

**STRENGTHENING AGRICULTURAL
COOPERATIVES: AN INQUIRY INTO
EXPERT BELIEFS**

by
Mahlon G. Lang



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Center for Cooperatives

University of California, Davis

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EXECUTIVE SUMMARY

Setting

In its simplest form, a cooperative is a group of people with a clear and common interest in a clear and common purpose. The cooperative succeeds when it provides clearly understood benefits to patrons who know they cannot achieve their objectives alone. Their representatives (directors) know what is expected of them and they hire a manager whose role is clearly understood.

For cooperatives, the consequences of increasingly complex markets and marketing challenges are outlined by Vilstrup and Groves¹ and paraphrased below.

As cooperatives become more complex, optimal performance becomes more difficult to achieve and communicate. These difficulties arise from:

- more complex products and processes and associated capital requirements
- more complex redemption plans
- competing interests in the returns to each product
- diverse memberships and conflicting interests in delivery, grading, etc.
- challenging coordination tasks
- complex relationships with other firms.

These complexities can dilute focus and create conflicting interests and vagueness or conflict in purpose. As complexity grows, maintenance of efficient and competitive operations requires more effective communication, resolution of competing product interests, more complex terms of delivery for growers, and greater knowledge.

The Study

A study to elicit the beliefs of experts about the keys to cooperative success drew primarily upon two information-gathering activities.

1. A survey of persons known to have some expertise relative to agricultural cooperatives was conducted from March through July of 2001. The group included academics, cooperative council leaders, government specialists, cooperative accountants, CEOs, CFOs, directors and other cooperative leaders. They were asked to register their reactions to as many as 87 different belief statements about success factors affecting cooperatives. Based on their responses to preliminary questions, the respondents were subdivided into two groups. One group, almost entirely from California, was most knowledgeable about California's fruit, nut and vegetable cooperatives. A second group included respondents from 26 states and was most knowledgeable about commodity marketing, agricultural supply and service cooperatives.
2. As the survey progressed, open-ended interviews were conducted with senior cooperative leaders in California. These were active and retired top management, directors and lenders to

¹ Cooperatives in Agriculture, ed. David Cobia Prentice-Hall 1989 p344

cooperatives, some of whom had held state and national leadership roles for as long as 50 years. Like the survey respondents, they were asked about keys to cooperative success.

Keys to Cooperative Success

1. **A Clear and Unique Purpose:** Unless the cooperative has a clear and commonly understood purpose, members will rightly treat it like any other business and it will lose what should be a competitive advantage.
2. **A Board With Skills to Direct:** In directing the cooperative, the board's most important roles are: (1) to hire management to develop and implement a strategic plan and (2) to evaluate management based on its success in doing so. This requires specific skills and experience.
3. **A Board with Willingness to Lead:** The CEO reports to the Board. The board shouldn't direct operations, but must explicitly hold the CEO accountable for performance of basic business disciplines, auditing, goal-setting and achievement.
4. **Competent Cooperative Management:** Cooperative management is unique. It demands all the skills required of management in an investor-owned company, but in a user-owned business, it also requires unique member relations and communications skills.
5. **Specialized Cooperative Management Compensation Programs:** Cooperative management is unique because it has unique stakeholders, and because measures of management performance may differ from those of other firms. These measures, possibly including measures of longer-term financial performance, should be recognized in management incentives.
6. **Highly Effective Member Relations Programs:** The member relationship is vital to a cooperative. Unless it is a monopoly, the cooperative will always operate in a market environment and compete with non-cooperative firms. Member relations must assure (1) that members know why they are best served by being members and (2) that every member contact is reinforcing the message.
7. **Flexible Marketing and Financial Structures:** Cooperatives compete with companies that provide diverse products in diverse markets and draw upon rapidly-changing production and process technology. Cooperatives must be sufficiently flexible to compete in this environment.
8. **Non-Dilution of Member Capital:** A clear link between member capital and member benefit must be maintained as cooperatives adjust. Capital for indirect benefits cannot be funded solely or directly by members.

What Can Be Done By Cooperative Boards?

1. Specifically and annually answer the question: Why is our business a cooperative?
2. Use a nominating committee to identify skills required on the board and the names of members who could provide them.
3. Create and implement long-term professional development for directors. Convince directors that they must be committed to longer-term professional development as directors.
4. Define expectations of management and develop long-term measure of performance.
5. Develop management incentive programs serving the long-term interest of members.
6. Recognize and emphasize the importance of member relations.
7. Develop marketing and financial alliances to reinforce the value of membership.

What Can Be Done By Cooperative Support Organizations?²

Some of the following are already provided by support organizations.

1. Emphasize and publicize the primary benefits of cooperatives to members and to the public.
2. Identify and develop models for director identification and development.
3. Cooperate with other support organizations in developing longer-term, higher-level director development programs.
4. Support research to define performance measures and appropriate incentives for management.
5. Emphasize to cooperatives the importance of good member relations programs.
6. Identify flexible strategies for cooperative structure and finance. Develop objective evaluation criteria by which to compare alternative marketing and financial structures.

² Academic Cooperative Centers, State and National Councils, CoBank, National Society of Accountants for Cooperatives, USDA

Introduction

As a unique form of business, the cooperative presents unique challenges. While cooperatives face most of the same competitive and environmental challenges as investor-owned firms, their form of business organization presents other challenges as well.³

The aim of this report is to identify factors believed by experts to be important to the success of cooperatives. To identify those factors, two activities were conducted:

1. a survey of cooperative experts to assess their beliefs about selected characteristics affecting success and failure of cooperatives
2. a series of open-ended interviews with experienced cooperative leaders to obtain their insights on the same issues

Framework for Inquiry

The survey was designed to assess expert beliefs and insights about five characteristics of cooperatives that distinguish them from investor-owned firms.⁴ These are:

1. the user-owner relationship⁵
2. user control through the board
3. user control through management
4. user-driven market management
5. cooperative finance

The User-Owner Relationship

Users, most of whom are also owners, create cooperatives to serve a unique purpose. Issues related to success are whether a clear and unique purpose still drives the cooperative and what role members play in reinforcing that purpose.

Accordingly, related belief statements were developed.⁶ For example, do members:

- understand how their cooperative works?
- believe they control the cooperative?
- understand the purpose of their cooperative?
- understand their role in financing their cooperative?

³ Lang, Mahlon G., *Pacific Coast Cooperatives: Selected Characteristics and Major Challenges*, Center for Cooperatives, University of California, November 2001.

⁴ There is no formal, theoretical base for this framework. It is composed of structural features and principles unique to cooperatives and resulting challenges in marketing and finance.

⁵ User refers to agricultural producers who market through or buy from their marketing or supply cooperatives. Non-member patrons are also users. They may benefit from patronage refunds, but do not receive other benefits unique to members and have no voting rights.

⁶ A complete list of belief statements and responses is available through the UC Center for Cooperatives in a separate document: "Factors Affecting the Success of Agricultural Cooperatives: A Survey of Expert Beliefs".

User Control Through the Board

Member-patrons directly elect a board of directors to establish direction for the cooperative and to hire, evaluate and compensate management. Related questions are: Do directors understand and accept their essential roles? Are they capable of performing them? Are they being prepared to carry out those roles?

Respondents were asked to indicate degrees of agreement or disagreement with statements related to directors⁷:

- knowledge
- experience
- leadership skills
- relationship to top management

User Control Through Management

Cooperative management differs from the management of investor-owned firms because of the user-owner relationship. User-owners have a more complex set of expectations of management than do owners of investor-owned firms.

For example, successful operation of the cooperative clearly depends upon correspondence between management incentives and cooperative objectives. Therefore, belief statements were developed with respect to the:

- Challenges facing management
- Compatibility of management incentives and member interests

User-Driven Market Management

As a direct result of user ownership, cooperative operations are user-driven. Fruit, nut and vegetable marketing cooperatives have commitments to market their members' production. Supply and commodity cooperatives may have agreements with members or, in the absence of formal agreements, expectations to provide a higher level of service to members.

As a result, cooperatives may have less flexibility than investor-owned firms in the management of assets. This is particularly true for those marketing perennial crops. Many approaches to supply management or balancing have been used by cooperatives when supplies are short. When supplies are large, cooperatives attempt to build markets.⁷ Accordingly, survey belief statements were developed to assess the appeal of alternative means of balancing supply and demand. These were derived from questions like the following:

- What options can cooperatives exercise to stabilize their market outlets?

⁷ These may include purchases from non-members, imports when supplies are short along with market building, sale of delivery rights and cooperative encouraged acreage reduction when crops are long.

- What options can cooperatives exercise to meet marketing commitments when there are short crops?

