



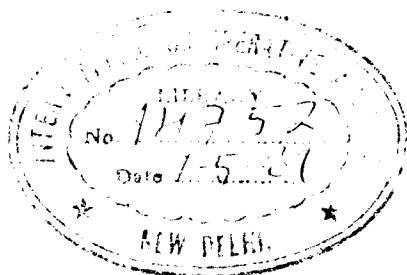
**AGRICULTURAL  
COOPERATION**  
*in* **DEVELOPING  
COUNTRIES-**  
**A MANAGEMENT  
APPROACH**

**E. V. MENDOZA**

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**SAXENA, DIRECTOR, INTERNATIONAL CO-OPERATIVE ALLIANCE**

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A MANAGEMENT  
APPROACH**



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**EUGENIO V. MENDOZA**

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# FOREWORD

The International Co-operative Alliance, as the representative organization of the world co-operative movement, encourages the production of useful literature on co-operative subjects. When such literature deals especially with the developing countries, it is doubly welcome because of the acute scarcity of material dealing with problems of that part of the world. I am, therefore, delighted to respond positively to Gene Mendoza's invitation to me to contribute a foreword to his book "Agricultural Co-operation in Developing Countries — A Management Approach."


Mr. Mendoza deals in this study with of course the more traditional areas of management, viz., organisation policies and procedures, questions of structure, financial management and planning. In addition, the book gains considerably in usefulness by his reflections on at least three important areas which are of great concern to Co-operators all over the world, and two of which have particular relevance to the developing world.

First, he emphasizes, quite rightly, the significance of co-operative principles — principles which if rightly understood and applied, infuse their own ethos and discipline into the working of the organisation. Too often, I am afraid, organisations have been blamed when in actual practice they had long ago ceased to be co-operatives. Some major studies issued under unimpeachable authority have, unfortunately, fallen into this trap. Secondly, he gives prominence to the relationship of the co-operative movement and the government. It is obviously a subject on which the last word will not be said, if ever, for a long time. But what is clear and beyond dispute is that too much interference from the government, too much politically vested interest by individuals who are trying to use the co-operative as a springboard for their own political career, is bound to weaken the spirit of self-help and mutual help among members which must remain the motor force of a co-operative. One of our research studies dealing with a comparative assessment of the performance of industrial co-operatives in four countries makes the point that indiscriminate financial incentives from the government to co-operatives, for instance, lead to the creation of spurious organisations which at the



first chance convert themselves to private profit-making organisations. Discussions on the subject of Co-operatives and the State at our 1978 Central Committee meeting in Copenhagen, now issued as a publication, underline the deleterious nature of government interference in the movement. The broad division of responsibility between the Government and the movement which Mendoza suggests cannot be disputed although the fact that excellent co-operative legislation which meets the most exacting demands of co-operative principles co-exists with the worst form of government interference and highhandedness makes one wonder if the issue has been explored deeply enough. Finally, Mendoza draws our attention to the very important aspect of Co-operation among Co-operatives, the new principle adopted in Vienna in 1966 at the ICA Congress on the recommendation of the Principles Commission. Co-operative organisations, even in developing countries have not infrequently achieved significant dimensions. According to recent information, co-operative banking institutions in France, Japan and Germany have acquired high positions in the world banking league. If the economic power in these organisations could be joined together to advance the frontiers of the co-operative sectors, what tremendous potential could the movement realise! What is required, as Mendoza states, is the recognition of Co-operation as a system and imaginative thinking which could knit close ties between co-operative organisations around workable projects, thus laying the basis of sustained relationships. A number of practical examples of co-operation among co-operatives are to be found in the Report of a Working Party which was discussed at our Congress in Paris in 1976.

Mendoza's book is comprehensive, readable and will be of use particularly to students of Agricultural Co-operation. It is a study written by an Asian, born and brought up in the social and cultural milieu of the East and who has had long experience of managing agricultural co-operatives. He has carried out the task with commendable clarity. I can recommend the book to students of Agricultural Co-operation and to those interested in problems and principles of Co-operation.



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3rd July, 1980

# INTRODUCTION

This exposition on agricultural cooperation is centered on the theory and practice of cooperative management which are particularly relevant and applicable to agricultural cooperation in developing countries. It is precisely directed towards practitioners, teachers and students of agricultural cooperation.

Specifically, this endeavor is intended to serve as a practical guide for cooperative officials and employees in firming up their cooperative orientation and broadening their working knowledge and skill of management technology and techniques. They will thus be in a better position to address themselves to their respective tasks with more dedication and proficiency. On the other hand, this effort is also designed to be a useful textbook on agricultural cooperation, in general, and agricultural cooperative management, in particular, in the secondary and collegiate levels. Students of agricultural cooperation will therefore be imbued with the proper understanding and appreciation of agricultural cooperation at an early stage, and in the process will constitute themselves into a hard core of enlightened young cooperators who will hopefully become dedicated and real cooperative leaders of tomorrow.

The sequential development of the topics starts with a presentation of basic background information on agricultural cooperation in general. The discussion then shifts to the more essential aspects of agricultural cooperation from the time an agricultural cooperative is organized until it becomes operational. Particular focus is placed on the two most critical areas in cooperative management, namely: cooperative marketing management and cooperative financial management.

It is fervently hoped that in its totality this venture, just like agricultural cooperation itself, will have more than sufficient commendable traits to offset its limitations and deficiencies. For then, it will fulfill the expectation of contributing a modest share in the endless process of upgrading the efficiency and effectiveness of agricultural cooperatives as valid service organizations for improving the lot of millions of small farmers in developing countries.

**CHAPTER I**

**AGRICULTURAL COOPERATION  
AND DEVELOPMENT**



## CHAPTER I

# AGRICULTURAL COOPERATION AND DEVELOPMENT

*Agricultural cooperation is an effective tool for the attainment of the multiple goals of development, particularly economic goals. It is a specialized field of economics and represents an exact replica of the economy and the economic system. A symbiotic relationship exists between agricultural cooperation and industrialization.*

### I. DEVELOPMENT: ITS GOALS AND PROBLEMS

#### A. *Meaning of Development*

Development may be defined as that particular aspect of nation building which is geared towards the attainment of certain goals of society. Although the literature on economics may offer other definitions of development, all definitions of development convey two basic characteristics, namely: (a) it involves mainly the attainment of certain goals and (b) it represents a people-oriented national effort.

#### B. *Specific Goals of Development*

Understandably, the goals of society are bound to vary, as they do indeed vary, among the different countries. Such factors as (a) the form of government; (b) state policies and programs; (c) type of economy; (d) stage of economic development; and (e) the desire of the people themselves particularly in a market economy, just to mention the more relevant, determine the goals of society.

It will be noted, however, that practically in all cases, especially in the so-called "developing" or "third" countries, the total effort revolves around seven common main goals: (a) growth, principally in terms of increase in real per capita income; (b) equity in the distribution of income and wealth; (c) full employment; (d) equilibrium between receipts and disbursements of foreign exchange; (e) preservation of individual freedom; (f) enhancement of culture and tradition; and (g) forging of unity among the people. Other usually enunciated goals as (a) price stability; (b) development of skilled manpower; (c) preservation of peace and order; and (d) building of infrastructure projects are actually mere ancillary. Although they are not as important as the seven aforementioned, they are nevertheless essential for the full achievement of the main goals.

Even a cursory examination of the foregoing common principal goals should make obvious two closely intertwined facts about their nature and character: (a) the multiple goals are of composite economic, social and political nature and (b) they are prone to interact in a negative manner, that is, they are bound to compete and, even worse, conflict with one another. This is indeed an

intriguing situation which adds heavily to the complexity of the problems of development.

### *C. Development: A People-Oriented National Endeavor*

Development, in a real sense, is an achievement of the people. It is one national endeavor which penetrates deeply the problems of human development in the full range of activities relative to agriculture, mining, manufacturing, construction, trade, transport and communication, and services (education, government, etc.). Thus, in the ultimate analysis, it is the sum total of all individual efforts of the entire manpower resources of a nation. The fact that development is people-oriented clearly defines and underscores the vital role of man in the whole process. This then brings into sharp focus the biggest dilemma of development — a man can either be an asset or a liability.

### *D. Problems of Development*

Development is a complex process that involves a host of problems. The problems are so complex that what appear as solutions provided by economics, sociology, psychology and anthropology have to be considered within the totality of a given situation. Otherwise, solutions applied indiscriminately and wrongly may create more problems, perhaps more serious than those which they intend to solve.

In the main, the problems that may emerge derive from the previously noted two basic characteristics of development: (a) the varied economic, social and political nature of the multiple goals which are not always compatible with each other and (b) the fact that development is people-oriented. For understandable reasons, only the more pertinent problems of development will be considered and the discussions will be brief and concise.

The first problem involves the extremely delicate task of establishing an ideal balance among the multiple goals, a situation usually referred to by economists as

“optimum mix.” This calls for the adoption of a fair method of amalgamating the different goals into an acceptable optimum preference or arrangement. Here, what is requisite is to balance the goals that are at cross-purposes with one another. The process actually involves the conversion of goals from negative into positive interactions.

A second problem which is closely related to the first pertains to the setting up of a system of priorities in the attainment of the multiple goals. The necessity for such a system is dictated mainly by the scarcity of resources. State policies and programs serve as basic guidelines in ascertaining the comparative degrees of urgency with which each goal should be pursued.

Furthermore, there is the patent need to make a careful and judicious selection of the different tools and devices that can be utilized in attaining the desired goals in the most expeditious and economical manner. There are several development tools which are prominently identified with each sector of the economy. They are involved mainly, if not entirely, with the production and distribution processes, the two main concerns of an economic system. In the field of agriculture, agricultural cooperation is considered one of the most proficient and effective tools of development.

And finally, the most crucial problem, in fact considered by many as the root problem, of development is how to harness the best in the individual to support with all sincerity and dedication the program of development itself, motivated by the desire to serve others and with full commitment to self-denial. Hard work and plenty of hard work is the basic ingredient for the success of any people-oriented program of development. The people must be properly and sufficiently motivated to engage themselves deeply in it, not because they have to but because they want to. To be truly effective, a development tool should provide such motivation—it should stimulate people to work. In this regard, agricultural cooperation has long demonstrated that it possesses a built-in capability to rally the farmers to work hard to help themselves and their fellow farmers. Viewed in its proper

perspective, agricultural cooperation is indeed a multilateral pledge of the farmers to promote their lot through honest and dedicated efforts.

## II. AGRICULTURAL COOPERATION AS A DEVELOPMENT TOOL

### A. *Agricultural Cooperation: A Specialized Field of Economics*

It is a well-known fact, although usually overlooked, that agricultural cooperation is a specialized field of economics. Agricultural cooperation is, of course, related to other social sciences such as sociology and psychology. But in the main, agricultural cooperation falls within the sphere of economics. It is extremely important that agricultural cooperation as a field of study be thus clearly identified in order that the proper bearing in its study may be established.

Agricultural cooperation is firmly founded on economic theories and can be explained and understood in the light of said theories. It should prove of immense value and interest to cooperators to illustrate this point. For one, such an illustration should clearly establish the theoretical basis and practical value of agricultural cooperation and, in the process, confirm the validity of the concept of agricultural cooperatives, its organic component. And for another and this is more important, such an illustration should generate a more meaningful appreciation of and motivate involvement in the actual efforts being exerted at present to propagate the movement. This should prompt those who are still outside the folds of agricultural cooperation to make full use of their academic inclinations by joining the ranks of agricultural cooperators. On the other hand, the further enriching of the technical background of those already in the agricultural cooperative movement should spur them to pursue their mission of service more effectively and with more dedication and vigor. Indeed, agricultural cooperation has more than its share of dead-weights of self-styled cooperators who are actually obstructions to the effective pursuance of the program.

It has to be profusely infused and strengthened with properly oriented genuine co-operators who will steer agricultural cooperation to the right tracks to make agricultural cooperatives more responsive to the needs and requirements of the farmers.

To this end, two illustrations will be presented: (a) agricultural cooperation in relation to the economic system and (b) agricultural cooperation in relation to the economy.

#### 1. Agricultural Cooperation and the Economic System

Agricultural cooperation is virtually an exact small-scale replica of an economic system. The following comparisons with particular reference to the specific need for agricultural cooperation, on the one hand, and the economic system, on the other, will help provide the proper enlightenment on the matter.

