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Financing Cooperatives

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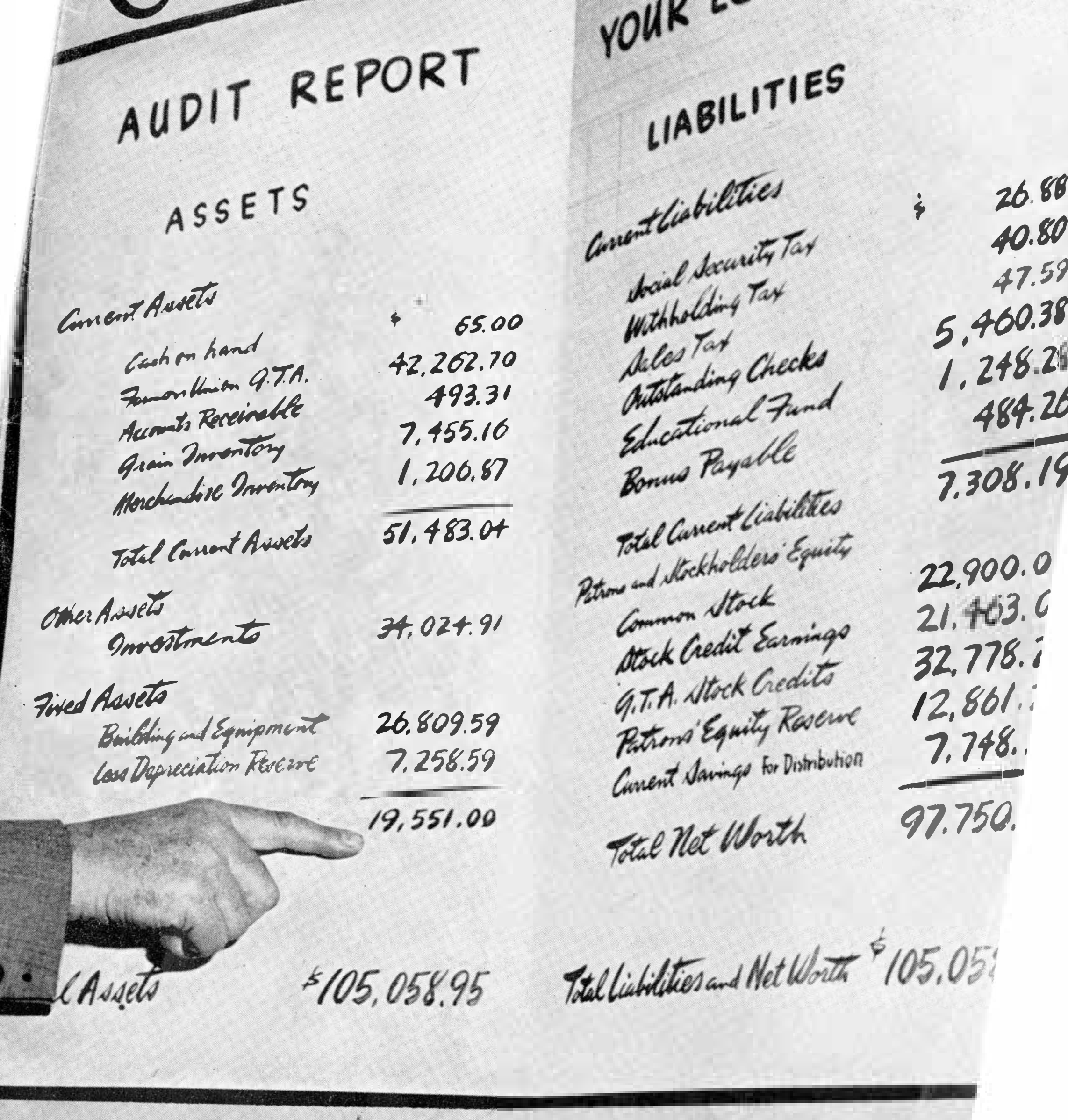

ECONOMICS AGRICULTURAL DEPARTMENT

Agricultural Experiment Station

SOUTH DAKOTA STATE CO

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Financing Cooperatives

By Ottar Nervik and Robert Gunderson[1]

Introduction

The increase in business activity in the last decade has had a great influence on the operations of farmer cooperatives. From 1939 to 1949 their dollar volume of business in the United States has increased four times. Membership in the same period doubled, while the number of associations declined slightly (Table 1). A rising level of prices has been an important factor in this expansion.

Other factors which have been important in contributing to the rising volume of business in cooperatives are the trend towards use of more machinery, gas and oil, fertilizer and greater use of prepared feeds. In 1939 the total expenditures for farm supplies in the United States was $3,217 million. In 1951 this had increased to $14,735 million.[2] If these figures are adjusted for changes in the price level, the expenditures for production supplies about doubled in this period.

Farm cooperatives have expanded the scope of their operations in recent years. Marketing cooperatives are handling more sidelines and purchasing associations are taking over processing and primary production. Among marketing cooperatives, grain elevators have in many instances started oil stations and lumber yards as part of their business. Creameries are handling eggs, poultry and in some instances are operating locker plants. Purchasing cooperatives, through their regionals, are operating oil refineries, oil wells, feed manufacturing plants and fertilizer plants. In this

[1]Associate Economist and former Research Assistant, respectively.

[2]Martin A. Abrahamsen and Jane L. Scearce. *Operations of Major Regional Purchasing Cooperatives*, 1941—1951. Farm Credit Administration, USDA Circular C-148. Washington, D. C. December 1952; Appendix Table A, p. 22.

Table 1. Farmers' Cooperative Marketing and Purchasing Associations, Number, Membership, and Business, United States, 1939 and 1949

Year	Marketing Associations			Purchasing Associations			Total		
	Associations Listed	Estimated Membership	Estimated Business	Associations Listed	Estimated Membership	Estimated Business	Associations Listed	Estimated Membership	Estimated Business
	Number	1,000 Members	$1,000	Number	1,000 Members	$1,000	Number	1,000 Members	$1,000
1939	8,051	2,300	1,729,000	2,649	900	358,000	10,700	3,200	2,087,000
1949	6,922	4,075	7,082,600	3,113	2,509	1,643,400	10,035	6,584	8,726,000

Source: Agricultural Statistics, 1951. USDA, Table 654, p. 568.

respect cooperatives are following the general trends in business.

Although the number of memberships has nearly doubled, there has been only a slight increase in the proportion of farm marketing and purchasing handled by cooperatives.

The increased dollar volume of business requires greatly expanded capital for facilities and for operations to provide the necessary services. This creates a particular problem for cooperatives because they have to obtain the greater share of their capital from members and patrons. Since the expansion in number of members is relatively smaller than the expansion in business volume, larger investments per member are necessary to maintain the financial position of cooperative enterprises. Part of this capital can be obtained by retaining patronage refunds; but there is a question whether this is sufficient. There may also be a need for more direct investment by members. There is a question whether farmers as a group have realized that more member financing is necessary.

South Dakota cooperatives are facing the same problems as cooperatives in the rest of the United States. Business volume has increased four times, and membership has doubled from 1939 to 1950. The number of associations declined slightly as it did in the country as a whole (Table 2).

Farm cooperatives are an important element in South Dakota in marketing farm products and purchasing farm supplies. The success or failure of cooperatives affect a major share of the farmers in the state. If cooperatives are to provide the services that farmers require, it is essential that they have a sound financial structure which will allow them to operate in an efficient manner.

The purpose of the study is to examine and evaluate the financing methods of South Dakota cooperatives. It was believed to be essential not only to study cooperative associations, but also to obtain the opinions of members on problems of cooperative financing. For this reason the study was divided into two parts: (1) a survey of cooperative associations, and (2) a survey of

Table 2. Farmers' Cooperative Marketing and Purchasing Associations, Number, Membership, and Business, South Dakota, 1939* and 1950†

	Marketing Associations			Purchasing Associations			Total		
Year	Associations Listed	Estimated Membership	Estimated Business	Associations Listed	Estimated Membership	Estimated Business	Associations Listed	Estimated Membership	Estimated Business
	Number	Number	$1000	Number	Number	$1000	Number	Number	$1000
1939	252	57,720	22,780	70	17,000	4,350	322	74,720	27,130
1950‡	210	97,080	110,810	92	40,000	17,900	302	137,080	128,710

*"Statistics of Farmers' Marketing and Purchasing Cooperatives, 1938-39, Marketing Season," Farm Credit Administration, June 1940, p. 31-34.