User Finance

A direct result of the “user benefit” principle is the fact that cooperatives return benefits (earnings, market access or other services) in proportion to patronage of the cooperative. As a result, there is no incentive for non-patrons to provide true risk capital to a cooperative, *as a cooperative*.⁸ Aside from dividends on equities earned as active users, non-users cannot share in the earnings of the cooperative.⁹ Only patrons can provide initial risk capital to the cooperative.¹⁰ Thus, finance and structure issues are both involved when “outside” capital is sought. Belief statements to elicit expert responses to alternative financing approaches focused on questions like these:

- How can cooperatives meet the financial challenges of competition in a changing food system?
- How do alternative organization structures, ventures with other firms and associated sources of capital affect the ability of the cooperative to meet competition and serve member needs?

In addition to the belief statements related to questions listed above, the survey included other statements related to new cooperative development, Capper-Volstead protection and some issues unique to supply or marketing cooperatives. These statements, as well as tabulated responses, are included in a separate document which can be secured through the Center for Cooperatives.

Methodology

In the first portion of this study, the belief statements were presented via electronic mail to 300 persons with expertise in cooperatives.¹¹ Those choosing to respond did so through a web site address imbedded in the electronic message they had received. As respondents submitted their answers, the website displayed a graphic summary of responses by belief statement.

The target audience for the electronic survey included groups with expertise related to agricultural cooperatives (Appendix I). Respondents were asked to identify up to two types of cooperatives with which they were familiar.

⁸ Cooperative statutes such as the Capper-Volstead Act establish that as a condition of protection under the Act, the cooperative either (1) limit dividends on shares or (2) observe the one member, one vote rule. Subchapter T of the Internal Revenue Code holds that the single tax principle applies only to cooperative earnings distributed in proportion to patronage.

⁹ Non-patrons may provide subordinated debt or preferred stock to a cooperative, but the returns on this “investment” are limited. This is not true risk capital in the sense of being able to share earnings and risks as stockholders would do. Non-patrons may provide true risk capital to an investor-owned subsidiary of a cooperative or to an investor-owned firm that is a joint venture partner to the cooperative, but this is not the same as an investment in the cooperative.

¹⁰ The cooperative may accumulate unallocated equity through non-member business or through the operation of investor-owned subsidiaries. But the initiation of this activity by a cooperative assumes that patrons provided initial risk capital.

¹¹ The programming and technical aspects associated with this on-line survey were managed by Jeremy Babcock of Reprographic Services at the University of California, Davis.

As shown in Table 1, based on the respondents' self-classifications, they were grouped as follows:

Experts on California fruit, nut and vegetable cooperatives. This group is referred to as fruit, nut & vegetable cooperatives. It includes 54 respondents from California and 7 respondents from national organizations (CoBank, USDA, NCFC) with knowledge of fruit, nut or vegetable marketing cooperatives or bargaining cooperatives. A total of 61 respondents fit in this category.

Experts on commodity marketing, supply and service cooperatives. This group of 100 provided responses for commodity, supply and service cooperatives. It includes all respondents with knowledge of grain, dairy, cotton, supply or service cooperatives. The respondents represent 26 states and the District of Columbia. One response was from Canada.

Table 1. Respondents to Beliefs Survey by Cooperative Type

Category	Abbreviations in Charts & Tables	Receiving Surveys	Fruit, Nut & Vegetable	Commodity, Supply & Service Respondents
			<u>RESPONDENTS</u>	
Academics	(Academics)	47	5	27
Government-USDA	(USDA)	15 ¹²	5	10
Cooperative Council	(Council)	16	2	6
Cooperative Lenders	(Lenders)	8 ¹³	6	8
Accountants for Cooperatives	NSAC	81	8	15
Directors	(Directors)	33	11	7
CEOs & GMs	(CEO)	21	14	6
CFO	(CFO)	12	8	4
Other Management	(Other)	19	2	7
Development Professionals	(DEVPRO)	49	0	10
TOTAL		300	61	100

Statistical Analysis

The survey belief statements took two forms. The one most commonly used asked respondents to register agreement or disagreement with a specific statement. A second form asked respondents to react to a "multiple choice" statement.

For the first form of belief statement, respondents were asked to indicate the strength of their agreement or disagreement. Their answers were coded: 1=strongly disagree, 2=disagree, 3=neither agree nor disagree, 4=agree or 5=strongly agree.

In the tables of findings, a single number from one to five shows the mean response to a statement by a respondent group. A number above three reflects agreement and a number below three reflects disagreement.

The mean response was calculated using a "t" test¹⁴ to determine whether the difference from 3 (neither agree nor disagree) was statistically significant, thereby reflecting significant agreement

¹² Three USDA respondents indicated that they were knowledgeable about both classes of cooperatives

¹³ Three lenders responded as knowledgeable about both classes of cooperatives. In addition, three respondents on the NSAC list identified themselves as lenders.

¹⁴ "t" statistics were calculated on a spreadsheet and critical values were taken from "t" tables.

or disagreement with the belief statement. Values found statistically significant at the .05 level appear in bold print.

For the second form of belief statement, experts were asked to indicate which of several statements most accurately reflected their beliefs. These data are not analyzed statistically, but rather reported in tables that show the total number of respondents and the percentage of that group choosing each of the possible responses.

Results are reported for all respondents to each sample and for individual groups within the sample.

Expert Interviews

Once the on-line, interactive surveys were initiated, the author conducted personal interviews with 14 persons from California who had extensive experience as CEOs, board chairs or other senior management positions with cooperatives (Table 2). The interviewees were asked to focus on the issues they thought most critical to the success or failure of cooperatives. They were also asked for ways to address challenges unique to cooperatives.

Table 2. Experts Interviewed

Name	Role(s)	Cooperative(s) Industries	Location
Allewelt, Bill	CEO RET, Director	Three Cooperatives, CoBank	Davis
Baccigaluppi, Roger	CEO, RET	Blue Diamond Growers	Sacramento
Barton, Gerald	Director, CEO	Diamond of California	Ripon
Beitzel, George	Financial, CEO, Director	Banking, Blue Anchor, Other	Elk Grove
Collin, Gus	Board Chair	Sunsweet Growers	Selma
Dicke, Larry	CFO	Blue Diamond Growers	Sacramento
(for Doug Youngdahl)	CEO		
Emigh, Mike	CEO	Valley Fig	Fresno
Hickman, George	Financial Industry RET	BOA, Production Credit	Davis
Janzen, Glen	CEO	Ranchers' Cotton Oil	Fresno
Keiper, Sam	VP Member Relations	Diamond of California	Davis
(for Michael Mendes)	CEO		
Payne, Walt	CEO, RET	Blue Diamond Growers	Sacramento
Prince, Jack	Executive Vice President	Western Division, LOL	Tulare
Schaeffer, Fred	Director	Multiple Cooperatives,	Marysville
Vangelos, Allan	CEO, RET	Calavo Growers Ret	Davis

THE USER-OWNER RELATIONSHIP

Expert Overview

The cornerstone of a successful cooperative is a clear, unique and common purpose that is understood by members and repeatedly reinforced. This was the message of experienced cooperative “practitioners” (CEOs, directors and bankers) interviewed for this research.

William F. Allewelt expressed the consensus¹⁵:

“The cooperative exists to provide a service to its members. Its role is to enhance the value of the farm firm. If it does not provide a unique service that cannot be provided by investor-owned firms, there is no reason for the cooperative.”

In a follow-up roundtable discussion, these words were clearly endorsed by other participants.¹⁶

Allewelt made a second central point:

“ Member control enables growers to choose which services the cooperative will provide—but there is a price for every unique feature.”

For example, in his experience, “cooperative members have chosen: (1) to market some products long after US growers were no longer able to compete with foreign growers, (2) not to process products produced in another state even though the cooperative could serve that market more profitably, (3) to accept (or tolerate) grading or handling practices which favor some members more than others, and (4) to continue to receive raw product from distant locations even though hauling costs had made these non-competitive.”

The interviewees agreed in general that:

- Such policy decisions, which favor some members but result in sub-optimal earnings for the cooperative, should be deliberate and their ramifications well understood by all members.” As members incur the costs of sub-optimal operations, it is especially important that members fully understand that such policy decisions are made for reasons other than optimizing results from the business operations.”
- Failure to recognize the unique role of the cooperative and the fact that it may forego earnings to provide unique services to members can lead it to invest in operations in which the cooperative is not competitive, thereby wasting member resources.

This can happen if members do not have a sense of ownership in the cooperative. According to Walter F. Payne¹⁷, a ‘mentality of membership’ is required so that members understand that they are assuming the risk when capital investment decisions are being made. This is critical if, as

¹⁵ William F. Allewelt, personal interview

¹⁶ A roundtable on December 6, 2001 to discuss an early draft of the research report, was hosted by the Agricultural Council of California and the Center for Cooperatives. It was attended by William Allewelt, Roger Baccigaluppi, Gerald Barton, George Beitzel, Gus Collin, Jack Prince and Fred Shaeffer. Persons unable to attend, but who specifically expressed support for the work included George Hickman, Walt Payne, Allan Vangelos. Others were unable to attend. The absence of comment is not taken as agreement or disagreement with statements in the report.