- a. *As to Purpose* — Society needs an economic system in order that the required goods and services may be *produced* and *distributed* in an orderly manner. Likewise, the farmers need agricultural cooperation precisely to enable them to *produce* and *distribute* the goods and services needed by society, including themselves, in a systematic way.
- b. *As to Key Activities* — In an economic system the *production* and *distribution* activities are guided by certain key aspects:

##### (1) *Production*

- (a) What goods and services to produce
- (b) How much to produce
- (c) How to produce

##### (2) *Distribution*

- (d) For whom to produce

Similarly, the *production* and *distribution* activities in agricultural cooperation are guided by the same keystones.

#### 2. Agricultural Cooperation and the Economy

The general idea is to show that agricultural cooperation is a perfect miniature model of an economy, both

in nature and character, to wit:

a. *As to Basic Nature and Behavior* — The economy is people. As people they have *needs* and they have to *work* — to satisfy their needs.

Likewise, agricultural cooperation is *farmers*. The farmers have *needs* and to satisfy their *needs*, they have to *work*.

b. *As to Guiding Principles or Policies* — The guiding principles of economic policy are *growth* and *stability*. The economy wants growth. It also needs stability — progressive growth that is based on firm foundation. The guiding principles of agricultural cooperation are also *growth* and *stability*. It demands *growth*. It should also strive for *stability*. Agricultural cooperation, as a matter of policy, should continue to push further the horizon of services. It should be a lasting institution of service for all generations.

c. *As to Required Attitude* — It is well recognized that the people can make or unmake the economy. In the final analysis the extent of the growth and stability of the country depends on the people's (a) hard work, (b) productivity, (c) efficiency, (d) motivation, (e) dedication, and (f) service to society.

In agricultural cooperation, it is always emphasized that its success or failure depends largely, if not mainly, on the extent of an identical type of support extended to it by the *farmers*.

## B. *Agricultural Cooperation and Its Spectrum of Services*

Agrarian reform, food production, land settlements, supervised credit, cooperative organizations and other forms of inducements are battering down the old structure and bringing about significant changes in agriculture. Production is sharply growing; opening up complex problems as well as opportunities not only in production but also in distribution or marketing in all its multifarious processes.

These developments have opened vast new frontiers of opportunity for the farmers — the possibility of lifting farming from its traditionally low level of productivity and consequently poor income for the farmers, to one of rewarding and profitable enterprise.

The situation imposes an imperative: that the small farmers be provided the means by which they can effectively overcome the heavy handicaps of their circumstances and share in the boons and benefits that current developments offer. They have one worthwhile answer in agricultural cooperation. Organizationally and financially, farmers left to themselves are not in a position to avail themselves of the multifarious technical advancement in agriculture.

Agricultural cooperation provides the means by which such farmers can multiply or increase their capabilities through group action. It encompasses practically all phases of economic activities related to the broad and complex fields of production and distribution or marketing including credit. With its efficacy and effectiveness in uplifting the socioeconomic lot of the small farmers more than adequately demonstrated and tested in the past, agricultural cooperation has indeed deservedly earned its rightful place as a reliable and potent development tool.

## III. AGRICULTURAL COOPERATION AND THE PRINCIPAL GOALS OF DEVELOPMENT

### A. *Attainment of Economic Goals*

The major contribution of agricultural cooperation in development is the attainment of economic goals rather than of the other multiple goals of development. This can easily be explained by the fact that agricultural cooperation is basically economic in nature and character.

Agricultural cooperation, to be sure, is directly involved in the total effort to achieve four common economic goals of society: (a) growth in the form of increased real per capita income; (b) equity in the



distribution of income and wealth; (c) full employment; and (d) balance of export-import payment of foreign exchange.

### **1. Growth in Terms of Increased Real Per Capita Income**

Among the economic goals of development, growth is considered the most important since it means more goods and services. Measured in terms of increase in real per capita income, growth is recognized as the most reliable indicator of the pace of development of a country. Agricultural cooperation contributes to growth in two specific ways which are closely intertwined: (a) increased productivity and (b) better marketing returns.

In agricultural cooperation, increased productivity is the net effect of one or a combination of a number of factors, foremost of which are: (a) adoption of such innovations as high yielding seeds, more effective fertilizers and pesticides and better and more extensive irrigation systems coupled with the employment of more scientific farm management techniques; (b) procurement of cheaper and better production inputs and farm machineries and equipment through mass buying; and (c) better use of credit mainly through supervised farming.

In addition, agricultural cooperation enables the farmers to secure better marketing returns for their products. Farmers, through agricultural cooperation, are able to handle their products even beyond the boundaries of their farms and extend the control of their products nearer the markets in the marketing processes with full access to such opportunities as greater bargaining power and economies of scale. Provided with the advantages of increased bargaining power and economies of scale, farmers can manage to introduce innovations in the marketing process and expand their marketing services to such vital areas as standardization, grading and marketing information with maximum efficiency and economy.

Finally, a very important feature of

agricultural cooperation is that it enables the farmers to buy their farm inputs at wholesale price and sell their produce at retail price thereby correcting the present situation where the farmers buy retail and sell wholesale.

### **2. Equitable Distribution of Income and Wealth**

In predominantly agricultural economies, there is a marked tendency for income and wealth to be over-concentrated in the industrial sector of the economy and in the urban areas. This situation is a direct offshoot of and clearly portrays the backwardness and inefficiency of agriculture. It suggests the imperative need to pursue a more responsive and effective agricultural development program which will support and keep pace with the industrialization of the country.

The principal target of such an agricultural development program is to place agriculture and the farmers in equal footing with the other sectors and workers of the economy so that the labor force in agriculture, which normally represents the largest force in a country, will receive more equitable share of income and wealth.

Agricultural cooperation can provide the means by which the farmers, voluntarily and through their own efforts, can make their farming activities more rewarding and profitable. It is important to mention that agricultural cooperation does not only have the capability to generate more income and wealth for the farmers but also has a built-in mechanism to spread out such generated income and wealth. This means agricultural cooperation is an ideal component of a program to remove the disparity in the distribution of income and wealth.

### **3. Reduction of Mass Unemployment**

As agricultural cooperation continues to forge ahead in maximizing its contribution to rural progress, more and more employment opportunities are naturally created as a result of the organization of additional agricultural

cooperatives and the expansion of the services of the existing ones. These job opportunities can be identified in (a) agricultural cooperatives themselves; (b) the government offices concerned; (c) the private business sector; and (d) the educational institutions.

In the agricultural cooperatives, the demand for the services are in the specific areas of (a) management and administration of agricultural cooperatives and (b) operation of the cooperative facilities and projects. Government offices involved in agricultural cooperatives offer job positions relative to the various phases of (a) cooperative promotion and organization; (b) cooperative education and information; (c) cooperative management, particularly on the technical and business aspects thereof; and (d) cooperative training and research. In the private business sector, there are many private companies offering cooperative management consultancy services and specialized services such as cooperative accounting and auditing. These firms are constantly in search for good cooperative talents. In the case of educational institutions, many of them are offering various courses on agricultural cooperatives and their demand for teachers on the subject can hardly be satisfied. In addition, agricultural cooperatives in the course of their trading operations actually help in the creation of more jobs in those industries with which they are transacting business.

It will be realized that the job opportunities in agricultural cooperation are varied in nature and range from the highly professional to the unskilled jobs. Employees in the higher operating levels in agricultural cooperatives come from a composite group of business graduates, agriculturists, economists, lawyers, accountants, engineers, and a host of other professionals. The growing complexity in the activities and in the size of agricultural cooperatives, as well as the peculiarities in their nature and character as business organizations, have of late effected a significant trend toward job specializa-

tion and the concomitant elevation of the different key positions into professional level, particularly that of the cooperative managers. Said jobs have to be professionalized in order that agricultural cooperation can remain at the forefront of the highly competitive business field as well as maintain its reputation as a pacesetter or innovator.

It is apparent that there are virtually unlimited ways by which one can get involved in agricultural cooperation as a means of livelihood. A job in agricultural cooperation, it is stressed, also carries with it the splendid opportunity to serve the economic and social well-being of the rural populace.

In fine, agricultural cooperation gains prominence even more as a development tool, this time in reducing mass unemployment in view of its tremendous job-creating potential.

#### **4. Balance of Export-Import Payments of Foreign Exchange**

Selling overseas is actually not a new dimension in the operation of agricultural cooperation. It has long realized the advantages, in fact the need, of engaging in export for two reasons: (a) to increase income and (b) to help earn valuable foreign exchange for the country.

In most developing countries, agricultural cooperation has penetrated the export markets of such products as tobacco, copra, jute, rice, corn and molasses. It has, however, a long way to go in pursuing the export program effectively and on a wider scale. But it can draw the necessary inspiration and encouragement from the experience of agricultural cooperation in the developed countries in taking advantage of export market opportunities.

Agricultural cooperatives in the Scandinavian countries, notably in Sweden and Denmark, are regular big suppliers of butter, cheese and bacon to different countries. Some big farmer-owned and-controlled cooperative associations in the United States, for example, the Sunkist Growers, Inc. of

Los Angeles, California and the Arkansas Rice Growers Cooperative Association of Stuttgart, Arkansas, have achieved steady growth in the export of oranges, citrus, grains, sorghum, soybeans, cotton, broilers and processed fruits. In this regard, it is of interest to note that a 5-million bushel capacity export elevator of the Farmer Export Company in Kansas City, which is owned by one million farmers in twelve states, was set up to serve the foreign markets of foods and feed grains in Europe, United Kingdom and Japan. Some agricultural cooperatives in Japan are also very active in the export market.

It is indeed significant that concrete steps have already been taken by some developing countries in Southeast Asia to engage in the foreign trading of selected commodities on a cooperative-to-cooperative basis. Given the proper encouragement and support, this program which is initially built around international cooperative trade has great promise in eventually opening the doors of the world market for agricultural cooperatives in the region.

### ***B. Attainment of Social and Political Goals***

There are three common goals that fall within the spheres of social and political concerns: (a) preservation of individual freedom; (b) enhancement of culture and tradition; and (c) forging of unity among the people or patriotism. Surely, the goals revolve around one basic thing — attitude of man. The active participation and thorough involvement of the farmers in agricultural cooperation contribute immensely to the awakening and intensification of the traits that must perforce characterize and dominate their strivings for social and political advancement. The value of agricultural cooperation as a development tool is centered on molding of the vital attitude of the farmers.

The concept of agricultural cooperation is usually illustrated based on the central theme of men working together for their

common good. Different countries have their own way of symbolizing the concept of agricultural cooperation. In the Philippines, for example, it is popularly referred to in the vernacular as “bayanihan” which in English means working together. And it is symbolized by a group of farmers carrying on their shoulders a bamboo hut, ostensibly owned by one of the farmers, that is being transferred to a new site. In this illustration, the prevailing attitude of the farmers can doubtless be seen and felt. There appears an apparently spontaneous and voluntary determination of the farmers to perform and achieve a common task.

The positive attitude of the farmers toward group action as epitomized in agricultural cooperation can be explained in terms of the underlying principles of cooperation. The basic features of the attitudinal pattern are concrete manifestations of the recognized principles of agricultural cooperation. A discussion of the principles of agricultural cooperation is presented in Chapter III.

## **IV. AGRICULTURAL COOPERATION AND INDUSTRIALIZATION**

The interdependence of the agricultural sector with the manufacturing sector must be clarified in order to underscore the fact that rather than being anathema to one another as is the belief of not a few, the agricultural and manufacturing sectors are dependent on each other for their growth.

### ***A. Industrialization and Economic Development***

Industrialization, or industrial growth, may be defined as the increasing share of the manufacturing sector in the total national income. It is often associated with the progress and prosperity of a country. Empirical evidence reveals that the most industrialized countries are the richest while the least industrialized countries are the poorest.

In the wake of the widespread enthusiasm over the results obtained from indus-

trialization particularly in the developing countries, industrialization is often confused with economic development itself. It must be made clear that although industrialization has already demonstrated its potential in hastening, on a long-run basis, the economic development of a country, it is actually only an aspect of, and not economic development itself. Furthermore, the encouraging results obtained by some countries from industrialization must not, by all means, be used as sole basis for making a liberal prescription of rapid industrialization. Industrialization and the strategy for it, particularly the question of the rate of industrialization and the choice of industries, should be premised on the other more important conditions and considerations.

