

Agrodok 38

Starting a cooperative

Farmer-controlled economic initiatives

Reitse Koopmans

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Foreword

Agricultural cooperatives usually develop in rural economies during the transformation from self-sufficiency farming to full market production. At this stage farmers often start realising their weak individual economic position in the market. By joining forces and initiating economic cooperation, farmers can strengthen their position in the market so that they can jointly benefit.

This publication is intended to serve as a guide to support farmers' groups through the difficult process of starting a cooperative business and to help them find their way and make their own choices in developing a successful enterprise. We realise that this publication is only a beginning and we would therefore appreciate receiving readers' comments or descriptions of the experiences of farmers' groups. In order to facilitate discussion we have included a number of statements in Appendix 2.

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1 Introduction

Agricultural cooperatives have a long history of successes and failures both in the developed and the developing world. Certainly in different parts of the industrialised world the formation of agricultural cooperatives has played a major role in the development of agriculture during the last 150 years.

These cooperatives were usually initiated by small farmers, owners of family farms, as a response to their weak position in the market. By joining forces they could improve this position and obtain better prices and services for the purchase of inputs and credit and the marketing of produce. The result is that within the EU countries agricultural cooperatives now have a market share of about 50% of the entire turnover in the agricultural sector.

In developing countries, cooperatives for agricultural and rural development were introduced in pre-independence times. There were some success stories, but there were also many failures. One of the reasons for failure was that often the cooperative concept was misused for ideological or political purposes. Governments and parastatals tried to influence and control cooperative development from above and often for their own purposes. This resulted in many poorly developed or unsustainable cooperatives. Some developing countries are still faced with the remnants of these state-controlled 'pseudo-cooperatives'.

A cooperative should be seen as a private business organisation that is jointly owned and controlled by its members, who also use its services. The objectives of a cooperative are primarily economic. It is not an easy task to organise and successfully develop a cooperative and generally a rather time-consuming and complicated process. Market conditions, government policies and the legal environment should be conducive for such a development. Moreover, strong leadership and management capabilities should be available, together with sufficient financial resources. These are all factors which are often scarce in de-

veloping countries. Often it is better to consider other forms of cooperation: a private business or a family enterprise, a farmers' association or another formal or informal type of partnership.

It is a widespread misunderstanding that cooperatives are a typical instrument for developing the poor. History has shown that cooperatives often are not the most suitable institutions for the development of the poorest farmers. This is because these people are often the least able to finance and organise a cooperative. Usually medium and somewhat larger farmers take the initiative for developing a cooperative in order to overcome certain deficiencies in the market. However, once the cooperative has passed its pioneering phase, the smallholders and poorest farmers can join and reap the benefits from this affiliation.



Figure 1: Drying coffee beans in a rural cooperative

Under the influence of current trends in market-oriented reform, privatisation, decentralisation and participation, cooperatives are currently

being rediscovered as a suitable organisational structure for realising the economic initiatives of farmers. Agricultural cooperatives in which the members both participate and contribute can thus become powerful instruments for the development of the rural economy.

The potential of independent and genuine cooperatives as a tool for rural development is increasingly recognised by many governments, donors and non-governmental organisations. Governments, however, should no longer interfere with the development of cooperatives, except by creating and facilitating a supportive legal and economic environment.

Agricultural cooperatives can be organised in many different ways. There is no prescribed format or model because of the great differentiation between economic, institutional, social and legal conditions in many countries.

2 What is a cooperative?

A ‘cooperative’ can be defined as a member-controlled association for producing goods and services in which the participating members, individual farmers or households, share the risks and profits of a jointly established and owned economic enterprise.

Usually a cooperative is established by farmers in response to unfavourable market conditions, which is a shared problem. This could be a problem related to the marketing of produce resulting in low farm-gate prices, to the supply of good-quality and reasonably priced farm inputs, such as seed and fertiliser, or to the supply of sufficient and cheap credit. By establishing a cooperative enterprise, farmers hope to rectify this problem, increase their farm income and strengthen the economic position of their farm. The cooperative enterprise is jointly owned and used by the farmers. These actively participate in the provision of resources for the cooperative (labour, capital and produce) and in decision-making (rules, regulations and management). The members of the cooperative share in the produced benefits and risks.

2.1 Characteristics

Cooperative organisations have a number of characteristics in common:

- open and on voluntary basis
- democratic control by members
- equitable member contribution to capital
- autonomy and independence
- provision of education, training and information
- cooperation with similar organisations
- the development of community concern

These have been defined as such at the ICA Congress of International Cooperative Alliance in Manchester, held in 1995.

Cooperatives are voluntary organisations open to all persons who are able to use their services and are willing to accept the responsibilities of the membership, without social, gender, racial or religious discrimination. Cooperatives are free to define ‘persons’ in any legal way they choose. Primary cooperatives usually choose only to admit individual persons. Cooperatives at other than the primary level are often owned by other cooperatives and organised in federations.



Figure 2: This farmer is proud owner and user of a tea cooperative

Cooperatives are democratic organisations controlled by their members, who actively participate in setting the policy of the economic enterprise and making major decisions. Members decide what form the cooperative will have, what the purpose of the business will be and the activities undertaken. The organisation is a genuine member-owned business driven by the needs and priorities set by the members.

The members of the cooperative contribute equitably to the capital of the cooperative. Usually they receive limited compensation, if any, on the invested capital subscribed as a condition for the membership. However, in return they can make use of the services and other advantages provided by the cooperative. Surpluses generated by the cooperative are usually re-invested in the cooperative for further development or set aside as a reserve. Members share potential benefits and

risks on an equitable basis, which means proportionately to the use made by the members of the cooperative services.

Cooperatives are autonomous and independent organisations controlled by the members and they are as independent of government and private firms as possible. The role of governments is restricted to creating a supportive and enabling environment for the formation of cooperatives, for instance by creating an adequate legal framework. Whenever cooperatives enter into agreements with other organisations including governments or when they raise capital from external sources they do so on terms ensuring democratic control by their members and safeguarding their independent status.

Cooperatives provide education and training to their members, elected representatives, managers and employees. This strengthens managerial and operational capabilities of staff and members of the organisation. This is important for building up bargaining power vis-à-vis the government and agro-industrial and trade conglomerates. It also widens the options for income-generating activities. Another objective of education and training is to provide members with better control over local agricultural production factors. Good information, both internal and external, is also essential for optimal communication between the cooperative and its members on one side and the authorities, opinion leaders and general public on the other.

By cooperating with similar organisations at local, regional or national level and by participating in cooperative structures, the cooperative organisation can often better serve its members' interests. The smaller cooperatives in particular can make use of additional services of other cooperatives, make better use of economies of scale through bulk purchases, or reduce operational costs and risks by combining activities.

Cooperatives working at grassroots or village level mobilise local resources and develop a concern for community. Usually cooperatives are organised community-wide and the members share local or regional problems. Cooperatives, by themselves, cannot be expected to

entirely resolve these problems, but they can contribute significantly to their resolution. They can assist people capable of helping themselves to escape poverty, create employment, or assist in distributing resources on a fair base. Through the cooperative the members can develop a forum to discuss environmental concerns or find possible solutions for socio-cultural problems.



Figure 3: Facilities provided by a cooperative (Agriterra)

2.2 How cooperatives differ from investor-oriented businesses

Cooperatives are economic organisations just like other business organisations. However, most business organisations are investor-oriented firms. They are owned by shareholders, who have invested capital in an economic initiative. Cooperatives are owned by the

members/users of the organisation. Table 1 displays the major differences between cooperative and investor-oriented businesses.

Table 1: Differences between cooperative and investor-oriented businesses

	Cooperative business	Investor business
Purpose	Maximise benefits for member-users	Maximise profits
Ownership	Vested in members	Vested in capital
Owners	Member-users	Investors of capital
Voting	Ranges from 'one man, one vote' principle to voting proportionate to each member's turnover or use	Number of votes depends on number of shares owned
Management	Management answerable to members	Management answerable to capital investors
Shareholding	Choice of shareholding or non-shareholding. If shareholding, constant value and limit on proportion held	Changing value of shares and no limits on shares owned

A cooperative is a user-oriented firm designed to maximise the long-term qualitative and quantitative benefits for the participants. For example, a producers' cooperative involved in the marketing of farm products will pay the members a fair price for their products according to market realities. In practice, the cooperative will thus reward good quality (= high revenues per unit) and increased productivity (= low cost per unit) of individual members and discourage poor quality and low productivity.

An investor-oriented firm is profit driven and will try to minimise the cost of farm produce, which they consider to be an input for their activities. They will pay the farmers the lowest negotiated price for their agricultural produce. By purchasing at a low price and selling at a high price, eventually after adding value (collecting, processing, marketing, distributing, etc.) the investor-oriented firm will try to maximise profits.

The cooperative can generate added value for farm products by initiating new activities further along the business or production chain from

producer to consumer. Processing of primary products, for example, could generate extra income for primary producers that otherwise would lead to excess profits for investor-oriented businesses. Farmers could start a joint storage and processing and packing unit for a certain crop. These activities could increase the productivity of the primary producers (the farmers) considerably and could be an important source of additional income for them.

2.3 Cooperative business principles

As we have seen above, a cooperative is a member-controlled enterprise, which is organised differently and has a different objective than the common type of investor-oriented firm. Like any other enterprise, however, the cooperative must be operated and managed on the basis of sound economic principles. This is essential to enable the cooperative to compete in the market and to be sustainable in the long run.

Three business principles apply to cooperatives (Rabobank, 2000): cost price, proportionality and self-financing.

Cost price principle

The cooperative delivers goods and services to its members at cost price. This means, for instance, a supply cooperative delivers supplies to farmers at cost price plus a so-called ‘mark up’ to cover operational costs of the cooperative and a net surplus. The net surplus is used to cover unforeseen costs and risks, to build up financial reserves and to pay bonuses or interest to the members. Only part of the net surplus should be considered as ‘profit’. The profit is often kept as a reserve fund for future investments or used as so-called appropriation profit to replace borrowed capital by the cooperative’s own capital. This is important since many new cooperatives in developing countries have difficulty in finding sufficient capital of their own.

Proportionality principle

The cooperative allocates the proceeds and costs of all transactions and members’ rights and duties, including liabilities and voting rights

according to the economic principle of proportionality. Various interpretations of this principle are used. It is important that a solution be selected that is based on practical considerations – it should not only be a matter of principle. Voting rights are sometimes based on the ‘one man-one vote’ principle, especially in banking and insurances cooperatives. In many agricultural cooperatives, however, proportionality is based on each member’s turnover or use made of the cooperative. For agricultural and rural development it is extremely important that both smallholders and large farmers in a region can participate on a fair and proportional basis. The ‘one man-one vote principle’ can be an obstacle for large farmers to join, since they bear relatively more risk but have no greater say. With full participation of both large and small farmers representing different farm sizes and stages of agricultural development in a region, the smallholders easily benefit from the advantages of being a member of a strong cooperative organisation. Such a broad-based cooperative will also increase the chances of finding sufficient funding and achieving good governance.

Self-financing principle

Risk-bearing capital will have to be exclusively provided by the members of the cooperative. The cooperative cannot attract venture capital from outside investors, because this would create a conflict of interest with the members. This means that the cooperative will have to reserve sufficient net financial surplus (appropriation profit) for solvency and continuity and growth of the firm in accordance with sound financial planning.

Mobilising capital is often difficult for cooperatives, but this becomes easier with the more assets (land, buildings, capital) the cooperative owns. A cooperative with sufficient institutional and member capital can safely borrow funds from banks or other sources.



Figure 4: Marketing of good-quality vegetables

2.4 Types and levels of cooperatives

There are many types of cooperatives; they can be oriented toward services, marketing or financing, or toward workers' or consumers' interests. Many cooperatives have a single purpose, such as input supply, marketing or production of a single (often newly introduced) crop for which no agricultural support is available. Other cooperatives have developed into multi-purpose enterprises that offer a wide variety of services to their members such as a broad supply of farm inputs, agro-processing and storage facilities, marketing and credit supply.

In this manual we will restrict ourselves to primary agricultural cooperatives, organised at local or regional level. Typical fields of interest of agricultural cooperatives are the following:

- ▶ input supply: purchase of seeds, fertiliser, machinery, artificial insemination, etc.

- collecting and processing of farm products: cooling, sorting and grading, storage, ginning, dairy production and other agro-processing activities
- marketing of products
- finance: banking, credit supply and insurance



Figure 5: Cooperative auction of fruit and vegetables (Agriterra)

2.5 Misuse of cooperative principles

Unfortunately, the principles of cooperative organisation have often been misused by governments, politicians or ideology-based groups. Heavy state interference in cooperative organisations has for many years prevented the development of healthy and sustainable producers' organisations in many countries in Asia and Africa. This has often negatively affected the economic position of farmers and has created an historical burden of non-viable or weak agricultural institutions in

many countries. In some other cases, cooperatives were successful at first, but were misused by politicians mainly to control the resources for their own benefits and at the expense of the members.