¹⁷ Walter F. Payne, personal interview

Roger Baccigaluppi¹⁸ said, members are to "deliver their products" to their cooperative instead of "selling" to the cooperative.

Survey Findings

While the interviews helped identify success factors, the survey provided an assessment of how well cooperatives perform relative to these factors.

The data represent responses of persons and groups with different kinds of expertise and knowledge of different types of cooperatives. Most often there is agreement, but when differences between respondent groups or samples occur, these are pointed out in the text.

Uniqueness of Purpose

The cooperatives that have endured tend to be characterized by clear and well-established purposes. The need for long-term assurance of a market led growers to form marketing cooperatives in the first place. The desire for fair treatment in handling and grading also made grower-owned companies attractive. So too did the ability of bargaining cooperatives to represent growers in negotiating terms of trade with canners and other first handlers. However, growers saw an assured market as the first priority.¹⁹ This is reflected in the title of the book A Home and A Price,²⁰ the history of the California Canning Peach Association.

As Table 3 shows, the survey of experts reinforced the importance of market access as a purpose of the cooperative, not only for fruit, nut and vegetable producers but also for commodity marketing, agricultural supply and service cooperatives. "Better terms of trade" was also cited by both groups. The same table shows that respondents most familiar with commodity marketing and supply cooperatives were more likely to see the cooperative as a competitive yardstick against which to measure the performance of other firms.

Table 3. The Purpose of the Cooperative

The most important influence of cooperatives I know best	Fruit, Nut and Vegetable Cooperatives n=61	Commodity, Supply & Service Cooperatives n=100
Market Access	59%	49%
Better terms of trade	26%	19%
A competitive yardstick	10%	23%
None	3%	2%
Other	2%	7%

Member Education

To help members understand the cooperative's purpose and strategies in a complex economy requires continual education about the economic environment and how the cooperative serves member interests. This was clearly communicated by experts familiar with both respondent groups (Table 4).

¹⁸ Roger Baccigaluppi, personal interview

¹⁹ Ronald Schuler, President, California Canning Peach Association, Presentation to Class in Cooperative Business Enterprise, University of California, Davis. November, 2000.

²⁰ By Frank A. Van Konynenburg for the California Canning Peach Association.

Table 4. The Greatest Need in Cooperative Member Education

	Fruit, Nut and Vegetable Cooperatives n=61	Commodity, Supply & Service Cooperatives n=100
Cooperative Principles	19%	29%
Competitive and Business Environment	66%	52%
Cooperative Finance	16%	16%
Cooperative Law	0%	0%
Other	0%	3%

Member Understanding and Communication

Respondents clearly indicated that if members ask their cooperative to provide a service, they need to know what decision they are making, its cost and which members it serves. This is reflected in Table 5.

Statistically significant responses from every expert group also agreed to the importance of the members' role in communicating with each other about the cooperative. This is consistent with the findings of an earlier study by Siebert²¹ that highlighted the importance of members' communications about the cooperative.

Although the experts' assessments of member effectiveness in communication is less than enthusiastic in both types of cooperatives (Table 5), member communication about California's fruit, nut and vegetable marketing cooperatives is ranked somewhat higher than that of members of commodity marketing and agricultural supply cooperatives. This suggests that the clarity of purpose of the California fruit, nut and vegetable cooperatives may be more apparent to members than is the purpose of the other group.

Again in Table 5, the survey assessment of members' understanding of their decision to leave earnings in the cooperative tends to confirm Payne's concern that members do not understand that they are the risk takers when investment decisions are made at the level of the cooperative.

Internal programs can strengthen member understanding and communication. Diamond of California and Blue Diamond Growers make extensive use of liaison committees, groups of members who work with a representative of the board and a representative of management to communicate to and receive feedback from members. The committees involve a large number of member growers in discussion about and feedback on seasonal activities.

Blue Diamond uses a young growers program for farm couples. There is a new class each year and three meetings for each class.

²¹ Jerome B. Siebert, "Co-ops: What Farmers Think!" UC Center for Cooperatives 1994

Table 5. Members' Understanding of and Communication About Their Cooperative

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
There must be a clear, common need that members understand and articulate in terms of how it's met by cooperative.	4.47	4.6	4.6	4.33	4.37	4.50	4.64	4.12	4.5
Members do understand and can communicate the importance of the cooperative to other members.	3.41	2.6	3.4	3.17	4.00	3.27	3.50	3.50	3.5
Must understand and support the strategies of their cooperative.	4.38	4.2	4.8	4.5	4.25	4.55	4.14	4.25	4.75
Do understand and support the strategies of their cooperative	3.26	3	3.2	3.17	3.37	3.27	3.5	2.87	3.5
Members can make informed choices between providing risk capital to their cooperative and current farm income.	2.80	2.20	2.8	2.5	3.00	3	2.93	2.86	2.5
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	14
There must be a clear, common need that members understand and articulate in terms of how it's met by cooperative.	4.42	4.37	4.6	4.38	4.2	4.14	4.83	4.55	4.6
Members do understand and can communicate the importance of the cooperative to other members.	2.91	2.70	2.8	2.87	3.2	2.43	3.33	3.18	3.00
Members must understand & support the strategies of their cooperative.	4.32	4.31	4.5	4.38	4.2	4.29	4.33	4.36	4.3
Members do understand & support the strategies of their cooperative	3.08	2.93	2.7	3.13	3.2	2.71	3.5	3.18	3.4
Members can make informed choices between providing risk capital to their cooperative and current farm income.	2.77	2.56	2.7	2.5	2.67	3	3.33	3.00	2.94

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

Academic: Researchers and Extension Specialists: NCR 194 Respondents
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USER CONTROL THROUGH THE BOARD

Expert Overview

Interviews with cooperative leaders quickly led to consensus on the importance of boards of directors and certain challenges they face:

- inherent conflicts of interest
- selection of capable directors
- confidence of board members in directing and evaluating management

Conflicts of Interest

Members of cooperative boards face these dilemmas:

To retain or not to retain earnings. Since cooperatives are inherently under-capitalized, boards may revolve retains or authorize payments when it is not in the interest of the cooperative to do so.²² This pressure can be so extreme that several of California's cooperatives have made advance payments to their members that were not supported by final earnings.

The very clear conflict of interest between returning current income to members and retaining earnings in the cooperative can be intensified by an individual director's personal financial situation or by social pressure, direct or indirect, from fellow members. In either case, the director can come under significant pressure not to act in the best interest of the cooperative.

Whatever the source, any pressure keeping directors from making objective, business-based decisions can be a factor in the cooperative's (1) inability to maintain a strong capital base, (2) tendency to become very highly leveraged, leaving it especially vulnerable in a cyclical business, or (3) failure to reduce its debt.

In the words of one interviewee²³:

If they (directors) can't afford to leave money in the cooperative, they can't make objective decisions about allocating earnings.

Special benefits which are unfair or inequitable. According to another long time observer and cooperative leader, over-reliance by the cooperative on a handful of very large members for throughput can leave the cooperative beholden to those growers. This situation gives the largest growers leverage to demand, and sometimes receive, special inequitable handling as a condition of remaining with the cooperative.²⁴

Multiple crops. The potential conflict of interest among growers of different crops handled by the same cooperative led an experienced and respected director to this observation:

²² George Hickman, Personal Interview

²³ Anonymous at author's discretion.

²⁴ George Beitzel

In specialty crops, the cooperative may be best served if it does not attempt to be a multi-crop organization. Otherwise, the director is representing a user interest that gains a higher role in the cooperative than the capital interest. There is an inherent conflict of interest.

To avoid dealing with the conflict of interest, directors may defer to the CEO when they should not. If directors in a multi-crop cooperative do not equitably represent the interests of all commodities handled, the organization will lose focus.²⁵

Lack of financial information. Another interview participant identified as a threat the more relaxed financial reporting relationship for some cooperatives than for investor-owned firms. Cooperatives not subject to securities regulations don't have the discipline imposed by required quarterly reports. Also, unlike publicly traded companies, cooperatives don't have listed stock prices that reflect investor confidence and performance. In the interviewee's²⁶ words:

"By the time members learn of bad news, a year may have passed and the damage is done."