### ***B. The Need to Industrialize***

The emergence of the imperatives to industrialize may be attributed to one root cause: increasing income levels of the people. The upward movement of income levels, the most reliable indicator that the country is becoming richer, creates some significant new trends and tendencies in vital aspects of the economy which are actually imperatives to industrialize.

#### **1. Demand for Manufactured Products**

The demand for purely agricultural products tends to decrease while the demand for manufactured products tends to increase. This change in the pattern of demand for goods and services is explained by the well-known "Engels law" which states that proportional expenditure for food decreases as income increases.

#### **2. Increasing Proportionate Share of Manufactured Products in the Export Market**

Manufactured products or articles have to be exported eventually to earn foreign exchange that will be used to import other manufactured articles to satisfy the increasing local demand for such manufactured articles. A country

cannot forever depend on export of agricultural raw materials to balance the trade payments.

The earning capacity for foreign exchange of agricultural raw materials is not too stable for two reasons: (a) they are subject to severe fluctuations in prices and (b) they are subject to substitution by man-made or synthetic products. Incidentally, the export of manufactured articles enables the manufacturing sector to further increase its share of earned foreign exchange.

#### **3. Faster Shifting of Labor Force from the Agricultural to Manufacturing Sector**

The shift of the labor force from the agricultural sector to the manufacturing sector tends to increase. This is a logical consequence of industrialization. In fact one of the ways of measuring industrialization is by determining the increase in the share of the manufacturing labor force to total employment in the country. This phenomenon is a direct result of the growth of agriculture through increased productivity. With the increase in per capita productive efficiency of the farmers, less and less farmers will be needed to supply the food and other farm product requirements of the country with the result that excess labor will be created in the agricultural sector. This excess labor force in agriculture will have to be naturally absorbed by the manufacturing sector otherwise the problem of mass unemployment and under-employment will be magnified. Provision should also be made for the long-run accommodation of the increasing labor force brought about by the high rate of population growth.

This is the crux of the policy giving more preference to labor-intensive industries over that of capital-intensive industries. The general idea here is to provide employment opportunities for the labor force that will be displaced in agriculture and also for the long-run

accommodation of the increasing labor force of the country as a result of an increase in population.

### C. *Basic Requisites for Industrialization*

A very significant characteristic of an economy is the interdependence of its various sectors. This means that no one sector of an economy can be developed completely independent of the others. The hard and fast rule is that they must cooperate with one another — on the basis of mutual support. An economic policy that is formulated under the guiding principles of *growth* and *stability* must lay stress on this vital factor of sectoral interdependence. Otherwise, the economy will be headed toward retarded growth and pronounced instability.

This general relationship of sectoral interdependence can be spelled out more in detail in the specific relationship between the agricultural sector, including agricultural cooperation, on the one hand, and the manufacturing sector, on the other. In a predominantly agricultural economy, agricultural growth is a basic requisite for a sustained industrial growth. To state the relationship more aptly, agricultural growth is *sine qua non* to industrialization.

The attainment of increased productivity in agriculture must take place simultaneously with advances in industry. There must be a wholesome agricultural and industrial balance wherein agricultural development matches the pace of industrialization. The support of the agricultural sector principally in the form of increased supply of agricultural products is vitally needed by manufacturing for three specific purposes: (a) *for food consumption* — to meet the demand of the manufacturing sector brought about by the higher income levels; (b) *for raw materials* — to supply the increasing requirements of factories; and (c) *for export market* — to increase further the inflow of foreign exchange needed to support the rising demand for imported articles.

As a corollary observation, a country which is simply lured to undertake much too rapid industrialization in the wake of a stagnant and backward agriculture soon

finds its economy beset with two serious problems: (a) threat of rising prices (demand for products is more than the supply) and (b) depletion of foreign exchange (more imports than exports). Unless adequately checked on time, the two problems can ultimately lead to the more serious problem of inflation or a reduction of the value of money and cause a general slowing down of growth and even dislocation of the economy in extreme cases.

### D. *Symbiotic Relationship Between Agricultural Cooperation and Industrialization*

Being inseparable partners in development, agricultural cooperation and industrialization should make it their paramount concern and obsession to know and understand each other better. It will perhaps considerably help the purpose if attention is focused on the symbiotic relationship between agricultural cooperation, on the one hand, and industrialization, on the other, wherein the specific inducements or benefits which one sector extends to and receives from the other are properly pinpointed and identified. This may well form the initial basic step in setting the stage for more enlightened thinking, a vital ingredient for the shaping up of a realistic and responsive program of intersectoral mutual assistance.

Two pertinent explanations have to be made at this juncture relative to the ensuing possibilities. In the first place it will be helpful to recall that in an earlier discussion particular mention was made of a number of specific benefits which agricultural cooperation can contribute to the economy as a development tool. In the subject discussion on this sectoral mutual relationship, essentially the same benefits are attributed to agricultural cooperation this time, however, directly and particularly addressed to industrialization. And in the second place, for purposes of clarity, the discussion is segmented into two complementary areas: (a) area of mutual support which includes concrete material economic benefits and (b) area of mutual understanding.

## 1. Area of Mutual Support of Economic Benefits

All the benefits or inducements involved in the symbiotic relationship between the two sectors are central to the whole task of development of both sectors. They are imperative as well as crucial factors for a vibrant agricultural cooperation and industrialization. This should heavily underscore once more the need for balanced and harmonious relationship between the two sectors.

### a. *Agricultural Cooperation to Industry*

Agricultural cooperation contributes to the growth and stability of the manufacturing sector in four ways: (a) it provides cheaper and better quality food and raw materials; (b) it generates foreign exchange; (c) it offers a wider and more organized market for manufactured products; and (d) it mobilizes savings to finance industrialization.

As discussed elsewhere, agricultural cooperation provides the farmers the opportunity to engage in the business and economic activities relative to production and marketing with maximum efficiency and economy. Thus, through agricultural cooperation, farmers can serve the requirements of food for consumption and raw materials for factories of the manufacturing sector with the following advantages: (a) the price is lower; (b) the quality is better; and (c) the supply is adequate and steady.

The agricultural sector also avails itself of agricultural cooperation in participating actively in the channeling of its produce to the export market. In this way, the foreign exchange position of the country is boosted considerably with the receipts from the exported products.

It is again mentioned that agricultural cooperation contributes to the increase of the income levels of the farmers. With a bigger real per capita income, the farmers' demand for manufactured products accordingly increases and so they constitute a wider and more organized market for manu-

factured products.

Finally, the agricultural sector represents a constant source of capital for the manufacturing industries. Income derived from such major agricultural crops as sugar, coconut, and rice are invariably used to finance the growth of the industrial sector. Agricultural cooperation affords the agricultural sector a convenient means by which the savings of the farmers can be mobilized and used for production purposes, including the establishment of more factories.

### b. *Industry to Agricultural Cooperation*

On the other hand, the industrial sector sustains the development of the agricultural cooperation, in particular, and the agricultural sector, in general, in the following manner: (a) provides cheaper and more efficient production inputs and farm tools and implements; (b) absorbs excess agricultural workers; (c) offers wider market for agricultural products; and (d) promotes technological consciousness.

Significant developments in the fertilizer industry are in the direction of (a) addition of micro-nutrients or trace elements in the fertilizers; (b) wide range of N-P-K formulation in compound fertilizers with the trend toward crop specialization; (c) mixing of selected insecticides and herbicide with fertilizers; (d) wider use of liquid fertilizer; and (e) improvement in physical texture particularly in granulated fertilizers. In the case of pesticides, which include insecticides, herbicides, fungicides, rodenticides, etc., continued advances are in the form of (a) increased factors of effectiveness and safety; (b) better toxicants, diluents and carriers; and (c) ease in handling and application characterized by the increasing preference for granules. Farmers have now a wider choice of farm machineries and equipment which are competing with each other in efficiency and in price. To be sure, great strides have been made in the areas of fertilizers, pest and disease control and other

cultural practices which, coupled with the discovery of high yielding and fast maturing seed varieties, are improving the complexion of agriculture in terms of increased productivity and production.

The important contribution of the manufacturing sector in increasing productivity and production is not limited to its role as supplier of said agricultural supplies and equipment. They have integrated with the sale of their products various forms of technical, research and extension services not only to enable them to have a better penetration of the market but also to update the farmers on the latest technological advances in the different phases of farming. They have under their employ technical men who go to the farm level to provide the farmers with all possible technical and farm management services. The suppliers also make effective use of demonstration farms where the farmers can see for themselves the benefits that can be derived from the adoption of sound farm management practices. They also disseminate to the farmers through various forms of publications latest results of research studies, technological innovations and other vital information for the guidance and information of the farmers.

As farm productivity and production rise, there will be a tendency for the labor force in a country to shift from the agricultural sector to the manufacturing sector. The manufacturing sector is looked upon to absorb the excess labor force in agriculture. This may indeed be considered a very important contribution of the manufacturing sector in neutralizing the problems of unemployment and underemployment. With this in mind, the marked preference of developing countries for labor-intensive industries over capital-intensive industries, for one, is understandable. And for another, the location of small-scale industries near the rural centers as against the establishment of big industries in the urban centers can be appreciated. Labor and

capital are the principal scarce resources allocated in the establishment of manufacturing industries. For purposes of opening employment opportunities for excess labor force in agriculture, developing countries favor the putting up of the so-called labor-intensive industries as an increase in the number of labor-intensive industries means more job opportunities. On the other hand, an increase in the number of capital-intensive industries is not necessarily accompanied by an increase in labor requirements but rather an increase in capital investment. Small-scale industries near rural areas facilitate the movement of displaced labor in agriculture from the farm to the factories and afford a more equitable dispersion of the labor force by obviating the over-concentration of the labor force in the cities.

Another important role of industrialization in the area of labor utilization in developing countries, aside from absorbing surplus labor in agriculture, is to create job opportunities for the increasing labor force of a country as a result of population growth. This important subject can of course be discussed only in passing.

In the same way that higher per capita income in the agricultural sector creates more demand for and consumption of manufactured products, the increase in income levels in the manufacturing sector chain-reacts in the form of more demand for and consequently increase in consumption of agricultural products. In most developing countries, around 50 per cent of the income is spent on food. On the basis of this observation, the growth of industry which means additional wages and income, results among others, in the establishment of new and bigger markets for the sale of food and other products by agricultural cooperatives.

By and large, the industrial sector is far advanced than the agricultural sector in making full use of science and technology in the various fields of endeavor. The many outstanding dev-

elopments in the industrial sector in terms of improved goods and services through the adoption of technological innovations are effective catalysts in inducing agricultural cooperation and the agricultural sector as a whole to follow the example set by the manufacturing sector by availing itself of modern technology to improve the posture of agriculture and agricultural cooperation. To the extent that the manufacturing sector influences the adoption by agricultural cooperation of agricultural technological advances, the manufacturing sector has a valid contribution in the modernization of agricultural cooperation and agriculture.

## 2. Area of Mutual Understanding

Hand in hand with mutual support, mutual understanding is an essential ingredient in drawing closer together agricultural cooperation and the manufacturing sector. It is desirable that a responsive and enduring communication link should be established between the two sectors that will allow a free and liberal two-way flow of information.

In the main, it appears that much headway has been made in creating a better climate of sectoral understanding. Where before the two sectors are far apart not only in distance, but also in thinking, today they view each other with more interest and concern. There is no doubt, however, that the efforts along this line have barely scratched the surface. Indeed, agricultural cooperation and industry are both rich in complexities that it will take some time before they can sufficiently understand each other.

For its part, agricultural cooperation throughout the world has continuing cooperative education and information program designed to give proper enlightenment to all segments of society of the principles and techniques of agricultural cooperation. In fact, promotion of cooperative education is considered a must in agricultural cooperation that it is indeed one of the

principles of cooperation itself. The different countries' cooperative education programs receive tremendous boost in various forms from international agencies foremost of which is the International Cooperative Alliance (ICA).

Aside from the ICA, excellent cooperative materials are published and distributed by (a) International Labor Organization (ILO) in Geneva, Switzerland; (b) Food and Agriculture Organization (FAO) in Rome, Italy; (c) American Institute of Cooperation (AIC) in Washington, D.C.; (d) Cooperative League of the U.S.A. (CLUSA) in Chicago, U.S.A.; and (e) Plunkett Foundation for Cooperative Studies in London, England.

