**Managing a Cooperative**

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**Management Defined**

There are many alternative definitions of management. One definition is “The process of designing and maintaining an environment in which individuals can work with others efficiently and effectively to accomplish set goals.” Other definitions of management might include phrases such as “Interacting with people to achieve results”, “Using resources to achieve objectives” or “Balancing tradeoffs”. Commons themes across the various definitions of the term “management” are the concept of allocating scare resources and directing individual efforts to achieve the organization’s purpose. Fully describing the functions and processes of business management is beyond the scope of this chapter. Instead, our major focus is to identify and discuss how the unique nature of the cooperative firm impacts its management.

Management is both an art and a science. There are undoubtedly principles of management and the structure of management activities can be identified and described. Aspects of management relating to operations and finance can certainly be scientifically analyzed. As an example, the process of budgeting, which is part of the planning process can be broken down into component steps and analyzed. On the other hand, many aspects of management involve working with human resources, communicating within and outside the firm, analyzing competitor’s actions and setting strategy. Those processes are more complex and involve both an art and a science.

The manager of a cooperative firm, or any firm, has many roles. The manager is the figurehead and spokesperson for the cooperative, representing the firm to external stakeholders. The manager is also a leader, guiding the activities of the employee group and is also part of the overall leadership in tandem with the board of directors. A cooperative manager is the gatekeeper or liaison between the board of directors and the employee group. The manager communicates the board’s strategic goals to the employee group and communicates employee concerns and needs to the board. The cooperative manager both receives and disseminates information. He or she also addresses disputes and job performance issues among the employee group, negotiates with suppliers, and makes a host of necessary day to day decisions. One of the key roles of the manager is to allocate the cooperative’s scarce resources, both financial and human capital, to best achieve the overall goals of efficiency and profitability. This requires an understanding of operations and finance, as well an ability to take calculated risks and adjust plans as needed. This requires a broad skill set including financial knowledge, understanding of operations, people skills, and many specific skills such as financial analysis, project management planning, critical thinking and decision making.

**Functions of Management**

The process of management is often separated into the functions of: planning, organizing, staffing, directing, and controlling. The related concept of coordination is also sometimes added along with the concept of meeting social and ethical responsibilities. All of these functions are present in the management of a cooperative. While the board of directors has the primary responsibility for strategic planning, the manager typically works in tandem with the board, suggesting strategies and analyzing alternatives. This can create some unique challenges for the cooperative manager. While strategic planning is primarily the board’s responsibility, board members, particularly newly elected members, may not have a good understanding of the industry environment facing the cooperative. The manager is responsible for short range planning including budgeting, and setting the daily, weekly and seasonal priorities. In most cooperatives the board of directors establishes a long range plan and overall budget for fixed asset replacement and the manager works within those parameters to make specific decisions on equipment replacement. The cooperative manager must work to maintain the separation between their responsibilities in short term planning and the board’s role in long run and strategic planning. Because they are customers and are operationally focused, some board members want to become overly involved in equipment related decisions. In addition to routine equipment replacement, most cooperatives have one or more infrastructure replacement or expansion projects on-going. Overseeing those projects is an important aspect of the manager’s planning role.

The organizing function refers to the managers efforts to direct the cooperative’s processes and people. A cooperative manager may decide to organize activities around geographic locations with a mid-level manager at each branch location, or create functional departments with managers overseeing, grain, agronomy, fuel and other function over the entire cooperative. The manager also orders and positions fertilizer and other farm supplies, decides where to hold grain inventory and develops plans for harvest and peak demand periods. All of those activities involving organizing the cooperative’s physical and human capital assets.

The staffing function is closely related and involves recruiting, hiring and on-boarding employees, as well as evaluating their performance, setting compensation and incentives and developing their skill sets. One cooperative manager described the staffing function as “Getting the right people on the bus, the wrong people off the bus, and then getting the people on the bus is the right seats!”.

As the name implies, the directing function involves instructing and guiding the employee group. In terms of the previous analogy, directing involves telling the person in each seat on the bus what to do. Directing involves straightforward activities such as assigning employees to specific task as well as more subtle actions such as providing encouragement and feedback to guide and improve job performance. In a cooperative where most customers are also member-owners, employee interactions with customers are critical. Part of the directing role of the cooperative manager may be to improve the customer relationship skills of front line employees.

The controlling function of management is the process of checking actual performance and outcomes against the plans and goals. In general, the controlling function involves establishing some sort of standards, measuring performance against the standards and making corrections when there are deviations. The controlling function can also involve ensuring that the cooperative is in compliance with its own internal policies and with all external laws and regulation. In a cooperative efficiency is extremely important. Pricing impacts the cooperative’s profits but also impacts the members at the farm level. For that reason, efforts to improve the cooperative’s profitability often focus on improving efficiency. A cooperative manager may monitor the cost per acre of fertilizer application or the per bushel cost of grain management to ensure that they are within historical standards or industry benchmarks. Other aspects of control involving monitoring the quality and quantity of both commodity and input inventories.