†"Statistics of Farmers' Marketing, Purchasing and Service Cooperatives, 1950-51," Farm Credit Administration, March 1953, p. 34-39.

‡1950 includes the percentage business done in the state by regional cooperatives while in 1939 these figures were not included.

members of the associations. The field work was started in August 1952 and completed in March 1953.

Study of Cooperatives

The survey included 25 elevator, 25 oil, and 10 creamery associations. Other types of cooperatives were not considered. The cooperatives were selected by stratified random sample from available lists of South Dakota cooperatives.

Elevator associations were obtained from the 1951 directory of grain elevators in South Dakota. Some elevators which were found not to be cooperatives according to a previous study of grain marketing were eliminated from this list. Oil associations were obtained from a list furnished by South Dakota Association for Cooperatives, and creameries were obtained from a list prepared by the South Dakota Dairy Association.

A problem arises in the classification of elevators. Many of them also operate oil stations, and it is often a question which part of the business is the most important. In this study they were all included among the elevators. Since some of the elevators are combination of grain elevators and oil stations, the data for elevators are not representative of the associations which handle only grain plus a few minor sidelines.

The information from cooperatives was obtained by personal interviews with the managers and from the records of the associations. Each cooperative was asked for a copy of the last annual statement. In some instances the manager did not have all the information available, and some either had exhausted their supply of annual statements or did not prepare any printed statement.

The information assembled was divided into four large categories: (1) general information on the cooperative, (2) need for and use of capital, (3) capital structure, and (4) relations with regional cooperatives.

Membership Study

Personal interviews were made with 150 members of 33 cooperative associations. At the outset an attempt was made to select the members by random samples from the membership lists. This proved impractical because many of the membership lists were out of date. Therefore, the last members who had done business at the cooperative before it was visited were chosen. No call-backs were used.

Sixty-one members from elevators, 59 from oil stations, and 30 from creameries were included in the study. These members were located in various agricultural regions in the state. It should be emphasized that many members belonged to more than one type of cooperative.

Financing Methods

The cooperative itself is not in business to make profit of its own, but to increase the profits or reduce the expenses of the individual members. Since the cooperative is run by members, is is natural that a major share of this capital comes from them.

Obtaining Capital from Members

The function of the cooperative is to serve the members, and this can best be achieved if members have final control over the operations of the association. For this reason it has long been a principle in cooperatives that equity capital be owned by members or patrons alone, and that there is a limit to the percentage of the stock that can be owned by each member. In the South Dakota Code, at present, the limit on stock held by an individual member is set at 5 percent of the outstanding common stock. The purpose of this limitation is to maintain democratic control of the cooperative.

Cooperatives also limit the amount of dividends paid on capital stock. When farmers invest in a cooperative, their main purpose is to have an agency which can sell their products or purchase supplies for them. The importance of the cooperative to them is that it may reduce their marketing and purchasing costs and consequently increase their net income. Such savings are more important to members than the return on the investment they have in the cooperative.

As a rule, cooperatives do not obtain capital from the investing public. The limitations on dividends on capital stock have also discouraged outside investors from putting money in cooperatives. In some past instances when private investors bought stock in cooperatives, they eventually obtained control of the association. Some cooperatives in South Dakota have lost their cooperative features in this manner.

In general, cooperatives have found it desirable to obtain most of their capital from their own members. This capital can be obtained by direct means through sale of stock or membership fees, or by borrowing from members, or by indirect means such as retaining patronage refunds.

Sale of Stock. Purchase of stock is a condition for membership in many cooperatives. In some, one share of stock is enough; in others prospective members may be required to buy more than one share. Sometimes the amount of stock required depends on the size of the farm enterprise. This has been particularly common in creameries. In most cases the amount of direct investment through purchase of stock is limited. Par value of stock generally varies from $10 to $100. In this study the most common par value was $25 (Table 3).

The total amounts which can be obtained through sale of capital stock to members is small in comparison with the capital required for acquiring facilities and for daily operations. A cooperative of 400

Table 3. Par Value of Stock, South Dakota Cooperatives, 1952-53*

	Elevators	Oil Stations	Creameries	Total
	Number of Associations			
$10 or less	3	10	3	16
$11-25	14	11	6	31
$26-50	1	4	0	5
$51 and over	5	0	0	5

*Information was not available for two elevators and one creamery.

members would obtain only $10,000 if each member purchased one share of stock with par value of $25, and $40,000 if the par value was $100. This is clearly insufficient for many cooperatives.

Certificates of Indebtedness. Funds can also be obtained by borrowing from members. Some cooperatives issue certificates of indebtedness which bear interest. This is a method which so far has been little used, and may have possibilities.

The advantage of certificates of indebtedness is that members with surplus funds may be willing to invest when they know that they receive a good return on their funds. These usually have a definite rate of interest and a due date. Consequently, this method may obtain funds which would not be invested in capital stock. One disadvantage in comparison to capital stock is that certificates of indebtedness are liabilities, and they do not solve the problem of a cooperative which has insufficient equity capital.

Preferred Stock. As an alternative some cooperatives have sold preferred stock with a fixed dividend. Preferred stock is equity capital, but the cooperative may have to pay income tax on the amount paid in dividends. In contrast, interest on certificates of indebtedness is considered a business expense.

Occasionally cooperatives borrow money from directors. This is usually not considered good business practice and should be unnecessary if the members take any interest in their cooperative.

Deferred Patronage Refunds. In the last 25 years, cooperatives have been obtaining an increasing share of their capital from members indirectly by deferring patronage refunds. Instead of paying patronage refunds in cash, cooperatives have allocated them to members but keep them for a period of years before payment is made. Such decisions are usually made by the members at the annual meeting. By doing this, cooperatives have been able to build up their capital to meet the needs of the business. In this method, member investment is in direct proportion to the amount of business they do with the cooperative.

Although the principle of this method is fairly simple there are some problems in its use. One problem which immediately arises is whether deferred refunds are to be considered part of the members' equity or a claim against the cooperatives. Many cooperatives issue capital stock or stock credits for deferred refunds, and if this is done, it is clear that they are members' equities. In other cases, there is a question whether to consider the deferred refunds as equities or liabilities. The practice among cooperatives vary in this respect. Legal clarification is necessary.

Another important problem is whether the deferred refunds are to be included in permanent capital or in short term or temporary capital. This is of great importance to management in its planning of the enterprise. Some cooperatives do not have any clear-cut policy in this respect, and probably even fewer of the members know what the policy of their cooperative is. Ordinarily, cooperatives defer refunds for expansion or for securing the financial position of the business. When enough has been obtained they may begin paying out. Even if members receive capital stock for the patronage refunds, it is desirable to have some plan for paying it out.

This problem of when and how patronage refunds are to be paid in cash is an important one. As mentioned before, some cooperatives have given no attention to this question. Others have set up certain plans, but some of these are not satisfactroy either from the viewpoint of management or members.

Revolving Funds. Among methods used in paying off patronage refunds, use of revolving funds has become common in recent years. In a revolving fund, patronage refunds are held back for a certain number of years and when cash payments are made the oldest are paid first.

An example will illustrate the principle of this method. If a cooperative uses a 3-year period and starts its operations in 1954, payments would run as in the schedule below, assuming the same net savings each year (Table 4).

Table 4. Example of a 5-Year Revolving Fund, Equal Amount Withheld Each Year

Year	Patronage Refunds Withheld	Refunds Paid in Cash
1954	$5000	0
1955	5000	0
1956	5000	0
1957	5000	$5000*
1958	5000	5000

*Patronage refunds withheld in 1954.