On the other hand, it is encouraging to note that many concerns in the manufacturing sector have taken the initiative in taking a closer look at agricultural cooperation and the economic and social conditions in the rural areas. Their interest is generally centered on the problems and needs of the farmers. These studies and observations have resulted in their involvement, either on their own or as principal company agencies, in agricultural cooperation, in community development projects, and in other socioeconomic action programs which, in general, are designed to improve the living conditions in the rural areas.

The experience of the Philippines in this regard is of particular interest. A group composed of the biggest industrialists in the country decided to translate into concrete terms their concern for the welfare of the farmers in the rural areas. They formed the Philippine Business for Social Progress or PBSP, through which they, as a group, can channel their assistance to the rural areas. Funded out of contributions of individual industrial firms equivalent to 1 per cent of their net income, the PBSP is now actively financing selected community development projects and is giving fruition to the desire of the industrial sector to contribute its share in creating a better economic and social environment for the farmers.



While assistance of this nature is largely directed to the agricultural sector in general and not particularly to agricultural cooperatives, it is a fact that the beneficiaries are the farmers themselves, the same group that agricultural

cooperation seeks to serve.

The emerging picture is a healthy indication of the growing consciousness of the sectors in welding their thinking and efforts into one solid cohesive force.



**CHAPTER II**

**THE GOVERNMENT  
AND COOPERATIVES DEVELOPMENT**



## CHAPTER II

# THE GOVERNMENT AND COOPERATIVES DEVELOPMENT

*The ICA and ILO declarations on the highly controversial issue of the role of the government in cooperatives development may be summed up: the government should assist and encourage but not manage and control the cooperatives. In this regard the government efforts seem to be characterized by some disturbing trends and tendencies which penetrate deeply into the very core of cooperative democracy, the essence of cooperation. The delicate situation strongly demands the setting up of well defined spheres of responsibility of the government and cooperative sectors to the end that their activities will not be at cross purposes with one another.*

The development of cooperatives in almost all countries in the world is governed by specific cooperative laws or statutes of the state. The United Kingdom set the pace in placing cooperatives development under the aegis of the law when the British Parliament enacted what is recognized as the first cooperative law in the world — the “Industrial and Provident Societies Act of 1852.” This was of course eight years after 1844, the year the first successful cooperative society in the world, the infamous Rochdale Society of Equitable Pioneers, was organized in Rochdale, England. This memorable event consequently earned for the United Kingdom, specifically England, the denotation of being the “cradle” of the cooperative movement in the world.

Since 1852, almost 5,000 cooperative legislations have been promulgated in different countries in the world. Understandably, the cooperative statutory provisions vary from one country to another. This is because the cooperative law necessarily has to be attuned to a number of factors or

conditions obtaining in a country. The most pertinent of them may be mentioned: (a) the type of government; (b) customs, traditions, history and culture; (c) kind and level of economy; (d) cooperative aspect of the goals of development; (e) the stage of cooperatives development; and (f) the degree of understanding of and belief in co-operation of the policymakers.

### I. BASIC PREMISE

Under the thesis that while it is true that cooperatives, by their very nature as voluntary organizations sprout from and properly belong to the private or non-government sector of the economy, it is equally true that the government has a share and responsibility in cooperatives development. Consequently, it is a conventional practice in developing countries to look upon a country's cooperative movement as being composed of two sectors, namely: (a) the cooperative or voluntary sector and (b) the

government sector. Inasmuch as both the government sector and the cooperative sector belong to just one and the same co-operative movement, it is assumed and expected that their relationship shall always be motivated by a common purpose.

The development of the cooperative movement, however, has been attended by clashes of opinions and views over a wide range of issues. One of the most controversial and divisive issues pertains to the specific role that the government should play in the development of cooperatives. This issue has perhaps sparked, and continues to spark, more controversy between the two sectors of the movement more than any other.

On the part of the government sector, there are actually two schools of thought anent the issue, namely: (a) restricted or limited government involvement and (b) unrestricted government participation. On the other hand, the thinking in the cooperative sector may be categorized into three, namely: (a) no government intervention whatsoever; (b) restricted government involvement; and (c) unrestricted government participation.

The purpose of the ensuing discussion is to pinpoint and establish some possible areas of working relationship that will serve as common avenues for the effective channeling of efforts and resources by both sectors.

## II. GUIDING CONCEPT

### A. Policy Statements

#### 1. The ICA and ILO Declarations

The first authoritative common frame of reference in the involvement of the government in cooperatives development was provided by the International Cooperative Alliance (ICA) in the form of a declaration at an international meeting in Lucknow in 1949, to wit:

“The role of government in relation to co-operative societies should be one of active helpfulness,

intended to stimulate co-operative enterprise, to guide it and keep it on sound lines without either attempting to compel or to replace local initiative or self-help. Government should in addition promote conditions under which co-operatives will thrive and develop.”

On its part, the International Labor Organization (ILO) at its General Conference in 1966 under Resolution No. 127 entitled “Cooperatives (Developing Countries) Recommendation, 1966” came out with the following declaration:

“ . . . governments should formulate and carry out a policy under which cooperatives receive aid and encouragement without effect on their independence. . . ” and “. . . each aid should not entail any obligations contrary to the independence or interests of cooperatives and should be designed to encourage rather than replace the initiative and effort of the members.”

The foregoing declarations of the ICA and ILO taken together constitute what is widely considered the ideal policy relative to the sectoral collaboration of efforts for the progressive and stable development of the cooperative endeavor. Viewed in its proper perspective, the policy affirms that the government has a definite role to play in extending aid, assistance and encouragement to cooperatives but in the process the government is cautioned against trampling upon cooperative democracy, the very essence of cooperation, by preserving at all times the autonomy and democratic nature of the cooperatives. In fine, the policy conveys a firm and clear message: the government should only *assist* and *encourage* but not *manage* and *control* the cooperatives.

#### 2. Pertinent Views of Renowned Co-operators

To further clarify the issues involved, it will perhaps do well to share the views of eminent co-operators.

Dr. M. Bonow, former ICA pres-

ident, contended that:

“ . . . it is absolutely essential that the long-term objective of making the cooperative movement an independent and autonomous one is kept constantly in mind. We would have mistaken the casket for the gem if we were to perpetuate an arrangement whereby the initiative and the democratic character of the cooperative movement would be impaired.”

Dr. Bonow deduced that:

“In the ultimate analysis it is the vitality of the people of a country which determines progress. Legislations, especially cooperative legislations, should provide the framework with which people’s capacity to bring about the desired change is enhanced. If the net result of legislation is to thwart this tendency, I am afraid, we would have done more harm than good.”

On the other hand, Herbert Waters commented:

“Governments all over the world recognize cooperatives not as ends in themselves but as a means of helping people to grow and mature, to improve their living, and to strengthen their freedom and independence.”

Concluding his commentary, Waters declared:

“Thus the government’s role is that of catalyst, coordinator, arbiter, and watch-dog to help the cooperatives achieve the lofty goals the people have set for themselves. The end product is not accumulation of learning but bringing the great number of neglected and forgotten people together to become a genuine force in the nation’s economic development.”

Another respected cooperator, Sir Malcolm Darling, commenting on the recommendations for partnership between the state and cooperatives in the All India Rural Credit Survey Report said:

“To raise an even more funda-

mental question, how will self-help and mutual help fare with so much done for the members by the government? Are they not only too likely to wilt or even be crushed under the weight of the proposed state structure? It is intended that the government should gradually withdraw from partnership as societies gradually become more competent to manage their own affairs; but, as India knows, it is never easy to persuade those in authority that the time has come for withdrawal, still less easy to get employees to train others to take their places. For myself, who always felt that societies should eschew financial aid from government since government helped them in so many other ways, I could wish that rural credit societies could be left to work out their own solution with, however, a larger or better trained staff to help them. . . .”

### *B. Cooperative Democracy Briefly Discussed*

Cooperative democracy is indeed the principal keyword in the participation of the government in the cooperatives development program. Consequently, it is axiomatic that there should be a thorough understanding of what cooperative democracy *means and how it works*.

In a real sense, cooperative democracy is a comprehensive and complex subject. It is certainly beyond the purview of this discussion to treat the subject extensively and completely. It will, therefore, suffice to dwell merely on the most basic aspects of cooperative democracy.

In a paper submitted to the 24th ICA Congress in Hamburg in 1969, Messrs. Roger Kirenc and Nils Thedin postulated that “democracy is the very essence of cooperation.” Mr. A.P. Klimov of the U.S.S.R. bolstered this assertion by stating that “. . . if this essence ceases to exist, cooperation dies or is degenerated.”

In the main, the meaning of cooperative democracy and how it works are

spelled out in the first and second cooperative principles adopted by the ICA Congress in 1966, both of which are here quoted in full:

1. Membership of a co-operative society should be voluntary and available without artificial restriction or any social, political or religious discrimination, to all persons who can make use of its services and are willing to accept the responsibilities of membership.

2. Co-operative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in a manner agreed upon by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.

The discussion of cooperative democracy within the context of the two aforementioned cooperative principles will be centered on (a) membership participation and (b) democratic administration.

### 1. Membership Participation

The members form the principal cog in the machinery of cooperative democracy and the efficient working of the said cooperative democracy machinery is in direct proportion to the members' interest and involvement in the affairs of their cooperative. In this sense, it can be rightfully said that cooperative democracy proceeds from the fact that "a person who joins a cooperative should do so voluntarily in full exercise of his autonomy" and that "the association of each member with the cooperative continues to be his free will and the individual autonomy of the member remains unimpaired. . . ." It is apparent that the autonomy of individual members is *sine qua non* to the democratic control of the cooperative by the members.

In the same report submitted to the

24th ICA Congress, Messrs. Kerinec and Thedin observed:

"a) The members must become aware, and to some appreciable degree, that the cooperative society is their business and that it is to their advantage to make full use of their democratic rights as members. Continuous education of members is thus a precondition to the existence of cooperative as a truly democratic movement.

"b) The greatest possible number of members must be sufficiently interested in their organization to acquire the minimum knowledge to read, understand and discuss the economic financial reports of the society and to assess its activities." Messrs. Kerinec and Thedin fittingly concluded:

"Basically, the cooperative is an association of people. It is entirely possible that such an association could continue for a long time without the active participation of the members in the democratic status of the society. But in the long run, however, the participation of the members is the sole guarantee that it will remember its ultimate goals and will not have an end in itself. As with life itself, democracy is a permanent creation and the least inattention will damage it. As for indifference to it, this attitude is fatal to it."

### 2. Democratic Administration of Cooperatives

In its prefatory explanations of the principle of democratic administration or control, the 1966 ICA Commission on Principles took special pains to give a clear and concise answer to the oft-repeated basic question: When can it be said that a cooperative is being administered in a democratic manner?

The reply to the question is provided by the ICA Commission on Principles itself:

"The primary and dominant purpose of a cooperative society is



to promote the interest of its membership. What the members' interests are in any given situation only they can determine. A cooperative therefore will not in the long run work well and prosper without agreed and efficient methods of consulting the members as a body and enabling them to express their wishes. Moreover, since it is the members who bring a cooperative into existence and whose constant adhesion and support keeps it alive, those who administer its affairs and, in particular, conducts its day-to-day business must be chosen directly or indirectly by the members and enjoy their confidence. It follows further that the administrators and managers are accountable to the members for their stewardship, report regularly in a business-like manner to the members' judgement. If the members are not satisfied, they have the authority and the power to criticize, to object, and in extreme cases, to dismiss and replace their officers and officials."

In brief, democratic administration of a cooperative has two fundamental requisites:

1. There must be a two-way channel or flow of communication between the members of the cooperative and its management and
2. The power to appoint and dismiss officials and employees, whether directly or indirectly, must be vested in the members.

The development of cooperative societies along accepted democratic lines demands strict adherence to the celebrated cooperative practice of "one member, one vote." This practice presupposes the equal status of human beings that compose a cooperative society giving the members equal rights and representation in their participation in the affairs of their cooperative.

Primary societies whose membership is made up of individual persons observe the "one member, one vote" practice without exception. However,

in the case of overhead organizations whose membership vary as to kind (individuals or associations) and as to size, it is recognized that it is not possible to apply strictly the "one member, one vote" manner of voting. Such organizations administer their affairs in a democratic manner through the adoption either singly or in combination of the following recognized acceptable bases of representation: (a) individual associations; (b) size of membership in associations; (c) amount of capital contribution; and (d) volume of transaction or patronage.

