

# MU Guide

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## Member Control of Cooperatives What it Means and How it is Exercised

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One of the fundamental principles of cooperatives is that they are controlled democratically by the members who use them. "Democratic" is defined as one vote per member, regardless of investment in or volume of business conducted with the cooperative. Farmers have indicated in surveys that they recognize and support the concept. At the same time, however, farmers often charge that cooperatives are not member controlled. This publication was designed to help members and managers understand what control means and how it is exercised.

### What member control means

Members control a cooperative when they (1) set major policies; (2) have the ability to change policies;



## MISSOURI FARM COOPERATIVES

and, (3) employ and dismiss the manager. This raises the question, "What is a major policy?"

The membership of each cooperative can define policy as it sees fit. One school of thought says members should only set general purposes and employ and hold accountable management. This school, however, is increasingly in disfavor in the corporate world and was never considered appropriate for cooperatives. Under the member control principle, members should exercise control over *all* major policies. State statutes may also specify which policies members control.

Major policies often regarded as appropriate for member control include:

- (1) determining purposes and trade territory;
- (2) setting pricing strategies;
- (3) determining capital structure;
- (4) establishing membership requirements;
- (5) setting patronage refund policies and plans for equity retirement;
- (6) establishing credit policies;
- (7) defining equitable treatment of members;
- (8) having and approving long-range operational plans;
- (9) establishing employee compensation and fringe benefit plans;
- (10) approving major investments and sale of assets;
- (11) approving changes in the articles of incorporation and by-laws;
- (12) approving major contractual arrangements; and,
- (13) approving plans for marketing agreements and pooling.

Members might tend to treat anything that is totally new as a policy matter. There is nothing wrong with this approach, provided the matter does not routinely become a matter for the membership to decide.



## How members exercise control

Members exercise control over a cooperative directly by voting at membership meetings and indirectly through election of a board of directors. State Incorporation Statutes require the board to manage the cooperative and give it wide latitude in doing so. The board also may be restricted by provisions in state statutes, articles of incorporation, and bylaws that specifically reserve control of certain matters to the membership. In most cooperatives, however, few issues are reserved for the membership to decide. Hence, the way members usually exercise control is through electing a board of directors.

All types of corporations have boards of directors. All boards are responsible for representing the interests of owners, protecting the public interest, and assuring proper management for the corporation. Responsibility for management is far different from managing. The responsibility is exercised by employing professional management personnel and monitoring their performance.

The amount of authority and responsibility delegated to management is largely left to the board. Each board must decide what "control" means. Maintaining control does not require numerous actions at every board meeting. If no major policy decisions need to be addressed, an appropriate course of action is to monitor activities and performance.

While all boards have the same general responsibilities, the board of a cooperative differs greatly from the board of an investor-owned firm (IOF) and the differences are consistent with the principle of member control. People who serve on the board of a cooperative are members of the co-op, selected by other members. They serve with little or no compensation. Board members of IOFs are selected by the board (although approved by owners) and might have no business relationship with the corporation. They often are well compensated.



## Actions members should take

Since much of the control authority is delegated to the board of directors, the most important single action a member can take is to actively participate in the director selection/election process. The proce-

dures followed by cooperatives for securing directors vary widely. Some co-ops use nominating committees. Others nominate two people for each open board slot. Others allow people to "run" for the positions. The procedure a particular co-op follows should be specified in the bylaws.

More important than the election procedures is selecting the "right" people as directors. Essential requirements include actively patronizing the co-op, having no conflict of interest with the co-op, and making a commitment of time to the job. General leadership characteristics are highly desirable.

Many people elected for the first time to a co-op board have limited off-farm business experience and no experience on corporate boards. This means the person must also make a commitment to learn the business *and* learn how to become an effective director.

Incorporation statutes outline methods that show members how to take direct action. Almost all co-ops in Missouri are incorporated under Chapter 274 or Chapter 357 of the Missouri Statutes. Chapter 274 specifies there must be at least one membership meeting a year, with members notified at least 10 days in advance. Further, 10 percent of the members may petition for a special meeting to accomplish specific business. If they petition, the directors must call a meeting. The chapter also outlines procedures for initiating the removal of a director.

Chapter 357 specifies the board of directors manages the general affairs of the co-op but says business policies are controlled by the shareholders (members). Policies specifically mentioned are: declaring dividends; setting aside reserve funds; establishing the method of distributing profits; amending the articles of incorporation, increasing and diminishing capital stock; and other general policies. The chapter also provides for removal of a director for cause at any annual or special meeting.



## Control versus management

Member control is quite different from management. It is the task of management to faithfully pursue the goals and policies of the membership and to periodically report on performance. Management should have the right to make a wide range of decisions on a day-to-day basis. Examples include establishing prices, hiring and firing employees, selecting vendors, preparing work and delivery schedules, and establishing daily priorities. Members cannot maintain control however, unless their elected representatives (the board of members) retain and exercise the right of

employing and evaluating management and making necessary managerial changes.

The membership can and should delegate actual management to a professional manager. Professional managers have many skills the typical member does not have. Further, management of an enterprise of any significant size is a full-time job. Perhaps of even greater importance is the timeliness of decisions. If members become involved in day-to-day operations, it will almost certainly lead to poor performance of the cooperative. Management must have the flexibility to fail as well as to succeed and be rewarded accordingly.



### Limitations and a major problem of member control

Members often face external restraints when policy decisions are made. Laws must be obeyed. Cooperative lenders, suppliers, and customers may also place restrictions on policies. Such restrictions do not violate the principle of member control. In fact, a precise wording of the principle would be, "members control the cooperative subject to legal and institutional constraints and the realities of the economic situation faced by the cooperative."

A cooperative faces a dilemma in representing the views of its membership. If operating properly, the cooperative reflects the views of a *majority* of its members. A majority can be as small as 51 percent. Even in a truly member-controlled cooperative, the goals of *all* members are seldom pursued. Unanimity is nearly impossible if the organization has a substantial number of members. Thus, a cooperative will not represent the views of *each* member; the test of member control is whether the cooperative pursues the goals of the *majority* of members. A member who is in the minority has three options: bow to majority rule, solicit support for the minority view, or leave the co-op.

Another constraint is the number of members who vote on issues relating to control. In many cooperatives, voting occurs at a membership meeting called for that purpose. Others permit proxy voting, voting by mail, or a combination of meeting, proxy, and voting by mail. Regardless of the method, the percent of members voting is usually low. Those who do vote set policy and those voters may or may not be representative of the membership.

### Conclusion

Members can control their cooperative by many means. An essential ingredient is being actively interested in and participating in co-op activities. Without member interest and participation, there is no guarantee members will control the cooperative.



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