In this case it would always have $15,000 in its revolving fund. Unfortunately such stability in savings is seldom found. If the volume of business and savings both fluctuate, the cooperative may have to pay large amounts in cash in years when savings are low. Again using a 3-year period the following situation could occur (Table 5):

Table 5. Example of a 5-Year Revolving Fund, Unequal Amounts Withheld

Year	Patronage Refunds Withheld	Refunds Paid in Cash
1954	$10,000	0
1955	10,000	0
1956	8,000	0
1957	5,000	$10,000*
1958	0	10,000

*Patronage refunds withheld in 1954.

To protect against such situations, sinking funds are used. This difficulty can also be avoided by not having a due date in the revolving fund in order that the cooperative is not obligated to pay a certain amount in a specified year. Revolving funds are used both when deferred refunds go into capital stock and when they are treated as a liability. The practical importance of a revolving fund without a due date is that the oldest refunds are always paid first.

Some cooperatives pay a percentage of each member's total refunds

in cash each year at the discretion of the board of directors or members. This would operate in the following manner, using 20 percent cash payment (Table 6).

Table 6. Example of Revolving Fund with Payment of 20 Percent of Total Deferred Patronage Refunds Each Year

Year	Patronage Refunds Deferred	Cash Payments	Deferred Patronage Refunds
1954	$1,000	$200	$800
1955	1,000	360	640
1956	1,000	488	512

This method is preferable for the beginning farmer since he receives some cash payments without waiting as he would have to in the ordinary revolving fund plan.

The difficulty of this method is that it is hard to explain to members, and that it involves a considerable amount of extra bookkeeping. Also management can never have a good picture on future commitments under this plan. Of course, it may not be necessary to make any cash payments in years when savings are low.

Some cooperative leaders have recommended that deferred patronage refunds be divided into two parts. One part to go into capital stock as permanent capital, and the other part to be paid out in cash either immediately or at some future date. The advantage of this is that funds would be clearly designated as permanent capital instead of being a commitment at some indefinite future time. A clear-cut policy such as this can also be easily explained to members.

Deferring of patronage refunds has proved to be an effective method of obtaining capital from members. However, lack of definite policy about the handling of the deferred refunds has weakened the financial position of many cooperatives and created problems in membership relations. In contract law it is an essential point that both parties to a contract understand its meaning. Deferring patronage refunds is a form of contract between management and members. All too often the terms of this contract are not clear to any of the parties.

Self-financing

To a limited extent cooperatives can use their savings to build up contingency reserves. Usually they are required by law to do so. The reserves are built up to provide a cushion against price declines or temporary losses. Any cooperative which wants to maintain a good financial status has to build up reserves for this purpose.

According to the Internal Revenue Code, farmer cooperatives can apply for tax-exempt status. Tax exempt cooperatives need not file income tax returns, but have to fulfill certain requirements to maintain their status. At present, this provision is not of great importance to most cooperatives, and about half of the cooperatives in the United States do not apply for tax-exempt status. It should be made clear that if patronage refunds have been allocated to patrons and patrons have been notified, they are not, at present, considered income to the cooperative. This is true regardless of whether the cooperative

applies for tax exempt status or not. Cooperatives which are not tax-exempt can treat part of their savings as a business profit and enter it in the books as surplus. In this case, the savings need not be allocated to members, but the cooperative is required to pay income tax on it.

Borrowing from Non-members

As any other business enterprise, cooperatives may at times have to borrow money. They may borrow from banks and other lending institutions, or from their business connections. When a cooperative belongs to a regional organization the regional may be a source of credit.

The Bank for Cooperatives, which was established in accordance with the Farm Credit Act of 1933, is an important source of credit for farmers' cooperatives. This bank gives three types of loans.

(1) Commodity loans are made to marketing associations chiefly for the purpose of making advance payments to patrons on products delivered, and secondarily to pay the costs of marketing.

(2) Physical facility loans are made for financing of buildings and other physical property.

(3) Working capital loans are made to finance current operations.

How South Dakota Cooperatives Are Financed

Most of the cooperatives in South Dakota do business in a limited area, and the number of members therefore seldom exceeds 1,000 active members (Table 7).

The number of members has an important bearing on the financing of cooperatives. If direct investment by members is to provide the necessary capital, a relatively large investment has to be made by each. Often the member does not need to make any cash payment, but can obtain a share from his retained patronage refunds. As the volume of business increases, the cash investments by members should be increased correspondingly, but this may be difficult to achieve. However, if members are more aware of what is happening to their cooperatives, they may become more willing to provide financial support.

Capital Needs of Cooperatives

The change that has taken place in the business of South Dakota cooperatives can be illustrated by comparing data obtained in this study with data from a study of South Dakota cooperatives made in 1939, covering the year 1936.

The business volume of the grain elevators in the present study was about ten times as high as that of the 1939 study. Oil stations and creameries had about four times the volume of business as compared to those included in the 1939 study (Table 8).

In examining this table certain factors should be recognized. The year 1936 was a very poor crop year in the state, and the volume han-

Table 7. Average Number of Members and Patrons of Cooperative Associations in South Dakota, 1937 and 1951

Type of Association	Average Number of Members		Average Number of Patrons	
	1937*	1951	1937*	1951
Elevator	137	428	261	487
Oil	276	588	458	632
Creamery	385	548	667	637

*Source: Brown, L. M. and Penn, R. J., "Cooperatives in South Dakota," South Dakota Experiment Station Bulletin No. 328, April 1939, Tables 1 and 3, pp. 6 and 10.

Table 8. Average Dollar Volume of Business Handled by South Dakota Cooperatives, 1936 and 1951

Type of Association	Average Purchasing		Average Marketing		Average Total	
	1936*	1951	1936*	1951	1936*	1951
Elevator	$18,460	$110,995†	$ 44,592	$554,108	$ 63,052	$638,464
Oil	49,624	218,801	—	—	49,624	218,801
Creamery	1,669	‡	139,087	‡	140,756	496,719

*Source: Brown, L. M. and Penn, R. J., "Cooperatives in South Dakota," South Dakota Experiment Station Bulletin No. 328, April 1939, Table 4, p. 10.

†Only 19 elevators indicated any purchasing.

‡Only one reported any purchasing; therefore, only total volume given.

dled by grain elevators was lower than average. In addition, many cooperative elevator associations since that time have gone into other lines of business, such as petroleum products, tires and tubes, and lumber products. Cooperative oil stations were relatively new developments in 1936; a great increase in farm consumption of petroleum products occurred in this period.

By comparing the figures on average volume of business and average number of members it is seen that the dollar volume of business per member is larger today than 15 years ago. The financing of this increase in business volume has to be done mainly by the members.

Capital Requirements

The change in capital requirements was examined by comparing the value of fixed assets, working capital, and inventories in 1939 and 1951. Data for this comparison were obtained in the survey. The year 1939 was selected as representative of the pre-war period. However, many cooperatives did not have the records for that year. Some had not even been organized at that time. To obtain a large enough sample, data from the year 1938, or one year in the period 1940-43, were obtained from some cooperatives.

The average depreciated fixed assets increased in these cooperatives from three to five times their 1939 value. Average working capital in all cases tripled. Inventory values also showed a great increase in all types of cooperatives (Table 9).

The increase in the value of fixed assets raises the question whether this has been matched by a corresponding increase in permanent capital.

Inventories also take a large

Table 9. Average Fixed Assets, Average Working Capital, and Average Inventories in South Dakota Cooperatives, 1939 and 1951

Type of Association	Average Fixed Assets (Depreciated Value) 1939	1951	Average Working Capital 1939	1951	Average Inventories 1939	1951
Elevator	$10,930*	$52,500	$26,491*	$134,953	$20,380*	$113,630
Oil	7,680†	40,420	15,460†	54,400	6,100†	32,000
Creamery	10,310‡	33,700	11,790‡	36,200	6,240‡	17,860

*Includes 5 with 1939 figures, 2 with 1938, and 2 with 1941.
†Includes 6 with 1939 figures, 2 with 1940, 2 with 1941, and 1 with 1942.
‡Includes 2 with 1939 figures, 1 with 1940, 1 with 1941, 1 with 1942 and 2 with 1943.

amount of capital in most cooperatives, with perhaps the exception of creameries. In addition to inventories, a good share of the capital is also tied up in accounts receivable which in 1951, on the average, amounted to $18,433 for elevators, $14,325 for oil stations, and $4,598 in creameries. In accounts receivable a marked variation was found among different associations. Some which had a strict credit policy kept these at a minimum, whereas others had a considerable amount of capital tied up in this manner.