Commenting on the various practices being resorted to by overhead organizations with regard to the manner of voting other than the "one member, one vote," the 1966 ICA Commission on Principles stated:

"It does not appear, however, that these departures from the strict rule of equality of persons have yet led anywhere to a distribution of voting power radically different from that which would have been made on a membership basis, and, from a practical angle and in the light of experience, they may represent a necessary or desirable concession for the sake of unity, equity or efficiency or any combination of these . . ."

The Commission also made this significant observation on the need of giving complete autonomy to the management of cooperative organizations:

"There is no doubt in the minds of the Commission that democracy in the management of co-operative organizations necessarily implies autonomy in the sense of independence of external control, apart from the obvious obligation of cooperative societies to bow to the same general laws as all other business undertakings and accept the discipline imposed by the State or the planning authorities. In a fully developed cooperative unit the

management must rest in the hands of the members and all decisions must be taken by the cooperators themselves, with no external influence. Autonomy is therefore a corollary of democracy.”

### III. SOME TRENDS AND TENDENCIES IN GOVERNMENT INVOLVEMENT IN COOPERATIVES DEVELOPMENT AND THEIR IMPLICATIONS

It would seem desirable at this stage to bring into sharp focus some detailed accounts of the various ways by which the governments of some countries have assumed their role in cooperatives development. For the purpose of this discussion, it is deemed preferable to cite in general the experiences of the Asian countries without referring to any particular country.

The discussion is segmented into two specific areas: (a) area of cooperative legislation including policy formulation and (b) area of program implementation.

#### A. *Area of Cooperative Legislation, Including Policy Formulation*

##### 1. **Promulgation of More Stringent Cooperative Laws**

It is the general consensus that there is an unmistakable tendency in most developing countries to promulgate more stringent and rigid cooperative laws and for governments to assume broader and broader powers of regulation and control of cooperatives.

In this regard, Mr. P. Weeraman, a noted cooperative leader from Sri Lanka, eloquently contended :

“Laws which vest the final decision in regard to certain financial and administrative matters in a government official and give powers to the government official to nominate directors and supersede boards

of management, may, even impose by-laws on the cooperatives, nullifying the very principles of cooperation, the presence of government officials as the executives of the society, all these tend to create inattention and indifference to the ideal of cooperative society. The legal limitations imposed on cooperative democracy are understood by the common man to be correct as the law is generally assumed to be correct. The inattention and indifference to cooperative principles shown by the law itself and by those whose function it is to be promoters and advisers of the movement, but who actually manage and control it, must surely permeate among the cooperators and even more among the public at large, in countries where the movement has been fostered by the government. This indifference all stems from the failure of the government to recognize that fostering the cooperative movement means promoting democratic institutions based on Cooperative Principles.”

Weeraman contended further that:

“Governments often lay down rules on matters that should be dealt with by the members themselves. To legislate to ensure the observance of cooperative principles is one thing but to lay down internal disciplines by law is another. Even provisions which are *per se* healthy for a cooperative society’s internal management becomes regimentation when they are laid down from above. When they are adopted by the members of their own free will, as their by-laws or working rules, they become internal disciplines of great moral value. Such internal disciplines result in material benefits as well, and so, ‘by a single notion cooperation raises the people’s standards materially as well as morally. If it failed in its moral task, it would also fail in its economic one’ (Fauquet). When internal disciplines are laid

down by the law of the land or any outside authority, they offend against the autonomy of the members and of the society. As has been pointed out, this autonomy is a corollary of cooperative democracy.”

In fine, this trend, which is alarming indeed, tends to reduce instead of increase the room for the unimpeded development of cooperatives as autonomous and independent democratic institutions. In addition, it abets instead of rectifies, the existing harmful misconception that cooperatives are government institutions or agencies, which actually they are not.

## 2. Planning and Organizing from Top to Bottom

The foreword to the Indian edition of the *Report* of the 1966 ICA Commission on Principles maintained that in the developing countries, the members of most cooperatives “are like the passengers of a train using it only when it becomes necessary to do so for their own individual purposes; the running of the train is not their business. This is what must inevitably happen when planning and organizing come from the top. No movement can grow from the top downward; least to the cooperative movement, for voluntary membership and democratic control are of the essence of the cooperative system.”

Government planners in most developing countries have of late exhibited keen interest and enthusiasm in giving cooperatives prominent and important roles in the government programs of development. It is hastily added, however, and this is actually the burden of the discussion, that as a general rule they work out cooperative plans and programs within the narrow confines and convenience of their offices — a typical case of planning from the top. Complacent and confident in their belief that they know the needs and problems of the cooperatives better than the members of the cooperatives themselves, most government planners usually go about their task without the

benefit or even a semblance of consultation with the cooperative sector. Such a government-initiated cooperatives program, observations in many developing countries show, aside from being understandably grandiose and optimistic, are inclined to take into consideration only the potentialities of cooperatives to the exclusion of their possible limitations.

This is not to say, however, that the planning of the cooperatives development programs from top to bottom is completely devoid of attendant benefits. The development programs of the government are a tacit recognition of cooperatives as vital and viable institutions for socioeconomic uplift. In the second place, such government-sponsored programs normally provide a package of financial and technical support that the government is in essence committed to channel to the cooperatives.

On the other hand, at least two adverse implications of planning and organizing the cooperatives program from the top may be cited. Firstly, it is the consensus that the initiative of the members to develop their cooperative into a self-reliant and independent organization is vitiated and severely dampened when the cooperatives program is made at the top and merely handed down to them for implementation. It is but fair and logical that the members should be consulted and made to participate in the framing of a plan that concerns them most and which can only succeed with their full support and cooperation. Secondly, planning and organizing from the top spawns confusion on the question of ownership of the cooperatives, particularly those overhead organizations which are actually creations of the government and are therefore for all intents and purposes government agencies. Such misconception in the minds of the cooperative members on the real identity of cooperatives is unhealthy and is bound to retard the growth and development of cooperatives.

## **B. Area of Program Implementation**

### **1. Setting of Unrealistic Target Objectives in Government-initiated Cooperatives Program**

Government planners are known to have developed a high degree of propensity in setting up too ambitious and unrealistic target objectives in cooperatives program in their desire that said cooperatives program will make a dramatic impact on the public in general. A common feature of cooperatives program is the usual quantification of target objectives using as standard criteria: (a) number of cooperatives organized; (b) amount of capitalization; (c) number of members; (d) amount of loans granted; (e) volume of business; (f) geographical coverage; and (g) frequency of training of officials and employees. Being too ambitious and consequently off-target, the objectives set forth soon appear quite hard if not impossible to attain. The attendant time pressure to reach the set goals then opens the floodgates for shortcut or crash program schemes, resulting invariably in the complete derailment of the program. Records of a long list of cooperatives which went out of existence as fast as they were organized are eloquent testimonies of failures to observe the fundamental tenet that cooperatives development is and must necessarily be a slow and gradual process.

### **2. Appointment of Cooperative Directors and Cooperative Managers**

In practically all developing countries, the government's cooperative office is empowered to nominate the directors of the boards of directors as well as to appoint cooperative managers. One of the government-nominated directors invariably becomes the chairman of the board. This practice is considered the most glaring example of the pronounced tendency of the government to control the cooperatives. This almost standard practice is parti-

cularly prevalent in the case of overhead organizations especially during the initial stage of their operations.

The justifications usually advanced for this arrangement are (a) the government nominees and appointees are in a position to extend management expertise and experience which cooperatives utterly lack and (b) the government nominees and appointees can effectively supervise the disposition of the financial exposure of the government in a cooperative.

While at first glance, the practice seems to be logical and sound, there is preponderant thinking that it needs to be fully reexamined in the light of its disturbing implications on the very essence of cooperative democracy. For example, it is contended that for the government to nominate the members of the boards of directors alone is tantamount to its assumption of complete control. This becomes even more complete in cases where the cooperative managers are appointed by the government. Under such a situation, since the cooperatives are for all intents and purposes under the control of the government, the opinion becomes persistent that it will just be placing things in proper order if such cooperatives are converted into government agencies or, that what should have been organized are purely government agencies with provision for gradual conversion into cooperatives. The government, in this particular case, will actually be doing a great service to the cooperative movement if the camouflage of those cooperatives be removed so that their true and real identity will be revealed.

The late Indian Prime Minister Jawaharlal Nehru came out with the following strong-worded observation in this regard :

“. . . nothing can be more fatal than government control, which is the embrace of death and I want to emphasize that there is no doubt about it. . . I will repeat, I will go on repeating, I dislike the association of government in cooperation

except as an agency helping raise funds, etc. . . It is really a way of life, and a way of life which is certainly not a capitalistic way of life and which is not a hundred percent socialist though it is much nearer socialism than the other."

With regard to the assertion that the government nominees or appointees will be able to impart to the cooperatives much needed management know-how and experience, there is a long list of cooperators who hold a contradictory view. They are quick to point out that the government itself has a severe scarcity of such resources and has never been known to be ever a prolific source of them. In fact, in many instances, it has been observed that the officials who come from the cooperatives themselves are better prepared to tackle their jobs than those coming from the government.

On the discharge of the function of "watch-dog" of government funds infused in cooperatives, there is a strong belief that closer supervision of cooperatives will serve the purpose of checking the proper use of government funds and is indeed perhaps a better alternative to the appointment of government officials in the management of cooperatives.

It is interesting to note that even the ICA Commission on Principles of 1966 expressed its own reservation on the subject arrangement:

"But if governments provide or guarantee large loans or take out large holdings of share capital they will insist on checking the use which is made of public money and as satisfying themselves that proper technical advice is being taken and due financial prudence exercised. Government may therefore ask that its representatives shall sit on boards of management for a time, not with power to veto, but to make sure that the aid provided is utilized in the way in which it was originally intended. The important consideration is that the government repre-

sentative shall not continue to sit a day longer than is necessary. The more successful a cooperative is, the more likely are the members to conceive the ambition of regaining independence of government supervision and work to achieve it."

### 3. Purchase of Share Capital

Some governments resort to the practice of extending financial assistance to cooperatives by purchasing share capital. In such a case, the government is usually allocated seats in the board of directors of the cooperative concerned, invariably that of chairman of the board.

These complementary moves of the government are open to suspicion. It is felt that the government buys shares of stocks of a cooperative only as a means to justify and render more acceptable its real motive of being represented in the board of directors.

In brief, the government extends financial assistance to cooperatives in two general forms, namely: (a) as loans and (b) as capital investment. A specific type of relationship between the government and the cooperative then emerges depending on the form of financial assistance extended. Financial assistance in the form of loans gives rise to a creditor-debtor relationship which actually treats the government and the cooperative as two separate and independent institutions. On the other hand, when the financial assistance is used to purchase share capital, the resulting relationship is one of stockholder of the cooperative. In which case, there is a fusion of the interests of the government and that of the cooperative. Premised on the assumption that the appointment of government representatives in the board of directors is more likely to be looked upon as a fair proposition, it would be logical to assume, therefore, that the government will be more inclined to consider the purchase of share capital as a better and preferable scheme than the extension of financial assistance in the form of loans.

For purposes of clarity, discussion should therefore be focused on two issues: (a) qualification of the government for membership in a cooperative and (b) propriety of vesting the government the right to appoint cooperative directors, particularly the chairman of the board. For purposes of a meaningful assessment and evaluation of the issues, it should be necessary to treat them within the context of the cooperative principles on membership and democratic administration or control.

Referring to the cooperative principle on membership, it should be emphasized that membership in a cooperative is open "to all persons who can make use of its services and are willing to accept the responsibilities of membership." When the government buys shares of stock of a cooperative, it becomes *ipso facto* a member of that cooperative. As a matter of practice, the requirement that a member-applicant should purchase at least one share of stock of the cooperative is actually contingent upon meeting the first two basic requisites for membership: firstly, that the member-applicant can make use of the services of the cooperative and, secondly, that he is willing to accept or assume the responsibilities of membership. When the government is therefore allowed to purchase share capital of a cooperative, making it an *ipso facto* member of the cooperative, it is assumed that the government can make use of the services of the cooperative as well as accept the responsibilities relative to membership. Otherwise, if the government is not in a position to comply with these, then its eligibility for membership is in question.