Performance vs. prestige. Throughout the series of interviews, respondents raised concern about the tendency for a seat on the board to be viewed more as an honor than as a position of responsibility. All interviewees took care to point out their admiration for, and familiarity with, strong directors. But the following observations were common:²⁷

- It is viewed as honor to be a director, for which one receives special benefits. These perquisites may divert attention from issues that require scrutiny.
- Benefits extended to board members may have the effect of getting them to defer to the chair or the CEO on important business matters.
- It takes courage to independently express a minority viewpoint. In some cases it has been desperately needed.²⁸

Board Competence

If agricultural cooperatives had not benefited from leadership by truly exceptional individuals, they would not have achieved the success they have enjoyed throughout the US. However, while there are such notable exceptions, the agricultural cooperative board often has many members whose professional orientation (agricultural production management) does not prepare them for the role of director.

Thus, while a number of growers and particularly grower leaders are professionals who have succeeded in other businesses, they are more often hands-on, operations and production oriented. It does not come naturally for them to guide a marketing organization. Interview participants stressed the need to bring "varied competencies" to the board.²⁹ In the absence of an explicit effort to do this, the production orientation of most directors makes it difficult to maintain a board of active, interested members with various viewpoints and experiences.

²⁵ Barton

²⁶ George Beitzel

²⁷ Multiple respondents echoed a list of observations provided by Beitzel

²⁸ Barton

²⁹ Baccigaluppi and among others.

One CEO reported that when his board was significantly downsized, the goal of developing a board with substantial business experience became more realistic. He also pointed out that voting in proportion to patronage led to the election of those who had the greatest financial interest in the cooperative.

Board Confidence

Agricultural cooperative directors are expected to perform professionally on a part-time basis in roles that are filled by counterparts in investor-owned firms after years of professional experience and presumed competence.

As data from the survey will show, directors often feel that they don't know how to evaluate the CEO and don't feel comfortable with the CEO as a peer, much less as a subordinate in the organization chart. This lack of confidence is a special concern given that the primary role of the board is to hire, evaluate and compensate or terminate a CEO.

As Beitzel observes, this lack of confidence may result in:

- Ignoring weaknesses pointed out by an auditor or lender, and failure to develop a corrective plan to address them.
- Lack of strong board oversight of the CEO, including lack of goal setting and/or meaningful performance evaluation.
- Lack of discipline by the board to develop and follow a well-crafted business plan.
- Entering into new or different business ventures without adequate analysis, cost benefit assessment or exit strategies.

Survey Findings

The survey did not address conflicts of interest on the board. Therefore, the foregoing statements about expert beliefs regarding conflicts of interest are the product of interviews alone. However, issues of board competence and confidence were directly addressed by the survey (Table 6). These findings are clearly supportive of findings from the interviews.

Director Competence

In the opinion of the surveyed expert observers (Table 6), the role of cooperative board chair is every bit as demanding as that of the chair in an investor-owned competitor. But the same respondents indicated strong disagreement with the statement that board chairs do possess and exercise such skills.

These findings applied both to the fruit, nut and vegetable cooperatives and to the commodity marketing and agricultural supply cooperatives. These evaluations differed by respondent group, with academics, lenders and accountants showing the greatest concern about the disparity between cooperatives and investor-owned firms in terms of leadership at the board level.

The inability of directors to critically evaluate a strategic plan also is a source of concern. In Table 6, the only group suggesting that directors are capable of reviewing a strategic plan was the directors themselves. This finding is especially significant since the strategic plan is one of the primary tools with which directors can evaluate the CEO.

Table 6. Directors' Competence in Their Roles

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Board chairs must possess and exercise business and leadership skills that far exceed likely levels of compensation in a cooperative.	4.07	3.6	4.0	4.33	4.00	4.36	4.07	4.12	3.5
Chairs do possess and exercise business and leadership skills that approximate those of the chair in a comparable investor-owned firm.	2.64	1.8	3.4	1.67	2.25	2.91	2.86	2.62	3.5
As a group, directors in cooperatives I know have sufficient knowledge and experience to conduct a critical review of strategic plans and their assumptions.	2.85	2.40	2.8	2.50	2.75	3.27	2.79	2.75	3.5
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	14
Board chairs must possess and exercise business and leadership skills that far exceed likely levels of compensation in a cooperative.	3.87	4.11	3.9	4.00	3.87	3.86	3.50	3.55	3.75
Chairs do possess and exercise business and leadership skills that approximate those of the chair in a comparable investor-owned firm.	2.67	2.56	3.1	1.87	2.47	3.14	3.17	2.45	2.94
As a group, directors in cooperatives I know have sufficient knowledge and experience to conduct a critical review of strategic plans and their assumptions.	2.56	2.33	2.5	2.37	2.73	2.86	3.00	2.64	2.56

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

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Director Confidence

The experts' concerns about board leadership and knowledge, along with their concern about the ability of directors to evaluate a strategic plan, offer an explanation for the findings reported in Table 7. Respondents in both samples stress that "board chairs must be fully comfortable as peers/leaders of top management." However, the same respondents are neutral at best and tend to disagree with the statement that "In practice, board chairs are fully comfortable as peers/leaders of top management." These findings offer credence to concerns that boards sometimes defer to CEOs when they should not.

Table 7. Directors' Confidence in Their Roles

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
If the cooperative is to succeed, board chairs must be fully comfortable as peers/leaders of top management.	4.36	4.2	4.6	4.83	4.25	4.55	4.36	4.12	3.75
In practice, board chairs are fully comfortable as peers/leaders of top management.	3.05	2.6	3.4	2.33	3.37	3.09	3.21	3.00	3.00
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	14
If the cooperative is to succeed, board chairs must be fully comfortable as peers/leaders of top management.	4.33	4.37	4.4	4.88	4.2	4.14	4.33	4.45	4.06
In practice, board chairs are fully comfortable as peers/leaders of top management.	2.97	2.96	3.4	2.50	3.2	3.00	3.00	2.55	3.00

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

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Building Stronger Boards

The crucial role of a cooperative board of directors was emphasized by both the survey (Tables 6 and 7) and by interviews with experienced leaders. The interviewees, however, were primary contributors of specific ideas about how to strengthen a board. Their suggestions included (1) improved selection of director candidates, (2) reduction in board size, (3) long-term development of directors, and (4) outside directors with vote and compensation.

Board selection. Top managers who have worked with, and appreciate, capable directors (especially chairs) stress the need to seek the most capable members and encourage them to run. They also stress that selection of candidates should not be heavily influenced by the CEO, which can create another conflict of interest.

Interview participants suggested that a permanent nominating committee should be charged with developing a pool of highly qualified candidates. One former director and CEO who serves as a director on a bank board said it is continually in search of qualified candidates who might be tapped when an opening on the board occurs. This approach could as well be used by cooperatives. It would not conflict with democratic principles if there were always an opportunity for any member to be nominated.

A related suggestion came from a former CEO who said that many of the best candidates do not run. If they believe that the board is composed of persons seeking office for prestige or to press a particular operating issue, they will question the board's effectiveness and conclude that they don't want to waste their time. However, the most qualified candidates can be encouraged to run if a nominating committee emphasizes that the role of the board is being taken seriously and significantly upgraded.

Board size reduction. Some respondents observed that reduction in board size has made it possible for members to be more selective in voting for directors and led to greater accountability, less anonymity and more efficient board meetings.

Director development. Part of the effort to strengthen the board involves external education. As shown in Table 8, the respondents clearly thought that such education should be focused on business and competition issues. This, however, would be only one part of a much broader program to strengthen the board.

Table 8. The Greatest Need in Cooperative Director Education

	Fruit, Nut and Vegetable Cooperatives n=61	Commodity, Supply & Service Cooperatives n=100
Cooperative Principles	5%	6%
Competitive and Business Environment	74%	67%
Cooperative Finance	16%	19%
Cooperative Law	0%	0%
Other	5%	8%

Internal education is an ongoing process at some cooperatives. Liaison and advisory committees such as those used by Blue Diamond are also logical places to identify and develop director

candidates. This will not assure that they have the requisite skills, but hopefully, will identify people capable of developing those skills. Furthermore, as one director said:

There ought to be an age limit to encourage more young directors. This would enable the board to groom and develop directors for leadership roles.

While introductory board education programs should address director roles, conflicts of interest, and other basic issues, the development of strategic planning skill is a much more time consuming process. The perceived inability of most directors to conduct a critical review of a strategic plan or evaluate management cannot be corrected with a training session. An aggressive and long-term program of director development is essential.

Outside directors. Because even capable member directors lack the range of skills needed on the board, experienced cooperative leaders suggest that the board have one or more outside directors whose skills complement those on the board. They also argue that outside directors should have a vote and should be competitively compensated.

USER CONTROL THROUGH MANAGEMENT

Expert Overview

Cooperative management is unique, requiring all skills used by managers of competing firms, but requiring as well the ability to understand and be responsive to the user-owner relationship.

The interview participants did not focus extensively on management issues. However, they did agree that:

- Cooperative management faces special challenges, in particular those related to member communication and the production-driven nature of the cooperative.
- Cooperatives face a special challenge in developing appropriate compensation programs for their management.