Capital Structure

The relationship between equity capital and loan capital is vital in judging the financial position of cooperatives, as in other business enterprises. Equity capital in a cooperative is represented by member investments in stock, deferred patronage refunds and allocated reserves.

Surpluses are sometimes considered part of the member equities, but they are not allocated to members and should perhaps be considered as belonging to the cooperative as an entity.

As mentioned earlier, there is a problem concerning deferred patronage refunds when capital stock or stock credits are not issued for them. A great majority of the cooperatives classified them as equities. The average investment per member in the cooperatives was $226 for elevators, $166 for oil stations, and $97 for creameries. Of this, 29 percent of the investments in elevators was in the form of deferred patron-

Table 10. Total Investment and Average Investment per Member by Type of Cooperative, 1951

	Common Stock	Preferred Stock	Part Paid Shares	Deferred Patronage Refunds	Allocated Reserves	Unallocated R & S	Total
Total Investments							
Elevator*	$ 643,678	$30,335	$186,339	$690,436	$348,858	$433,225	$2,368,891
Oil†	1,657,774	27,625	42,586	239,916	113,366	366,791	2,448,059
Creamery‡	93,013	———	16,214	98,821	86,904	223,068	518,020
Average Per Member							
Elevator	61.47	2.90	17.79	65.93	36.75	41.37	226.21
Oil	112.70	1.88	2.90	16.31	7.71	24.94	166.43
Creamery	17.46	———	3.04	18.55	16.31	41.87	97.24

*Includes 24 associations and 10,472 members.
†Includes 25 associations and 14,709 members.
‡Includes 9 associations and 5,327 members.

Table 11. Sources and Amounts of Loan Funds at the End of the Year, by Type of Cooperative, 1951*

	Commercial Banks	Bank for Cooperatives	Private Marketing and Supply Companies	Regional Marketing & Purchasing Cooperatives	Certificates of Indebtedness to Members	Other	Total
Elevators	$41,000	$112,823	$65,010	$184,183	$122,595	$ —	$525,611
Oil	20,000	—	24,056	40,327	35,100	5,500	124,983
Creameries†	—	—	—	—	—	—	60,489

*Includes 13 elevators, 12 oil stations and three creameries. The rest reported no outstanding loans.
†Amounts not listed separately to avoid revealing identity.

age refunds. About 17 percent of the member investments in creameries and 10 percent of the member investments in oil stations were of this type (Table 10).

In interpreting this table it is important to realize that the relatively high proportion of common stock is influenced by the practice of many oil cooperatives of putting patronage refunds into capital stock or stock credits.

Borrowed Capital

Surprisingly few of the cooperatives reported any borrowed funds at the end of the fiscal year, 1951. Twelve elevators, 13 oil stations, and 7 creameries indicated that they had no borrowed funds.

Some associations borrowed from members. At the end of the year elevators had loans from members totaling $122,595 and oil stations had a total of $35,100.

The major outside sources of credit were regional marketing and purchasing cooperatives. Only two cooperatives had loans from the Bank of Cooperatives, and few had loans from commercial banks. Some cooperatives obtained loans from private marketing or supply companies with which they did business (Table 11).

The borrowed funds at the end of the year do not always reflect the cooperative's need for borrowed capital. Particularly the grain elevators have a volume of business which fluctuates with the season. It is during harvesting time that they need a great amount of borrowed capital to carry their inventories.

The managers reported that the maximum loans in grain elevators were about twice as high as the amounts outstanding at the end of the year. Loans of oil stations and creameries did not vary much during the year (Table 12).

Table 12. Total Amount of Loans Needed During the Fiscal Year, by Type of Cooperative, Maximum and Normal, 1951*

Type of Association	Total Amount at End of Fiscal Year	Maximum Amount Needed During Peak Season	Normal Amount Needed During Year
Elevator	$525,610.62	$993,300.00	$560,800.00
Oil	124,982.76	162,200.00	128,850.00
Creamery†	39,689.12	50,000.00	33,000.00

*Includes 13 elevators, 12 oil stations, and 3 creameries.
†Does not include one creamery which had a large loan at the end of the fiscal year, but did not indicate maximum and normal amounts.

Permanent and Temporary Capital

The relation between permanent and temporary capital is another factor of great importance in evaluating the financial position of a business enterprise. Permanent capital includes funds which will be left in the organization for a long period of time. Examples of this type of capital are stock and long-term bonds. Temporary capital includes funds which can be used by the firm but which can be called for payment on relatively short notice. Most bank loans are of this type.

It is usually considered desirable to have all fixed assets covered by permanent capital, but most business enterprises borrow funds on a temporary basis to cover at least part of their working capital needs.

Deferred patronage refunds in a cooperative are difficult to classify in this respect. If they are treated as a liability and have a due date they should be considered temporary capital.

If deferred patronage refunds are considered to be member equities the situation is different. Even here there generally is an understanding that the members receive some cash payments in the future. For this reason it is doubtful whether the entire amount of deferred patronage refunds should be included in the permanent capital.

An exception would be made when the cooperative puts part or all of the deferred patronage refunds into permanent capital that is only to be paid out to members or patrons on a long-term basis. In such cases both the management and the members should clearly understand the situation.

The problem of whether deferred patronage refunds should be considered permanent or short-term capital is important because most cooperatives obtain a large share of their capital from deferred patronage refunds.

Elevators obtain over 29 percent of their capital from deferred patronage refunds, oil stations over 39 percent and creameries over 19 percent. Since many elevators and oil stations put their deferred patronage refunds into capital stock or stock credits, the actual amounts deferred are greater than shown in Table 10.

The permanent capital should at least be sufficient to cover the fixed assets. For instance, if a cooperative has a part of its deferred patronage refunds tied up in buildings and other facilities, it may have difficulty in paying them out. It was found that the majority of the associations in the study had sufficient permanent capital to cover their fixed assets, but there were 14 out of 55 which had insufficient permanent capital to accomplish this (Table 13).

Table 13. Number of Cooperatives Which Had Sufficient Permanent Capital to Cover Fixed Assets by Type of Cooperative, 1951

Type of Cooperative	Number with Sufficient Permanent Capital	Number with Insufficient Permanent Capital
Elevator	17	8
Oil*	20	0
Creamery	4	6

*Data for five associations not available.

Cooperatives which have insufficient permanent capital should be

making plans to correct this situation. Some associations have done so by transferring a portion of the deferred patronage refunds into capital stock permanently. Another alternative is to make an effort to obtain more capital from members by sale of capital stock.

A further comparison was made between total member investment, including unallocated reserves and surpluses, and total assets (Table 14).

Table 14. Member Investment Including Unallocated Reserves and Surpluses) as Percent of Total Assets by Type of Cooperative, 1951

Member Investment To Total Assets	Elevators	Oil Stations	Creameries
Percent	Number of Associations		
Over 90	2	11	2
75—90	2	9	1
60—75	6	4	4
50—60	6	0	0
40—50	1	1	2
30—40	4	0	1
20—30	2	0	0
10—20	2	0	0
Less than 10	0	0	0

Inventories and Accounts Receivable

Inventories and accounts receivable are both highly important factors in judging the financial position of cooperatives. Both of them reflect the way the organization utilizes its capital rather than its method of obtaining capital. High investments in inventories and accounts receivables tie up working capital and reduce the amount of funds available for new purchases or for payment of liabilities. Thus a cooperative can improve its financial position by obtaining more capital from members or by using its capital more efficiently. The latter involves speeding up the turnover of inventories, and reducing accounts receivable to a minimum.

To complete the survey of the financial position of the cooperatives, balance sheets were studied and certain commonly used ratios were computed. Unfortunately, many of the associations did not have annual statements available. The two ratios which were computed are accounts receivable to sales and sales to inventories. However, these ratios are not very meaningful for marketing associations, therefore, only data for oil stations are given in the tables.