Another category of state-owned cooperatives or collectives was exemplified, and is still remembered all too well, in the former socialist states in Central and Eastern Europe as well as the former Soviet republics. This model has also been applied in a number of African countries; see the case described in the text box below.

We want to stress here that cooperative principles do not lead on their own to this type of misuse. The latter type of cooperative was merely created solely for political reasons and in strictly state-regulated agricultural systems.

Case 1: State cooperatives in Ethiopia

The former Derg government (1975-1991) in **Ethiopia** established an extensive network of socialist agricultural cooperatives throughout the country to organise the peasants, control agricultural prices, levy taxes, and extend government control to the local level. These cooperatives were characterised by mandatory membership, quotas for grain to be delivered to the government, and boards of directors and managers appointed by the ruling party. Farmers came to view these as a synonym for government oppression.

This 'cooperative' system collapsed immediately following the government's overthrow in 1991. It was then transformed drastically: see case 6 in section 4.3.

3 Why are farmers interested in cooperatives?

Although some cooperatives are established to take advantage of a business opportunity, most cooperatives are started by farmers for defensive reasons. Often this is in response to an economic problem that has a negative impact on them. The problem could be, for example, a lack of sufficient agricultural marketing outlets, non-availability of agricultural supply or storage services or the absence of credit facilities. The farmers also realise that they share a problem that cannot be solved individually.

3.1 Advantages of working together

The most important feature of a cooperative is that farmers try to solve their problem or take advantage of an opportunity together, instead of trying to do this individually. A group of farmers has to first recognise the advantages of this, and they may subsequently discover that there is broad support in the region for their plan to work together.

Farmers may have several specific reasons for starting an agricultural cooperative:

- to mobilise more resources than they can individually supply
- to create attractive alternatives for purchasing goods and services
- to operate a business more efficiently than can be done on an individual basis
- because they recognise that the benefits outweigh the duties of membership
- because they recognise that as members of a cooperative they are part owners and not only clients.

Sometimes farmers would like to take advantage of an opportunity that requires more resources or capital than they can individually supply. This could be undertaking a new activity in the region, such as production of a new crop, that requires substantial investments or spe-

cialised production or storage activities that are not yet available. Examples are dairy production, cultivation of potatoes, setting up orchards and various processing activities.



Figure 6: A cooperative-owned threshing-machine (Agromisa)

A group of farmers may realise that, apart from helping themselves, no attractive alternatives exist for purchasing the goods and services they require. These alternatives could be for instance support from relatives, the private sector, local institutions or governmental resources. Buying goods or services through the cooperative should have clear advantages for the members over purchasing them elsewhere. Members of a cooperative may decide to deliver goods and services to non-members, in order to increase the turnover and the economies of scale. In this case, the members should receive certain benefits, such as in the form of discounts, which non-members do not get.

Each of the participants must see clear advantages in investing in joint economic initiatives instead of investing the same resources in their own farms. The proposed collective organisation should be able to operate more efficiently than the individual farmers in providing certain services. For instance it could be difficult and risky for a single producer to finance, organise and operate a business, but collectively this might be accomplished more efficiently.

Case 2: Farmers discover advantages of collectively purchasing inputs

In the early 20th century, nearly every village in **the Netherlands** had its own input supply cooperative, because by buying the inputs jointly farmers could get the farm inputs they needed for a lower price and with a guaranteed quality. Traders often cheated farmers by supplying sub-standard quality of fertiliser, realising that individual farmers were not able to control the quality.

In the village of Nieuw Helvoet, for example, farmers needed potash fertiliser with 40% K₂O for their potato crop. The farmer who was elected as secretary of the cooperative asked all of the members how much fertiliser they needed and then tendered among traders to ensure delivery of the quantity needed for a sufficiently low price. The tender document included a provision that the cooperative would take a sample of the product and would send it to a government laboratory for testing. If the laboratory discovered that the fertiliser contained less than 40% K₂O the price would be decreased accordingly.

The members were informed at what time the boat with fertiliser would arrive in the harbour and were asked to come to collect and pay for their order. This made it impossible for the traders to earn extra money by cheating farmers.

If a farmer was elected to the board of the cooperative, this increased his status in the village. If it was discovered that he tried to make some extra money through corruption, he would lose this status completely. So this never happened in this village.

In order to be attractive for a farmer, the benefits of membership in a cooperative should outweigh the duties. By becoming a member of a cooperative, each farmer can make use of the advantages of the cooperative: a good market price for their product and access to other goods, services, markets and credit. On the other hand, membership

entails duties, such as required contribution to the cooperative in the form of labour, land, equipment, capital, knowledge and/or expertise.

Members may recognise the advantage of not only being clients but also owners of the cooperative. They can participate in the formation and steering of the organisation and help to ensure that members get the proper services and goods that cover their specific needs. Moreover, they are also entitled to a fair share in any surpluses the cooperative enterprise achieves. Non-members do not have these advantages.

3.2 Economic benefits

In order to be attractive, the cooperative must offer advantages to the members compared to the alternatives. A cooperative enterprise can offer a range of economic benefits for producers.

The costs of farm inputs and supplies for members are lower, since these can be purchased in bulk, enabling the cooperative to negotiate lower prices than individual farmers have to pay.



Figure 7: Monitoring product quality may improve market prices

Good farm-gate prices to the members for selling their produce through the cooperative can be achieved, thus increasing farmers' incomes.

Availability of sufficient and good quality inputs can be improved, since the cooperative negotiates a guaranteed supply and quality of inputs.

Frequent price fluctuations can be further reduced.

Members could jointly undertake new activities by adding production value further along the production chain (see Case 3). By doing this they can increase productivity and generate income that otherwise would have benefited other businesses.



Figure 8: Adding value by producing packed milk

New services can be provided to farmers that are not yet available locally or that provide access to external resources and services.

Farmers can avoid linked markets, e.g. when the purchase of inputs or marketing of produce is linked to the provision of loans.

Competition and transparency in the market can be increased, thus breaking trade monopolies and ensuring better purchase and selling prices for members.

Case 3: Introducing a new activity: producing milk for ice cream

Cooperatives involved in marketing and processing can play a useful role by informing their members of changes in the market and enabling them to meet the changing demand. As the economy grew in Chennai (Madras), **India**, in recent years the demand for high-value dairy products, e.g. ice cream, increased considerably the local dairy cooperative can only produce these products with clean milk that is free of bacteria. Therefore, the cooperative taught its members in the villages around Chennai how to produce and store clean milk and the cooperative paid a higher price for it. This was quite profitable both for the producers and for the cooperative.

4 What is needed to form a cooperative?

4.1 Starting the cooperative

One of the conditions for starting an agricultural cooperative is that there be a group of motivated farmers who want to come up with an economic initiative to resolve a joint problem. Unlike an investor-oriented firm, cooperatives are not looking for a business opportunity that will provide the highest return on investment, but they seek a joint economic undertaking that supports their farm activities and could generate additional farm income. The economic motivation to form the cooperative, however, should be based on the same considerations as starting any other new business.



Figure 9: Brainstorming meetings of farmers are the start of a cooperative venture (Agriterra)

The potential members discuss their needs and common interests in forming a cooperative and they explore possible alternatives to solve their problems. Once they decide to pursue a cooperative business, they will discuss the purpose and scope of the activity and the potential advantages for the members.

It is important that one or more effective leaders with sufficient charisma are identified at an early stage. Leaders are the driving force in cooperative endeavours. They will achieve compromises among participants by taking into account both the interests and the needs of the members, which are often short-term interests as well as the long-term commercial goals (sustainability and reducing risks) of the cooperative enterprise.

For development of the cooperative, the potential members need to understand and accept the social and economic principles of doing business in a cooperative organisation. Therefore, the owners should assess the viability and potential benefits of the new business and agree that there are adequate returns to offset the risks taken and the costs incurred. The understanding and acceptance of member ownership and control is fundamental to a decision to form a cooperative, and the group needs to be convinced of the desirability and practicality of the cooperative form of business.

Women often play an important role in making the decision of whether or not to join a cooperative. There is a large imbalance between women's participation in cooperatives and the involvement of women in agriculture. Therefore, it is important to involve women as much as possible already in the initial stages of the discussions in order to get their full support and active participation. (See also Further reading: FAO, 1995.)

Setting up a cooperative enterprise is often a time-consuming and complicated process. Structure and management of the organisation should correspond with the capabilities and resources of the members. If the members have little experience with cooperative activities and

limited organisational capabilities, it is better to start with a relatively simple single-purpose cooperative, e.g. one that provides farm supplies for a common crop.

To be a member of a cooperative it is also necessary to be committed to the organisation and be an active user of the cooperative's services and products. There is no value in having non-committed members, who are not active users. Inactive members undermine the cooperative and should not participate. Members should actively participate at three levels in the cooperative organisation:

- in the provision of resources (capital, labour, delivery of produce)
- in the decision-making processes of the organisation (as a member)
- in the produced benefits, such as by sharing in the surplus generated by the enterprise, in the provision of interest on shared capital and by making use of the joint facilities and services

All the issues mentioned above and related questions should be discussed prior to the establishment of the cooperative, including the criteria and rules for active membership.

Case 4a: First condition for success: motivated members

Like many other small farmers in Africa, traditional subsistence farmers in Uganda face problems in marketing their products. The farmers' power in negotiating with buyers of their products is weak due to lack of information on actual market prices and the supply of small quantities. In addition, limited access to credit forms a barrier to diversifying into high-value crops. Thus, for individual farmers there is little opportunity to increase their incomes.

In April 2005 a group of 140 farmers from two rural producers' organisations in **Uganda** established a multi-purpose cooperative to overcome these marketing problems. The group of initiators sought assistance from the Uganda Co-operative Alliance to guide them in the formation of the organisation. The cooperative they established is entirely member owned, used and controlled.

The members selected a hard-working and committed group of leaders. Jointly they developed a comprehensive business plan and this guided them to success. The cooperative uses economies of scale to secure market power and negotiate good prices in the market. By pooling resources, cooperative members have been able to add value to products and to access services.

For example, the cooperative purchased a drying installation in order to add value to their maize. The supply of a large quantity of dried maize helped the cooperative to sell their produce at a price 2.5 times higher than the local open market price. In addition, the cooperative is now able to purchase inputs at discounted prices. Farmers within the cooperative receive high-quality maize seed at a price that is 35% lower than the open market price.

The cooperative disseminates market information to producers so that they have access to current commodity prices. An informal partnership with a financial cooperative gives member farmers access to financial services and credit. Members also capitalise on the knowledge and experience of an expert management team.

As initial benefits of the cooperative have not gone unnoticed, the enterprise has grown from 140 to over 1,000 contributing members within one year. Members belonging to 11 rural producers' organisations joined and all of them contributed to the share capital.

As part of its medium and long-term plans, the cooperative intends to recruit another 3,000 members and to diversify into honey production and paprika growing as high-value enterprises. Adding value to their produce is also high on the agenda.

4.2 Committed leaders

Developing leadership within the organisation is one of the most important tasks, since most members have no prior experience in managing a larger business. Leadership does not refer to one single person but should be present and organised at all levels of the organisation. The future of every cooperative depends upon the identification and development of active and committed leaders. Active individuals and potential leaders should be identified at an early stage. These persons should be trained and exposed to practical experience in order to develop skills and knowledge in future leadership for a variety of positions and cooperative functions. Regular training opportunities should be provided for all members who have aspirations to serve in boards, committees or working groups.

An effective board of directors teamed up with qualified professional management is essential for success of the cooperative, not only in the

start up phase, but also during further development. The management and board of directors should have - within their mandate - sufficient freedom to operate the enterprise in the best interests of the members. This is especially important in periods when external (market) conditions may require flexible management structures and rapid adaptation. Well-informed members and full transparency are of course prerequisites.



Figure 10: Skills development of leaders is essential (Agriterra)

To remain successful and dynamic, the organisation needs the best available members to serve the interests of all its members. Making provisions for the future must therefore not stop at material and financial investments. Leaders should also be given the opportunity to develop their skills and knowledge in order to a continuously changing external environment and challenges.

Development of a cooperative structure, including a board of directors and management, is discussed in more detail in Chapter 6 .