Although they share the same highly concentrated global food and fiber market, the businesses with which the cooperative competes have fewer institutional restrictions on compensation or providers of capital. In contrast, the cooperative CEO may have limitations on sources of supply³⁰, limited access to risk capital and incentives to focus on a single product produced by the cooperative's members.

Furthermore, as a group, the cooperative's members rightly expect special treatment. These expectations demand time and attention, reaching far beyond concern with stockholder interests and customer sensitivity—the principal concerns of the CEO in an investor-owned firm.

The search for appropriate incentives to reward cooperative management was the subject of addresses at the annual meeting of the National Council of Farmer Cooperatives in January 2001 and in March 2001 at the annual meeting of the Agricultural Council of California. The same concern was behind a request to one interview participant to develop a long term compensation program to address the special challenge of retaining management. It has also motivated several California cooperatives to seek cooperative analogues to stock options.

Survey Findings

Survey findings reinforced statements of the interviewees, emphasizing the uniqueness of demands facing cooperative management. Member communication was viewed as the greatest challenge. The survey findings also documented concerns raised in interviews about the difficulty in creating long-term management incentives.

Table 9 shows that the greatest challenge for cooperative management is seen as that of explaining to members the value of the cooperative relative to alternatives. This is followed closely by reconciling market realities with member expectations. These two responses are very closely related and both are clearly communication issues. They were consistent across expert groups and between the two groups of cooperatives.

³⁰ This becomes an advantage when crops are short if the members are committed to the cooperative.

Table 9. The Greatest Challenge Facing Cooperative Managers

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Communicating Cooperative Value Relative to Alternatives	41%	40%	40%	50%	50%	36%	36%	38%	50%
Acting Quickly When Board Agreement is Needed	5%	0%	0%	0%	0%	9%	7%	13%	0%
Harmonizing Member Desires and Market Demands	38%	20%	60%	33%	38%	45%	50%	25%	0%
Maximizing Return on Assets	15%	40%	0%	17%	0%	9%	7%	25%	50%
Other	2%	0%	0%	0%	13%	0%	0%	0%	0%
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Communicating Cooperative Value Relative to Alternatives	47%	41%	42%	38%	47%	57%	67%	36%	50%
Acting Quickly When Board Agreement is Needed	7%	0%	0%	0%	7%	0%	17%	27%	12%
Harmonizing Member Desires and Market Demands	27%	33%	33%	25%	27%	43%	17%	18%	19%
Maximizing Return on Assets	14%	23%	25%	13%	13%	0%	0%	18%	12%
Other	5%	4%	0%	25%	7%	0%	0%	0%	7%

Table 10 focuses on challenges faced by the cooperative itself, with the experts giving top priority to hiring capable management and developing capable directors. Both beliefs are reflected in responses to statements included in Table 10.

While both were identified as the two greatest challenges to cooperative success, finding capable management was viewed as a greater concern by the commodity marketing and agricultural supply group.

Table 10. The Greatest Challenge Facing Cooperatives

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Member Communications During Consolidations	10%	0%	0%	0%	13%	18%	21%	0%	0%
Election of Capable Directors	31%	60%	40%	17%	25%	45%	7%	50%	25%
Hiring, Retaining Top Management	30%	0%	40%	33%	50%	18%	43%	13%	25%
Financing Cooperatives With Member Equity	8%	20%	20%	0%	0%	0%	14%	13%	0%
Strategies & Structures for Grower Ownership	15%	0%	0%	33%	13%	18%	0%	25%	50%
Other	7%	20%	0%	17%	0%	0%	14%	0%	0%
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Member Relations, Communications During Consolidations	16%	19%	30%	0%	20%	0%	33%	9%	12%
Election of Capable Directors	23%	19%	20%	25%	13%	29%	17%	55%	19%
Hiring, Retaining Top Management	30%	23%	30%	25%	47%	14%	50%	18%	38%
Financing With Member Equity	12%	27%	10%	0%	7%	0%	0%	9%	12%
Strategies & Structures for Grower Ownership	14%	12%	10%	25%	13%	43%	0%	0%	19%
Other	4%	0%	0%	25%	0%	14%	0%	9%	0%

Management Compensation

Survey respondents were generally clear (Table 11) in their beliefs that:

- Cooperative management must have compensation programs adequate to attract chief executives comparable to those of investor-oriented firms.
- Existing compensation programs are not seen as adequate to attract chief executives comparable to those of investor-oriented firms.

Painful experience has demonstrated that high levels of compensation do not guarantee top management performance. This is why experts raise concern over long-term management incentives, as reflected in their responses in Table 11, which clearly indicate that:

- If cooperatives are to succeed, management compensation must be tied to maintenance of long-term (5-10 year) performance of the cooperative.

- In practice, management does not have clear financial incentives to achieve long-term (5-10 year) performance goals for the cooperative.

Table 11. Beliefs About Executive Compensation Levels and Long-Term Incentives

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
If cooperatives are to succeed, cooperative management must have compensation programs adequate to attract chief executives in comparable investor-oriented firms.	4.18	4.2	4.0	4.67	4.12	3.91	4.29	4.37	3.75
In practice, top cooperative management has compensation programs adequate to attract chief executives in comparable investor-oriented firms.	3.0	2.6	2.8	2.67	3.37	3.27	3.0	2.87	3.0
To succeed, management compensation must be tied to maintenance of long-term (5-10 year) performance of the cooperative	4.16	4.0	3.8	4.67	4.25	4.45	3.93	4.00	4.25
In practice, management has clear financial incentives to achieve long-term (5-10 year) performance goals for the cooperative.	2.72	2.4	2.8	2.17	3.25	2.55	2.57	3.12	3.00
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Cooperative management must have compensation adequate to attract executives in comparable investor-oriented firms.	4.22	4.37	4.0	4.5	4.07	3.14	4.67	4.45	4.25
In practice, cooperative management has compensation adequate to attract executives in comparable investor-oriented firms.	2.86	2.93	2.7	2.62	2.8	2.57	2.83	3.09	3.00
To succeed, management compensation must be tied to maintenance of long-term (5-10 year) performance of the cooperative	4.05	4.19	3.9	4.63	4.00	4.00	4.00	3.82	3.88
In practice, management has clear financial incentives to achieve long-term (5-10 year) performance goals for the cooperative.	2.75	2.78	2.7	2.00	2.93	2.71	2.17	2.91	3.06

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

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Management Selection and Compensation

Interviewed leaders and surveyed experts both agreed on the importance of issues involving management compensation. Given an environment in which cooperatives must compete with investor-owned firms, they said, cooperative members cannot afford management that is any less competent than that of their competitors. Furthermore, it is difficult to envision an ideal cooperative manager who does not have an understanding of cooperatives grounded in experience. This requirement has three effects: (1) it narrows the field of potential candidates, (2) increases the likely cost of management skill, and (3) increases the importance of long-term incentives.

In response, several agricultural cooperatives, with the assistance of major accounting firms, have developed deferred compensation programs for the executives. Their value varies annually based on the performance of the cooperative relative to strategic and operating goals—and therefore the long-term viability of the cooperative.

Vesting in such programs occurs on a fractional basis from year to year. For example, an executive may be vested in only one fifth of the fund in each year following its deposit in year one. Loyalty (retention) of executives is rewarded as are efforts to assure not just the survival of the cooperative, but also high levels of performance.

The ultimate aim of compensation programs for cooperative management is to harmonize the rewards to management with the interests of members. Such programs are a step toward this goal.

However, complete harmony with member interests remains difficult to achieve. Some suggest that management should feel “all of the pain” that members do when they experience losses. The implication is that if growers lose money, management should lose money too. But, as one retired CEO said.

The acquisition of land to plant trees is not one of the risks I took when I chose to be in management rather than in farming.³¹

Cooperative management cannot be held accountable for the consequences of decades-long land use decisions by growers, much less entire industries. The prior suggestion is not realistic.

The ideal compensation program is yet to be designed. That this is a priority is reflected in the fact that it is an increasingly common theme in cooperative education and one that directors and executives are working to address.

³¹ Walter F. Payne, Interview

MARKET MANAGEMENT

Expert Overview

The cooperative's commitment to serve the interests of its member-producers presents a perennial challenge of market management—making a home for output from relatively fixed member acreage in the face of changing market demands and industry conditions.

Meanwhile, members expect unique services from their cooperative, but periodically receive market messages that provide attractive short-term alternatives to selling through their cooperative. These may appeal to members who take the relative certainty of their cooperative for granted, overlooking the fact that alternative markets are not always available and that alternative buyers cannot always guarantee payment.³²

This requires consistent communication to bolster member relations. In the interviews with experts, that was the primary finding relative to market management—a finding that points directly to the importance of a clear understanding of the unique purpose of the cooperative and the need for continual reinforcement of that purpose. Members need to know how they benefit in the best of times and in the worst of times. They also need to know what they are giving to get those benefits and what they will lose if they let their membership lapse.