For some of the cooperatives the ratios are decidedly unfavorable and indicate that management will have to make serious efforts to reduce their accounts receivable and increase the turnover of inventories. For instance, four associations had accounts receivable which were over 10 percent of their annual sales (Table 15). Many of

Table 15. Grouping of Accounts Receiveable to Sales, 17 Oil Cooperatives, 1951

Accounts Receiveable To Sales, Percent	Number of Associations	Ratings
0— 2	2	Good
2— 5	9	Fair
5—10	2	Poor
10—15	4	Unsatisfactory

Table 16. Turnover as Indicated by Ratio of Sales Divided by Inventories, 17 Oil Cooperatives, 1951

Ratio	Number of Associations	Rating
Over 18	3	Good
12—18	1	Fair
6—12	7	Poor
Under 6	6	Unsatisfactory

these oil cooperatives had a very low turnover of inventories which suggests that capital could be used more efficiently (Table 16).

To complete the picture, the ratio of net operating savings to sales is given for 32 associations from which the necessary information was obtained. This shows a substantial range between the more successful enterprises and the less successful ones within the same classification (Table 17). For instance, for oil stations the highest ratio was 10.4 and the lowest 0.6.

Table 17. Net Operating Savings to Sales by Types of Cooperatives, 1951

Net Operating Savings to Sales	Elevators	Oil Stations	Creameries
Percent	Number of Associations		
10 and over	0	1	1
7.5 to 10	1	2	1
5.0 to 7.5	1	7	2
2.5 to 5.0	3	3	2
0 to 2.5	3	3	1
Net loss	1	0	0
Total	9	16	7

Disposition of Patronage Refunds

In a preceding section various methods of handling deferred patronage refunds were discussed. In this section the results of the study of South Dakota Cooperatives on disposition of patronage refunds will be given.

Cooperatives differ as to the amount they will defer. Some associations defer all patronage savings, some only a percentage of the total refunds, and others pay all refunds in cash. In general the newer associations which are building up their capital tend to hold back most of the refunds.

A major portion of the elevator and oil associations deferred at least a portion of the current year's savings in 1951. Creamery associations, on the other hand, did not use this method of financing to as large an extent (Table 18).

Table 18. Methods of Distributing Patronage Refunds by Type of Cooperative, 1951

Type of Cooperative	Pay Entire Amount In Cash Currently	Defer a Portion and Pay a Portion in Cash Currently	Defer Entire Amount
	Number of Associations		
Elevator*	6	2	15
Oil†	6	3	14
Creamery‡	5	1	2

*Two reported a loss for the year's operations.
†Two could not find the data.
‡One had no patronage refunds and one paid on a pool basis every month.

The associations were asked if they ever had paid any cash refunds and when the last payment had been made; two elevators and nine oil stations reported that they never had paid out any cash refunds on a current basis. However, 19 elevators, 18 oil stations, all 10 creameries reported that they had paid some cash refunds either on a current basis or for a previous year at least once in the last five years.

In order to obtain a clearer picture of the disposition of patronage refunds in these cooperatives, the total refunds for each type of cooperative were calculated. The deferred refunds, current cash refunds, and cash paid out for previous years were totaled separately. In elevators and oil associations, slightly over half of the total refunds were deferred. In contrast, creameries paid most of their refunds in cash (Table 19).

In allocating patronage refunds,

Table 19. Distribution of Total Patronage Refunds by Type of Cooperative, 1951

Type of Cooperative	Total Refunds	Amount Deferred	Current Cash Refund	Cash Paid Out for Previous Year
Elevator*	$411,706	$209,630	$202,076	$58,854
Oil†	401,017	208,998	192,020	21,689
Creamery‡	183,053	37,748	145,305	10,189

*Two reported a loss for the year's operations.
†Two could not find the data.
‡One had no patronage refunds and one paid on a pool basis every month.

16 elevators, 3 oil stations, and 3 creameries reported that patronage refunds were paid by departments. Four elevators, one oil station, and five creameries made allocations for each commodity. The remainder, 5 elevators, 21 oil stations, and 2 creameries allocated refunds on the basis of the entire operations.

Handling of Deferred Patronage Refunds

When cooperatives defer patronage refunds they may be carried either as equities or as liabilities, depending on the practice of the cooperative.

In all, 40 associations carried deferred patronage refunds in the member equity sections. Eight associations carried them as liabilities. The remainder did not defer any patronage refunds.

The next problem of interest is what were the plans for paying out deferred patronage refunds. One-third of the cooperatives used revolving funds; this was particularly common among elevators.

In addition some oil stations revolved their capital stock, and some paid a percentage of the total deferred patronage refunds. The number having no definite plan was relatively large (Table 20).

Though the majority of cooperatives in the study had some plan, either revolving fund, revolving stock, or others, there is still the problem as to when refunds would have to be paid out. One cooperative issued revolving fund certificates which had a due date. This was the only association which had a due date on its patronage refunds. The majority of the cooperatives using revolving funds had no fixed period of revolving. Only three had definite periods of one, four and five years . However, even these were not obligated to retire within the fixed period, although they were at

Table 20. Number of Cooperatives Using Various Methods of Handling Deferred Patronage Refunds, By Type of Cooperative, 1951

Type of Cooperative	Do Not Defer Patronage Refunds	Revolving Fund	Revolving Capital Stock	Percentage Paid of Total Deferred Refunds	No Plan	Part Permanent Capital
			Number of Associations			
Elevator	6	12	0	2	5	0
Oil	2	5	10	3	4	1
Creamery	4	1	0	0	5	0

Table 21. Date Revolving Fund Started, By Type of Cooperative*

	Elevators	Oil Stations	Creameries	Total
	Number of Associations			
1935-40	2	0	0	2
1940-45	1	2	1	4
1945-50	4	5	0	9
1950-	1	0	0	1

*Twelve elevators, seven oil stations and one creamery used revolving funds. Four elevators did not know when plan was started.

the present time paying out according to such schedules.

The revolving fund in most of these cooperatives is essentially an agreement to pay the oldest refunds first if any payments are made. The advantage to cooperatives of handling the refunds in this manner is that the association does not need to pay refunds in years when earnings are low. If a due date is used, that part of the refunds which is payable becomes a claim against the cooperative.

With the exception of two associations, all cooperatives notified members by letter about the amounts deferred annually. One notified members by issuing revolving fund certificates, and one issued certificates of indebtedness. Both of these paid interest on deferred refunds. Apart from these two, only one other cooperative paid interest on deferred patronage refunds.

The revolving fund plan is a fairly new development in cooperative financing. Of the cooperatives included in this study, most had started the plan between 1945 and 1950 (Table 21).

One important legal problem in connection with distribution of patronage refunds is the contractual agreement between the cooperative and its members. The cooperative should have a legal obligation "to return to its members on a patronage basis all funds received in excess of the cost of goods sold. Such an obligation may arise from the association's articles of incorporation, its by-laws or some other contract."[3]

To find out what provisions the cooperatives had in this respect they were asked whether they had a mandatory obligation in by-laws or other legal instruments to distribute net savings on a patronage basis. Eight cooperatives did not have such an obligation. This indicates a need for cooperatives to check their by-laws with competent legal advisors.

Keeping Membership Up to Date

In most cooperatives not all patrons are members, nor are all members patrons. In the financial policy of the cooperative this involves two problems. First, the cooperative should make an effort to stimulate patrons to invest the necessary capital to become members. If a high proportion of the patrons are not members, the remainder have to carry a greater burden in providing permanent capital. In this study it

[3]American Box Shook Export Co. v. Commissioner of Internal Revenue 156F 2nd, 629, 1946.

was found that elevators had 88 members to each 100 patrons, oil stations 93 and creameries 86. It is possible that the number of patrons is underestimated, but it indicates that most of the patrons are members. Many cooperatives apply patronage refunds on stock until sufficient number of shares are earned. This practice would tend to equalize the number of members and number of patrons. Secondly, many cooperatives have a large number of inactive members on their list who probably should be paid off.