Case 4b: Other conditions: leadership and good planning

The success of the cooperative in **Uganda** introduced in Case 4a has been due to several factors. The first major factor is member commitment. The cooperative has a large member base because it is an attractive marketing venue for producers; farmers clearly recognise that the benefits outweigh costs.

Another major factor is initial leadership and good planning. The cooperative enterprise is the outcome of exhaustive exploration and planning. Leaders in the community identified problematic issues and searched for solutions. They explored the feasibility of different options, and having decided on a cooperative, obtained the necessary assistance to put their vision into action. With the assistance of Uganda Cooperative Alliance, members were trained and empowered, and a clear and focused marketing plan was created.

Finally, the cooperative sought the assistance of experts. Members obtained knowledge and acquired a capable management team with the assistance of an organisation with ample experience. Now, the experience of this cooperative enterprise is a model for other farming communities in the area.

4.3 Other factors for success

In addition to having dedicated members and committed leaders, there are five major factors, or conditions, that initiators need to take into account when establishing a cooperative: the market, technical and economic feasibility, the legal environment, financing and organisational structure. Good planning and advice are also of the utmost importance.

Market

Existing and future market conditions and opportunities should be thoroughly studied, since they will largely determine the success or failure of the cooperative. The cooperative enterprise could achieve economies of scale through better utilisation of personnel, equipment or other resources as well as by sharing the financial burden or managing risk.

The operation should be economically viable and the cooperative should be well positioned in the market so that it will be able to compete with other providers of similar goods and services. The basic setup of the enterprise and the required resources (land, labour, capital, expertise and information) have to be studied. The applied technology and organisational requirements will have to be determined and possible alternative solutions have to be found.

Technical and economic feasibility

The technical and economic feasibility of the business should be properly evaluated. Potential risks, such as technological, political, organisational, financial and market risks, will have to be analysed and basic strategies be designed to overcome and manage them. A business plan reflecting both a long-term and short-term vision needs to be made and the required level of investment determined.

During this preparatory stage reliable advisers or trusted consultants could play an important role by advising the members of the cooperative, doing market research and/or conducting a feasibility study. The high level of risk associated with starting a new enterprise demands that decisions be taken on the basis of the best information obtainable. Organisations that could help to identify suitable advisers or consultants are national producers' organisations or international agriculture agencies such as the ones mentioned in Useful addresses.

Legal environment / legislation

The presence of an enabling and supportive legal environment or legislation is essential. This means that there are no legal, administrative or political barriers for groups of farmers to elect their own leaders and to establish a cooperative organisation. Cooperatives also should have the freedom to organise themselves in the most appropriate way – that is, in a way that is comparable to investor-oriented business organisations. They should not be hampered by special rigid legislation or bureaucratic rules that apply to cooperatives but not to non-cooperative businesses.

This means that the cooperative must have the freedom to market the goods produced and delivered by the members, to earn profits on sales and to distribute the net returns to the members. Furthermore, the members of the organisation should be allowed to decide on future policies and new activities undertaken by the enterprise. Preferably, legislation on cooperatives should be elementary or related to the framework only, leaving scope for the members to regulate their own cooperative business.

Case 5: Framework legislation on cooperatives

Countries in Western Europe like **Denmark** have large, strong agricultural cooperatives. These hold an aggregate market share of more than 50% of the entire turnover in the agricultural and agri-business sector. Amongst them are some of the leading companies in the dairy, fruit and vegetable, meat, animal feed and credit/banking sectors.

These countries have only framework legislation for cooperatives, which is comprised of very concise legal provisions. The legal approach is not to prescribe how cooperatives should regulate their affairs, but to require that they do so. This is to ensure that both members and third parties have basic rights and certainties in the matters regulated by the cooperatives. This approach has proved to be very successful and stimulating for cooperative development.

It should be noted that many developing countries still have very rigid and tutelary legislation on cooperatives left over from the past, which is often harmful and counter-productive for the successful development of economic cooperative enterprises. In such cases it could be worthwhile to consider other organisational options. More details on how to design statutes and by-laws of cooperatives are given in Chapter 6.

Financing / capital

Newly formed cooperatives usually require a significant amount of capital. This could come from three sources:

- the members
- net surpluses generated by the cooperative
- external sources

Member finance is the most important source, especially in starting up the cooperative.

With a sufficient share of member financing it is easier to attract additional external financing, such as loans. It is often difficult to raise sufficient funds exclusively from the members. A potential challenge is that expected financial returns are only generated after some time, when the cooperative is fully operational and earning a profit. This could take a number of years. Members thus must be willing to postpone their returns on investment and be patient. More on financing of cooperatives is presented in Chapter 7.

Case 6: Transformation of state cooperatives into farmer-controlled enterprises

The **Ethiopian** government that came to power in 1991 after the overthrow of the socialist Derg government (see Case 1 in 2.4) embarked on an extensive programme of economic and political liberalisation. This included steps to promote the development of democratic, free-market-oriented and professionally managed agricultural cooperatives. The groundwork for this initiative was laid in 1994 by the agriculture agency ACDI/VOCA, when a large number of volunteers from the North were fielded in a farmer-to-farmer extension programme.

These initial efforts were followed by implementation of a 5-year cooperative development programme aimed at revitalisation of Ethiopian cooperatives. Technical advice and training in cooperative organisation, operation, and business management were provided to government officials, cooperative promoters, board members, managers and accountants. In addition to restructuring primary cooperatives, the programme also concentrated on establishing professionally managed secondary level unions specialised in input supply, marketing and credit. The shareholders of these unions are primary cooperatives, so the unions are fully controlled by farmers.

This programme has had a dramatic impact. Over 1,400 agricultural cooperatives throughout Ethiopia have been reoriented, restructured and legally registered. Fourteen cooperative unions have been established as agricultural cooperatives. Their shareholders are other agricultural cooperatives that take advantage of economies of scale. Cooperatives have become major players in agricultural input and output markets.

Organisational structure

In the given environment and market conditions, the cooperative has to select and develop its organisational structure in the most practical and efficient way to achieve its goals (Rabobank, 2001). There are no blueprint models for an appropriate organisational structure and business method. These will be determined by the members. Each cooperative has to develop its own autonomous structure depending on the commercial objectives of the organisation and the market conditions in which the enterprise operates.

5 Cooperative management

Cooperative organisational development is based on two principles:

- putting members' interests first, so that all the goals achieved ultimately benefit the members
- maintaining an entrepreneurial approach in identifying and pursuing business opportunities

5.1 Finding the balance

The management of the cooperative has the difficult task of finding a balance between operational success and member satisfaction, which is often focused on the short term. Combining both short-term economic success and long-term sustainability can best be achieved if the members develop a well-defined vision, clearly formulated objectives and a phased strategy for business development. See Case 7 in the text box below.

Case 7: Finding the balance between short-term and long-term objectives

The problem of finding a balance is illustrated by the following cases involving very differently organised farm supply cooperatives.

The first cooperative sold everything its members needed, in all varieties and sizes. Nothing was ever out of stock. The society's warehouse was open all day, every day. A large, well-trained staff was available to instruct members in the use of all the products. The cooperative would deliver any quantity of supplies to the members' farms, if requested. Prices charged to the members were very low. Members were not required to pay until harvest time.

The second cooperative was very different. It only stocked the most popular items and never more than a single variety. Members had to collect supplies themselves and to pay immediately in cash. The warehouse was open only on working days and then only for a few hours. Members had to know exactly what they wanted and how to use it, since there was no staff to advise them. Its prices were fairly high. Furthermore, because the cooperative wanted to keep stocks as low as possible, it often ran out of important items.

Both co-operatives failed. The first cooperative provided every possible service to its members but the cost was far too great. It soon ran out of money and had to go out of business. The second cooperative had very low costs and was very efficient. But it failed to meet its members' needs and they were forced to buy supplies elsewhere. The cooperative soon went out of business because its sales were so low.

This example shows that both principles: 1) to satisfy members' needs, and 2) to keep costs as low as possible, are equally important. A farm supply service cannot survive unless it does both. The management of a farm supply cooperative must find the correct balance so that members' needs can be satisfied and costs controlled.

Business plan

Once approved by the (potential) members, the strategy for business development will be worked out in a business plan. This will include detailed planning of activities, budgeting and financial-economic planning. The business plan will also include a strategy for organisational and human resources development, which should be implemented in harmony with the development of business activities.

Such a plan will also include indicators for monitoring and evaluating achievements. Continuous monitoring is essential in order to adjust targets in time once the business is in full swing and unexpected developments occur.

5.2 Development of a cooperative structure

In each cooperative there should be a structure in place to ensure effective and ultimate control by the members. This includes the right to:

- draw up or change the by-laws and rules of the cooperative
- decide on general and business policy issues
- take decisions regarding election, appointment and dismissal of the board of directors and the supervisory board
- approve of an operational plan, budget and financial accounts, general conduct of business and management of the cooperative.

The organisational structures of cooperatives are partly determined by law and partly by the cooperative itself. Most countries have a cooperative act or other relevant legislation. As we have seen in section 4.3, there cannot be a single blueprint for all cooperatives. Each cooperative has to develop its own structure to suit its specific situation and objectives. Large-scale cooperatives need more complex organisational systems to ensure that all member interests are represented. In most countries the law prescribes some system of external auditing. This, however, should not replace internal control mechanisms.

Formation of a steering committee

The formation of a cooperative usually starts with the identification of leaders to represent the group of initiators. A steering committee is formed that often coordinates several working groups of potential members appointed to study opportunities or to work out various organisational aspects. The steering committee assumes a number of important responsibilities such as: determining the initial feasibility of a cooperative, building trust among potential members and selecting advisers or resource persons for the group.

Steering committee members should have good business sense, an understanding of the problems to be addressed, as well as some knowledge of cooperative organisations. They should be respected members of the community and be viewed as credible sources of information. Many potential members will base their decision to join the new cooperative on the credibility of the steering committee. Steering committee members are expected to be responsive and articulate in answering questions from potential members and other stakeholders.

In many cases, members of the steering committee will go on to serve as the interim board of directors for the cooperative until the formation process of the cooperative is completed.

The general meeting of members

The general meeting of members is the supreme organ of the cooperative. This means that the general meeting makes all basic decisions

regarding the structure and operation of the cooperative. However, in the early stages of cooperative activities, members may not always be in a position to participate effectively in the decision-making process, because of lack of understanding and experience of both members and leaders.

In such situations it is often advisable to organise discussion seminars prior to the general meeting in order to ensure that members participate actively in meetings and are able to make effective and informed contributions. At these seminars, members could be informed in detail and discuss the issues on which decisions need to be made at the general meeting. In such a seminar it would also be possible to invite resource persons such as bank officials and local decision-makers, who are in a position to analyse issues from all sides. Thus, members can be informed extensively but left to form their own opinions.

The gender aspect should receive sufficient attention so that female members of the cooperative play an adequate role in decision-making. Social and cultural barriers might restrict the participation of women in all stages of the process, but measures should be taken to ensure that their opinions and voices are heard and that they actively participate in taking important decisions or be elected to the board and other posts.



Figure 11: Checking milk quality at a dairy cooperative (Agriterra)

The board of directors

In the cooperative's first or formative general meeting, members will appoint the cooperative's first management board or board of directors. The board of directors is responsible for running the cooperative. It should consist of at least two members who can be asked to act on

behalf of the cooperative either jointly or individually. It is advisable that they act jointly to guarantee control of management. The statutes should spell out whether the board can act and make decisions only on the explicit authority of and with the approval of the members, or whether the board can act more independently, thus acting on behalf of the members without having to consult them on every issue.

The members of the board of directors may carry out the board's activities as their main work, as a part-time job, or as an honorary occupation. This depends on the size of the cooperative and amount of work involved. In many cooperatives the functions can be carried out on a part-time basis with perhaps one or two paid clerks to assist the board. As the business and needs of the members expand, however, more and more time will be needed and it may become necessary to employ a full-time manager.

The supervisory board

While the board of directors is responsible for running the cooperative, the purpose of the control or supervisory board is to exercise the members' control over the decisions made by the board of directors. The functions of the supervisory board should also be laid down in the statutes. The supervisory board should consist of at least three members elected by the general meeting.

The manager

As the business operations expand, it may become necessary to recruit a full-time, qualified manager. This should be a talented professional manager with sufficient experience and capabilities to balance the need to achieve the cooperative's long-term objectives (the joint business interests and sustainability) with the needs of individual members. The importance of selecting and appointing a suitable manager of the cooperative cannot be over emphasised.

Development of the leadership team

The role and level of involvement of the leadership team changes throughout the process of formation of a new cooperative. In the early

stages of development, leaders have a high degree of involvement in promoting the concept and forming the steering committee. Once a manager is appointed, the role of the manager increases as a number of responsibilities are shifted from the steering committee to the manager. Although many organisations delay the hiring of a manager until the cooperative is fully operational and running, it may sometimes be advantageous to hire a manager earlier in the process to assist in member recruitment, securing funding and in overseeing construction activities.