Market forces are always present and a cooperative's efforts to deal with market failure do not completely insulate it or its members from those forces. As a consequence, communication to members is critical to make clear the costs and benefits of providing the primary service.

For example, it is important for growers to understand that the guarantee of a market for their product requires new market development costs in some years. If new markets are identified, they may come with a commitment to provide product subsequently. In other years, the cooperative may have to make cash market purchases or source fruit from non-member or even foreign suppliers to preserve its long-term market outlets.

In each case, there are costs (higher retains from growers or lower payments to growers) if the cooperative is to deliver on its long-term commitment to assure a market for its members. Cash payments to non-members or payment for imports from other countries can concern members. Similarly, excess production brings with it a need to find new markets or, as in very unpleasant and real current cases, to pay members for only a portion of their crop. If members do not understand this, they may view the action of their cooperative as contrary to their own interests.

Those who manage agricultural cooperatives are well aware of the challenges in both seeking alternative markets for over production and meeting commitments when member production is insufficient. Over time, these managers have developed marketing approaches that address both yield (supply) and market (demand) variability. Their additional challenge is to help members understand the techniques they use and their reasons for doing so.

³² Bitter experience shows that even cooperatives cannot make this guarantee simply because they are cooperatives.

Survey Findings

Experts tend to believe that the greatest competitive weakness of cooperatives is the fact that they are production-driven. As seen in Table 12, this belief is held by both experts on the California fruit, nut and vegetable cooperatives and experts on the commodity marketing, supply and service cooperatives. This viewpoint is unsurprising given that, according to both expert groups, the most important purpose of cooperatives is to provide market access (Table 3). As indicated in the discussion of that finding, the growers' primary interest is that of assuring a home for their product.

Assuring a market, while reducing risk for individual growers, creates an ongoing challenge for the cooperative as a whole. Once this commitment is made, oversupply can threaten the cooperative's competitive position. Further, because of the ongoing need of cooperatives to market occasional large crops, they assume commitments to new markets in order to place their members' production. As a result, they are sometimes left with questions about how to serve those markets when their production falls short.

Table 12. The Greatest Competitive Weakness of Cooperatives

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Member Finance	20%	20%	60%	0%	25%	0%	21%	0%	0%
Slow Decision Making	11%	0%	0%	0%	0%	36%	7%	25%	75%
Production Driven	61%	40%	40%	83%	75%	64%	64%	63%	0%
Other	8%	40%	0%	17%	0%	0%	7%	13%	25%
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Member Finance	19%	15%	30%	0%	20%	0%	33%	36%	19%
Slow Decision Making	18%	15%	20%	0%	27%	33%	0%	9%	31%
Production Driven	54%	63%	40%	75%	53%	50%	67%	45%	37%
Other	9%	7%	10%	25%	0%	17%	0%	9%	13%

Survey respondents indicated that cooperatives need to be flexible in evaluating alternative strategies for managing their members' production.

As the statistics in Table 13 show, the impact of the cooperative on market structure appears to vary with the nature of the market. Experts knowledgeable about California's fruit, nut and vegetable cooperatives do not tend to believe that markets are less concentrated because cooperatives are present. This is probably because these cooperatives are the principal businesses

in the agricultural markets they serve. In contrast, experts knowledgeable about commodity marketing and agricultural supply cooperatives have strongly held beliefs that markets are less concentrated because cooperatives are there.

Table 13. Cooperatives and Market Structure

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
In the (industries) I know best, market structure would be more concentrated if there were no cooperatives.	2.95	3.40	4.4	3.17	2.87	2.27	2.79	2.62	3.5
Concentration in food markets and globalization require that cooperatives that market different products work together to be competitive.	3.92	3.8	4.0	4.50	3.75	3.91	4.07	3.37	4.0
Success will depend upon use of federations, unification, joint ventures or other structures that combine equities of existing cooperatives.	4.08	4.0	2.4	4.5	4.00	4.09	4.21	3.71	3.5
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
In the (industries) I know best, market structure would be more concentrated if there were no cooperatives.	3.68	4.0	4.4	3.38	3.73	2.86	2.67	3.55	3.63
Concentration in food markets and globalization require that cooperatives that market different products work together to be competitive.	3.88	4.07	4.4	4.13	3.73	3.57	3.5	3.18	4.0
Success will depend upon use of federations, unification, joint ventures or other structures that combine equities of existing cooperatives.	4.07	4.33	4.2	4.38	4.13	3.57	4.33	3.64	3.5

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

Academic: Researchers and Extension Specialists: NCR 194 Respondents
 USDA: USDA-RDA-Cooperative Services Personnel (USDA Website)
 Lenders: CoBank Executives (CoBank Website and NSAC E-Mail Addresses)
 Accountants: Accountants and Attorneys (2) Who Work For or With Cooperatives (NSAC)
 Directors: Directors and Chairs of Cooperatives
 CEOs:CFOs: CFOs and Other Ranking Executives (3)

There are no apparent differences in beliefs among respondents regarding the need for cooperation among cooperatives to meet the marketing challenges imposed by concentration of

global food markets. Table 13 reflects strong beliefs that continued joint action among cooperatives is required to meet the challenge of increasingly concentrated global markets.

Stabilizing or Strengthening Sales

Full line distribution, branding and category management. Respondents supported the notion that cooperatives must establish or strengthen their positions in retail markets through branding and category management. As shown in Table 14, this view was common to experts on both types of cooperatives. There was some difference in intensity of response among sub-groups. Directors and CEOs in the California group endorsed this view.

Full-line distribution received weak support from the California group, and none from the commodity cooperatives. Most of that group's sales are of relatively large-scale industrial products or products used for further processing without dealing directly with retailers. Thus, full-line distribution strategies have not tended to become an issue for them.

Using non-member suppliers to meet market demands. When cooperatives succeed in expanding their markets, they must continue to meet those demands even when their members' production falls short. Even though there are very good business and economic reasons for this response, member relations clearly can be affected if the cooperative purchases products from non-members. In Table 14, directors in the California sample were the only sub-group to indicate significant support for the idea.

Foreign sources of supply. There is minimal support among respondents in the California sample for the use of foreign sources of supply to meet shortfall—again coming only from cooperative directors. There is no support from commodity supply and service cooperatives. The opposition to using foreign sources of supply by the commodity marketing and supply cooperatives is predictable. Imports always represent a threat to those groups as marketers, whereas for specialty producers they can periodically help to stabilize and maintain markets.

International memberships. The receptiveness of experts to alternative sources of supply is markedly different when international memberships are considered. Statistically significant support for international memberships comes from lenders, CFOs, directors and CPAs who are knowledgeable about California cooperatives. The greatest support for international memberships in commodity marketing cooperatives comes from academics and lenders.

Supply Management

The survey did not address the broader subject of overall commodity supply management. In California's fruit, nut and vegetable markets, as well as in commodity markets nationwide, national public policy—either through marketing orders or commodity programs—has historically been used to manage supply.

Grower managed and funded programs to reduce excess supplies have recently been used to reduce peach acreage and some cooperatives have made decisions to pay members only for a fraction of their deliveries. Understandably, these programs are unpopular and used only in extreme situations.

Table 14. Beliefs About Market Management Issues

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
To succeed, the marketing cooperatives I know must become full line distributors of related consumer products:	3.5	2.8	2.4	2.83	2.62	3.45	3.43	3.0	4.5
To succeed, the marketing cooperatives I know must develop branded lines and or a category management.	3.68	3.00	3.0	3.5	3.50	4.0	3.77	3.87	4.5
To succeed, the marketing cooperatives I know must use non-member suppliers to meet market demands.	3.31	3.6	2.4	3.33	3.12	3.64	3.14	3.62	3.5
To succeed, the marketing cooperatives I know must use foreign sources of supply to meet market demands.	3.10	3.2	2.2	3.33	2.75	3.64	2.79	3.62	3.0
To succeed, the marketing cooperatives I know must welcome international members if it makes their cooperative more competitive.	3.70	3.40	3.6	4.00	3.75	3.36	3.5	3.75	4.0
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
To succeed, the marketing cooperatives I know must become full line distributors of related consumer products:	2.78	3.48	2.2	3.00	2.60	3.67	3.20	2.9	2.69
To succeed, the marketing cooperatives I know must develop branded lines and or a category management.	3.44	3.04	3.1	3.5	3.27	3.5	3.60	3.30	3.75
To succeed, the marketing cooperatives I know must use non-member suppliers to meet market demands.	3.05	3.04	3.0	3.25	3.13	3.83	2.8	2.9	2.81
To succeed, the marketing cooperatives I know must use foreign sources of supply to meet market demands.	2.74	2.93	2.8	3.25	2.80	2.83	2.20	2.60	2.32
To succeed, the marketing cooperatives I know must welcome international members if it makes their cooperative more competitive.	3.45	3.48	3.5	3.88	3.40	3.00	3.4	3.30	3.5

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

They do emphasize the importance to cooperatives of finding ways to stabilize and strengthen their relationships with increasingly concentrated handlers. Increasingly, therefore, particularly as cooperatives attempt to secure and maintain access to concentrated retail outlets, they are in a position to (and face a need to) make use of approaches like those listed in Tables 13 and 14.