In this regard, it will be realized that while the government can easily claim that it is willing and prepared to assume the responsibilities that go with membership in a cooperative, its eligibility for membership based on whether or not it is in a position to support the services of the cooperative poses more of a problem, and is vulnerable to question. This is because while the willingness to accept the responsibilities of

membership is a matter of attitude, the issue of whether or not it has a need for the services of the cooperative is a question of facts.

It should however be emphasized at this juncture that the usual blanket allegation that governments are not eligible for membership in cooperatives since they definitely cannot use the services of the cooperatives appear not to tally with facts. To cite a few examples, the government can possibly utilize the marketing services of cooperatives in the distribution of essential products. Likewise, the government can avail of the services of consumers' cooperatives in the sale and distribution of prime commodities. It is therefore out of focus with the real facts to make a sweeping and massive allegation that the governments are not in a position to use the services of cooperatives and are therefore not eligible for membership therein.

There are of course valid observations that in some instances some governments have no use for the services of cooperatives from which they managed to purchase share capital. It is in such instances where it can be said that there is an open and flagrant violation of the cooperative principle of membership. Under the situation, the cooperatives involved lose their character as democratic institutions and are converted in fact into mere government fixtures or agencies.

The second issue, that is, on the propriety of giving the government the right to appoint cooperative officials or employees, is considered more complex and delicate and falls back squarely on the cooperative principle of democratic administration or control. The logic of the government in this particular issue is developed along the following lines: that the government owns interest in the cooperative in the form of share capital; that it is incumbent on the government to protect its said interest in the cooperative; and that in order to be able to effectively protect its interest, the government should be represented in the board of

directors and the hired management, and finally the government should have the right to name a man of its own choice to assume said positions.

Outspoken critics come out with the interesting and very relevant observation that the said logic of the government is untenable and a classic case of a wrong conclusion based on an equally wrong premise. The bone of contention is that from the standpoint of cooperative democracy, the ownership by the government of shares of stock of a cooperative should not carry with it the right to appoint cooperative officials and employees. As a member of a cooperative, the government, it is contended, should enjoy the same rights as the other members with respect to the election of cooperative directors. And more to the point, it is imperative that the government should be the first one to bow to and observe the rules and regulations of the cooperative and should be the last one to aspire for a favored treatment. In essence, the exercise by the government to appoint cooperative director as well as cooperative managers is apt to foment discrimination and draw a wedge in the membership in the process creating two classes of members in the cooperative: a first or special class to which the government belongs and a second class of members to which all other members are categorized. Cooperative democracy certainly does not contemplate the adoption of a double standard of membership in a cooperative thereby creating more than one class of membership. But rather it stands solid for an association of human beings enjoying equal rights.

Furthermore, for the government, especially if it has no use for the services of a cooperative, to back up the use of right to appoint cooperative directors and cooperative managers merely on the basis of the purchase of share capital is for it to argue against the fundamental concept of the dual role of the members as owners and users of the cooperative. It would in effect place the interest of a member-user subservient to that of a mere

member-owner. On the other hand, attempts to justify such an arrangement by citing the substantial holdings of the government in a cooperative is not valid. To do so, will only expose its lack of understanding and appreciation of the basic fact that in a cooperative the power of control should reside in the members as individuals on the basis of who they are and not on what they have.

#### 4. Utilizing Cooperatives for Special Government Programs

Many governments utilize cooperatives as principal implementing agencies of special programs in the nature of price support, subsidies, distribution of controlled items, and the like. In fact, some governments are known to go even to the extent of organizing cooperatives for the sole purpose of carrying out such government special projects.

Some serious implications of this arrangement arising out of the peculiar nature of the government's special programs result. In the first place, the said projects, except possibly for a few, are not cooperative in nature in the sense that they are not intended to serve only the members of the cooperative but the public in general. Consequently, a new orientation which is completely different from that of a cooperative is introduced. In the second place, the very nature of said projects, as is well recognized, usually offers vast opportunities for the commission of irregularities.

Another serious implication, this time arising out of the cooperative's desire to take advantage of the tremendous income-producing potentialities of a project, is that the said motivation is bound to change the posture of a cooperative from that of service-oriented to a profit-oriented organization. This tendency is of course capable of creating more complications of equally serious proportions in instances where cooperatives are organized solely for that purpose. For one, the coopera-

tives are organized not out of the needs of the members as should be the case but that of the government. For another, such cooperative, as has been previously stressed, will in all likelihood be branded as a government agency.

To escape being exposed to such serious problems with all their harmful implications, some cooperatives wisely see to it that such government programs are cooperative in nature and are not prone to irregular transactions. Otherwise, they refrain from participating in the special government programs even if it means losing the opportunity to generate more income for their cooperatives.

#### IV. DISTRIBUTION OF SPHERES OF RESPONSIBILITIES: A SUGGESTED PATTERN OF APPROACH

Thus far, several pertinent facts emerge out prominently in the discussions. The first involves the establishment of the basic premise that government aid and assistance are necessary in the development of cooperatives into viable socioeconomic vehicles of service. The second spells out the main guiding concept under which said government efforts should be channeled to the cooperatives with particular emphasis on the need to preserve at all times the workings of cooperative democracy. The third impresses on some apparently controversial practices which most governments have resorted to in carrying out their mission of assistance to the cooperatives.

The sectoral delineation of responsibilities in accordance with the suggested pattern of approach is outlined as follows:

##### *A. Exclusive Areas of Responsibility of the Government Sector*

###### 1. General Scope

Cooperative legislation, regulation and supervision.

###### 2. Specific Activities

This involves:

- (a) proper enforcement of cooperative laws and regulations;
- (b) close supervision of cooperatives to ensure that they operate in accordance with their articles of incorporation and bylaws and within the context of cooperative principles;
- (c) registration and liquidation of cooperatives;
- (d) auditing of cooperative transactions; and
- (e) prosecution of erring cooperative officials and employees.

##### *B. Exclusive Areas of Responsibility of the Cooperative Sector*

###### 1. General Scope

Organization, management and operation of cooperatives.

###### 2. Specific Activities

This includes:

- (a) framing and adoption of articles of incorporation and bylaws;
- (b) election of officials;
- (c) appointment of employees;
- (d) management of business operations; and
- (e) disposition of savings or surpluses.

##### *C. Areas of Responsibility of Both Government and Cooperative Sector*

###### 1. General Scope

Covers all other pertinent phases or aspects of cooperatives development with each sector assuming varying degrees of responsibility.

###### 2. Specific Activities

This deals on:

- (a) financing;
- (b) cooperative education and information;



(c) training of officials and employees;

(d) provision for technical and management services; and

(e) formulation of policies and programs on cooperatives development.

Understandably, the foregoing suggested guide is outlined in broad and general terms as well as limited to the most essential activities. However, it is firm enough to provide sufficient bases for the proper identification and orchestration of the various forms of involvement of the government in cooperatives development.



**CHAPTER III**

**COOPERATIVE MANAGEMENT  
AND ORGANIZATION POLICIES  
AND PROCEDURES**



## CHAPTER III

# COOPERATIVE MANAGEMENT AND ORGANIZATION POLICIES AND PROCEDURES

*The validity of the supposition that the proper organization of a cooperative is a condition precedent for its sound management is thoroughly re-examined from the viewpoint of the practitioners of cooperative management. Experience clearly shows that the initial activities of the management of cooperatives are invariably directed toward the rectification of organizational defects. Some basic organization policies and practices are flashed back: (a) proper understanding of the cooperative principles; (b) strict adherence to the "bottom-up" method of organizing cooperatives; and (c) right choice of the type of cooperative corporation.*

### I. CLOSE TIE-UP BETWEEN ORGANIZATION AND MANAGEMENT

A fundamental assumption in cooperation is that its proper organization is a basic requisite to its sound management. In other words, proper organization is *sine qua non* to sound management. And conversely stated, the assumption is that in order that a cooperative may be managed successfully, it is necessary that the cooperative must in the first place be organized in strict conformity with the firmly established and accepted policies and procedures.

It is felt, however, that this link between the proper organization of a cooperative, on the one hand, and its sound management, on the other, should be thoroughly discussed and reexamined this time from the standpoint of the active practitioners of the management of cooperatives. This is because the management of

a cooperative stands to feel the initial adverse impact and experiences the greatest difficulty in rectifying the ill-effects of an improperly organized cooperative.

A point that should be reemphasized in this regard is that the members play a major role in the management of a cooperative.

A very relevant fact therefore emerges at this juncture — that is, the management of a cooperative is not only created by the members but perhaps more important, the kind or quality of the management of a cooperative is determined by the members. This direct and positive relationship between the quality of the members, on the one hand, and the quality of management, on the other, can be better visualized if viewed under two contrasting situations. In the case for example of a fully enlightened membership, the chances are they will elect among themselves qualified and competent members of the board of directors who in

turn can be expected to appoint also qualified and competent employees. On the other hand, take the case of a not fully enlightened membership. In all likelihood, they will elect among themselves unqualified and incompetent members of the board of directors who in turn will most likely appoint employees who are likewise unqualified and incompetent. Thus the whole complexion of the management of a cooperative, that is, whether it will be strong or weak is clearly reflective of and depends on the quality of the membership.

However, it is not enough that the members should be prepared and conditioned into becoming active and devoted owners as well as users of their cooperative. In addition there should be a suitable organizational framework that will give proper direction and thereby maximize the combined thinking and efforts of all concerned. This is another element that should be present in any cooperative that will make way for its sound management.

From the very start therefore the efforts of the management of a cooperative are normally diffused on two distinct and separate fronts, any of which is a man-sized job, namely: (a) the rectification or correction of organizational deficiencies and (b) the performance of business activities. What is particularly disturbing and rather unfair or unjustified about the whole thing is that while the performance of the business activities of a cooperative is really the principal job and responsibility of the management, the rectification of whatever shortcomings there are in the organizational phase is a job that usually consumes the greater portion of the time and efforts of the management.

Against such a background, certain basic guidelines for a more effective organization of cooperative are presented and discussed. In the main, the discussion will touch on the following basic guidelines for the organization of cooperatives: (a) proper understanding of the cooperative principles; (b) strict adherence to the "bottom-up" method of organizing cooperatives; and (c) right choice of the type of cooperative corporation.

## II. BASIC GUIDELINES FOR THE ORGANIZATION OF COOPERATIVES : PROPER UNDERSTANDING OF THE COOPERATIVE PRINCIPLES

The cooperative principles constitute the solid foundations of cooperation. Shed off the principles, cooperation is not cooperation.

To date, the most important documents in the evolution of cooperative principles are (a) the 1844 "Laws and Objects" of the Rochdale Society of Equitable Pioneers; (b) the 1937 formulated cooperative principles of the ICA; and (c) the 1966 reformulated cooperative principles of the ICA.

The "Laws and Objects" which represents the first set of written cooperative principles in the history of cooperation was fathered and handed down to the cooperative world by the infamous Rochdale Society of Equitable Pioneers in 1844. The text of the "Laws and Objects" which also includes extracts of amendments made and registered on 7 August 1845 is presented in full in Appendix A.

The ICA came out with its first version of the cooperative principles in 1937. In its Congress held in Paris during said year, the ICA formulated the following cooperative principles:

### A. Primary Principles

1. Open membership
2. Democratic control
3. Dividends on patronage
4. Limited return on capital

### B. Secondary Principles

5. Political and religious neutrality
6. Cash trading
7. Promotion of education

However, in order that cooperation can keep up with its dynamic nature in the wake of the fast changing world, the ICA decided to reexamine the cooperative principles it formulated in 1937. This effort culminated in Vienna in 1966 when the ICA Congress then convened approved the reformulated set of cooperative principles

as recommended by the institution's Commission on Cooperative Principles.

The following discussion of the cooperative principles is centered on the 1966 ICA reformulated principles which are the ones currently being used universally. They are six and their areas of concern are: (a) membership; (b) democratic administration; (c) interest on share capital; (d) disposal of savings or surplus; (e) education; and (f) inter-cooperative cooperation.

## A. *Membership Principle*

### 1. **Statement of Principle**

The membership principle is quoted in full as follows:

Membership of a co-operative society should be voluntary and available without artificial restriction or any social, political or religious discrimination, to all persons who can make use of its services and are willing to accept the responsibilities of membership.

