. This is usually true. However, the members feel they should have a part in decisions taken by cooperatives. By comparing all these answers, the study seems to indicate that members do not have this feeling.

CHAPTER 8

RELATIONS WITH REGIONAL COOPERATIVES

Importance of Regionals

Regional cooperatives have been increasing steadily in importance. With the growth of cooperatives, they have been finding it necessary to integrate vertically in order to maintain the services and products necessary. Sometimes it has been a matter of vertically integrating or going out of business entirely.

In the study fourteen elevator, twenty oil and five creamery associations belonged to regional marketing or purchasing cooperatives. However, the five creameries did not sell through a regional but they purchased a small amount of supplies from regionals. Many of the cooperatives, especially elevator associations, belonged to more than one regional.

A few of the other associations also have a small amount of business with regionals even though they did not belong to the regional. There were four elevators and three creameries that followed this practice.

The dollar volume of business that local cooperatives in the study have done with regionals indicates that regionals are an important part of the South Dakota cooperative system. Twelve elevator associations sold $4,135,000 of grain through regional marketing cooperatives. Eight elevator associations purchased $1,099,331 of merchandise from regional purchasing cooperatives while the oil associations purchased $3,298,987 of merchandise from purchasing regionals. The creamery associations bought only a few thousand dollars worth of supplies from regionals.

Financing of Regional Cooperatives

Membership of regional cooperatives is largely made up of local associations scattered throughout a wide area. Some regionals also permit individuals to become members but largely it is local cooperatives that make up the membership. Therefore, local cooperatives have the major responsibility for the financing of regional associations. Since local associations are made up of individual member-patrons, the load of financing of regionals actually falls upon the members of the local cooperatives. Therefore, financing of regionals is tied closely to the financing of local associations. It necessitates locals to have some of their capital tied up in regional associations, which creates a need for additional capital by local associations.

The regional cooperatives get their capital funds in much the same way as do local associations. They may get the funds from the individual members, which in this case are the local associations, or borrow the funds. However, they have the additional method of getting it from individuals who are members of the locals. The study was concerned only with funds obtained from individuals and from local cooperatives. It did not attempt to investigate other methods.

Very few members of local cooperatives in the study had made investments in regionals. Seven members invested a total of $2,300 and three members indicated they had invested a small amount.

Local cooperatives, however, had large investments in regionals. A complete breakdown of investments as to type was impossible. However, the total investments show the importance of local cooperatives financing of regionals (Table 22).

Table 22. Investments in Regional Cooperatives by Type of Cooperative

Type of Cooperative	Marketing Regionals: Number Reporting	Marketing Regionals: Investment	Purchasing Regionals: Number Reporting	Purchasing Regionals: Investment
Elevator	12	400,018.56	9	119,235.35
Oil	0	0	20	989,153.82
Creamery	5	3,362.88	0	0

Investments held by local cooperatives in regional associations may be direct cash investments or indirect investments coming from the deferring of patronage refunds. When patronage refunds are deferred, they are allocated to each member cooperative which in turn may allocate them to their member-patrons.

Very few cooperatives in the study made direct investments in regionals. Only six elevator and seven oil associations reported such investments. The six elevator cooperatives had a total direct investment of $18,650, of which $2,100 was in stock and $16,550 was in certificates of indebtedness. The seven oil associations had direct investments of only $575 which was all in stock.

The major portion of membership investment was obtained indirectly by withholding patronage refunds. Nearly all of the patronage refunds from the regionals were withheld in 1951, with only four cooperatives reporting any cash refund paid currently by regionals in that year (Table 23).

Table 23. Deferred and Cash Refunds Received from Regionals by Type of Cooperative in 1951

Type of Cooperative	Cash Currently: Number Reporting	Cash Currently: Amount	Deferred: Number Reporting	Deferred: Amount
Elevator	4	5,431.46	17	90,378.76
Oil	0	0	20	142,382.02
Creamery	0	0	2	340.39

The revolving fund method was generally used in handling the deferred patronage refunds by regional associations. Fourteen elevator associations reported that they belonged to regionals using the revolving fund plan while only one indicated they did not. Two did not know if the revolving fund plan was used. All twenty oil cooperatives belonged to regionals having revolving funds. Five of the creameries belonged to regional associations using revolving funds while two did not know.