**The Unique Aspects of Managing a Cooperative**

A cooperative manager needs to operate an efficient and effective business organization, respond to their competitive environment, manage human resources, meet customer needs and comply with all applicable rules and regulations. Those challenges are obviously not unique to the cooperative business model. There are some area where the cooperative managers face different challenges, relative to managers of other types of firms and need different skill sets. Some of these differences related to the frequency and nature of contact with the owners, the complexity of the cooperative objective function and the avenues by which members receive benefits, the balancing act between protecting the viability of the cooperative and maximizing returns.

Closer, More Long Term Relationship with Customers

In most firms the manager has relatively infrequent contact with the owners. The manager of a publicly held corporation may report to shareholders on a quarterly or even annual basis with the actual contact limited to the select shareholder who have major ownership holdings. Depending on the size of the firm, the manager may or may not have interaction with customers. If a customer in an investor owned firm becomes dissatisified they may discontinue their use of the firm. They are unlikely to have future contact with the manager. In a cooperative the manager has daily contact with members who are also customers and owners. Member owners have frequent contact with the manager and value the opportunity to express their preferences and opinions on the cooperative’s operation. A dissatistified member still has and investment in the cooperative and will remain an owner for many years until the equity is revolved. For these reasons the cooperative manager has a closer and longer term relationship with customers and owners.

As mentioned, the manager of an investor owned firm must respond to the needs and opinions of the major shareholders. Because most cooperatives operate on a one member-one vote structure, the cooperative manager is under more pressure to communicate and respond to every member. When it comes to a vote on a merger or restructuring, or even a vote on a bylaw amendment, the smallest producer has the same weight as that of the largest customer.

Cooperative Manager Works in a Spotlight

Because of the frequent interactions with member-owners, the cooperative manager tends to work in a spotlight. Members judge the performance of the cooperative and the manager during every transaction. Customers owners are used to expressing their opinions directly to the manager. In single location cooperatives many members expect to be able to drop into the manager’s office during every visit. Additionlly, cooperative managers are more likely to have a hands on role in operations relative to their counterpart in investor owned firms. All these factors can make decisions on product line, inventory levels, hours of operation or seasonal locations more political relative to other business forms.

Cooperative Manager Has Different Controls and Incentives

In an investor owned firm the manager focuses on meeting the objectives of the major stockholders or owners. Those objectives are generally to maximize the profits of the firm. In order to align the manger with those objectives, many managers of investor owned firms have compensation or bonuses tied to the firm’s profitability. In a publicly owned firm the manager may receive stock options which become valuable if the profits increase and the stock prices rises. In a cooperative, equity is only held by users and does appreciate in value. This eliminates to possibility of stock options as an incentive. Because the cooperative’s profits is based on transactions with member-users, profitability is not the only objective. This makes it more difficult to base compensation and incentives on performance. Producer members may also object to the cooperative diverting returns from patronage toward employee and manager compensation. A cooperative manager must also respond to every member (who often have an equal vote). This makes their job more complex relative to the manager of an investor owned firm who can concentrate on the concerns of the majority stockholder.

More Complex Objective Function

The objective of an investor owned firm is to maximize the return on investment of the owners. In the cooperative business model the objective is more complex. Members also have transactions with the cooperative, purchasing inputs and selling commodities. The prices of those transactions impact their returns at the farm level. The cooperative’s role in providing services and creating a stable market or source of supply also impacts their farming profitability.

Distributing Returns is More Complex

In an investor owned firms profits may be distributed as dividends, in proportion to ownership. Many publicly traded firms do not distribute profits but rather retain the funds as retained earnings. The firm’s stock price is based on investor projections of future profits so existing members benefit from the stock price appreciation. In a cooperative, the distribution of returns is much more complex. Cooperative distribute funds as cash patronage. They also distribute patronage in the form of qualified and non-qualified stock whih have different tax treatments. When the cooperative distributes patronage in the form of equity they are both distributing something of future value (revolving equity) and also retaining funds. Retained patronage is simultaneously a method of retaining funds and distributing benefit. Cooperatives can also retain profits as unallocated equity, also called unallocated retained earnings that is a general reserve fund. All of the distribution decisions have impacts on the cooperative’s cash flow, the cooperative’s equity level, the individual’s equity ownership and member’s return from the cooperative.