Among individual cooperatives some were found which had about twice as many patrons as members, while on the other end of the scale, one cooperative had three times as many members as patrons.

In general, it is desirable that the control be exercised by members who are active patrons. For this reason, it is a good practice to pay the member who retires from farming his equity in cash. The financial position of the cooperative may not always allow this, but provisions should be made for this if possible.

A member would get more of a feeling of ownership if he knew that his investment would be paid to his family in case of death, or to him if he retires or leaves the area.

The practice among cooperatives in this respect varies. This study indicates that most cooperatives pay out cash in case of death. Practically all buy in capital stock, but some which buy in capital stock do not retire patronage refunds and other member equities.

The majority also retire the member's investment when he leaves the community, but not to the same extent as in case of death. Here again, more cooperatives pay for capital stock than for patronage refunds and other equities (Table 22).

When the member retires from farming his chances of getting his

Table 22. Payment of Member Equities in Case of Death, Retirement, or Departure, by Type of Cooperative

	Capital Stock		Patronage Refunds		Other Equities	
	Pay Out	Keep	Pay Out	Keep	Pay Out	Keep
			Number of Associations			
In Case of Death						
Elevators	24	1	20	4	20	4
Oil*	22	2	19	5	18	6
Creameries†	9	0	8	2	7	3
Total	55	3	47	11	44	14
In Case of Retirement						
Elevators‡	19	5	15	8	15	8
Oil§	9	14	7	16	6	17
Creameries†	9	0	9	1	8	2
Total	37	19	31	25	29	27
In Case of Departure						
Elevators‡	22	2	17	6	17	6
Oil§	17	6	14	9	13	10
Creameries†	9	0	9	1	8	2
Total	48	8	40	16	38	18

*One left decision to discretion of Board of Directors.
†One had no capital stock.
‡One paid cash on capital stock, 15 percent on the rest.
§One left decision to Board of Directors when members retired from farming or left the area.

investment back are less favorable.

Although a cooperative may have a policy of paying out in case of such contingencies, it should be pointed out that the cooperative may not act according to the stated policy.

Even if the cooperative pays cash in these cases, it may still have many non-active members. It was found in the study that some of the members had done no business with the cooperative for many years. Sometimes they had joined other cooperatives or were trading with private dealers. In the long run it would be an advantage to cooperatives to retire equities of such members in order that membership represents the active patrons.

Before any member investment is retired, the by-laws should be examined to determine whether they authorize such retirement. If they do not, a change in by-laws may be necessary.

Credit Policy

A cooperative's credit policy influences the methods in which funds are used and consequently has a direct bearing on the amount of capital the organization requires.

In developing a credit policy, management has to weigh the consequences of having a strict cash and carry plan or selling on a credit basis. By refusing to sell on credit, accounts receivable can be brought down, but such a policy may lose customers.

Decisions on credit policy may affect farmers in different ways. A cash and carry policy would benefit members who are in the habit of paying cash, since extension of credit necessarily involves some losses which can only be recuperated by higher service charges. It may on the other hand be hard on the member who is short of cash. Thus there are bound to be different interest groups among the members regarding the question of making credit sales.

The members' opinions on this question is of importance for management if it is concerned about maintaining good membership relations. In this study, members were asked whether cooperatives should extend credit or not. Seventy-five percent of the members interviewed felt that cooperatives should extend credit. Most of them indicated that credit was necessary if the cooperative wanted to stay in business. However, the great majority of those favoring extension of credit indicated that there should be a limit both as to the amount and the length of time. In other words, they favored a definite credit policy.

Twenty-five percent of the members interviewed felt that cooperatives should not extend credit. Some of these indicated that credit would be given to more prosperous members and to those having influence with the manager.

Some cooperatives have organized credit cooperatives to help take care of the members' credit problems. It is also possible that the cooperatives can help both themselves and their members by providing information about available sources of credit, and the manner in which loans can be obtained.

What Members Think of Financing Methods

Frequently conflicts arise within cooperatives between members, boards of directors, and managers. Managers, for example, are responsible for day-to-day business transactions. Because of this they often want to decide on policy questions. Managers and board of directors are responsible for developing business policies, but the members should be informed on these policies. The members are entitled to a clear statement of the facts from the management.

The general policies of the management should have the approval of the members, if the cooperative is to be run in a democratic manner. This is essential for good membership relations and is particularly important in financing of cooperatives, since the members contribute the major part of the capital.

In the membership study, efforts were made to determine the members' opinions on various means of financing, and the extent to which they participate or feel they have an opportunity to participate in policy questions of this nature.

Members' Preferences Regarding Financing Methods

In order to determine members' preferences in financing of local cooperatives, 150 members were asked to rank four methods in order of preference. The great majority showed a preference for financing by deferring refunds. Of the 142 which offered an opinion, 98 ranked this method as the number one choice. Next in order of preference came purchase of stock by members. Sale of certificates was ranked third and borrowing fourth. Borrowing was the last choice of about 60 percent of the members.

The members were also asked whether in principle (1) they should finance their cooperatives according to the amount of business they do with the cooperative, or

(2) all members should have an equal investment, or

(3) they should invest as much as they want.

Forty-three percent indicated that they preferred number (3), 29 percent preferred (2), and 25 percent preferred number (1).

There is an apparent contradiction in the answers to the questions dealing with the methods the members would prefer in financing their cooperatives and the answers to questions on the principles they felt their cooperatives should follow. Most preferred patronage refunds as a means of financing, which implies that members invest according to the amount of business done, yet only 25 percent answered that members should invest according to the amount of business done.

In the first place, they may have been thinking that, if they have to invest, deferring of patronage refunds is preferable as far as they are concerned. On the other hand, if somebody else is willing to invest more, he should be permitted to do so.

If cooperatives want to obtain additional capital by direct investment of members, it would help in

their financing program to know what types of investments farmers prefer. To obtain some information in this respect, members were asked whether they prefer to invest surplus funds in securities with fixed values or in securities with fluctuating values.

The members showed a great preference for securities with a fixed value with 84 percent indicating a preference for this type. Only 13 percent favored securities with fluctuating values, and 3 percent had no opinion.

A further question was asked how they would invest surplus funds not needed in the farm business. No definite ranking among preferences was given in this question. The answers indicated the same preferences for securities with a fixed value. Government bonds were mentioned 99 times, farm land 27 times, cooperatives 24, postal savings 11, insurance 9, banks and common stock 7, other real estate 4 times. Others mentioned once were business in town and oil stock (wild cat).

Importance Given to Cooperatives

Do farmers belong to cooperatives because it is convenient, or because they consider them essential? Further, are members willing to support their cooperatives by investments? Some questions included in the schedule show attitudes of members to these questions.

Each member was asked whether he felt that farmers should invest some of their operating capital in cooperatives in the same manner that they invest in land and equipment. Eighty-six percent answered yes on this question, 13 percent no, and 1 percent offered no opinion.

The members were then asked how much they would invest if their cooperative needed additional capital for expansion of facilities and services. Forty-three percent were willing to invest in cooperatives. Forty-two percent reported that they would not invest additional capital in local cooperatives, 15 percent did not have any opinion. Whether members are willing to invest or not, depends on the particular situation, and these replies do not necessarily reflect what they would do. Some of those who indicated that they would not invest in a local cooperative gave as a reason that they already had invested enough.

More information about member attitudes in this respect can be gained by examining what they actually are doing with respect to investments in cooperatives. The members were asked, therefore, how much they had invested. Few of them knew the size of their investments in cooperatives. Out of 150 members, 83 did not know how much they held in capital stock, and 109 did not know how much they had invested in deferred patronage refunds. However, 79 percent said that they received notification of patronage refunds withheld. These answers indicate that members do not pay much attention to their investments in cooperatives. This was confirmed by the fact that 27 percent did not know how much they received in cash last year.

The data on investment indicate that many cooperatives have not been able to make members realize that cooperatives are their business. There also seems to be a lack of communication between cooperatives and members. This is indicated by the relatively few members who knew how much they had invested in their cooperatives. A further indication was given in comments made by members. Many felt they did not know enough about the manner in which the cooperative planned to handle the patronage refunds which are deferred.