Special Problems in Handling Deferred Patronage Refunds from Regional Associations

When patronage refunds are deferred by regional associations, they are allocated to each local cooperative according to patronage. The local associations in turn have three alternatives for handling these refunds. They may combine the deferred patronage refunds from the regional associations with their own deferred patronage refunds and make allocations to their patrons from this total. Another alternative is to allocate the deferred patronage refunds from the regional associations separately from the savings on their own operations. The third alternative is to pay income tax on the deferred patronage refunds from the regional associations and put them in surpluses without allocating them to members.

When deferred patronage refunds from the regional association are combined with their own deferred patronage refunds, many problems may arise to the local association. Members will have an equity in or a claim against the local cooperative for the amount deferred by the regional associations. However, the local association may not have received any cash for these deferred patronage refunds. If no cash has been received, these refunds are represented by an investment in the regional and would appear to the members to be readily available if called for. The regional cooperatives, however, may have a large portion of the deferred patronage refunds invested in fixed assets which would make them unavailable. If the members of a local association looked at the balance sheet of their cooperative and saw a large amount of deferred patronage refunds listed, they might think the cooperative could pay out some cash. If the deferred patronage refunds were tied up permanently in the regional association, the financial position of the local association would be jeopardized. The same thing could happen if the regional association went bankrupt, because the local association would be faced with claims or equities to retire for which no cash may ever be received.

Another problem arises when the local association patronizes regional cooperatives in only a few of the products which it is handling, but allocates deferred patronage refunds to members according to total purchases or sales. All members receive deferred patronage refunds from the regional cooperative and contribute to its capital, but some may not use products from the regional cooperative. The local association can solve this by allocating deferred patronage refunds by commodity or by department.

When the deferred patronage refunds from the regional cooperative are allocated separately from the local association's own savings, the balance sheet will show a balance for each of the amounts. The members are not apt to think there is too large an amount in deferred patronage refunds and, therefore, are not apt to vote for payment of the refunds.

Opinions on Financing of Regional Cooperatives

When discussing the financing of local cooperatives, it was brought out that the opinions of the members concerning different methods of financing should be considered. For regional associations that is equally true. The management and board of directors of the regionals are often in conflict with the management and members of the local associations. If the relations between regional and local associations are to remain good, the regionals must consider the opinions of the local associations. However, regionals have two factions that must be considered. They are the members and the management of the local associations. Therefore, opinions as to methods of financing were obtained from both the members and the managers of the local cooperatives.

In order to find the members' preference as to financing of regionals , the members were given four methods to choose from. They were then asked to rank these methods by order of preference (Table 24).

Table 24. Members' Preferences in Financing Regional Cooperatives

Methods of Financing	Ranking 1/			
	1	2	3	4
Defer savings	71	21	22	8
Sell stock or certificates of indebtedness directly to farmers	31	42	27	19
Local associations invest in stock or certificates of indebtedness	5	39	57	17
Borrow money	16	16	12	75

1/ Some gave no opinion or partial opinions.

Again the members feel that deferred patronage refunds should be employed, with borrowing money used only after the other methods fail. If the regionals are going to finance directly, the members would rather do it than have the local association do it. The reason for this may be that when members do the financing, the individual member has the choice of investing. When the local association does the investing, every member is actually making an investment regardless if the member likes it or not.

The members were then asked if they would invest in regional associations if asked to do so. Forty-two percent indicated they would, 39 percent said they would not, while 19 percent had no opinion. If the regional were to obtain funds from farmers, 63 percent said they would prefer stock, 28 percent said they would prefer certificates of indebtedness, and 9 percent had no opinion. However, many of the members were unfamiliar with the term certificates of indebtedness. Members who had previous experience with certificates of indebtedness rated them very high.

Members also felt that the sale of certificates of indebtedness should be open to people other than farmers. Fifty-four percent said certificates should be sold to others, 39 percent said they should be sold only to farmers, and 7 percent had no opinion.