COOPERATIVE FINANCE

Expert Overview

A clear, strong relationship between member capital and member benefits strengthens a cooperative, but this relationship is not always clear. That was the message of those interviewed who also agreed that cooperatives must be flexible and open to a range of unifications, joint ventures and marketing alliances.

The participants were in general agreement that the use of member capital and permanent capital should be guided by the objective of reinforcing the member relationship to the cooperative. There was considerable discussion about how to achieve this objective, but leaders emphasized the importance of efficient use of member capital and of innovative approaches to capital formation.

Furthermore, investment in non-member processing operations can, if there are synergies with member operations, strengthen the member relationship to the cooperative. Earnings from non-member business also can provide an important source of permanent capital, thereby reducing the equity required of members for a given investment.

However, as cooperatives seek to respond to such market opportunities, it is important that investments be evaluated in terms of their contribution to the strength of the member relationship as well as the financial viability of the cooperative. If cooperatives attempt to compete in operations without significant synergies—those that do not strengthen the member relationship directly or indirectly—they are at a competitive disadvantage. Their members would logically challenge such investments.

Cooperatives are also limited by the provisions of Capper-Volstead in terms of non-member business they can pursue.

With the foregoing in mind, the interviewees emphasized:

- The need for members to have a strong sense of ownership in their cooperative. Members often do not recognize themselves as risk takers when “the cooperative” makes an investment. Unless they view it as “their cooperative”, the behaviors one would expect of those who own and control a business—relationships essential to strength in a cooperative—will not develop.
- The need to focus on, and communicate about, additional unique services that directly or indirectly benefit members.

Survey Findings

An increasingly competitive food and fiber system has led to an increasing demand for capital. Members have repeatedly been told of the need for capital, but balk in responding. According to respondents, members' reasons for doing so are not surprising: (1) the benefit is not clear and (2) the payoff is slow in coming.

As Table 15 shows, the greatest obstacle to member financial commitment is inability to see a clear benefit at the farm level. Thus, it is important that cooperatives select investments that they can “sell” to their members on the basis of member benefit. It is equally important that members be able to clearly see the connection between their investment and a benefit through the cooperative. The dilution of member capital will create concerns.

Table 15. Members’ Reasons for Caution in Providing Risk Capital

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Think they are not the only source of equity	7%	20%	0%	0%	13%	9%	7%	0%	0%
They have no confidence in the cooperative	8%	0%	20%	17%	13%	18%	0%	0%	0%
They don't understand the need	10%	20%	0%	0%	0%	9%	29%	0%	0%
The reward/payoff is not clear	56%	40%	80%	83%	50%	36%	36%	75%	0%
The reward/payoff is slow in coming	11%	0%	0%	0%	13%	18%	14%	25%	100%
Other	8%	20%	0%	0%	13%	9%	14%	0%	0%
Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Think they are not the only source of equity	3%	7%	0%	0%	0%	0%	7%	0%	0%
They have no confidence in the cooperative	8%	13%	0%	22%	0%	13%	0%	0%	0%
They don't understand the need	13%	7%	8%	0%	33%	0%	20%	17%	33%
The reward/payoff is not clear	46%	40%	75%	44%	67%	75%	40%	50%	17%
The reward/payoff is slow in coming	24%	33%	17%	33%	0%	13%	27%	17%	33%
Other	5%	0%	0%	0%	0%	0%	7%	17%	17%

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

Academic: Researchers and Extension Specialists: NCR 194 Respondents
 USDA: USDA-RDA-Cooperative Services Personnel (USDA Website)
 Lenders: CoBank Executives (CoBank Website and NSAC E-Mail Addresses)
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Financing Alternatives

Because cooperatives have limited sources of risk capital, alternative approaches to marketing and finance have been explored. These alternatives to exclusive reliance on member equity include:

- Building permanent (unallocated) capital with non-member business. Commonly used.
- Unifications of major cooperatives. The largest dairy cooperatives in the state have participated in major unifications with other dairy cooperatives within California and with national dairies.
- Joint ventures among cooperatives. Most recently, Sunkist and Florida's Natural, both cooperatives, announced a marketing joint venture.
- Joint ventures between cooperatives and investor-owned firms. A joint venture between Land O' Lakes and Mitsui of Japan was used to achieve technical, marketing and financial synergies to market whey products.
- Acquisition of investor-owned subsidiaries by cooperatives. Diamond created its own Diamond Nut Subsidiary. Blue Diamond acquired subsidiary companies that market macadamia and hazel nuts.
- The creation of financial trusts that acquire preferred shares in cooperatives. Diamond, Sunsweet, Farmland Industries and Land O'Lakes are cooperatives that have used preferred stocks to enhance the equity segment of their balance sheet.

Because some of these approaches to cooperative finance are relatively new, they are not widely understood. As cooperatives look to new and unfamiliar sources of capital, members may ask how the use of these alternatives might affect their cooperative.

As part of the expert survey, respondents were asked to react to belief statements about these alternatives. Their responses are detailed by group in Tables 16A and 16B. With few exceptions, the responses indicate that none of these alternatives is inherently threatening to member ownership or control of the cooperative.

Clearly, the statements to which participants responded are highly generalized. Furthermore, financial options must be evaluated on a case-by-case basis in terms of how and whether they strengthen the members' relationship to the cooperative. However, the responses indicate that there is nothing inherently objectionable to any of the alternatives.

Survey respondents were asked to respond to the statement that cooperatives should rely exclusively on allocated (member) equity as a source of risk capital, accepting unallocated equity under absolute necessity and with caution. Virtually all respondents disagreed with this statement. Responses of both groups of experts clearly made the point that cooperatives should look beyond their membership for permanent capital.

A second belief statement asked experts to respond to the following: "Cooperatives must acquire risk capital via non-member business to the extent that it serves their members' interests and to

the extent that they can legally do so.” Respondents agreed strongly with this statement just as they disagreed strongly with the first. Again, the response was consistent across sample groups.

**Table 16A. Beliefs About Issues in Cooperative Finance
(California Fruit, Nut and Vegetable Cooperative Experts)**

California Fruit, Nut and Vegetable Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	61	5	5	6	8	11	14	8	4
Cooperatives should rely exclusively on allocated (member) equity as a source of risk capital, accepting unallocated equity under absolute necessity and with caution.	2.38	2.20	3.0	1.33	1.75	3.36	2.43	2.50	1.5
Cooperatives must acquire risk capital via non-member business to the extent that it serves their members' interests and to the extent that they can legally do so.	3.77	3.40	2.6	4.17	4	3.73	3.93	3.87	2.33
Joint ventures with investor-owned entities inevitably weaken a cooperative and its long-term ability to serve members.	2.05	1.80	2.4	1.33	2.12	2.45	2.07	2.12	1.5
The use of preferred stock or related financial participation by "outside" investors inevitably weakens the cooperative and its long-term ability to serve members.	2.53	2.2	3.6	1.00	2.5	3.27	2.93	1.86	1.75
Cooperatives should, as circumstances permit, meet capital requirements through joint ventures with other cooperatives.	3.90	4.20	4.2	4.33	4.00	3.36	4.07	3.50	4.0
Cooperatives should, as circumstances permit, meet capital requirements through joint ventures with investor-oriented firms.	3.66	4.00	3.4	4.33	3.75	2.91	3.86	3.50	4.0

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

All: All Respondents
 Academic: Researchers and Extension Specialists: NCR 194 Respondents
 USDA: USDA-RDA-Cooperative Services Personnel (USDA Website)
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 Directors: Directors and Chairs of Cooperatives
 CEOs:CFOs CFOs and Other Ranking Executives (3)

Joint Ventures with Investor-owned Entities and Cooperatives

The survey also elicited beliefs relative to (1) the effect of joint ventures with investor-owned firms on the relationship between cooperatives and their members and (2) the advisability of meeting capital requirements through such joint ventures.

No group in either sample believed that joint ventures with investor-owned businesses were threatening to the cooperative member relationship. Respondents from both samples said cooperatives should, as appropriate, seek joint ventures with investor-owned businesses. The

only hesitation came from directors, whose caution could arise (as it should) from a need to know about the terms of the venture involved.