### 2. **Discussion of Principle**

It is by no mere coincidence that the first principle should deal on membership. A basic characteristic of a co-operative is that it is organized, owned, managed and controlled by those who will actually use its services. Thus the members constitute the principal figure and represent the most important sector in a cooperative. It is therefore but appropriate that the principle on membership should head the list of cooperative principles.

The membership principle, it will be realized, has particular reference to two vital aspects of membership, namely: (a) nature of membership and (b) acceptance of membership.

#### a. *Nature of membership*

The principle is emphatic that membership of a cooperative should be voluntary. This means that the decision to join a cooperative should be made by the potential member himself and no other. It is considered necessary that a potential member should join a co-

operative on his own volition and free will or accord since such an action presupposes full understanding of and belief in cooperation. One who was just forced or compelled to become a member of a cooperative naturally cannot be expected to give his wholehearted support and loyalty to the cooperative. Without membership support, no cooperative can possibly attain its objectives.

It is pertinent to stress that in no other organization has voluntariness been practiced more consistently and in the highest form than in cooperatives. For that reason, voluntariness has become a veritable by-word in and an indelible hallmark of cooperation that the term "voluntary" has been attached to the movement itself, thus the connotation voluntary movement for the cooperative movement. In like manner, the cooperative sector is often referred to as the voluntary sector.

#### b. *Requisites for membership*

The principle fully clarifies the meaning of and philosophy behind the so-called membership. It will be noted that while the principle seeks to remove such impediment for membership as "artificial restriction or any social, political or religious discrimination," it makes membership contingent on strict compliance with two requisites or conditions, specifically, a potential member should (a) be able to make use of the services of the cooperative and (b) be willing to accept the responsibilities of membership. Although the two aforementioned conditions set forth for membership can be interpreted to imply that membership of a cooperative is not completely open, the said conditions are actually built-in provisions for the setting up of two ingredients which are essential for strong membership support, namely: (a) a community of interest in the membership with the availment of services as the common denominator and (b) unqualified acceptance of the membership of their duties and responsibilities.

In this regard and viewed in its proper perspective, the membership

principle aims to forestall any possible misconception or abuse of the term "open membership" as cooperatives were, wittingly or unwittingly, inclined to do so in the past by interpreting it literally. The complete omission of the term "open" is precisely intended to foster the principle's correct and uniform interpretation.

### 3. Implications of the Principle

It is evident that the principle sets forth the democratic character of the cooperative and underscores the need of drawing into its fold as large a membership as possible. Under this premise, certain significant social and business implications of the membership principle come to the fore.

#### a. *Enables large number of people to put up their own business organization*

It paves the way for a large number of people particularly those in the low-income group, propelled with a common bond of interest, to engage in business in the dual capacity of owners of their organization or member-owners as well as users of its services or member-users.

#### b. *Makes possible accumulation of capital*

Ordinarily laboring under the handicap of limited financial resources, individually, the members of a cooperative can afford to contribute only a meager amount to the capitalization of their cooperative. The smallness of the amount of capital contributions of the individual members is, however, balanced by the large number of members. A large membership, therefore, makes possible the accumulation of capital out of the small capital contributions of the individual members.

#### c. *Builds up big volume of business*

It insures the building up of a substantial volume of business, thus enabling the members to take advantage of the actual working of two economic theories whose effectiveness

is associated with and, in fact, is proportionate to the volume of business, namely: (a) bargaining power and (b) economies of scale.

## B. *Democratic Administration Principle*

### 1. **Statement of Principle**

As constructed, the democratic administration principle reads in full thus:

Co-operative societies are democratic organizations. Their affairs should be administered by persons elected or appointed in a manner agreed by the members and accountable to them. Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form.

### 2. **Discussion of Principle**

The principle which in the main highlights the primacy of cooperative members bestowed with equal rights focuses attention to three points of extreme interest: (a) nature of organization; (b) administration of affairs; and (c) membership control.

#### a. *Nature of organization*

While the membership principle substantially indicated and established the democratic nature of a cooperative, this pushes the point even further by stating categorically that the cooperative is a democratic organization. As such, it is an association of people which fully recognizes the primacy of individuals not on the basis of what they have but rather on the basis of what they are. In other words, cooperation elevates man as an individual and bestows on him the dignity, rights and honor that he fully deserves. A cooperative is, therefore, an organization where the poor are placed on equal footing with the rich.



This is not to say, however, that the rich have no place in a cooperative. Or to put it in another way, that cooperatives are only for the poor to the exclusion of the rich. Certainly, cooperatives cannot and should not stand on such a fallacious and unhealthy proposition.

The truth of the matter is that every individual, regardless of station in life, can, in more ways than one, contribute to the growth and development of a cooperative as well as derive benefits from it. The point being stressed is that a cooperative is one organization which, because of its orientation and nature of operations, is particularly suited to serve the needs and interests of the low-income group better than that of the well-heeled. Thus, the poor have tremendously a lot more to gain than the rich in membership in a cooperative. But again, the point cannot be overemphasized that cooperation, on the one hand, and the moneyed people, on the other, are not anathema to one another. Although more of the rule than the exception, there are better placed people who have at heart the best interest and welfare of the needy. There may, therefore, be instances when cooperatives can avail themselves to the maximum not only the financial capability of the rich sector but more appropriately of its decidedly more superior and advanced management expertise. The realization of such a harmonious working relationship between the two sectors can indeed usher in a glorious era in the annals of cooperation.

b. *Administration of affairs*

The principle is explicit that in the administration of the affairs of a cooperative the members have the power to determine (a) *who* should administer the affairs of the cooperative and (b) *how* they should be placed in office. This broad power granted to the members which is in the very realm of administration and management should at best be viewed as another concrete

attestation of the supreme role of the members in a cooperative in accordance with its democratic nature.

In actual practice, the setting up or structuring of the management organization system follows a more or less definite pattern in all types of business corporations such as the cooperative. The two basic sequential steps involve: (a) the election of members of the board of directors and (b) the appointment by the board of directors of the general manager and his staff, otherwise known as hired management. Incidentally, this direct, continuous and active participation of the members in the management of a cooperative gives rise to what is recognized as a three-component structure in its management with the members representing the first component, the board of directors the second component, and the hired management the third component. Under this scheme, the basic authority to administer the affairs of a cooperative is specifically vested in the board of directors which is directly accountable to the members. The said authority comes from the members of the cooperative themselves and is embodied in the cooperative's articles of incorporation and bylaws. It may be cited, however, that in some countries, this authority, which is provided by the members, supports and complements in particular a similar authority expressly provided in the pertinent cooperative law of a country.

It can be deduced from the foregoing that the subject principle is actually placed into practical use in cooperatives. It will be realized in this regard that inasmuch as the administration of the affairs of a cooperative is vested in the board of directors and inasmuch as the board of directors is elected by the members, in the final analysis it can justifiably be claimed that the members actually have the first and last say on who will administer the affairs of their cooperative as well as how they will be elected or appointed.

The full implication of this prin-

ciple will not, however, come into bold relief unless the responsibility that goes with the authority of the members in this regard is also highlighted. Definitely, it is the height of injudiciousness for the members to simply exercise their authority without assuming the corresponding responsibility attached to the said authority. The specific burden of this discussion is that if the members have the authority and power to: (a) place in office officials of their particular choice or preference and (b) determine the manner the said officials should be placed in office, then it is the inescapable responsibility of the members to: (a) exercise due diligence and wise judgement in placing at the helm of their cooperative officials who will more than prove equal to the task and (b) harness the services of officials in a manner that is tempered with fairness and justice in close keeping with the democratic character of a cooperative.

### c. *Membership control*

Perhaps no other practice in cooperation can equal, much less surpass, the popularity of the "one member, one vote" practice. Although a mechanism intended principally to support and preserve democratic control in a cooperative, the "one member, one vote" practice has been closely identified with, erstwhile a veritable trademark of, cooperation that there are obvious tendencies to elevate it to the category of the cooperative principle of democratic administration itself.

The subject principle, it will be observed, attempts to view the "one-member, one vote" practice in a more appropriate perspective specifically as a basic support practice for democratic control itself, when it made a distinction between the exercise of democratic control in primary societies whose members are individuals and federated societies whose members are associations, to wit:

" . . . Members of primary societies should enjoy equal rights of voting (one member, one vote) and participation in decisions affecting

their societies. In other than primary societies the administration should be conducted on a democratic basis in a suitable form."

It is patently clear that the "one member, one vote" practice can be applied effectively and without any problem in the case of primary societies whose members are individuals or natural persons. However, the said practice cannot be strictly applied in those societies, more particularly the federated type, whose members are associations or juridical persons. As suggested in the principle, democratic control in such societies should be carried out through some other democratic practice. One such practice is the so-called representative voting whereby for purposes of equitable representation, different brackets of membership for the member-cooperatives are set with specific inclusive ranges of number of members. Each bracket is then allocated a specific number of votes. For example, a first membership bracket of up to 100 members may be allocated one vote, a second membership bracket of from 101 to 250 members may be given two votes, and so on.

It ought to be stressed, however, that regardless of the type or kind of society, that is, whether primary or non-primary, it is the essence of the principle that the democratic control should be (a) placed in the hands of the member-patrons or member-users and (b) based on membership.

It is fundamental in a cooperative that it should be managed and controlled by those members who are actually using its services. Thus, there should be a clear distinction between member-owners and member-users. The plain member-owners who are not using or patronizing the services of the cooperative have for all intents and purposes, forfeited their right to manage and control the cooperative. On the other hand, those members who are availing themselves of the services of the cooperative have all the right to manage and control it.

The two more effective devices or mechanisms that can be adopted to achieve democratic control of a cooperative by the member-users are (a) patronage voting and (b) revolving fund capital plan. In patronage voting, additional votes are given to the members based on the volume of business transacted by the members. This is in accordance with a preset or predetermined schedule of number of votes. Patronage votes, it is stressed, are actually incentive votes intended to encourage the members to increase their patronage of the services of their cooperative. On the other hand, the revolving fund capital plan is a financing scheme that is unique to cooperatives, one of the significant features of which is that the ownership and control of a cooperative is held by those members who continuously contribute to the revolving equity fund which is formed out of funds generated from their use of the services of their cooperative. The revolving fund capital plan is discussed in detail in Chapter IV .

### 3. Implications of the Principle

A number of implications of the principle deserve to be emphasized, to wit:

#### a. *Affirms the democratic nature and purposes of a cooperative*

The administration and control of the affairs of a cooperative are placed in the hands of the members themselves with each member in a primary society having voting rights on the basis of "one member, one vote." In other words in a cooperative, it is the man and not the money that votes. The principle also implies that the management control of the affairs of a cooperative should be placed in the hands of those members who are actually using the services of their cooperative, otherwise known as the member-users.

#### b. *Underscores the need for the members to be fully conscious of their duties and responsibilities*

The practically complete and absolute authority given to the members to manage and control the affairs of

their cooperative in turn offers a stirring challenge to them to accept and assume the duties and responsibilities that go with such authority.

#### c. *Stresses the necessity for an equitable representation of the members in secondary societies*

The principle counsels secondary societies to carry out the administration of their affairs in a manner whereby their member-associations can in turn represent the interest of their individual members in an equitable manner in order that the democratic nature of their cooperative may be properly preserved.

## C. *Interest on Share Capital Principle*

### 1. Statement of Principle

Quoted in full is the limited interest on share capital principle:

Share capital should only receive a strictly limited rate of interest, if any.

### 2. Discussion of Principle

This is the shortest of the principles. And precisely because it is short, the principle, particularly the rationale or philosophy behind it, has to be explained at length.

#### a. *Definition of "Share Capital" and "Limited Interest"*

Initially there should be a full understanding of the key phrases in the principle, namely: (a) share capital and (b) limited interest. Share capital, according to the more acceptable definition, is the contribution of the members to the permanent capitalization of a cooperative. In the case of a stock corporation, the purchases by the members' of shares of stock represent the members share capital. In a non-stock corporation, however, the contribution of the members to the capital account of the corporation partakes of share capital.