Figure 12 shows a possible result of this process: the organisation scheme of a cooperative.

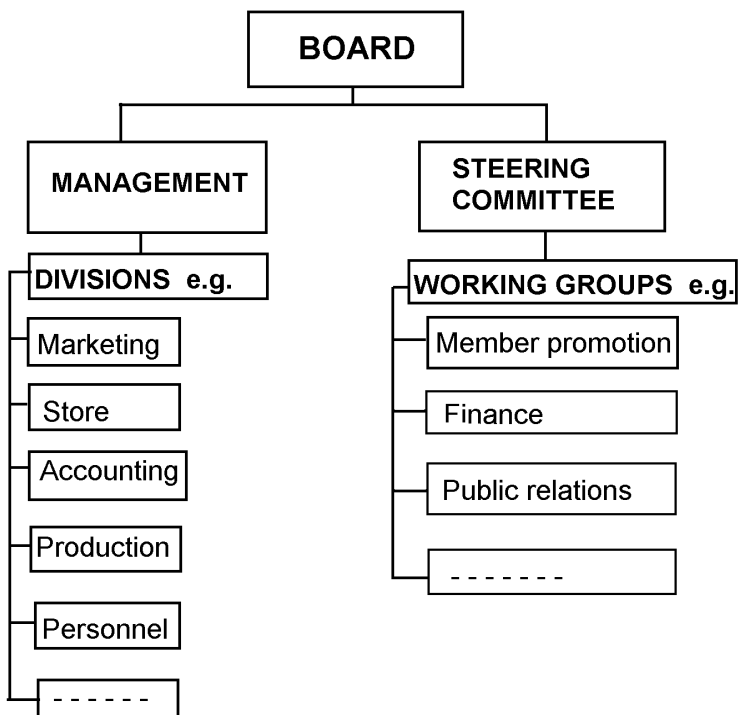


Figure 12: A possible organisation scheme of a cooperative

6 Statutes and by-laws

The results of discussions on cooperative formation need to be written into cooperative statutes and by-laws. Statutes are the interpretation of the cooperative law for that particular cooperative. By-laws are a set of written operational rules that are based on the statutes and needed for proper functioning of the cooperative.

Statutes

Statutes regulate not only the existence of a cooperative, but also the direct relationship between the cooperative and its members. The statutes are the internal legislation, on which legal relations between members and the cooperative are based. Consequently, they should be as detailed as possible. Cooperatives have the freedom to prepare statutes regarding all matters necessary for a good functioning of the organisation and for achieving its objectives, as long as they stay within the limits of the cooperative law, which may vary from country to country.

Cooperative movements, governments or other institutions often make a set of model statutes available that can guide the founding members in formulating statutes for their specific cooperative. However, model statutes are intended as guidelines only and they should not be imposed on the founding members. New cooperatives often accept model statutes without discussing their contents section by section. This means that members do not understand the meaning of the statutes, nor whether they are needed for their particular cooperative. This situation can be avoided through ample discussion.

If statutes are not properly discussed, it could happen that a few members create and impose their own rules and run the cooperatives according to their own style and for their own benefit. This is likely to result in some members being unhappy with the results and becoming apathetic about their involvement in the cooperative. Outside resource persons may be needed at this stage, particularly if they are familiar with the process and the legal requirements. An experienced staff

member of a federation of cooperatives may be able to play a useful role by advising the new cooperative in this matter.

By-laws

By-laws are operational rules that define the rights and responsibilities of members, directors and management. Directors are particularly responsible for ensuring that the cooperative and its members adhere to the by-laws.

By-laws perform two additional functions. First, they describe in more detail how cooperative affairs will be directed to ensure that laws will not be violated. Second, the by-laws address issues not specifically spelled out in cooperative law or in the statutes, but which are necessary to make the cooperative an effective, well-designed organisation.

Support in legal affairs

COPAC (see Useful addresses list) has compiled a list of cooperative legislation from a variety of sources, which may be consulted and used when developing cooperative statutes and by-laws. This includes legislative databases maintained by the Food and Agriculture Organisation (FAO) and International Labour Organisation (ILO) as well as governmental and cooperative websites.

7 Finance

7.1 Distinctive features of cooperative finance

The need for finance in a cooperative is not different from that in commercial companies, yet the role it is given in determining the success or failure of the organisation is different. This difference partly stems from the fact that cooperatives represent people-centred organisations, as opposed to capital-centred commercial companies.



Figure 13: Training in modern animal husbandry for members of a dairy cooperative (AEC)

Cooperative members are frequently referred to as shareholders. Their liability is either linked to the share capital they contributed, or has been limited even further to the value of just one or two shares (see also table 1). Equity capital, also known as ownership capital, must be regulated in the statutes. It may be written into the statutes, for exam-

ple, that the equity capital can be paid in instalments rather than in full at one time. A minimum sum or percentage should, however, be fixed.

The statutes should also make provisions for any statutory reserves required by law as well as any other reserves thought necessary, like a voluntary reserve fund.

The surplus earned by the enterprise could be divided between investments and dividends as would be the case in a commercial company. However, it is usually distributed in three ways:

- Some goes to the members as a kind of interest paid on the basis of the capital they have invested in the cooperative.
- Some is paid as a bonus or a discount and serves to reimburse the members according to their trade volume with the cooperative.
- Some is retained as institutional capital to replace borrowed capital in order to finance the growth and development of the organisation.

Distribution of any net surplus needs to be decided by the general meeting.

7.2 Sources of capital

The capital needed for development and growth of a cooperative can come from three sources:

- the members themselves
- net surpluses generated by the cooperative
- external finance such as bank loans

The best source of financing for a cooperative is from members. The more financing members provide, the less the cooperative business will need to borrow from other sources.

Usually, cooperatives sell common and preferred shares to members to raise capital. The common shares are usually tied to voting rights. Preferred shares also can be sold to outside investors and members. Although owners of preferred shares have no voting rights, this stock

carries less risk than common shares. Members of the community in which the cooperative is to be located may purchase preferred shares to keep the cooperative as a local business.

The capital created through the retention of surplus earned, also called appropriation profit, represents a commitment by members who otherwise would have had that portion of surplus allocated to them. It is called the institutional capital and it does not cost the cooperative any interest.

Members' participation in the financing of the cooperative should not, however, be restricted to share contributions and payments into the reserve. Members can be induced to make larger contributions towards the financing of the cooperative where it is seen to be to their benefit. An example can be payment to them of a form of dividend on members' money which exceeds the statutory requirements.

Case 8: Participation of both large and small farmers

Cooperative organisations in **Zambia** have a membership composed largely of rural smallholder agricultural producers. Given their limited economic means the mobilisation of shared capital by members has been insufficient. As a result the economic basis of the rural cooperatives is very weakly developed and the prospects of these cooperatives are bleak.

It is very desirable for the development of strong cooperatives that farmers with a wide range of different-sized farms in various stages of development work together in the same organisation. With full participation of larger farmers, better governance and funding prospects often become available. Social coherence of course is a pre-condition for this. Under polarised or feudal conditions cooperation will be difficult anyway.

The cooperative can borrow debt capital, e.g. from banks. The allowed or desirable amount depends on how much risk or equity capital members initially invest, on cash flow, on quality of management and on the degree of risk in the venture. Members should contribute equity capital amounting to at least half the total capital requirements. But, it usually takes several years of operation to reach this goal.

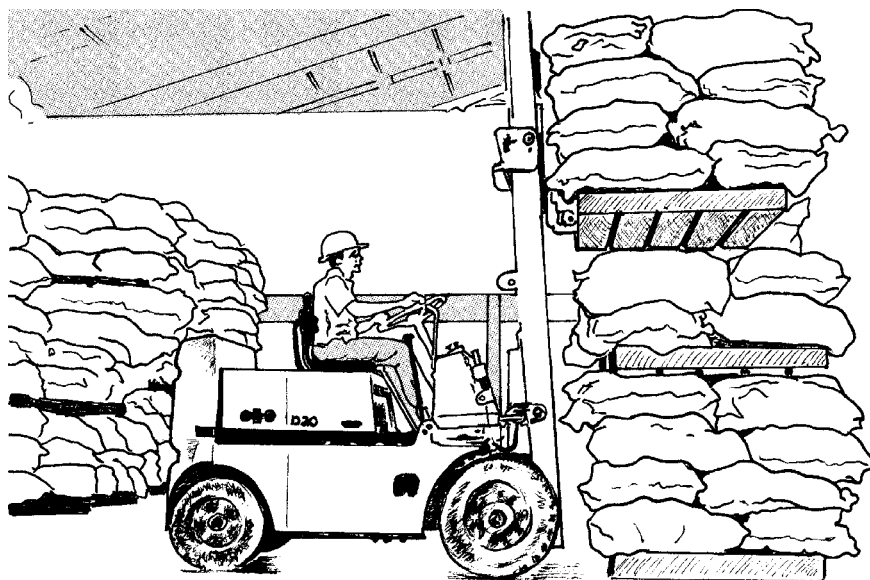


Figure 14: Storage of rice seed in an input supply cooperative

Long-term credit is the usual way of acquiring part of the money to finance land, buildings and equipment. The period of the fixed asset loan depends on a number of factors, but it is usually related to the facility's projected life. The Steering Committee should explore various sources of long-term loans and recommend the source that can supply the financing best suited to the proposed cooperative.

In an FAO publication (see Further reading: FAO, 2004) the authors describe a number of innovative ways and strategies to raise capital, e.g. through deferred payments. Some of the innovative approaches to cooperative financing that have been successfully used in western countries could also be applied in the South.

8 Potential pitfalls

Considerable time and effort are spent in starting a new cooperative. Like all new organisations, they are vulnerable in their formative years. Avoiding the pitfalls experienced by others helps to increase the chance of success. Below we mention some potential pitfalls and recommendations to avoid them.

➤ *Lack of clearly identified objectives and strategy*

A new cooperative should not be formed just for the sake of forming one. The potential member-users must identify and formulate a clear vision, purpose and goals of the undertaking, including an approved strategy to reach these goals.

➤ *Inadequate planning*

Detailed plans for reaching the defined goals and purpose of the cooperative are important. In-depth surveys (e.g. through questionnaires and farm surveys) of the potential member-users' needs coupled with business feasibility studies are often necessary. The organisational process should be stopped if there is not sufficient interest from potential member-users or if the set-up is not economically sound or too risky.

➤ *Failure to use experienced advisers*

Most persons interested in setting up a cooperative have no experience in cooperative business development. Using resource persons experienced in cooperative development can save a lot of time and expense.

➤ *Lack of leadership*

Calling on the services of experienced resource persons cannot replace leadership from the organising group. Decisions must come from the potential member-user group and its appointed leadership. Professional resource persons should never be involved in decision-making.

➤ *Lack of member commitment*

To be successful the new cooperative must have the broad-based support of the potential member-users. The support of lenders, lawyers, accountants, cooperative specialists, and a few leaders won't make the cooperative a business success.

➤ *Lack of competent management*

Most cooperative members are busy operating and managing their own farms and lack experience in cooperative management. Experienced and qualified management could be hired to increase the chances for business success.

➤ *Failure to identify and minimise risks*

The risks involved in starting a new business can be reduced if identified early in the organisational process. Careful study of the competition, government regulations, trends, environmental issues and of alternative practices helps to reduce risk.

Case 9: Failure to identify and minimise risks of sudden market changes

The failure to identify and minimise risks can lead to the downfall of a successful cooperative. This is shown by the example of a **dairy cooperative in Central Kenya**, which was not prepared for sudden changes in the market. This cooperative was established in 1982 with the objective of taking over the marketing activities from middlemen, who had until then greatly profited from these activities.

The members followed all of the necessary steps to start the cooperative. With the assistance of a regional cooperative officer, the initiative was prepared by the leadership and agreed upon by the members. Alternatives to co-operatives were explored, leading to the decision that forming a cooperative was the strongest option. A budget was drawn up and a steering committee was established. This steering committee explored the feasibility of the cooperative. Then, with the assistance of the Ministry of Cooperatives, an institutional design was decided upon. Member commitment was secured by a commitment fee. Next, members elected officials to administer the cooperative. Finally, a bank loan was secured to finance start-up costs, such as the purchase of transport vehicles to deliver milk to customers and establishment of a secretariat.

This comprehensive planning process paved the way for 14 successful years of operation. However, one policy change, liberalisation of the dairy market, led to the sudden collapse of the cooperative's main customer, a large cooperative milk processing plant. The dairy cooperative's inability to secure reliable alternative markets strained members' commitment and consequently led to its closure after 16 years of operation.