Four and ½ Ways Members Benefit from a Cooperative

There are at least four clear avenues of benefit to members from their cooperative. As discussed, the first is through the prices paid or received. Favorable prices provide an immediate benefit which is popular with all members, particularly younger members who have little invested in the cooperative. These members often say: “why doesn’t the cooperative simply increase prices paid on commodities rather than creating profits which must be distributed?” The problem with offering favorable prices is that the manager may mis-estimate costs and end up operating at a loss. The cooperative model also depends on retained profits to both create member equity and to finance both infrastructure reinvestment and equity retirement. The members of a cooperative with favorable prices may also not appreciate the performance of the cooperative since because its profits at the cooperative model will be low. Additionally, the cooperative’s competitors may meet the favorable price resulting in the cooperative benefiting nonmembers as much as members.

One of the major avenues of cooperative member benefit is through patronage which may be in a combination of cash and stock (retained patronage). The structure of patronage creates a balancing act. The cooperative must balance cash patronage which provides an immediate return to the member with retained patronage which provides cash flow for infrastructure re-investment and equity retirement. In addition to the balancing act between member return and thc cooperative’s cash flow, patronage refunds create a balancing act between member groups. Younger members may favor retaining funds for infrastructure reinvestment while older and inactive members will push the cooperative to concentrate on equity retirement.

The topic of infrastructure reinvestment suggests the next major avenue for cooperative member benefit: through access to the firm’s services. In some cases cooperatives offer services and market access which would otherwise be unavailable to the members. For example, if sugar beet producers did not have access to a processing cooperative they would be forced to grow less profitable crops such as corn or soybeans. In other cases the cooperative may be providing superior services. In the case of a large scale grain farmer the ability of the cooperative to rapidly dump trucks and handle grain is a major value component. If the grain farmer is forced to wait in a long line at the dump pit they may end up having to idle combines and decrease their efficiency on the farm.

While it is not common for a cooperative to pay dividends on invested capital, that is another potential avenue of benefit. Depending on the state of incorporation and the section of the tax code the cooperative is operating under the dividends may be restricted to 8%. That restriction, often referred to as the “subordination of capital” goes back to the original Rochdale principles. It should be noted that the Rochdale Pioneers operated in an environment of low interest rates. One could argue that the intent of the principles was that there should be only a reasonable return on invested capital so that the majority of profits could be distributed as patronage. In the U.S. most agricultural cooperative have elected not to pay dividends on invested capital. In recent years a few cooperative have experimented with revolving equity into a dividend paying class of preferred stock. While this requires diverting some profits into dividend payments it allows the cooperative to maintain the equity base. Many members appear satisfied at a longer revolving period if they receive dividends at some point. The new hybrid cooperative-investor owned firm business form obviously provide a return on invested capital for the investor class of members.

The final avenue of benefit, which is sometimes referred to as ‘half of a benefit” since it accrues to both members and nonmembers, is the impact of the cooperative on the competitive environment. This brings up the concept of the cooperative as a “**competitive yardstick**”. The competitive yardstick is a well-known analogy for justifying why the presence of a cooperative is thought to promote competition. The concept is that because the cooperative distributes profits to the users in proportion to, the firm has no incentive to charge excessive prices. The cooperative therefore provides a comparison or “yardstick” of the fair and appropriate prices in a market place. The cooperative therefore helps to keep other firms competitive and in so doing creates a competitive marketplace. This is often referred to as the “**invisible benefit of the cooperative**”.

**Member Control in a Cooperative**

Democratic control is a fundamental cooperative principle. However the processes by which members exercise their democratic control are often misunderstood. Cooperative members generally do vote on policies, nor do they vote on hiring employees, or even hiring the CEO. Members vote to elect board members, with the vote generally occurring during the annual meeting. During some annual meeting they may be asked to vote on amendment to the bylaws or articles of incorporation. They may also vote on a major structural change such as merger or dissolution at regular annual meeting or a special meeting of the membership. While important, democratic control through voting is limited.

Members also exercise control by voicing their opinions to the board and manger. That frequent contact with members is one of the factors that makes managing a cooperative unique. Because every member has the same voting right in most cooperatives, the manager must respond to every member, not just the major users or major equity holders. The final avenue of member control is for the member to vote with their feet and discontinue using the cooperative. However, because of their equity holdings, inactive members may still choose to try and influence the cooperative’s decisions.

Due to the greater interaction between the board and CEO and the membership, decisions in a cooperative tend to become more political. Decisions on making a location seasonal, or changing the product line or hours of operations can become major issues with the membership. This leads to what has been termed “**The Cooperative Dilemma**: do we operate as a membership organization or as a business enterprise?” Most would argue that the manager should operate an efficient business organization but he/she must also realize the inherent differences that arise when the customers are also owners who expect to have frequent opportunities to provide input to the manager.