

# INFORMATION ABOUT CALIFORNIA MARKETING COOPERATIVES

by

**Leon Garoyan**  
*Director*  
*Center for Cooperatives*



**Center for Cooperatives**  
**University of California**

# The Center For Cooperatives

## WORKING PAPER SERIES

The Working Paper Series is designed to fulfill part of the less formal communications objectives of the Center for Cooperatives. The series presents papers dealing with cooperative issues or topics of interest to cooperative members, employees, elected officials, and others having an interest in cooperatives. Papers in this series express viewpoints and opinions about a fairly broad spectrum of cooperative topics, but are not intended to be finished reports of formalized research by the authors. Some papers are informative only, while others are, in addition, provocative. We intend for them to be educational.

Working Papers are published at irregular intervals, reflecting the financial position of the Center, as well as the interests of authors and availability of papers. They are intended to be brief in nature because they most frequently will not be exhaustive of their subject, but no editorial limit is imposed. Likewise, because the papers reflect opinions and viewpoints of the authors, there is only minor editing involved.

We hope the papers contribute to a better understanding of cooperatives, and lead readers to other more comprehensive publications on topics where further information is desired.

Because the mandate from the California Legislature, when it established the Center, intended that research and educational activities include both agricultural and mutual benefit cooperatives, the Working Paper Series may include papers of interest to both sectors. However, at times the emphasis may be stronger with only one of the two cooperative audiences. To help readers to identify the intended orientation, we follow a numbering system that distinguishes the intended audience by major orientation. Though papers are numbered consecutively during each year, those with primarily an agricultural orientation have the suffix 'A' with the number, and those primarily oriented to mutual benefit cooperatives are suffixed by 'MB'.

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Director

## **Information About California Marketing Cooperatives**

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California agricultural marketing cooperatives are often considered to be somewhat different than typical cooperatives in many parts of the nation. For example, California's cooperatives were established to provide improved marketing services to farmers. Midwestern cooperatives often started by providing farm production inputs to members. In the north central states, the milk processing cooperatives are functionally closer to California cooperatives. What both have in common is the emphasis on marketing a single commodity, rather than marketing multiple products.

Questions arise on how California's marketing cooperatives are changing to meet changes in the economic environment surrounding them, and how they are responding to what appears to be an increased rate of international involvement of major firms. To find out how they are presently organized and financed, we surveyed 15 of California's largest marketing cooperatives and several prominent marketing cooperatives in other states. The results of this brief survey are reported in this working paper.

## **Organizational Form**

Cooperatives in which individuals are direct members are considered centralized in organizational structure, while those cooperatives that have other cooperatives as their direct members are considered to be federations. Some California cooperatives were organized in local community associations of growers, mainly to assemble and to pack or prepare their products for markets. In turn such local cooperatives might have joined with other local cooperatives to form another cooperative to perform more sophisticated activities, including refrigeration, packaging, and distribution of products to markets.

Most of the state's marketing cooperatives were organized as centralized, direct membership organizations. Growers hold a direct membership in the cooperative, and participate directly in the exercise of their responsibilities as members. Some of the early federated cooperatives have reorganized as centralized cooperatives, but I do not recall any centralized cooperatives having restructured as federated.

There are advantages and disadvantages to both structures. Federated structures are sometimes considered to be more democratic with more involvement of members in decisions. Since each "local" cooperative has a board of directors, it is obvious there are more leaders involved in decision making. Sometimes decisions are influenced more by "political" than business considerations. Centralized cooperatives are considered to be more efficient because they can reach decisions by one board of directors, rather than by considering multiple groups when making business decisions.

Our survey reveals that the centralized form of cooperative prevails with marketing cooperatives in California. Of the 15 cooperatives in our survey, 11 are centralized and 4 are federated in structure.

Significantly, organization form does not affect the nature of business activity, involvement in non-member business, how the cooperative operates financially, or in terms of foreign involvement. The survey did not reveal any differences in these respects between federated and centralized cooperatives.

### **Non-member Business**

Cooperatives may engage in providing services to non-members, but there are various restrictions in the amount of non-member business they may conduct. Generally, non-member business allows flexibility to the cooperative to adjust its sales without necessarily impacting its members' farming operations. Also, non-member volume helps to expand market share without having to make long-term financial commitments when excess processing capacity exists.

