Introduction to the Cooperative Entity

Most business law courses in universities and law schools touch lightly, if at all, on the cooperative business form. Students learn about the intricacies of corporations, partnerships, limited liability companies, and other more exotic business forms, but they are rarely exposed to the cooperative form, even though a substantial number of business transactions are conducted by or with businesses organized as cooperatives. This book is designed to fill the gap and provide an introduction to the cooperative entity and to the law of cooperatives.

Why is it important to know about the cooperative form of business? In our experience, attorneys who have had limited exposure to the cooperative form often face a steep learning curve when negotiating with cooperatives on behalf of their clients or when attempting to represent a new client that happens to be organized as a cooperative. Although cooperatives are similar in many respects to other businesses, certain characteristics are distinctly different and not necessarily intuitive to an attorney familiar with corporations and partnerships. Also, clients seeking to form a new business might be well advised to use the cooperative form under certain circumstances, but such advice must be based on at least a working knowledge of the cooperative form and its advantages and disadvantages vis-à-vis other types of business entities.

A. Basic Description of Cooperative Form of Business

Assuming, then, that knowledge of the cooperative form is useful, what is a cooperative? Although economic and “legal” definitions of the cooperative entity will be provided later in this book, a cooperative business generally
has the following characteristics: (1) It is owned and controlled by the people who use its services or buy its products (its “owner/customers”); (2) its primary focus is to provide its services or goods to its owner/customers and not to the general public; (3) it is democratically controlled by its owner/customers, and each owner/customer has one vote regardless of the amount of services or products it purchases from the cooperative; and (4) the primary objective of the cooperative is to maximize benefits to its owner/customers rather than profits.

The development of the cooperative form is unique in comparison to that of other business entities in that the modern cooperative form was largely developed by individuals and small businesses reacting to the emergence of large business entities, such as corporations and limited partnerships, and seeking a way to successfully compete with these larger businesses, in both selling their goods and purchasing needed services or supplies. Smaller buyers and producers found that they could leverage their buying and selling power by joining together in groups. While a single individual or small business might find itself at the mercy of the prices and policies of a large business, representatives of a group of such cooperating buyers or producers could obtain more favorable prices and terms. The cooperative form was also developed as a way to provide services or goods that would otherwise be unavailable, either because the cooperative’s members lacked the capital or expertise to provide such services or goods by themselves or because the particular market was too small to interest larger businesses. It was the need to establish an economic and legal framework for such cooperative entities that led, over the course of many years, and through many failed experiments, to the generally accepted principles and characteristics that make up the modern cooperative.

Cooperatives are also unique in comparison to other business entities because of the differing treatment that they receive from the federal and state governments in comparison to the treatment given other business entities. The basis for such differing treatment arises from policies tied to the basic nature of cooperatives. The rewards from their operations go almost entirely to their owner/customers rather than to outside investors, and in many cases, they provide services or products that would otherwise be unavailable from investor-owned enterprises. Preferences were given to cooperatives in the early twentieth century in response to the success of agricultural cooperatives in helping individual farmers rise from economic depression. The success of such preferences then led to policy makers using the preferences to create opportunities for cooperatives, as in the case of rural electric and telephone cooperatives, which were able to provide services to rural Americans not available from larger entities, in part because of tax advantages and opportunities for low-cost, government-backed financing. While preferences continue to be extended to some coopera-
tives today, in some cases, governments have also imposed restrictions on cooperatives based on their unique characteristics.

In addition to the practical and legal differences discussed, there are also important intangible differences between the cooperative and other business entities. For example, the attorney representing or negotiating with a cooperative will often find a distinctive pride of ownership among a cooperative’s owner/customers. Although consumers have brand loyalty to corporations, only with the cooperative does the owner/customer have the ability to directly govern the course of the business and control the quality of the product or service. Owner/customers of cooperatives, if asked about the benefits of their cooperative, will often focus not only on the price of goods and services or the quality of management, but also on their ability to control the quality of goods and services, to interact with other owner/customers, and to directly control the direction of the business.

Another characteristic of the cooperative is not so much a required element as it is an unavoidable by-product of the cooperative form and the reasons for its development. Because cooperatives are formed by their owners for the specific purpose of providing a particular service or product, for the most part the cooperative is primarily focused on the delivery of one product or service. While the typical business concern is willing to enter into any line of business, provided it produces a profit for its partners or shareholders, the cooperative tends not to stray far from the original purpose for which it was founded. Also, unlike other business entities, cooperatives are required in many cases to limit their activities by statute or because of the specter of unfavorable tax consequences.