The management of the cooperative was not prepared to adapt timely to the new market situation and the leadership was not strong enough to retain the member commitment necessary to survive the resulting uncertainty. This uncertainty may have been avoided had the risk of market liberalisation been identified earlier, and a strategic plan developed to manage the policy change. This example stresses the significance of continuous planning in order to adapt to a changing economic environment.

➤ *Poor assumptions*

Often, potential member-users and cooperative leaders overestimate the potential volume of business and underestimate the costs of operation. Anticipated business success that ends in failure places the organisers in a bad light. Sound business assumptions tempered with a dose of pessimism often proves to be wise.

➤ *Lack of financing*

Many new businesses are under-financed. Inefficiencies in start-up operations, competition, failure to comply with regulations and delays are often the causes. The first months of business operations and even the first years may not be profitable, so adequate financing is important to survive this period.

➤ *Inadequate communication*

Keeping the members, suppliers and financiers informed is critical during the organisation and early life of the cooperative. Lack of or incorrect information and insufficient transparency create apathy or suspicion. Directors and management must decide to whom and how communications are to be directed.

9 Establishing a cooperative

The second part of this handbook provides general guidelines for establishing an agricultural cooperative. As many different types of cooperatives exist, it is not possible to provide standard ‘prescriptions’ on how to start. Moreover, economic, cultural and legal environments may vary considerably in each situation, each requiring a specific approach and solutions.

Critical path of decisions

The formation of a member-controlled agricultural cooperative is a complicated process in which many actors or stakeholders are involved. First, objectives, structure and set-up of the cooperative enterprise need to be discussed and established. The best way to proceed is to undertake systematic and step-by-step preparation before the group arrives at its ultimate decision to start the real business. These steps form a kind of critical path that should be followed prior to this ultimate decision of the members. Many questions come up which should be answered. Together, these steps usually represent the most critical stage in determining success or failure of the initiative, as will be discussed in further detail below.

Good preparation: essential but complex and time consuming

In many respects, cooperatives resemble other businesses. They have similar physical facilities, perform similar functions and must follow sound business practices. In this respect the preparations are the same as for every other type of enterprise active in the market. As an organisation, however, a cooperative is distinctly different and more complex to start.

As noted in section 2.2, cooperatives differ from other agri-businesses mainly in their purpose (cooperatives benefit members), in ownership and control by members, and in the distribution of benefits to users and members. Therefore prospective members must jointly develop and agree on the idea and plans for setting up a cooperative business.

Starting a cooperative is thus an interactive learning process of the initiators and other stakeholders including potential member-farmers, initial leaders, community members, lenders and suppliers or customers. A critical number of member-owners must agree to participate before the cooperative business can start.

The complexity involves working towards an agreement on vision, mission and feasibility of the proposed agricultural cooperative. A high level of trust and confidence in the initial leadership and advisers and also among the potential members is a must. Without these it is difficult to secure the member commitment required to finance and support the cooperative once it is operational.



Figure 15: Once a cooperative is established, all participants can be proud of their achievement

Raising sufficient finances to serve as institutional and working capital is essential but can be complicated. Involving farm leaders, advisers and other professionals, as well as obtaining organisational support from others can facilitate the process. In this way potential pitfalls can be avoided. Use of advisers and/or consultants during the process plays a major role in compensating for the lack of experience. They can assist in tackling complicated matters which may surface during

the decision-making process. They can provide support in studies and in commercial, technical, organisational, financial and legal issues.

Advisers must be carefully selected on the basis of their professional knowledge, experience and trust. The entire process can be rather time consuming. It usually includes the organisation of many formal and informal meetings as well as considerable effort in coordinating the large group of individuals and organisations. Leaders must therefore demonstrate a combination of expertise, enthusiasm, practicality, dedication and determination to see that the project is completed.

Eight steps for cooperative development

There is no fixed set of rules for forming a cooperative, nor can any list of steps be exhaustive for all situations. Keeping that in mind, we present eight preliminary steps that form the common basis for forming new cooperatives, including the activities to be undertaken and by whom. The ultimate goal of starting a cooperative can only be reached once these preliminary steps, or sub-objectives, have been accomplished. In this approach we largely follow the sequence given in Cornell, 2001 (see Further reading).

This sequence of events, activities and tasks is summarised in Appendix 1 and Figure 16.

The group must:

- 1 develop the idea for a joint economic initiative after agreeing that there is a common problem to be solved or a promising opportunity,
- 2 build consensus for the enterprise by interesting potential members,
- 3 identify potential leaders, select a steering committee and prepare a work plan and divide tasks,
- 4 conduct a feasibility study and member survey,
- 5 work out an institutional structure and reach an adequate level of trust among potential members,
- 6 secure commitment from members for a detailed business plan,
- 7 secure commitment from other key stakeholders,
- 8 assemble staff and assets to start up the cooperative enterprise.

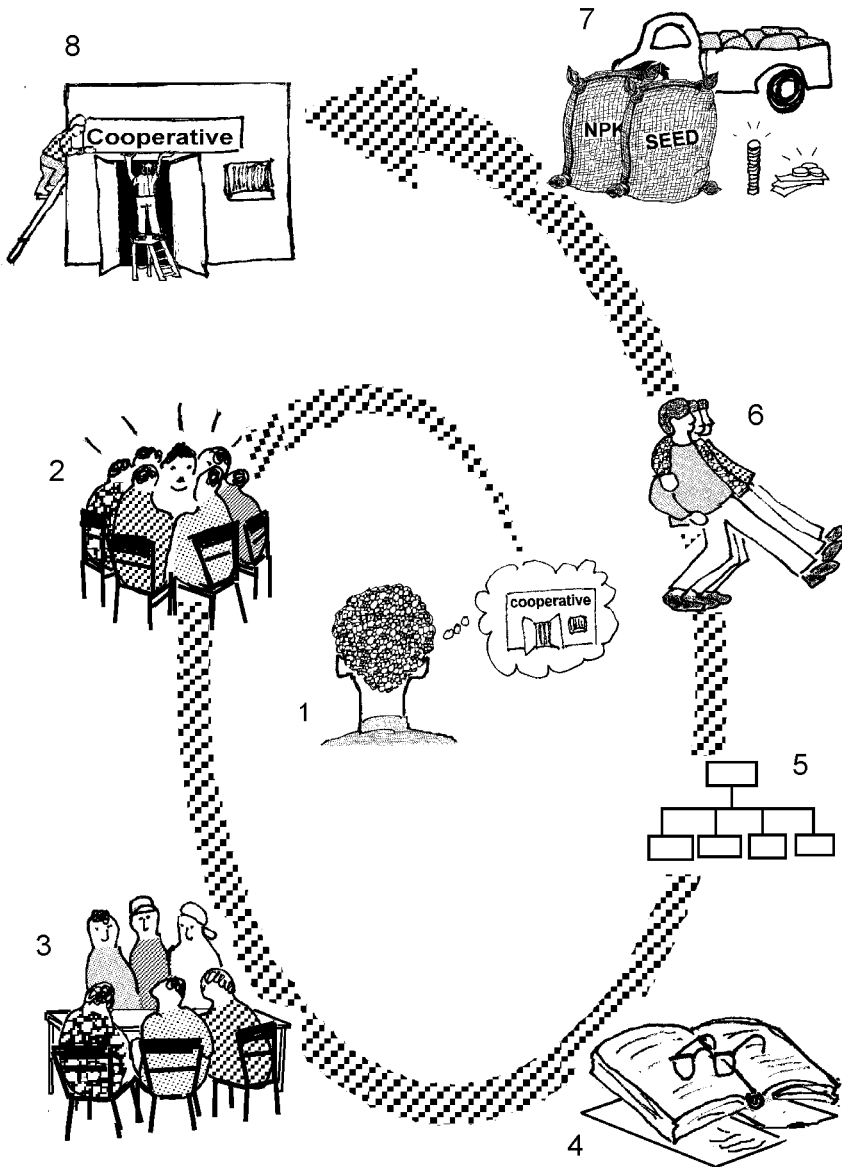
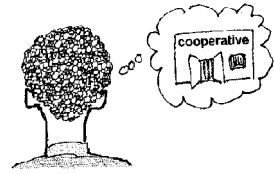


Figure 16: The eight preparation steps of cooperative formation

These eight steps should be considered as an iterative process. Although activities associated with each step must be completed before proceeding to the next phase, often it is advisable to go back to a previous step when new information comes to light. Revision of earlier preliminary decisions might be needed and the process should be partly repeated based on the new facts. Before beginning the process the group needs to agree on the criteria that constitute a green light at each step, thus making it possible to move on to the following one. Likewise, it has to be clear which other criteria might constitute a red light, meaning it is time to abandon the process and explore other options.

Step 1: Developing the initiative

The first step in developing a cooperative is to work out ideas by collecting information, by clarifying the need for and purposes of a cooperative and by pulling together a core group



committed to the idea. Usually the core group consists of individuals who have a common problem; this can also be a perceived business opportunity. They have discussed the problem and possible solutions and have decided on developing a joint economic initiative. One or more individuals take the lead and act as initiators.

Before preparing detailed plans, the core group needs to define and agree on the scope, nature, precise circumstances and background of the problem. The core group also has to define the proposed economic activity and discuss whether or not a cooperative organisation is the best approach. This should be followed by an exploration of whether the economic initiative is viable.

At this stage a number of critical questions have to be defined and answered:

- What will be the nature of the cooperative enterprise?
- What benefits will the cooperative provide for its members?
- What markets will it operate in; what will be its standing within those markets; what will be the scope of its activities?
- Who will be its members; how many will there be and what kind of relationship will they have with their cooperative?
- What position will the cooperative hold in the minds of its members, its customers and its other stakeholders?
- How will it be led and managed, and how will members participate in these processes?
- How will the activities of the cooperative be financed?
- What approaches, working methods and systems will be used? What technology will be used?

Much attention will be paid to the economic motivation to form a cooperative. Comparing levels of expected returns or benefits with the expected costs involves a detailed analysis of expected business performance.

Once the group agrees on the scope and nature of the business and has studied the costs and benefits of the enterprise, the process can move on to the next step: building consensus among the key stakeholders on the cooperative approach.

The main activities that take place during this first step are summarised below.

Step 1: Developing the initiative

Actors involved: core group, potential members, advisers/consultants

- Work out proposed initiative and ideas
- Pull together committed core group
- Define critical questions
- Discuss cooperative as one of several options
- Collect information
- Explore relevant market/economic need
- Discuss scope and nature of problem
- Study economic and social aspects of problem

Step 2: Building consensus



After exploring and establishing the nature, scope and viability of the business in a series of initial meetings, the core group prepares to present the idea to potential members in a public meeting. Thorough preparations include a detailed inventory of opportunities and risks of the undertaking and of possible institutional alternatives. Other legal and organisational options may be considered, e.g. establishing a business, company, association or partnership.

At this point the group must answer several important questions:

- Will forming a cooperative create the right organisational structure to solve the group's problem?
- How will a cooperative address the identified problem or seize the potential opportunity?
- How do the relative strengths and weaknesses of a cooperative compare with those of other available alternatives?

The discussion should begin with a review of what cooperatives can and cannot accomplish. In general, forming a cooperative cannot correct imbalances in overall supply and demand. For instance, creating a new producer cooperative will not improve the product prices received if there is a general over-supply of those very products. However, if

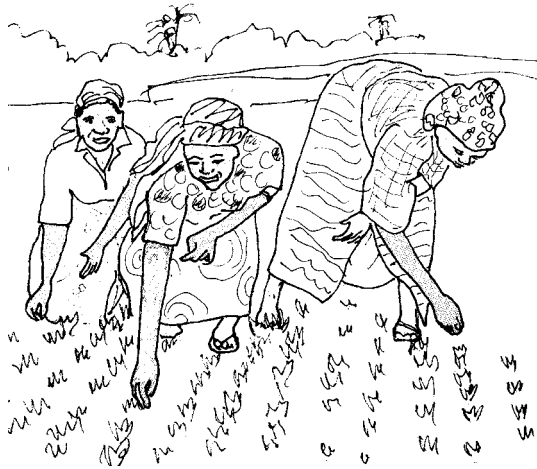


Figure 17: Working together in an agricultural cooperative

farmers forming a cooperative have some unique product that allows them to capture a particular and advantageous market niche, a new cooperative may be the solution.

Other factors such as the likelihood of conflicts between members should be considered. Therefore, it is important to first analyse whether or not the problem can be solved more effectively by a cooperative or by a private business enterprise or in some other way. See the text box below for an illustration of this.