Eleven cooperatives in our survey handled non-member products, ranging from as low as 2 percent of the cooperative's volume, to 21 percent. On average, less than 12 percent of these cooperatives' volume was accounted for by non-member business. Four cooperatives handled only members products. Form of organization was not significant in whether non-member business was handled.

## **Type of Product Marketed**

Most California marketing cooperatives were organized to market one or a related group of products. For various reasons, it was not necessary for a cotton ginning or marketing cooperative to also market fruits, for example. Thus specialization of product was a characteristic of California cooperatives, brought about by the cropping patterns of a region. Some changes are occurring, with some formerly specialized commodity cooperatives broadening their offerings in response to market opportunities.

Commodities marketed by cooperatives often can be sold in various forms: fresh, canned, frozen, dried. Some are sold for consumption in their natural state, while others require conversion. Generally, the larger the alternatives availed by cooperatives, the larger will be their economic benefits.

Eight of the cooperatives marketed products in both natural or fresh form, and in processed forms. Three cooperatives engaged in fresh product marketing only, while four were engaged only in processed forms.

## **International Involvements**

The marketing of food products has assumed an international scope of substantial magnitude. The sale of products in international markets has become an important outlet for most California products, because state farmers produce in excess of domestic requirements, and because of product quality and uniformity. These advantages make it possible to compete internationally.

A new dimension is the advent of multi-national, multi-commodity marketing firms that are able to access products from their most economical sources to sell in their most advantageous markets. To determine the activities of cooperatives to compete with such firms, we asked several questions about the international involvement of cooperatives.

Only three of the 15 cooperatives had a partnership relationship with a foreign business or were involved in a joint venture with a foreign business either for sourcing of products, or sales. One of the 12 indicated moving in the direction of a joint venture, and one is considering an independent foreign operation.

Two cooperatives had producer members operating in a foreign country. One was a fresh commodity marketing cooperative, and the other is a cooperative that sources raw products not grown in the U.S. for processing.

Two cooperatives are sole owners of a foreign business involved in either production, marketing, or distribution of products. Two others have direct international representation for sales purposes, but not as sole owners.

The conclusion is that California marketing cooperatives employ diverse methods to attain an international presence, but few have direct business organizations that they own in foreign markets. How adequate this will be for the future is a question that needs to be considered by boards and managers of California cooperatives.

## Operating Procedures

Operating marketing pools is a well established practice among California marketing cooperatives. Pooling is a practice that allows the cooperative to group members products of like variety, quality, grade, etc. into large lots to increase efficiency of operations, to enhance marketing opportunities, and to eliminate variations in prices returned to growers. Fourteen of the cooperatives operated with pools for grower payments.

Pools can be for various lengths of time, depending on the nature of the product, its perishability, its form, etc. Perishable products may have widely fluctuating prices due to market or production characteristics, and therefore, cooperatives handling such products are apt to use shorter duration pools. Fungible commodities and those that can be stored may enable longer-term pools, such as seasonal or annual pools.

Thus, wide variation exists among marketing cooperatives. Four use seasonal pools, five use annual pools, one uses monthly pools, and two use weekly pools. Only one cooperative did not use a pooling system for grower payments.

Most of the cooperatives use single-commodity pools, which would be expected because of the single-commodity specialization that prevails. Those which handle multiple commodities use a multiple commodity pooling system, which becomes fairly complicated as adjustments are made among commodity returns.

The question of pooling practice becomes a current issue when cooperatives engage in foreign sourcing of prod-



ucts, or when the cooperative becomes a multi-commodity marketer. It may also arise when different demands exist for a product, such as fresh or processed, and when weekly, monthly, or seasonal differences in product production and prices exist.

### **Capitalization**

Cooperatives have the option of requesting tax exempt status under federal income tax regulations if they meet conditions imposed by the Internal Revenue Service and tax legislation. Because some cooperatives have felt their options were restricted if they maintained their Section 521 status, they have given up their exemption. Nine of the marketing cooperatives surveyed have maintained their 521 tax exempt status, while 5 were not operating under exempt status. These included cooperatives that engage in the sale of non-member products, or who have earnings that may be held as non-allocated income.