Deferred Patronage Refunds

Although members preferred that cooperatives obtain their capital by deferring patronage refunds, this does not necessarily mean that they are satisfied with the rate at which refunds are withheld, or with the length of time refunds are held back before cash payments are made. However, there seemed to be no serious feelings of dissatisfaction with the present methods used by cooperatives. Eighty-eight percent answered no to a question whether they had any objections to methods used by their cooperatives in obtaining capital. However, many of them indicated that they would like to receive some cash payment.

Members have to pay income tax on patronage refunds when they are deferred. Since they have to make a cash payment for the income tax, they often feel that a corresponding amount should be paid out in cash. This is especially important to beginning farmers who are often short of funds.

Another problem which is of interest to cooperative management is whether members consider the refunds to be part of their ownership capital or a claim against the cooperative. Sixty-two percent considered the refunds to be part of their owership capital, 19 percent as a claim against the cooperative, and 19 percent had no opinion. As a rule, the members' opinions in this question coincided with the practice of the cooperative to which they belonged.

The members were asked further what evidence they should receive from the cooperative for the deferred refunds. Twenty-eight percent felt that stock should be issued, 23 percent indicated that a letter of advice was sufficient. On the other hand, 7 percent preferred certificates of indebtedness, and another 7 percent, revolving fund certificates. Thirty-five percent had no opinion on this question.

Forty-five percent felt that the deferred refunds should have a due date, 27 percent preferred no due date, while 28 percent had no opinion.

If a due date were used, the majority, 56 percent, preferred 5 years, 30 percent 10 years, and 14 percent less than 5 years.

The problem of having a due date on the deferred patronage refunds is a difficult one for cooperatives. From the cooperative's viewpoint, it is not advisable to have due dates because refunds coming due in years when savings are low may jeopardize its financial position. On the other hand, members like to be

assured of receiving their refunds at a certain time. The strong preference for refunds with due dates indicates that members are highly interested in receiving cash payments. In this respect they seem to put their own interest before the interest in the cooperative.

Participation by Members

In financing, it is helpful if members feel that policy decisions are made by them, and not by the manager and board of directors alone. This is particularly true when the cooperative obtains funds from members by deferring patronage refunds. Deferring of refunds is a decision to reinvest the members' capital, and this decision should be made by them.

When the members were asked whether they had an opportunity to vote on distribution of savings, 59 percent felt they had an opportunity to vote, but only 34 percent reported that they voted during the preceding year. Twenty-four percent did not feel they had an opportunity to vote on this question, and another 17 percent had no opinion.

Forty-nine percent felt that these decisions were made by the Board of Directors, and only 27 percent felt that it was the members who made the decision, 24 percent did not know who decided. Some reported that according to the bylaws such decisions are taken by the board of directors.

Most of the managers, 71 percent, reported that such decisions were taken by the board of directors. Apparently both members and managers agree that these decisions are taken by the board of directors. There are, of course, different interpretations of the term "making the decision," but the study certainly indicates that members do not feel that they have the deciding voice.

There is a basic conflict between manager, board of directors, and members about policy making. The manager and the board of directors often feel that they are in a better position to know what policies should be followed. Usually this is true. Therefore, management suggests and recommends policies. It should make all possible efforts to explain the facts and the possible consequences of particular policies, and then let the members decide. It should never be forgotten that the cooperative belongs to the members and that the decision and final responsibility should be theirs.

Regional Cooperatives

Regional cooperatives have been increasing steadily in importance, and have been finding it necessary to integrate vertically in order to maintain the services and products necessary. Vertical integration in a marketing cooperative means carrying their marketing activities closer to consumers. In purchasing cooperatives it means undertaking wholesaling and processing activities.

In the study, 14 elevator, 20 oil and 5 creamery associations belonged to regional marketing or purchasing cooperatives. Many of the cooperatives, especially elevator associations, belonged to more than one regional.

A few of the other associations also had a small amount of business with regionals even though they did not belong to the regional. There were four elevators and three creameries in this situation.

The dollar volume of business that local cooperatives in the study have done with regionals indicates that regionals are an important part of the South Dakota cooperative system. Twelve elevator associations sold $4,135,000 of grain through regional marketing cooperatives. Eight elevator associations purchased $1,099,331 of merchandise from regional purchasing cooperatives while the 20 oil associations purchased $3,298,987 of mercandise from purchasing regionals. The creamery associations bought only a few thousand dollars worth of supplies from regionals but did not sell through regionals.

Financing Regional Cooperatives

Membership of regional cooperatives is largely made up of local associations scattered throughout a wide area. Some regionals also permit individuals to become members, but largely it is local cooperatives that make up the membership. Therefore, local cooperatives have the major responsibility for the financing of regional associations. Since local associations are made up of individual member-patrons, the load of financing of regionals actually falls upon the members of the local cooperatives. Therefore, financing of regionals is tied closely to the financing of local associations. It makes it necessary for locals to have some of their capital tied up in regional associations, which creates a need for additional capital by local associations.

The regional cooperatives get their capital funds in much the same way as do local associations. They may get the funds from the individual members, which in this case are the local associations, or borrow the funds. However, they have the additional method of getting it from individuals who are members of the locals. The study was concerned only with funds obtained from individuals and from local cooperatives. It did not attempt to investigate other methods.

Very few members of local cooperatives in the study had made investments in regionals. Seven members invested a total of $2,300 and three members indicated they had

Table 23. Investments in Regional Cooperatives by Type of Local Cooperative, 1951

	Marketing Regionals		Purchasing Regionals	
Type of Cooperative	Number Reporting	Investment	Number Reporting	Investment
Elevators	12	$400,018.56	9	$119,235.35
Oil	0	0	20	989,153.82
Creamery	5	3,362.88	0	0

invested a small amount.

Local cooperatives, however, had large investments in regionals. A complete breakdown of investments as to type was impossible. However, the total investments show the importance of local cooperatives in the financing of regionals (Table 23).

Investments held by local cooperatives in regional associations may be direct cash investments or indirect investments coming from the deferring of patronage refunds. When patronage refunds are deferred, they are allocated to each member cooperative which in turn may allocate them to their member patrons.

Few of the cooperatives studied made direct investments in regionals. Only six elevator and seven oil associations reported such investments. The six elevator cooperatives had a total direct investment of $18,650, of which $2,100 was in stock and $16,550 was in certificates of indebtedness. The seven oil associations had direct investments of only $575 which was all in stock.

The major portion of membership investment was obtained indirectly by withholding patronage refunds. Nearly all of the patronage refunds from the regionals were withheld in 1951, with only four cooperatives reporting any cash refund paid currently by regionals in that year (Table 24).

The revolving fund method was generally used in handling the deferred patronage refunds by regional associations. Fourteen elevator associations reported that they belonged to regionals using the revolving fund plan while only one indicated they did not. Two did not know if the revolving fund plan was used. All 20 oil cooperatives belonged to regionals having revolving funds. Five of the creameries belonged to regional associations using revolving funds while two did not know.

Table 24. Deferred and Cash Refunds Received from Regionals by Type of Cooperative in 1951

	Cash Currently		Deferred	
Type of Cooperative	Number Reporting	Amount	Number Reporting	Amount
Elevator	4	$5,431.46	17	$ 90,378.76
Oil	0	0	20	142,382.02
Creamery	0	0	2	340.39

Special Problems in Handling Deferred Patronage Refunds from Regional Associations

When patronage refunds are deferred by regional associations, they are allocated to each local cooperative according to patronage. The local associations in turn have three alternatives for handling these refunds. They may combine the deferred patronage refunds from the regional associations with their own deferred patronage refunds and make allocations to their patrons from this total. An alternative is to allocate the deferred patronage refunds from the regional associations separately from the savings on their own operations. The third alternative is to pay income tax on the deferred patronage refunds from the regional associations and put them in surpluses without allocating them to members.

When deferred patronage refunds from the regional association are combined with their own deferred patronage refunds, many problems may arise to the local association. Members will have an equity in or a claim against the local cooperative for the amount deferred by the regional associations. However, the local association may not have received any cash for these deferred patronage refunds. If no cash has been received, these refunds are represented by an investment in the regional and would appear to the members to be readily available if called for.