The same groups were asked about joint ventures among cooperatives. Unsurprisingly, they endorsed these ventures more strongly than joint ventures with investor-owned firms. During interviews, several participants volunteered that cooperation among cooperatives like that used by Sun Diamond is needed by California cooperatives.

Preferred Trusts (Preferred Stock)

Of the recently employed approaches to cooperative finance, the strongest beliefs were expressed about the preferred stock programs used by several cooperatives to meet long-term capital needs. While some concern was expressed in interviews about the potential use of these instruments to wrest control of cooperatives from their members, there was little evidence of this concern among the survey respondents. Those from all but two expert groups and from both samples strongly disagreed with the suggestion that these programs "weaken the cooperative and its long-term ability to serve members."

**Table 16B. Beliefs About Issues in Cooperative Finance
(Commodity Marketing & Agricultural Supply Coops)**

Commodity Marketing & Supply Cooperatives	All	Academic	USDA	Lenders	Accountants	Directors	CEOs	CFOs	Other
Number of Respondents by Category	100	27	10	8	15	7	6	11	16
Cooperatives should rely exclusively on allocated (member) equity as a source of risk capital, accepting unallocated equity under absolute necessity and with caution.	2.29	2.56	2.8	1.25	1.87	2.71	2.17	2.27	2.31
Cooperatives must acquire risk capital via non-member business to the extent that it serves their members' interests and to the extent that they can legally do so.	3.65	3.63	3.1	4.13	4	3.29	4.00	3.91	3.31
Joint ventures with investor-owned entities inevitably weaken a cooperative and its long-term ability to serve members.	2.20	2.15	2.3	1.25	2.47	2.86	2.17	2.09	2.25
The use of preferred stock or related financial participation by "outside" investors inevitably weakens the cooperative and its long-term ability to serve members.	2.56	2.67	3.3	1.12	2.6	3.14	2.83	2.45	2.31
Cooperatives should, as circumstances permit, meet capital requirements through joint ventures with other cooperatives.	3.89	3.93	4.2	4.00	3.93	3.57	4.33	3.64	3.69
Cooperatives should, as circumstances permit, meet capital requirements through <u>joint ventures with investor-oriented firms.</u>	3.43	3.33	3.4	4.00	3.40	2.57	4.00	3.64	3.38

Figures in bold print represent responses that differ from neutral at the 95% level of statistical significance, thereby reflecting strong agreement (>3) or disagreement (<3) with the belief statement.

Please refer to footnotes in the preceding table.

RECOMMENDATIONS

What Can Be Done By Cooperative Boards?

1. The board should specifically and annually answer the question "Why is our business a cooperative?" This can be done as part of strategic planning or annual planning review.
2. The board should use a nominating committee to identify skills required on the board and to list the names of members who have those skills or could develop them. The nominating committee should actively encourage those persons to run for the board and should make it clear why their skills are needed.
3. The board should implement long-term professional development plans for directors. Introductory programs on directors' roles are necessary but insufficient for director development. The same is true of brief workshops. If programs of cooperative support organizations are inadequate, cooperatives should jointly organize extended (annual 4-5 day) professional development programs for directors. In some cases, smaller boards would make this more realistic.
4. The board should specifically define realistic long-term expectations of management and incorporate related performance measure in longer-term compensation programs. Sources of information on realistic options may include major consulting companies or other cooperatives that have used their services.
5. The board should develop management incentive programs that serve the long-term interest of members. These should be reviewed annually and adjusted as appropriate.
6. The board should emphasize the importance of member relations. In cooperatives that are too small to have their own member relations staff, management performance evaluations should incorporate specific expectations as to member relations and communications.
7. As part of the strategic planning process, boards should verify that their cooperative is structurally positioned to compete on a long-term basis as a cooperative. As alternative marketing and financial alliances are discussed, the board must evaluate those alternatives based not only on their strategic importance to the cooperative, but also on their impact on individual member incentives related to services, member costs, member value, and member control.

What Can Be Done By Cooperative Support Organizations?³³

Some of the following are already provided by support organizations. (If redundant with existing activities, this is by way of endorsement.)

1. Support organizations should emphasize and publicize the direct benefits of cooperatives to members and to the public. The emphasis of promotional literature and research

³³Academic Cooperative Centers, State and National Councils, CoBank, National Society of Accountants for Cooperatives, USDA

should be on how cooperatives assure markets and supplies, reduce risk, stabilize markets, and improve coordination. They should focus on how and when these serve the members, taxpayers and the general public more than on the appeal of the cooperative idea alone.

2. Support organizations should identify, report on and develop models for director identification and development. The roles and activities of nominating committees should be described and reported. This information should address issues such as independence from the CEO, democratic processes and other issues related to assurance of continued member control.
3. Support organizations should cooperate in director education. Just as cooperatives have consolidated, acquired subsidiaries or pursued joint ventures to deal with the reality of global and domestic competition, cooperative support organizations should combine to design long-term director development programs to meet the long term needs of cooperatives. These may require services beyond the capacity of the support organizations. They also assume a new level of commitment by directors to the development of the board. Director development programs organized by individual cooperatives should more often be identified and communicated to other cooperatives.
4. Support organizations should support or conduct focused, applied research to define cooperative performance measures, and to create management incentives. Some cooperatives and consulting firms have developed long-term compensation models. These are imperfect, but in the process of developing models, measures of performance unique to cooperatives also have been developed. These should be considered by other cooperatives.
5. Support organizations should emphasize the importance of good member relations programs. The National Council of Farmer Cooperatives has recognized the best member relations and communication programs. This is an especially important source of models and should be explicitly promoted to other cooperatives. All such efforts assume that a clear and unique cooperative benefit to members.
6. Support organizations should identify flexible strategies for cooperative structure and finance. They should develop evaluation criteria to compare alternative marketing and financial structures in terms of their impact on cooperative members.

Additional Information Available

This report has focused on presentation and analysis of responses to selected belief statements included in a 2001 survey of cooperative experts. Not all responses are reported in this document. A complete summary of expert responses to all 87 belief statements is available as a companion report entitled "Factors Affecting the Success of Agricultural Cooperatives: A Survey of Expert Beliefs". These data and statistical analyses are available upon request from the Center for Cooperatives, University of California, One Shields Avenue, Davis, CA 95616.

APPENDIX — SELECTION OF SURVEY PARTICIPANTS

The on-line survey was sent via electronic mail to persons for whom e-mail addresses were available and who were associated with a group recognized for some form of expertise related to agricultural cooperatives. The author actively sought e-mail lists associated with expert groups and used the following:

1. Academic experts: An email address list for a research group recognized by USDA and the land grant universities as NCR 194 was copied from the University of Wisconsin Center for Cooperatives website.³⁴ The survey was sent to all members of that group along with other scholars known to have expertise in cooperatives.
2. Government experts: Electronic mail addresses for Rural Business Administration-Cooperative Services, Washington, DC website.
3. Cooperative Council: The website of the National Council for Farmer Cooperatives was a source of e-mail addresses for experts at the national level. Addresses of state councils around the nation were not complete and were secured in part through personal contacts by the author.
4. Lenders: The CoBank website was a source of electronic mail addresses for most of the respondents who referred to themselves as lenders. However, some persons responding as lenders were initially contacted as members of the National Society of Accountants for Cooperatives.
5. Accountants and Attorneys: The membership list of the National Society of Accountants for Cooperatives (NSAC) was a source of e-mail addresses for this group. All regional officers received survey forms. Most of these respondents identified themselves as accountants or attorneys. Some California respondents identified themselves as lenders.
6. Directors of Cooperatives: Electronic mail addresses for this group were relatively difficult to secure. Directors or people who knew them were the primary sources of addresses and these were "spotty". Some cooperatives were very helpful in providing addresses for their directors, others were understandably cautious about doing so.
7. CEOs of Cooperatives: Secured through personal knowledge of the CEOs and former CEOs or from company websites. The primary population was in California.
8. CFOs of Cooperatives: Secured through personal knowledge of the CFOs and former CFOs, from company websites or from the NSAC membership list. The primary population was in California.
9. Other employees of cooperatives: Persons referred to by the CEO or otherwise known to be knowledgeable about cooperative issues. These tended to be member relations vice presidents or communications directors. The primary population was in California.

³⁴ The author wishes to thank Professor Kim Zeuli, University of Wisconsin and Chair of NCR-194 for actively promoting the survey to participants.

10. Cooperative Development Professionals: A group known as Cooperation Works! has focused on new cooperative development issues and is composed of persons who specialize in new cooperative development.³⁵ Herb Cooper-Levy provided the e-mail list of participants in Cooperation Works!

³⁵ Denise Spanjer, a member of "Cooperation Works!", volunteered the electronic mail addresses of active cooperative leaders in the Northern Plains who completed survey forms on grain marketing and agricultural supply cooperatives.