### **Revolving Funds**

Cooperatives use several methods to gain capital from members. The most prevalent is the use of revolving funds, which allows cooperatives to keep members contributions to capital on a fairly current basis and to reflect their patronage. A problem with the revolving fund method of accumulating equity capital from members is that the volume of products delivered by members varies from year to year due to unequal annual production, and that prices may vary correspondingly. Thus, fluctuations may occur in the amount of capital contributed by members from year to year.

Ten cooperatives used revolving funds as the basis for capitalizing the cooperative. Revolving funds are revolved on average 4.7 years for the firms in the survey. It has been commonly thought that for all cooperatives in California, the average is a 7-year revolving cycle, suggesting that those in the survey were operating on a shorter cycle. Partly this may be explained by the amount of total capital that revolving funds represent. For those surveyed, revolving funds represented an average of 74% of total capital, with a range of 34%, to a high of 100%.

### Base Capital Plan

Three cooperatives use a base capital plan, which is a capitalization system designed to provide a stable equity base for each member. Because it is calculated for each member in relation to the cooperative's capital needs and the member's individual deliveries during a base period, it ties member use more closely with member financing of the cooperative. The base period for determining member's capital contributions was 6 years in one instance, and two used an 8-year period.

### Retained Earnings

Traditionally, the earnings of a cooperative result from members transactions with the cooperative, or as a result of services, such as marketing, that the cooperative performs on behalf of their members. Any surplus in these transactions are allocated to each member in proportion to their patronage. Thus, there is no infusion of capital in the cooperative that is not allocated to members. When revenues result from sources other than from members, the cooperative may have the discretion to retain that income without allocation. Such unallocated income

provides a capital base for the cooperative that does not carry a contingent liability. Having unallocated earnings provides a degree of financial flexibility that would not otherwise exist.

Ten of the cooperatives surveyed had some earnings that were not allocated to members. The amount of total capitalization such earnings represented averaged 15 percent, and ranged from 7 percent to 25 percent.

### **The Nature of Cooperatives Debt**

Cooperatives surveyed rely on a combination of sources for long-term debt. One relied solely on the Cooperative Banking System (e.g. CoBank) for its long-term debt, and one relied solely on private placement for long-term debt financing. The remainder of the cooperatives rely on a combination of sources for financing long-term debt. One cooperative in the survey has no long-term debt.

On average, the cooperatives financed 33 percent of their long-term debt through CoBank, 23 percent through commercial banks, 25 percent through private placements, and 17 percent through other sources, such as insurance companies, revenue bonds, etc.

Of those cooperatives which financed long-term debt through the cooperative banking system, on average, 47 percent of the debt was serviced from this source. Likewise, those cooperatives financing through commercial banks averaged 58 percent of their long-term debt from such sources. The four cooperatives that used private placements averaged just under 62 percent of their debt in this manner. Of those using other sources, such as insurance companies, these averaged just under 43 percent of

such cooperatives' debt.

Cooperatives surveyed did not necessarily obtain operating capital from the same sources as they obtained long-term financing. Two cooperatives financed through the cooperative banking system only, and two financed operations through the commercial system only. On average, 35 percent of the cooperatives financed operations through the cooperative banking system. The cooperative banking system accounted for 45 percent of the operating loans obtained by such cooperatives. Commercial banks averaged 50 percent of the short-term borrowings of cooperatives surveyed. Commercial banks accounted for 65 percent of the borrowings of those dealing with them.

A few cooperatives employed other sources of capital only to a limited scale. These included operating leases, and member and employee investment certificates.

### **Observations About Cooperative Marketing Directions**

Centralized cooperatives are more numerous among California's major marketing cooperatives than are federations of cooperatives. Does this mean one organizational form is superior than the other? Not necessarily. The start of small cooperatives in local communities by neighborhood groups might be considered normal, given transportation, communication, and business conditions 75 or more years ago. The joining of these local cooperatives into federations was a logical next step as the cooperatives found there were activities and functions they could not achieve alone.