The regional cooperatives, however, may have a large portion of the deferred patronage refunds invested in fixed assets which would make them unavailable. If the members of a local association looked at the balance sheet of their cooperative and saw a large amount of deferred patronage refunds listed, they may think the cooperative could pay some cash. If the deferred patronage refunds were tied up permanently in the regional association, the financial position of the local association could be jeopardized. The same thing could happen if the regional association went bankrupt, because the local association would be faced with claims or equities to retire for which no cash may ever have been received.

When the deferred patronage refunds from the regional cooperative are allocated separately from the local association's own savings, the balance sheet will show a balance for each of the amounts. In that case, the members are not likely to think there is too large an amount in deferred patronage refunds and, therefore, are not apt to vote for cash payment of the refunds.

Opinions on Financing of Regional Cooperatives

When discussing the financing of local cooperatives, it was brought out that the opinions of the members concerning different methods of financing should be considered. For regional associations that is equally true. The management and board of directors of the regionals sometimes have different viewpoints than the management and members of the local associations. If the relations between regional

and local associations are to remain favorable, the regionals must consider the opinions of the local associations. However, regionals have to consider two groups. They are the members and the management of the local associations. Therefore, opinions as to methods of financing were obtained from both the members and the managers of the local cooperatives.

In order to find the members' preference as to financing of regional cooperatives, the members were given four methods to choose from. They were then asked to rank these methods by order of preference.

Again the members felt that deferred patronage refunds should be employed, and money borrowed only after the other methods fail. If the regionals are going to finance directly, the members would rather do it than have the local association do it. The reason for this may be that when members do the financing, the individual member has the choice of investing. When the local association does the investing, every member is actually making an investment regardless whether he likes it or not.

The members were then asked if they would invest in regional associations if asked to do so. Forty-two percent indicated they would, 39 percent said they would not, while 19 percent had no opinion. If the regional were to obtain funds from farmers, 63 percent said they would prefer stock, 28 percent said they would prefer certificates of indebtedness, and 9 percent had no opinion. However, many of the members were unfamiliar with the term certificates of indebtedness. Members who had previous experience with certificates of indebtedness rated them very high.

Members also felt that the sale of certificates of indebtedness should be open to people other than farmers. Fifty-four percent said certificates should be sold to others, 39 percent said they should be sold only to farmers, and 7 percent had no opinion.

The second set of opinions as to preference of financing came from the managers of the cooperatives in the study. Managers were asked how regional cooperatives should obtain additional capital for expansion of facilities or other purposes.

The managers agreed with the members in preferring that regionals finance their operations by deferring patronage refunds. However, while members rated borrowing capital their last choice, local managers had borrowing as their second choice. One reason for this difference of opinion on borrowing capital may be that managers felt that they might be responsible for getting funds from members if it was decided to obtain funds by sale of stock or certificates of indebtedness to members. Many managers also felt that if the regional was seeking direct investment from local members it would be competing for funds the local cooperatives could use.

Managers also seemed to feel that the regionals should go to the individual member first if using a direct method of financing. They

probably felt that their local cooperative did not have the necessary capital for making direct investments into regionals.

Members' Opinions About Belonging to Regional Cooperatives

The members' opinions about regionals can easily affect the relationships existing between local and regional cooperatives. There are members who believe their local cooperative should not belong to regional associations. An attempt was made in the study to find out whether members felt their local association should belong to a regional cooperative, and to find out why some members felt their local cooperatives should not belong to a regional association.

Thirty-six percent thought their local should belong to a regional marketing cooperative, while 43 percent were opposed to belonging. Twenty-one percent had no opinion.

Fifty-seven percent thought their local association should belong to a regional purchasing cooperative while 17 percent were opposed to belonging. The remaining 26 percent had no opinion.

It can be seen that many more members would want their local association to belong to a regional purchasing than a regional marketing cooperative. Largely responsible for this difference of opinion was the fact that many felt membership in regionals would reduce the flexibility of operations. This was more pronounced for marketing cooperatives.

Many of the members had a resentment against regional cooperatives because they felt regionals had been too aggressive in their campaign to obtain business and members. Others thought that some of the regionals had become too dictatorial.

In other instances, members felt their local cooperative should not belong to regionals because of practical reasons. Creamery associations especially, find it difficult to market through regional cooperatives.

When local cooperatives belonged to regional cooperatives, the majority of members were favorably inclined toward regionals. However, the study indicates that the regional has to be careful in pushing itself into local associations.

Summary and Conclusions

During the last 15 years there has been a great increase in the dollar volume of business done by cooperatives. In this, cooperatives have followed the general business trend of higher activity and higher prices. Purchasing associations have been strongly influenced by the great expansion in use of machinery, gas and oil, fertilizer and prepared feeds. The total expenditures for farm supplies in the United States increased from $3,217 million in 1939 to $14,735 million in 1951. Many marketing associations are

also affected by this expansion in the volume of farm supplies since they too often handle farm supplies.

This expansion in business volume has made great demands on the capital resources of cooperative associations. Most of the additional capital needed has to be obtained from members.

In this study of the South Dakota marketing and purchasing cooperatives the methods used in obtaining capital were examined. Members of cooperatives were also interviewed to obtain their opinions about various methods of financing.

The cooperatives relied heavily on deferred patronage refunds as a method of obtaining capital. Nearly half of the investments by members and patrons were in the form of deferred patronage refunds. Members preferred this method to other methods of financing local and regional associations, although many indicated that they would like sufficient cash refunds to pay income taxes. However, some members had objections to the methods used in handling deferred patronage refunds. The reason for these objections were partly that the cooperative had no plan for handling deferred patronage refunds, and partly a lack of understanding by the member.

The study also showed that a number of cooperatives had insufficient permanent capital. There is a definite need for better financial planning in a great many cooperatives.

Other problems brought out in the study are concerned with membership relations. Among these is lack of communication between management and members. This is a serious problem when cooperatives are financing their operations by deferring patronage refunds. There also seemed to be a feeling among members that they had only a minor voice in decisions taken in financial matters. Greater member interest in their associations would be a great help. Also failure to keep membership up to date is a serious drawback.

The solution to the financial problems of cooperatives probably lies in stimulating member interest. Greater interest based on an understanding of the business problems of their organizations should make members willing to make larger direct investments. For most cooperatives it still will be necessary to obtain funds by deferring patronage refunds. If they do so, plans should be made for providing more permanent capital.

One alternative which has been suggested is to keep part of the refunds permanently, only to be paid out in case of death, retirement, or if the member leaves the community. The remainder could be paid out in cash currently or within a certain time period. Of course, such payments could only be made if the financial situation permits it. Other alternatives include revolving funds with fixed periods, revolving funds without any fixed periods, and issuing stock credits. If stock credits are issued the stock could also be revolved. It has to be kept in mind, though that revolving funds with

fixed periods can lead to difficulties if large payments have to be made in years when business volume has been low.

A few cooperatives in this study were seriously considering changing to a system in which they would keep a part of the refunds without allocating them to members. This would involve paying income taxes for the amount withheld without allocation to members.

Whichever method is chosen, it is important that the contractual agreement between the association and its members is clear and understandable to both parties.

Cooperatives have a responsibility to explain their business and their problems to members. The members, on the other hand, should try to obtain a better understanding of their organizations and of the economic climate in which they operate.

Too many members are thinking in terms of the thirties when economic progress was relatively slow. The last decade has probably seen more rapid changes in our whole economy than any previous period of the same length. Many private businesses are making necessary changes to adjust to this situation. If farmer cooperatives are to stay in business, they and their members will have to make a careful appraisal of their methods of doing business, their location, and their financial organization.

Not all financial problems of cooperatives can be solved by more investments from members. Some associations have been adequately financed, but have still run into difficulties because funds have not been used as well as they should. Excessive inventories and accounts receiveable often tie up large amounts of capital which could be put to better use. Often cooperatives have expanded into new lines which bring losses and tie up additional capital. If management asks members to provide more capital, it is management's duty to see to it that this capital is efficiently used.