Case 10: Machinery cooperatives, a source of conflict

In Western Europe, machinery cooperatives were set up to organise the joint use of machinery and agricultural implements in reaction to the rapid mechanisation and capital intensification of agriculture that took place starting in the early twentieth century.

The cooperative approach to this problem was not very successful, however, because of many conflicts that arose between members who needed the machinery at the same time. Machinery services provided by private contractors turned out to be a much better solution for land preparation and harvesting operations. Informal arrangements between neighbours or family members were also widely applied. Clear arrangements on the use of machinery made between several neighbouring farmers often worked better and was a better way of avoiding conflicts.

Public meeting

Once the core group is convinced that a cooperative is the best organisational form to realise their objectives, they organise a public meeting to determine whether there is enough support for establishing a cooperative. The core group will present its preliminary findings: the perceived common need, why a cooperative will meet that need and what the benefits and limits of cooperatives are. Building consensus on the economic initiative of a cooperative is the objective of this meeting. The key is whether there are sufficient individuals and organisations willing to join and support the cooperative as active members or external supporters beyond the membership of the core group.

A cooperative must be formed and registered in accordance with the provisions of national legislation; see section 4.3. Therefore, getting

started also means understanding the legislative framework for cooperatives. This process involves extension, information and training activities.

The formation of any cooperative is based on the mutual need of its members. Therefore, clarity is needed as to what kind of cooperative is being formed. This will critically influence who will become its members, the eligibility for membership and how the cooperative will function.

At the public meeting there has to be plenty of time for discussion so that everyone who wants to can express their views and ask questions. The opinions of women should be sufficiently heard and their potential role as active members and potential leaders of the cooperative should be adequately discussed. Good moderation of the discussions, for instance by a professional outsider as a trainer, visualisation tools (such as charts and graphs) are helpful; above all, attentive listening is essential. These should result in a fairly good appreciation of the differences or similarities in perception that exist among potential members and help to identify key persons in the cooperative. The minutes of this meeting must be recorded. All questions, insights and agreements should be written down and distributed to the participants afterwards for agreement.

Once the members agree to the proposals, a budget should be created to finance initial activities.

Step 2: Building consensus

Actors involved: core group, potential members, community members

- Discuss within core group whether a new cooperative can adequately address identified problems and opportunities
- Study organisational alternatives
- Hold initial meetings to review scope and nature of a cooperative solution
- Propose cooperative approach in public meeting
- If there is sufficient interest among potential members, create initial budget

Step 3: Establishing a steering committee



Formation of a steering committee is the next step in creating a cooperative. The composition and qualifications of committee members should not be taken lightly. The steering committee will assume a number of important responsibilities such as:

- selecting advisers
- determining the initial feasibility of a cooperative
- building trust among potential members.

The steering committee members need to be available to see the project through to full development. Those considering becoming a member of such a committee should realise that a significant amount of time, energy, and commitment will be required. They must have an unselfish attitude and, for the most part, no expectation of immediate financial compensation for a lot of hard work. Committee members should be representative farmers in the area and together form a demographic cross-section of the potential membership.

Steering committee members should have a good business sense, an understanding of the problems to be addressed, as well as knowledge of cooperative organisations. They should be respected members of the community and be viewed as credible and trusted sources of information. In many cases, they will go on to serve on the cooperative's interim board of directors. Many potential members will base their decision to join the new cooperative on the credibility of the steering committee.

It will be next to impossible for each potential member to thoroughly examine all the ramifications of organising a new cooperative. That responsibility falls on the steering committee. Steering committee

members are expected to be responsive and articulate in answering questions from potential members and other stakeholders.

Once the steering committee is nominated in a public meeting, the tasks to be undertaken in the next stages will be defined, e.g. studies and institutional design. Working groups of potential members will be formed to undertake or follow up on these assignments. Detailed task descriptions for these working groups will facilitate coordination. Once the timetable is made and agreed upon, the group can proceed to the next phase of development.

In this third step of cooperative development basic questions have been answered, such as: Is there a need for a cooperative? Is a new cooperative the most desirable option? The steering committee now embarks on building trust among the potential members. This trust will be essential in laying the groundwork for securing member commitment to join and support the cooperative. The steering committee members become the initial champions for the proposed cooperative.

Although member recruitment is listed as the sixth step in forming a cooperative, laying the groundwork for the membership needs to begin when the steering committee first meets. Many cooperatives in the process of being formed hold several meetings for potential members, conduct surveys of them, mail regular updates to them and collect initial down payments on membership fees. All of these activities provide a good indication of the level of interest in and commitment to the cooperative.

Step 3: Establishing a steering committee

Actors involved: core group, potential members, advisers/consultants, lenders

- Identify leadership
- Establish steering committee
- Install working groups
- Agree on timetable and tasks
- Assign tasks to potential members for subsequent steps
- Build trust among potential members

Step 4: Feasibility study and member survey



At this point, the group through the leadership of the steering committee will have to work out the details of the proposed cooperative operations. An in-depth feasibility study focused on the market and a membership survey are usually needed to determine whether the proposed cooperative can become a viable enterprise.

The purpose of a feasibility study is to examine critical opportunities and obstacles that might make or break the formation of the enterprise, as well as to consider other factors that help determine its viability.

Critical issues include:

- demand for the products to be marketed
- market potential and challenges
- infrastructure and logistics
- operating costs
- availability of financing

Other relevant issues to be addressed in such a study include:

- Is there a critical volume of business needed to be profitable?
- Is there a critical degree of participation required to serve a specific area?
- Are enough potential members willing to join and support the organisation?
- What returns can members expect to receive?
- What is needed to attract a sufficient volume of business from members?
- Are there enough qualified leaders willing to develop and direct the cooperative?
- Can a balance be found between members' needs and cooperative profitability?
- Is the group capable of making decisions?



Figure 18: Local initiatives of farmers can reveal opportunities of cooperating (ICRA)

The committee should also determine whether there are opportunities to work with existing cooperatives. This could help avoid the duplication of efforts or the build up of costly excess capacity when increased utilisation of existing capacity would be the best approach. Alliances or joint ventures with other cooperatives may provide a good economic alternative for potential members. These may be by far preferable to costly operations or investments in plants, equipment or assets that already exist. Also, previous experiences, successes and failures of similar cooperatives in the region should be taken into consideration.

A survey of prospective members is a useful activity in helping to determine feasibility and in building trust. The survey can help gauge the willingness of potential members to join and support the cooperative.

Case 11: Inadequate planning and poor assumptions

The importance of sufficient planning prior to the establishment of a cooperative is illustrated through the example of a rice farming cooperative in Ghana. The objective of this cooperative could not be more ideal: to combat rural poverty through collective action. By increasing the area planted with rice and raising productivity through introduction of improved farming techniques, the members hoped to increase their farm income. Joint marketing initiatives would lead to better prices for their produce.

The situation facing rice farmers in Ghana, however, is far from ideal. Land is fragmented, soils are low in fertility and the majority of producers lack access to agricultural credit and thus the technical expertise and means to adopt improved farming methods.

To overcome these barriers, local farmers initiated the aforementioned cooperative, starting with five farmers working on *nobua* basis. This a local system in which producers work together to farm individuals' plots of land in turns. This pooling of resources allowed the farmers to adopt modern methods of production.

Unfortunately, an initial lack of technical expertise in modern farming practices limited the gains of the cooperative. Individuals did not see the expected increase in yield or the corresponding increase in income.

In reaction to this setback, the cooperative obtained outside help to capacitate farmers in modern production and agro-processing methods, marketing, and necessary administrative responsibilities. This training increased productivity. It did not, however, prepare farmers for the increased costs associated with the new production techniques, nor for the risk of drought and periods of low demand. These disappointments led to mistrust among members and many reacted by threatening to separate from the cooperative.

Inadequate planning thus threatened the sustainability of the cooperative. The cooperative did obtain outside training assistance for farmers, but this training might have served farmers better if it had been conducted before the cooperative was put into practice. External factors such as the weather and the rice market could also have been taken into account in initial feasibility studies, thereby creating more realistic expectations of costs of production and expected benefits.

Through interviews and questionnaires useful information can be obtained concerning the characteristics of potential members and their wishes:

- location of prospective members
- size and types of farms
- area under different crops or number of livestock and need for services
- willingness and possibility to invest in a cooperative business

- willingness to patronise the proposed cooperative business
- willingness to accept the proposed membership rules and responsibilities
- attitudes towards cooperative businesses in general.

Also, it has to be decided whether or not the members will be obliged to do all their business in the relevant area with the cooperative. If not, members will be free to also do business with private or cooperative competitors, which could decrease the turnover of the cooperative and lead to lower margins. The potential impact of the proposed cooperative's operations on members should also be investigated.

The steering committee either conducts the feasibility study and member survey itself or hires a consultant to do this. In some cases, governments, local institutions or foreign donors may provide financial or technical assistance. Initial payments by potential cooperative members may also cover part of the cost.

Most attempts at organising voluntary associations involving many individuals require some kind of external support. This support could come from individuals or organisations that have no direct financial interest in the new cooperative, but that support the goals of the group. Similar organisations such as a federation of cooperatives could also play a major role in this stage. Also, professional farmers' organisations could support new cooperatives in their initial stages by facilitating steering committee meetings, assisting the group in finding resources or funding and by acting as a catalyst to pursue potential opportunities. Specialised help in legal and financial matters could also be obtained through such organisations.

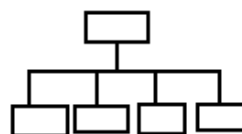
Step 4: Feasibility study and member survey

Actors involved: core group, potential members, advisers/consultants, lenders

- Conduct feasibility study
- Survey potential members
- Agree on feasibility and inform stakeholders
- Obtain support and expertise from third parties

Step 5: Organisational design

If the feasibility study and member survey show that starting a cooperation is feasible and that there is sufficient interest, the steering committee should work out the design of the organisation. The organisational structure will be partly determined by law (cooperative acts, tax laws, land law, banking law, company acts and other relevant legislation) and partly by the cooperative itself, depending on its nature and specific situation. There cannot be a single blueprint for all cooperatives. Each cooperative has to develop its own structures to suit its objectives and the local culture and social structure. During this process, a range of elements needs to be considered to ensure relevance, efficiency and flexibility.



From the members' point of view, the structure of the organisation should be such that it creates benefits for them. Cooperatives need to offer the best cost-benefit package to their members compared to the alternatives. Members expect goods and services from the cooperative that are relevant to their own enterprise, and they expect to obtain these at comparable prices.



Figure 19: Meeting organised by female members of a rural cooperative (AEC)

The following issues should be reflected in the organisational design:

- How can the cooperative grow, innovate and further develop along with potential changing needs and circumstances?

- How will it keep abreast of what members expect?
- How can it combine the goals of meeting the members' needs and operational efficiency?
- How can the cooperative be financed?

Every cooperative must include the general meeting as a structure ensuring that the effective and ultimate control of the cooperative remains in the members' hands. This body will have the power to:

- draw up and change the by-laws,
- decide on general and business policy issues,
- elect/appoint/dismiss board of directors and supervisory board,
- approve the operational plan, the estimate of revenue, the adoption of the balance sheet and the general conduct of business and management.

In most countries, the law prescribes some system of external auditing. This, however, cannot replace internal control mechanisms since external audits often give insufficient information. Internal reporting should indicate whether members' interests are being taken care of efficiently and future prospects of the cooperative being considered.

The results of the discussions on the above points need to be incorporated in cooperative statutes and/or by-laws. Statutes regulate not only the existence of a cooperative, but also the direct relationship between the cooperative society and its members. Cooperatives are free, within the limits of cooperative law, to make statutes regarding all matters necessary for the functioning of the cooperative organisation and for achieving its objectives. Often governments or institutions make available a set of model statutes, which can be used as a guideline only. The founding members will need to formulate the statutes of the cooperative themselves.

Cooperatives, like any other organisations, also need a framework of rules of behaviour or by-laws. By-laws or rules state how the cooperative will conduct its business. These rules should ensure that the enterprise remains under the control of its members. The by-laws govern

the relationship between members, management and staff and third parties. It may be practical to form a sub-group to gather information and draft the preliminary statutes and by-laws. An outside resource person such as a legal councillor may be needed at this stage.

The preliminary statutes can then be discussed by all the founding members. A cooperative can start with very basic by-laws and refine them after the business plan has been developed. As the organisation develops, however, some rules may become redundant and it may then be necessary to change them or adopt new ones instead.