The second set of opinions as to preference of financing came from the managers of the cooperatives in the study. Managers were asked how regional cooperatives should obtain additional capital for expansion of facilities or other purposes. They were then given six choices which were to be ranked in the order of preference (Table 25).

Table 25. Managers' Preferences in Financing Regional Cooperatives

Methods of Financing Regionals	Ranking 1/					
	1	2	3	4	5	6
Retain savings until capital is built up	34	3	3	4	0	0
Borrow capital	4	17	5	9	0	9
Sell stock directly to farmers	5	13	10	2	8	3
Sell certificates of indebtedness to farmers or other individuals	2	6	9	13	5	5
Local associations invest in stock and if necessary obtain funds from members	0	4	6	5	22	3
Local associations invest in certificates of indebtedness and if necessary raise funds from members	0	1	7	6	6	20

1/ Some gave no opinion or partial opinions.

The managers were similar to the members in preferring deferred refunds as their first choice, but where members put borrowing capital last, the managers ranked it second. A partial reason for the difference of opinion is that the managers felt that they would probably be responsible for getting funds from the members if the last four preferences were employed and they felt this would be a difficult task. Many managers also felt that regionals would be competing for funds that their local cooperative could use.

Managers also seemed to feel that the regionals should go to the individual member first if using a direct method of financing. They probably felt that their local cooperative did not have the necessary capital for making direct investments into regionals.

Members' Opinions About Belonging to Regional Cooperatives

The members' opinions about regionals can easily affect the relationships existing between local and regional cooperatives. There are members who believe their local cooperative should not belong to regional associations. The members who have this feeling may belong to cooperatives which are now affiliated with regionals or they may belong to cooperatives which are not affiliated with regionals. An attempt was made in the study to find out whether members felt their local association should belong to a regional cooperative, and to find out why some members felt their local cooperatives should not belong to a regional association.

First, the members were asked whether they felt that their local cooperative should belong to a regional marketing association. Thirty-six percent thought their local should belong to a regional marketing cooperative, while 43 percent were opposed to belonging. Twenty-one percent had no opinion.

Secondly, members were asked whether they felt that their local cooperative should belong to a regional purchasing association. Fifty-seven percent thought their local association should belong to a regional purchasing cooperative while 17 percent were opposed to belonging. The remaining 26 percent had no opinion.

It can be seen that many more members would want their local association to belong to a regional purchasing than a regional marketing cooperative. Largely responsible for this difference of opinion was the fact that many indicated membership in regionals would reduce the flexibility of operations. This was more pronounced for marketing cooperatives.

Many of the members had a resentment against regional cooperatives because they felt regionals had been too aggressive in their campaign to obtain business and members. Others felt that some of the regionals had become too dictatorial. Also, in local cooperatives which did not belong to regional associations, members were influenced by managers who had a feeling against regionals.

There were members who belonged to only marketing or purchasing cooperatives and gave an opinion only on the type of cooperative they belonged to. This accounts for many of the no opinion answers.

In other instances, members felt their local cooperative should not belong to regionals because of practical reasons. Creamery associations especially, find it difficult to market through regional cooperatives.

When the members' local cooperative belonged to a regional cooperative at the present time, the majority were favorable toward regionals. However, the study indicates that the regional has to be careful in pushing itself onto local associations.

CHAPTER 9

SUMMARY AND CONCLUSIONS

In the past few years the business volume of cooperatives has increased, more services have been added, and the price level has risen sharply. This created a definite increase in the need for capital with large increases evident in average fixed assets, average working capital, and average inventories. At the same time there has not been a proportional increase in members; therefore, cooperatives have to obtain more capital per member.

It is usually believed that cooperatives should be financed largely by their members. Cooperatives in this study were strong on this point as they were largely financed by their members. However, the investments in cooperatives were relatively low when compared to investments in the rest of the farm enterprise. Direct investments by members were very low.

Deferring patronage refunds was employed extensively as a method of financing by the cooperatives in the study. Members indicated that they preferred this method to all others, both in financing local associations and in financing regional associations, although many indicated they would like sufficient cash refunds to pay income taxes. However, some members had a resentment against the methods being used in handling deferred patronage refunds. Much of this dislike came from the cooperative having no plan for handling deferred patronage refunds or from a lack of understanding by the member.