All of these characteristics of the cooperative entity have acted in combination to make cooperatives, regardless of their size, the “stealth businesses” of our economy. Because cooperatives operate primarily for the benefit of their owner/customers, and not for the general public, cooperatives typically advertise less than other businesses do and have less need to establish public “brands.” Also, because cooperatives are not owned by outside investors and they typically have no SEC (U.S. Securities and Exchange Commission) reporting requirements, public data on the financial activities of cooperatives usually is not publicly available, and the media and financial community have no reason to place cooperatives in the limelight. For these and other reasons, although cooperatives provide a wide variety of products and services to a substantial number of consumers and have a sizeable impact on our economy most people are unfamiliar not only with the role of cooperatives in the economy, but also with the characteristics of the cooperative entity itself. Before examining these characteristics in detail, it is worth taking a side trip to briefly explore the actual impact of cooperatives on the economies of the United States and of countries throughout the world.
B. Importance of Cooperatives in the United States and World Economies

The economic importance of cooperatives makes a compelling case for obtaining a working knowledge of the cooperative entity. There are over 47,000 cooperatives in operation in the United States today, with those cooperatives serving almost 120 million members. Statistics show that, in 2007, just the top 100 revenue-producing cooperatives in the United States had over $170 billion in revenues. Clearly cooperatives play an important role in the U.S. economy.

How is it that cooperatives have such a widespread impact on the economy? While most people are aware of certain types of cooperatives, such as agricultural or electric cooperatives, cooperatives actually produce or deliver a wide variety of goods and services, including health care, insurance, telecommunications, financial services, child care, housing, and consumer products such as hardware and groceries. These types of cooperatives are often referred to as consumer cooperatives. Other types of cooperatives have a strong economic impact as well. For example, marketing cooperatives, which include agricultural cooperatives, sell the products of their members into the relevant market.

Many well-known businesses with established brand names are cooperatives, even though consumers might not be aware of them as such. Familiar names include Ace Hardware, a retailers cooperative with over three billion dollars in revenues whose owner/members operate over 4600 independent stores; Land O’Lakes, a national agricultural marketing cooperative that is one of the largest producers of butter and cheese in the country and which directly employs over 6000 workers; Sunkist Growers, a citrus growers cooperative with over 6000 members that has licensed its brand name for use on over 600 products; and the Associated Press, a news agency owned by its 1500 daily newspaper members.

Cooperatives in certain other industries are not recognized as such, although their brands are well known. For example, the mutual insurance company, in which policyholders have certain ownership rights in the company, is a form of cooperative, with larger mutual insurers including Nationwide Mutual Insurance Company, Mutual of Omaha, and State Farm Insurance. Credit unions are also cooperative entities and, as a group in the United States, have over 85 million members and assets of over $700 billion. Also, while cooperatives in some other industries are certainly recognized as cooperative entities, their impact and scope are less recognized. For example, over 860 distribution electric cooperatives (cooperatives that provide power directly to consumers) serve more than 40 million people in 47 states. More than 1.2 million families live in homes owned by cooperative housing associations located across the country.
Cooperatives play an important role not only in the United States, but around the world. The International Co-operative Alliance, an organization formed in 1895 to represent and serve cooperatives worldwide, first began to collect statistics on cooperatives in 1897 and recently estimated that over 800 million people worldwide are members of cooperatives. Its collected statistics indicate that cooperatives provide over 100 million jobs worldwide, and that cooperatives unquestionably have a significant positive impact on national economies throughout the world.

The worldwide significance and impact of the cooperative entity has not gone unnoticed. The United Nations declared 1995 to be the “International Year of Cooperation.” During his term as Secretary-General of the United Nations, Kofi Annan said that cooperatives “provide vital health, housing and banking services; they promote education and gender equality; they protect the environment and workers’ rights. Through these and a range of other activities, they help people in more than a hundred countries better their lives and those in their communities.” The United Nations has recognized that cooperatives can play a special role in increasing economic and social progress in both developed and developing countries, and in 2005, a report of the Secretary-General stated that “[u]nlike other types of private sector business organizations, cooperatives subscribe to a set of core values and principles . . . which emphasize social responsibility and community development.” The increasing international recognition of cooperatives was further enhanced in 2000, when the Internet Corporation for Assigned Names and Numbers (ICANN), the international body responsible for global coordination of the use of Internet domain names and addresses, approved use of the .coop extension for use by cooperatives.

Having discussed the distinctive nature of the cooperative entity and its importance in our economy and in economies worldwide, let us now turn to a fuller description of the cooperative entity and a brief history of its development. The brief history presented in the next chapter is not intended to be exhaustive, but we hope it will provide additional context within which to understand the cooperative’s emergence, rapid expansion, and still-evolving characteristics.

Notes

2. Id.


7. Id.