Would cooperatives now starting out do so as a federation of new local cooperatives? Probably not. The advantages of planning, decision making, and financing by a strong entity with a single board are fairly apparent. And, with modern communication, transportation and capitalization alternatives, the same pressures of the past no longer exist.

The joint venture as a cooperative alternative was not as well recognized in the past as it is today. Thus, a cooperative seeking to expand its economic or business base might do so as a joint venture rather than as a federated cooperative.

Cooperatives remain today as businesses to provide services to members, just as when they were started. However, there are business advantages to extending services to other producers. None of the cooperatives over extended themselves with non-member business, however. They averaged only 12 percent among them, a very modest amount. Cooperatives may need to consider how they may provide marketing services to non-members who are not potential cooperators without damaging their original objectives, and not running afoul of regulations. There are ways this can be done, if cooperatives find it advantageous to increase their market representation. Obviously, the cooperatives in our survey have not over-reached in this respect.

Some marketing cooperatives have shed their single commodity orientation, and have taken on related commodities where the marketing channels are the same. This probably will be the direction of the future, and single-commodity cooperatives will be competing with the same product mix. At that time, further consideration may be

justified to see if cooperatives may develop a large food company, such as "General Cooperative."

Although the survey itself did not deal with the trend for regional international trading blocs, I believe the organization of trading blocs will be the key structural marketing development during this decade. The organization of trading blocs and the ability to compete in terms of price and quality will be the main restrictions to access to large foreign markets. The EEC views itself with the potential of 380 million consumers within 18 countries. Other trade regions being considered consist of South America; the southeast Asia nations, and North America.

To enter such blocs at favorable terms of trade, cooperatives may need to develop partnerships with growers or cooperatives within countries in the blocs, so as to source their products from such countries, to be marketed under the cooperative's brands. This maintains a market presence for cooperatives in countries that might not otherwise have opportunities to have a significant market exposure for their brands.

Boards of directors of cooperatives may be challenged to identify their cooperatives interests and involvement with cooperatives and producers in other countries. The compelling reasons include:

- the existence of a free trade agreement with Canada
- the potential for a similar agreement with Mexico
- closer integration with Central and South American countries that may establish trading blocs
- the potentials for closer ties between the EEC and

Eastern European countries

- the attractiveness of the development of stronger economies in Pacific Rim countries.

As cooperatives develop operating bases in other countries, boards will need to establish arrangements for the fair distribution of earnings for U.S. members and members in other countries. Separate pooling would provide an incentive for U.S. members to approve such international expansion.

The developments of non-member patronage and foreign ventures provide an opportunity for cooperatives to accumulate earnings that may be retained by the cooperative, to reduce capital contributions from California members, or to provide capital to enter into profitable but higher risk operations that might not be justified with growers capital.

The implications for cooperatives are astounding. The agendas for board meetings should be interesting during the next several years, because some very exciting opportunities are being identified which require imagination, determination, and a fresh look at cooperative objectives. If boards, don't look at such issues now when they have time to make decisions, it will be very apparent that their board agendas in a few years will be quite uninteresting.









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## **ABOUT THE CENTER FOR COOPERATIVES**

The Center for Cooperatives was established by the California Legislature in 1987 as a center in support of research, education, and extension activities to "advance the body of knowledge, concerning cooperatives in general and address the needs of California's agricultural and nonagricultural cooperatives..."

The Center's objectives are to promote:

- **EDUCATION.** The Center offers formal and informal educational programs to those involved in cooperative management and develops teaching materials for all levels of interest.
- **RESEARCH.** To help the state's cooperatives reach their objectives, research is conducted on economic, social, and technical developments. A practical aspect of this research: the provision of competitive research grants, and studies for government agencies on how cooperatives can help achieve public policy objectives.
- **OUTREACH.** The Center is prepared to inform the public on cooperatives and their significance to the economy of California.

Located on the University of California, Davis campus, the Center is a University-wide academic unit. Its teaching and research resources are drawn from interested professionals from all University of California and state university campuses, other colleges and universities, as well as sources indigenous to the cooperative business community.

The Center is prepared to receive gifts and contributions from the public, foundations, cooperatives and other like sources and has established an Endowment Fund.