Another problem the study brought out was that some cooperatives have a lack of sufficient permanent capital; consequently, some cooperatives have been forced to finance fixed assets with short-term capital.

Other problems brought out in the study were concerned with membership relations. Included among the more important problems were the failure of some cooperatives in keeping their membership current and the lack of communication between the cooperatives and their members. The lack of communication has caused some members to feel they do not have an opportunity to participate in decisions on financing.

In conclusion, cooperatives must make plans for financing to meet problems that are constantly appearing with the changing economic conditions. In formulating these plans they must not only consider the economic welfare of the cooperative but also the opinions of their members. The study suggests several problems that cooperatives should take into consideration.

There are several items to consider in the financial structure of cooperatives. First, plans should be made to obtain adequate capital. With the per member investment relatively low, cooperatives should be able to obtain more capital from their members. Secondly, plans should be made to have sufficient permanent capital. One solution to this is to transfer a portion of the deferred patronage refunds into capital stock permanently. Thirdly, definite plans should be formulated for handling deferred patronage refunds. Cooperatives should be sure that these plans are understood by the members.

The study also brought out other items to consider. Cooperatives should strive to keep their membership current. If necessary, a separate fund could be set up for the retirement of capital stock, patronage refunds, and other equities. Some cooperatives should be giving the individual members more of an opportunity to participate in decisions taken on financing.

This could probably be worked out by having the board of directors and the managers make recommendations to the membership and let the members make the final decision. In general, the study brought out a need for more educational work with cooperative members.

With the coming of new economic conditions and with further expansion of cooperatives, there will undoubtedly be new problems arising which will call for new methods of financing. Cooperatives must keep pace with the changing conditions.

APPENDIX

Appendix Table 1. Date of Organization of Cooperatives by Type of Cooperative

Year Organized	Elevator	Oil	Creamery
Before 1920	10	0	2
1920 - 1930	3	5	2
1930 - 1940	5	10	2
1940 - 1945	1	4	3
After 1945	3	6	0
Date unknown	3	0	1

Appendix Table 2. Methods of Obtaining Membership by Type of Cooperative

Type of Cooperative	Earn Share	Buy Stock	Either
Elevator 1/	12	3	9
Oil	14	0	11
Creamery 1/	5	0	4

1/ One cooperative unclassified.

Appendix Table 3. Par Value of Common Stock by Type of Cooperative

Par Value	Elevator 1/	Oil	Creamery 2/
$10 or less	3	10	3
11 - 24	1	2	2
25	13	9	4
26 - 49	0	3	0
50	1	1	0
100	5	0	0

1/ Data unavailable for two associations.
2/ One association had no capital stock.

Appendix Table 4. Percentages Purchased by Elevator Associations from Regional Cooperatives

Percent	Refined Fuels	Oil	Tires and Tubes	Feed, Seed and Fertilizer	Machinery	Other
100	6	6	6	1	3	0
75 - 100	0	0	0	0	0	1
50 - 75	1	1	0	2	1	1
25 - 50	0	0	0	4	0	1
10 - 25	0	0	0	1	0	0
0 - 10	0	0	0	1	0	0
None	0	0	1	3	0	0

Appendix Table 5. Percentage Purchased by Oil Associations from Regional Cooperatives

Percent	Refined Fuels	Oil	Tires and Tubes	Feed, Seed and Fertilizer	Machinery	Other
100	19 1/	17	13	4	12	2
75 - 100	1	3	3	1	0	6
50 - 75	0	0	3	1	1	7
25 - 50	0	0	1	0	1	1
10 - 25	0	0	0	0	0	0
None	5	5	5	2	0	7

1/ Includes two with 99 percent.

Appendix Table 6. Percentages Sold by Elevator and Creamery Associations Through Regionals

Percent	Elevators	Creameries
100	4	0
90 - 100	5	0
75 - 90	1	0
50 - 75	1	0
25 - 50	1	0
10 - 25	0	0
0 - 10	2	0
None	11	10

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