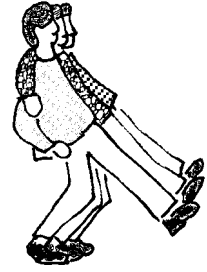
Cooperatives vary strongly in the amount of capital they need to get up and running. Virtually all cooperatives require some level of member financing, usually in the form of stock purchases or membership fees. Member financing not only provides equity for the cooperative, it also provides a financial base that makes other investors, particularly banks, feel more secure in investing their funds in the cooperative. In addition to member equity, most cooperatives need to borrow money to get started and to maintain their operations. Loans can come from banks and other financial institutions. Other loan sources are local, state and federal government programmes and various private for-profit and non-profit organisations. The steering committee and its advisers are responsible for determining the amount and type of financing needed by the cooperative and a strategy for getting it. These will be incorporated in the business plan (see Step 6).

Step 5: Organisational design

Actors involved: core group, potential members, legal advisor

- Determine organisational structure
- Prepare preliminary statutes and rules or by-laws
- Determine capital need
- Raise initial capital (members, third parties)

Step 6: Member commitment



The next step in establishing a new cooperative involves securing enough commitment from potential members to create a viable enterprise. Usually several tasks have to be completed before final member commitment can be given:

- Earlier assumptions and potential risk have to be analysed.
- A detailed business plan has to be completed.
- The required level of each member's investment has to be determined.
- Members' rights and responsibilities have to be defined.
- The need for management/staff and the skills required have to be assessed.

A first step in securing sufficient member commitment is to critically review and evaluate the assumptions on which the feasibility study was based (see Step 4). Uncertainties, both external and internal, which may lead to certain risks in operating the business, should be identified. The associated external risks



Figure 20: Women listening attentively and raising voice in a meeting

can be unexpected market developments, changes in technology or new processing methods. Other threats might be sudden changes in financial or governmental policies. Internal uncertainties involve the interests and attitudes of potential members of the cooperative.

Some assumptions made in earlier steps might appear to be too optimistic or turn out to be based on insufficient or not entirely realistic

information. (See Case 12.) Before embarking on a business plan, proposals and strategies to manage these potential risks should be made.

Case 12: Unrealistic objectives and insufficient member commitment

Based on their ability to improve members' incomes, cooperatives have often been used as a tool for rural development. But should this be a cooperative's main objective? Ideological objectives and government involvement have threatened the sustainability of cooperatives in developing countries. The following example is from a **rice growers' cooperative in Tanzania**, whose unrealistic objectives were initially developed by the government rather than by its members.

The cooperative was founded in 2002 by a group of 720 mostly retired officers, who had been given agricultural land previously belonging to a former state-owned farm to grow rice. One of the main objectives of the cooperative was rural development. It aimed for its members to settle in the area with an ultimate objective of establishing a village around the farm. The cooperative also formulated economic objectives, the main one being increased productivity. Through expansion of the cultivated area and adoption of modern farming methods and mechanised agriculture, the cooperative hoped to satisfy local and export markets. In addition, the cooperative aimed to secure higher prices for their members' produce, thus increasing farm incomes.

Since its start the cooperative has achieved some successes. It has expanded its capital and could purchase a tractor for its members and has also invested in the renovation of buildings, such as offices, a school, a seminar hall and a dispensary. Some fifty of its members have increased their incomes sufficiently enough to buy homes and land. Additionally, the cooperative has grown to 860 members (as of 2005).

Are these initial successes enough to offset the negative trends that threaten long-term sustainability? Poor assumptions failed to prepare members for actual costs of production. Lack of electrification has forced farmers to pay a high cost for pumping irrigation water, and the cost of inputs have been much higher than anticipated because of poor infrastructure and abolishment of subsidies on inputs. Many of the farmers turned out to be unable to invest in modern farming implements. As a result, members have reverted to traditional farming techniques, such a hand weeding. Unable to see the benefits of the cooperative, member commitment is now decreasing, which is worrying.

The lesson learnt: success and sustainability of the cooperative over the long-term will depend on the ability of leadership to secure sufficient member confidence and commitment to reverse negative trends and set realistic targets. In order to succeed, members will have to take charge, identify problems and opportunities, and, most importantly, make decisions that reflect their own needs rather than the government's. The ability of members to clarify objectives, plan, and lead the cooperative will influence its success, and ultimately, determine whether it can survive.

Business plan

After this critical review of basic assumptions, the steering committee prepares (or commissions someone else to prepare) a detailed business plan. This is a more in-depth version of the feasibility study, working out the selected alternative. The business plan serves two primary purposes:

- to provide a blueprint for the initial operation and further development of the cooperative,
- to provide supporting documentation for potential members, financial institutions and other investors.

A typical outline of a business plan includes:

- executive summary
- description of the enterprise
- market analysis
- research and development related to the product or service
- marketing and sales plan
- description of the organisational structure
- key personnel and financial data.

The plan will include many of the same components of a business plan developed for any other type of firm. However, a well-balanced plan for a cooperative should address some additional considerations. In addition to the items in the outline mentioned above, the business plan includes a description of what strategies the cooperative will adopt to address the potential risks. It should provide a set of financial projections based on the best knowledge available. This can be done by pre-

senting financial predictions, including operating statements, balance sheets and cash flow projections, for a period of at least three years.

Financial projections should be built on several scenarios reflecting the impact of member actions. For example, what would happen if a certain percentage of members did not meet their obligations? What level of losses or price depreciation might members tolerate? What happens if a significant number of members overproduces or finds more attractive alternatives? Is there sufficient flexibility in the business plan for timely adjustments to be made in the event of changes in the economic and social environment? In this regard a cooperative is often less flexible than a private company.

A sensitivity analysis can determine how changes might affect the business plan during the period between securing member commitment and actual start-up of the business. These variables can be, for example, availability of supplies, prices, interest rates and government policy.

The manager, if hired at this point in the process, would play an active role in creation of the business plan. The management structure should be spelled out in the document to ensure that an effective decision-making capacity is in place. The plan should identify the management skills required to implement it. A bookkeeping or financial accounting system should be set up. An appendix should include the adopted or proposed statutes and by-laws, as well as other pertinent legal documents such as membership agreements or equity instruments.

A well-qualified adviser or consultant, experienced in both cooperatives and the agricultural sector, can be an invaluable resource in writing and explaining the business plan. The detailed plan will be discussed in a meeting of the potential members. An interim board of directors will be elected and assigned the task of finalising further legal and financial preparations. Usually the members of the steering committee will act as an interim board in the start-up phase of the busi-

ness. This phase will last until a board is elected by the members during the first statutory general meeting; see below.

The cooperative equity drive is one of the important financial preparations. It includes a description of total expected benefits to members, such as:

- projected prices paid to or by members
- new markets
- patronage refunds or cost savings

Other projected benefits that might encourage potential members to join and invest in the cooperative are market/supply security, increased bargaining power and more control over their economic destiny.

It is critical that the steering committee members demonstrate a thorough understanding of the business plan. It might be beneficial to also involve key external stakeholders such as advisers, lenders, potential customers or management in the meetings with potential members. Presentations from consultants involved in conducting the feasibility study or writing the business plan can add to the document's credibility and help convince members to join. A separate presentation or meeting might be advisable to present plans to lenders who are being approached to provide financing to the cooperative and/or to potential members.

Member commitment

During this phase it is essential that members commit to becoming actual owners of the proposed enterprise. A thorough feasibility analysis has indicated that the operation is economically feasible. The necessary level of member financing has already been determined. A high level of confidence in the success of the proposed cooperative has been established among potential members. The detailed business plan provides a clear picture of the strategies that will be adopted to operate a successful business.

At this point, potential members will be ready to act and sign up without the need for a lot of last-minute promotion and information. Members of the steering committee play a vital role in this process. They build confidence in the proposed cooperative by signing up first. When the steering committee feels that enough members have joined the cooperative, the first general membership meeting or formation meeting is convened. At this formation meeting, the members elect a board of directors to replace the steering committee. Cooperative statutes and by-laws are approved to replace the set of provisional rules.

Step 6: Member commitment

Actors involved: directors, members, advisor/consultant, accountant, lawyer

- Develop detailed business plan
- Explain and confirm legal identity
- Set up books/accounting system
- Hold first members' meeting to approve the business plan
- Conduct member equity drive and sign-up
- Appoint board of directors

Step 7: Involving other stakeholders

In order to be successful, a starting cooperative relies on many stakeholders other than members: management, employees, lenders, suppliers and customers. These must commit their support to the cooperative for it to succeed. Commitment allows their relationship to be formalised.



At this time, the board of directors should appoint a manager who is a key stakeholder in the organisation. For some lenders, competent management is the most important factor they look at in making a loan decision.

Case 13: The role of professional management

After Bangladesh gained independence during the 1970s, its new government promoted development of state-controlled cooperatives. Dairy production was considered an ideal extra source of income for small farmers who were mainly cultivating rice. A state-controlled dairy cooperative was established for producing and marketing fresh milk, yoghurt, butter and other dairy products. Initially the cooperative was successful in expanding milk production and raising the income of farmers.

However, in the early nineties the situation drastically changed as a result of trade liberalisation when large amounts of cheap milk powder were dumped on the Bangladeshi market. Run by uninterested civil servants accountable to the government and not to farmers, the state cooperative could not quickly adapt to the new situation and it began accruing large losses.

The government withdrew and an independent board of directors was elected. The transition to a genuine farmer-owned cooperative was a difficult one. But through professional management together with a commercial business approach, the cooperative expanded in a few years from 4300 to 40,000 members. Farmers' incomes were raised ten-fold, lifting the household earnings of about 300,000 people to well above the poverty line. The income from dairy production has since become reliable and constant. In the year 2000, the cooperative paid a total of US\$ 1.5 million in dividends to producers.

New cooperatives require a uniquely qualified individual to balance the business needs with those of individual members. The new manager should be fully familiar with the business world but also sensitive

to the workings of a membership organisation. This person needs to be involved in or be able to carry out all of the other necessary activities such as hiring additional staff and acquiring the necessary plant, machinery or equipment.

Any new business needs to be adequately capitalised. Usually the amount of capital provided by members is not adequate to fully finance the new cooperative business. Depending on the level of risk associated with the start-up of the cooperative and the amount of member equity raised, lenders may be interested in providing debt capital as an additional source of financing.



Figure 21: Improving inefficient transport could be an important task of the cooperative (AEC)

There are two basic approaches to utilising debt financing for starting up the cooperative.

- Loans are normally secured at the cooperative level and are paid back from the cooperative's cash flow.
- Members may also seek individual loans to invest capital in the cooperative and be individually responsible for paying off their individual loans. This may be effective in situations where members have significant business assets of their own for use as collateral and thus are able to absorb interest expenses.

Step 7: Involving other stakeholders

Actors involved: board of directors, members, lenders, manager, customers/suppliers

- Formalise relations with customers or suppliers
- Appoint manager
- Secure necessary additional financing

Step 8: Starting up the enterprise

After accomplishment of all preliminary steps, the cooperative can formalise its start by holding a general meeting and opening its doors for business. In a general meeting, the provisional board of directors requests the approval of the members to proceed with all necessary steps to start up operations, which may include investments in infrastructure, logistics and personnel. During this meeting several committees of working groups may be appointed to work out the numerous technical, organisational and administrative issues.



Figure 22: Building facilities for storage and processing can take a lot of time (Agriterra)

The new cooperative will need to obtain any permits or licenses required to conduct business. If employees are hired, employer requirements must be fulfilled, including arrangements for withholding taxes and social security deductions. Membership records need to be established to document the business volume of each member and the amount of equity investment or credits. The board must select a bank to handle the cooperative's accounts as well as an auditor.

Personnel recruitment is listed as the last step in the formation process. Some starting cooperatives identify key potential personnel much earlier in the process, for example in the feasibility study or business planning stages. Key persons can be hired as consultants at an early stage with the mutual intent that they will work for the cooperative once it is formally established. This approach also has the effect of making investors feel more comfortable about financing because proposed management staff have been identified.

Step 8: Starting up the enterprise

Actors involved: members, board of directors, manager, staff, accountant

- Hold general meeting
- Establish committees
- Secure necessary assets
- Obtain necessary permits, carry out preparatory financial and administrative tasks
- Recruit personnel

Useful addresses

Agriterra

Agriterra is a Netherlands' agriculture agency founded in 1997 by organisations of farmers, regional producers, rural women and youth and by the National Cooperative Council for Agriculture and Horticulture. It promotes, facilitates and supports linkages between rural people's organisations in the Netherlands and Africa, Asia, Latin America, Central and Eastern Europe. Agriterra is a founding member of AgriCord.



PO Box 158, NL-6800 AD ARNHEM, The Netherlands

T: + 31 26 4455445

F: +31 26 4455978

W: www.agriterra.org

E: agriterra@agriterra.org

AgriCord

AgriCord (est. 2003) is the international alliance of national agricultural agencies. These are non-governmental organisations for development cooperation with structural links to farmers' and rural members' organisations in their respective countries. All these agencies are funded or steered by organisations of farmers, rural women, young agrarians, cooperatives and agri-businesses. AgriCord promotes international linkages and cooperation between its members. The members are partners of the IFAP Development Cooperative Committee (see below) which facilitates direct contacts between farmers and rural member organisations within this platform.

PO Box 247, B-3000 LEUVEN, Belgium

T: + 32 16 244705

F: + 32 16 242136/87

W: www.agricord.org

E: info@agricord.org

International Federation of Agricultural Producers (IFAP)

IFAP (est. 1947), the world farmers organisation, advocates for the interests of over 600 million farm families via 110 national organisations in 75 countries. It is a global network of farmers from the North and South enabling these to exchange concerns and set common pri-

orities. IFAP concentrates on development of agricultural cooperatives and trade. The organisation has specialised committees e.g. for development cooperation and agricultural cooperatives and also regional committees for Africa, Asia and Latin America.

60, rue Saint-Lazare, F-75009 PARIS, France

T: +33 1 45 26 05 53

F: +33 1 48 74 72 12

W: www.ifap.org

E: coops@ifap.org

Agri-ProFocus

Agri-ProFocus (est. 2005) is a network of 19 Dutch development and agricultural organisations, credit and training institutions, research centres and the government. It aims to support producers' organisations in the South by matching their specific needs with appropriate organisations and services in the Netherlands. In addition, it aims to be a platform for the exchange of knowledge and experience of its members, gained through working with producers' organisations.

PO Box 108, NL-6800 AC ARNHEM, The Netherlands

T: +31 26 3542074

F: +31 26 3542070

W: www.agri-profoc.us.nl

E: info@agriprofoc.us.nl

International Cooperative Agricultural Organisation

ICAO (est. 1951) is a specialised ICA organisation for agricultural cooperatives and farmers worldwide. It represents 47 member organisations in over 38 countries. Agricultural cooperatives account for 36% of the cooperative societies represented by ICA members.

W: www.agricoop.org

International Cooperative Alliance (ICA)

ICA (est. 1895) is an independent non-governmental international association, which unites, represents and serves cooperatives worldwide. ICA has 222 member organisations from 91 countries active in all sectors of the economy. Together these cooperatives represent more than 800 million individuals worldwide. ICA members are national cooperative federations or specialised cooperative associations. They tend to promote cooperative development at national level.

W: www.coop.org

Table 2: ICA member organisations in Africa

Country	Name	Postal address	Phone / Fax
ICA Africa	Main Office – Kenya E: ica@icaafrica.coop L: www.icaafrica.coop	P.O Box 67595 00200 Nairobi	T 254 24343060 F 254 24343204
ICA Africa	Project Office – Burkina Faso E: aci@icarao.coop L: www.icaafrica.coop	01 BP 6461 Ouagadougou 01	T 226 307328 F 226 307329
Mauritanie	Terre Vivante E: tayeb@toptechology.mr	Nouackchott	T 222 25 16 41 F 222 25 51 36
Cape Verde	Fédération Nationale des Coopératives de Consommation (FENACOOP)	CP 416 Praia	T 238 263 38 83 F 238 263 40 11
The Gambia	Federation of Agricultural Coop- erative Societies (FACS)		T 220 437 27 73 F 220 437 77 73
Senegal – UNCAS	L'Union des Coopératives Agri- coles du Sénégal E: uncas@sento.sn	BP 3225 Dakar	T 221 825 91 38 F 221 825 91 32
Burkina Faso	Union Régionale des Coopéra- tives d'Epargne et de Crédit du Bam (URCBAM)	BP 150 Kongoussi	T 226 40 45 92 38 F 226 40 45 93 00
Ivory Coast	La Société des Coopératives Agricoles d'Agboville(SCAGBO)	BP 717 Agboville	T 225 23 54 74 50 F 225 23 54 71 50
Ghana	Ghana Cooperative Council Ltd.	P.O Box 4034 Accra	T 233 21 23 21 95 F 233 21 23 37 25
Benin – UDP	Union Départementale des Producteurs du Borgou	B.P. 1022 Parakou	T/F 22961 03 61
Benin	Fédération des Caisses d'Epargne et de Crédit Agricole Mutuel du Bénin (FECECAM)	B.P. 0843 Cotonou	T 229 36 14 70 / 36 15 05 F 229 36 15 52
Kenya	Cooperative Bank of Kenya Ltd (CBK)	P.O Box 4823 100200 Nairobi	T 225579 / 334832 F 227747
Kenya – CIC Insurance	Cooperative Insurance Com- pany of Kenya (CIC) E: ltdcic@cic.co.ke	P.O Box 59485 00200 Nairobi	T 254 020 2823000 F 254 020 2823333 / 31
Tanzania – TFC	Tanzania Federation of Co-operatives (TFC)	P.O Box 2567 Dar es Salaam	T 184081-5 F 184081
Uganda	Uganda Cooperative Alliance E: ucags@infocom.co.ug (UCA)	P.O Box 2215 Kampala	T 256 41 258898 F 256 41 254495
Lesotho	Co-operative Lesotho Ltd	P.O Box 146 Maseru 100	T 320683 / 320684 F 320684
Namibia	Namibia Cooperatives Advisory Council (NCAC) E: CoetzeeB@mawrd.gov.na	P.O Box 3117 Windhoek	
Botswana	Botswana Agricultural Marketing Co-operative Union	P.O Box 70 Lobatse	T 330528 / 330508

Country	Name	Postal address	Phone / Fax
Zambia	Zambian Cooperative Federation (ZFC) E: ZCF@Zamnet.zm	P.O Box 33579 Lusaka	T 260 228538 / 55 F 260 1 222516
Zambia	Credit Union and Savings Association of Zambia	P.O Box 30703 Lusaka	F 260 1 223837
Mauritius	Mauritius Co operative Union (MCU) Ltdmcul@intnet.mu	Devi House, Dr. Perdreau St. Port Louis	T/F 230 212 2922

International Labour Organization of the United Nations (ILO)

The Cooperative Branch of ILO (1949), based in Geneva, advises ILO member states on technical cooperation, organises international meetings, documents and informs public awareness of cooperatives and promotion of cooperative values and principles. The former MAT-COM programme of ILO produced a series of training manuals on management and operation of agricultural cooperatives and common problems encountered (see Further reading).

W: www.ilo.org/coop

Committee for Promotion and Advancement of Cooperatives

COPAC (1971) is a partnership of ICA, IFAP, FAO and ILO, among others. These work together on equal terms to promote and coordinate sustainable cooperative development. Their instruments are policy dialogue, technical cooperation and concrete collaborative activities. COPAC has contributed to achievement of ILO Recommendation no. 193 on Promotion of Cooperatives in 2002. COPAC has compiled a list of cooperative legislation from a variety of sources.

15, Route des Morillons, 1218 Grand Saconnex, GENEVA, Switzerland

T: + 41 22 929 8825

F: + 41 22 798 4122

W: www.copacgva.org

E: copac@coop.org

Rabo International Advisory Services BV (RIAS)

RIAS (est. 1989) is a subsidiary of the cooperative Rabobank Group of the Netherlands. It transfers Rabobank's experience and technology in banking, finance, cooperative development and agribusiness into tools for the emerging markets of Central and Eastern Europe, Africa, Asia and Latin America. It provides consultancy, management support

and twinning activities. Next to banking, these services relate to restructuring and development of agribusiness and of cooperative business organisations. Its main fields of interest are agricultural marketing and input supply in agriculture. Its advice comprises all essential organisational, financial and legal aspects.

PO Box 17100, NL-3500 HG UTRECHT, The Netherlands

T: +31 30 2163670

F: + 31 30 2163677

W: www.rabobank.com/rias/

E: RIAS@rn.rabobank.nl

Further reading

FAO (2001) Agricultural Cooperative development - a manual for trainers

Consisting of 8 modules:

- 1 Understanding cooperatives
- 2 Participation training & learning
- 3 Communication
- 4 Organisational development
- 5 Cooperative management
- 6 Tools for planning and organising cooperative activities
- 7 Participatory appraisal, monitoring and evaluation
- 8 Accounting

Weblink: <ftp://ftp.fao.org/docrep/fao/005/X0475E/X0475E00.pdf>

MATCOM (1978) Cooperative management training manuals

- Agricultural cooperatives - Learning elements

- Agricultural cooperatives – Trainer’s manual

Both series cover a very wide range of subjects.

www.ilo.org/dyn/empent/empent.portal?p_prog=C&p_lang=EN search
‘Publications and Reports’

Reference from section 2.4:

FAO (2004): New strategies for mobilizing capital in agricultural cooperatives. By J.D. von Pischke and J.G. Rouse. Rome (50 pp). See also weblink: www.fao.org/documents/show_cdr.asp?url_file=//doc-rep/007/y5469e/y5469e00.htm

Reference from section 4.1:

FAO (1995): The Gender Dimension in Rural Cooperatives.

Paper commissioned by FAO for the Centennial Meeting of the International Cooperative Alliance (ICA).

See also weblink: www.fao.org/sd/rodirect/roan0008.htm

Reference from sections 2.1, 2.3 and 4.1:

Rabobank International (2001): Cooperatives and cooperative banks. Their contribution to economic and rural development

By W. van Diepenbeek (ed.)

Reference from Chapter 6:

Weblink: www.copacgva.org/legislation.htm information on cooperative legislation

Reference from Chapter 9:

Cornell (2001): Considering cooperation: a guide for new cooperative development. By B.M. Henehan and B.L. Anderson. Cornell University, Ithaca, USA 49 pp.

Weblink: www.ruralfinance.org/ search: resources > service provision > member-owned institutions > rural cooperatives

Appendix 1 Eight steps

Table 3: *Eight steps for development of a cooperative*

Step	Activity
1	<p>Developing the initiative</p> <ul style="list-style-type: none"> - Work out proposed initiative and ideas - Pull together committed core group - Define critical questions - Discuss cooperative as one of several options - Collect information - Explore relevant market/economic need - Discuss scope and nature of the problem - Study economic and social aspects of problem
2	<p>Building consensus</p> <ul style="list-style-type: none"> - Discuss within core group whether a new cooperative can adequately address identified problems and opportunities - Study organisational alternatives - Hold initial meetings to review scope and nature of a cooperative solution - Propose cooperative approach in public meeting - If sufficient interest among potential members: create initial budget
3	<p>Establishing a steering committee</p> <ul style="list-style-type: none"> - Identify leadership - Establish steering committee - Install working groups - Agree on timetable and tasks - Assign tasks to potential members for subsequent steps - Build trust among potential members
4	<p>Feasibility study and member survey</p> <ul style="list-style-type: none"> - Conduct feasibility study - Survey potential members - Agree on feasibility and inform stakeholders - Obtain support and expertise from third parties
5	<p>Organisational design</p> <ul style="list-style-type: none"> - Determine organisational structure - Prepare preliminary statutes and rules or by-laws - Determine capital need - Raise initial capital (members, third parties)
6	<p>Member commitment</p> <ul style="list-style-type: none"> - Develop detailed business plan - Explain and confirm legal identity - Set up books/accounting system - Hold first members' meeting to approve the business plan - Conduct member equity drive and sign-up - Appoint interim board of directors
7	<p>Involving other stakeholders</p> <ul style="list-style-type: none"> - Formalise relations with customers or suppliers - Appoint manager - Secure necessary additional financing
8	<p>Starting up the enterprise</p> <ul style="list-style-type: none"> - Hold general meeting - Establish committees - Secure necessary assets - Obtain necessary permits, carry out preparatory financial and administrative tasks - Recruit personnel

Appendix 2 Statements

This publication is intended to serve as a guide to support farmers' groups through the difficult process of starting a cooperative business. It may help them find their way and make their own choices in developing a successful enterprise. We realise that this publication is only a beginning and would appreciate receiving comments or experiences of farmers' groups or other interested readers.

In order to facilitate discussion we include the following statements.

- Cooperation between agricultural producers provides many advantages.
- Cooperation on a voluntary basis between agricultural producers is not an easy job.
- Cooperatives usually work in an institutional environment, which is often complex and in which government policies play a major role.
- Governments often interfere into successful cooperatives in order to (mis)use the benefits of cooperative development for their own advantage.
- There are other forms of cooperation between agricultural producers which are not as complex as cooperatives and often more suitable; such as self-regulating groups, private enterprises, family enterprises, etcetera.

You are kindly invited to send your comments and reactions on the following statements to:

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