On the other hand, as its name suggests, limited interest implies that there

is a ceiling on the rate of interest. The ceiling or maximum rate of interest, in the case of cooperatives, is normally prescribed by the government cooperative agency and is usually lower than the going rate of interest on capital. As contemplated in the principle, the range of the subject interest on share capital is from zero or nil to the maximum rate fixed by the government agency concerned. A cooperative has the option to declare any rate of interest within such a range using the amount of savings realized as indicated in the cooperative's year-end audited financial statement as the major determining factor.

b. *Rationale of principle*

With such a clarification of terminologies, the stage is perhaps set for the discussion of the rationale behind this principle. For a better appreciation and understanding of the said rationale, it is felt that the basic role of capital in a business enterprise must first be re-examined. The area of investigation may be centered on the two general kinds of business corporations, the ordinary corporation, on the one hand, and the cooperative corporation, on the other hand, with particular reference to the *need for* and *purpose* of capital in each kind of corporation.

Both being business organizations, an ordinary corporation and a cooperative corporation need capital. Otherwise, they will not be able to operate. Capital is something that a business organization cannot do without. And in both cases, they suffer from such problems as lack of adequate and cheap source of credit and financing as well as lack of financial management expertise.

The similarity between the two kinds of corporation insofar as financing is concerned abruptly ends on the next point, that is, on the purpose of capital. In an ordinary corporation, capital is looked upon as an investment to make profit. This is understandable since the stockholders which supply the capital, on the one hand, and the

customers who use the goods and services, on the other, are in the main, separate and distinct groups. The compensation or benefit that the stockholders expect to receive from their risk capital has only one possible source – the profit of their corporation – since, as earlier stated, they do not actually use the goods or services of their corporation. Under the situation, it is just but proper and fair that certain benefits should accrue to the stockholders, in this particular case, in the form of profit.

The situation, however, in a cooperative corporation is a real study in contrast. This is because in a cooperative corporation, capital is merely used as a tool to cater goods or services to the members who are actually the owners and suppliers of capital. In a cooperative corporation, therefore, the members perform a dual role – that of member-owners and member-users. And since the paramount objective of a cooperative corporation is to serve the needs of its members, the service motivation takes priority over that of profit. As owners and suppliers of capital, the members expect to reap more benefits from the use of the services of their cooperative than from the use of their capital. Consequently, the members must be prepared to provide capital to their cooperative under an arrangement whereby their share capital will receive just a limited rate of interest as provided for in the subject principle.

3. **Implications of the Principle**

This principle which upholds the fact that in a cooperative corporation the well-defined role of capital is to serve as a tool or instrument to provide the services that the members need and therefore such capital contributed by the members should earn limited rate of interest only, has a number of significant and far-reaching effects and implications.

a. *Affirms the service orientation of a cooperative*

The principle places into sharper

focus the fact that service and not profit is the principal motivation of a cooperative. It is extremely imperative that this basic orientation should sink deep in the minds and guide the actions of the members, officials and employees of a cooperative.

**b. *Forestalls speculation on capital contribution***

The operation of the principle completely removes the element of speculation on the capital contribution of the members. Under this scheme, for example, purchases of shares of stock cannot be considered as an investment opportunity because of the limited interest earnings of share capital. The fact is also underscored that a cooperative is an association of people and not of capital.

**c. *Provides cheap capital***

The principle enables the cooperative to have access to and actually use capital which commands only a nominal rate of interest. The availment of such cheap capital is an advantage that the management of a cooperative enjoys.

**d. *Emphasizes the importance of sound financial management***

The principle is bound to create some problems or difficulties in encouraging the members to increase their capital contribution in the cooperative mainly because of the limited interest condition. The possible assumption by the members of such a lukewarm attitude in this regard is truly understandable and an expected natural initial reaction. Various measures such as the waging of relevant education and information programs are of course at the full discretion and command of the management of a cooperative to counteract tendencies of the like. It is incumbent on the management, however, to initiate, hand in hand with such persuasive drives, a sound program of financial management so that the capital resources, limited as they are, can be used in the most effective and efficient manner. This is a stirring mes-

sage which the principle conveys which should be properly heeded and not overlooked.

**e. *Underscores further the need of sound general management***

The principle suggests that the paramount concern of the management of a cooperative is to operate at the highest possible level of efficiency in order, among others, to boost the capital contributions of the members out of the savings from operations and also from funds which may be generated out of the operations like retains in the case of marketing cooperatives. This is of course an indirect but truly effective way of raising capital which can possibly counteract any difficulty in raising direct capital contribution. The principle indeed supplies one of the many compelling reasons why the management of a cooperative should at all times operate at a high gear of efficiency.

**f. *Increases amount available for patronage refund***

In allocating the net savings or surplus, the schedule of which is expressly stipulated in a cooperative's bylaws, it is standard practice to first set aside funds for reserves and for other specific purposes. The remaining balance is then allocated for (a) interest on share capital and (b) patronage refund. In this regard, as a matter of policy, the interest on share capital enjoys priority in allocation over that of patronage refund. It will therefore be realized that the amount that will be allocated for patronage refund depends entirely on the amount that will be earmarked for interest on share capital. Without the benefit of the subject principle, a situation may arise when even the entire balance of the net savings allocated for interest on share capital and patronage refund may not even be sufficient to cover payment of the interest on share capital which, as earlier stated, has a prior claim on the said allocation. The subject principle comes in as a safeguard to ensure that

not only a certain amount is left for patronage refund but, more important, that the amount set aside for patronage refund is always larger than that for interest on share capital in line with the conventional practice in cooperatives of giving premium to patronage refund over that of capital. In actual practice the board of directors has the option to decide how much interest shall be declared on the share capital subject only to the regulation prescribed by the government agency concerned.

*g. Minimizes concentration of wealth*

The subject principle suggests fully and is in complete compatibility with one of the ultimate objectives of cooperatives of effecting an equitable distribution of wealth. The net effect of the operation of the principle under discussion is that capital receives a smaller share of the savings of a cooperative. Thus, the principle systematically regulates the possible concentration of wealth to those with large capital contributions in the cooperative. Instead, a more equitable distribution of wealth is made possible by plowing back to the members more of the savings of the cooperative based on patronage and not on capital.

**D. Disposal of Savings Principle**

**1. Statement of Principle**

The disposal of savings principle is stated as follows:

Surplus or savings, if any, arising out of the operations of a society belong to the members of that society and should be distributed in such manner as would avoid one member gaining at the expense of others.

This may be done by decision of the members as follows:

- (a) By provision for development of the business of the Co-operative;
- (b) By provision of common services; or,

- (c) By distribution among the members in proportion to their transactions with the Society.

**2. Discussion of Principle**

It is evident that this principle draws even a larger wedge, particularly in point of orientation, between an ordinary corporation, on the one hand, and a cooperative corporation on the other. Through this principle, the cooperatives establish themselves firmly as service-oriented organizations. In the process, cooperatives opted to drop the term "profits" and adopted instead the terms "savings" or "surplus" which are considered more appropriate and compatible with the nature of their operations.

The discussion of the principle is hereby developed in the light of two interrelated issues: (a) ownership and nature of savings and (b) basic guiding philosophy for and manner of distribution of savings.

*a. Ownership and nature of savings*

The question of ownership of the savings is a well-settled issue in the principle. The statement is very firm that the savings belong to the members of the cooperative. The matter of ownership of the savings is, however, only one side of the pertinent issue; it is because the nature of the savings should also be well defined. Certainly, the nature of the savings is a critical factor to be considered in the disposition of the savings particularly in the identification of the rightful claimants thereto. Although it may be granted that this matter is clearly implied in the principle, still it is believed that full understanding and comprehension of the principle itself is largely anchored on a definite establishment of the nature of the savings.

In attempting to shed full light on the matter, it is probably safe to assume that considering the operations of a cooperative, the savings are definitely off-shoots or products of the patronage of the services of the cooperative by the members. And proceeding from this accepted fact, it is possible not only to

make the general statement that the savings belong to the members of the cooperative but more important and pertinent is a supporting statement that the claims of the members on the ownership of the savings is based on their capacity as users or patrons of the services and not merely as owners of the cooperative. To be more specific, the basic premise in this regard is that the savings of a cooperative belong to the members who used its services or the so-called member-users and not to the mere member-owners who did not use the services of the cooperative. A clear distinction is therefore now made between the two usual kinds of members in a cooperative — the member-users and the members-owners. And pursuing now the matter to its logical conclusion, it can be said that since the savings of a cooperative are owned by the member-users, the said savings should be distributed to the member-users in proportion to their use of its services as spelled out in the principle in question.

**b. *Basic guiding philosophy and the manner of disposition of savings***

The principle took special effort to put forth in clear terms the basic philosophy which should govern the distribution of savings, that is, the savings "should be distributed in such a manner as would avoid one member gaining at the expense of others." This norm of conduct which epitomizes to the hilt the democratic nature and purposes of cooperatives is the common thread that runs through and puts into line all aspects of the subject principle. It is therefore not surprising that the subject principle is invariably referred to as the "economic justice" principle.

In order that the pertinent portion of the subject principle with regard to the disposition of savings may be interpreted and discussed in its proper perspective, it will be taken up under the following headings: (a) general manner of allocating savings; (b) salient features of the scheme; and (c) general formulae for the distribution of patronage refund.

**(1) General manner of allocating savings**

The principle states that the savings may be distributed in three ways, to wit:

- (a) By provision for development of the business of the Co-operative;
- (b) By provision of common services; or,
- (c) By distribution among the members in proportion to their transactions with the Society.

In the implementation of the first two aforementioned manner of distributing savings, the *reserves* which are usually set up in cooperatives for various purposes may be cited as examples of provisions for the development of the business of the cooperative. On the other hand, the funds allocated for various activities involved in cooperative education, information and training are actually provisions for common services.

The third prescribed manner of distributing savings, that is, by "distribution among the members in proportion to their transactions with the Society" is the best known and most widely practiced of them all. Actually it is the subject referred to in most cooperative circles as "patronage refund."

Some quarters of course have raised a question on the indiscriminate and all-embracing use of the term "patronage refund" on a point of technicality. They claim that a distinction has to be made on the use of "patronage refund" and "patronage dividend." Their position is that the term "patronage refund" should be used more appropriately in the case of those cooperatives, such as consumers cooperatives, which in the course of their operations must perforce charge their members more than the actual cost of the goods or services. Thus it will just be proper for such cooperatives to refund to their members the excess amounts they were charged under the proper term of "patronage refund."

As to the use of the term "patronage dividend," they advanced that the

said term should be properly used in the case of those cooperatives, such as marketing cooperatives, which derive savings by selling the products of their members at a price higher than the liquidation price earlier committed or paid to the members. The difference between the liquidation price to the members and the selling price to the consumers, according to them, partakes of savings that should be returned back to the members under the term "patronage dividend." At any rate the prevalent tendency or practice is to use the terms "patronage refund" and "patronage dividend" interchangeably in all types of cooperatives without any particular distinction.

**(2) Pertinent features of the scheme of disposition of savings**

The scheme of distribution of savings as enunciated in the subject principle has three pertinent features: (a) it is subject to the approval of the members and contained in the cooperative's by laws; (b) there is no fixed pattern as to the manner of its distribution and the corresponding allocation thereof; and (c) not all the savings are returned to the members.

(a) *The distribution of savings is subject to the approval of the members and is specifically provided in the cooperatives' bylaws*

The principle expressly provides that the manner of disposition of savings, an important matter as it is, should be subject to the approval of the members in accordance with the democratic nature of a cooperative. The general guidelines are set by the members and their decision in this regard is normally stipulated in the bylaws of a cooperative.

(b) *There is no fixed pattern on the manner of disposition of savings as well as on the allocation thereof*

The principle merely outlines the basic guidelines which cooperatives can take into account in considering the manner of disposition of savings. In

other words, there is no fixed or prescribed pattern on the manner of disposition of savings nor on the allocation of savings for each. The members are actually free to exercise their discretion on the matter.

There is, however, one pertinent observation that can be made on this specific provision, that is, the lack of particular reference to the interest on share capital which normally is allocated from the savings.

(c) *Not all the savings are returned back to the members*

Even a cursory examination of the principle itself should conclusively show that not all the savings are distributed to the members. The truth of the matter is that the provision for the development of the business of the cooperatives as well as the provision for common services are what we call as cooperative funds against which the individual members have no claim. Actually the members are recipients of only the limited interest on share capital and/or patronage refund, the payment of which is even sometimes deferred.

This point is emphasized because of the common observation that in justifying their contention that a cooperative is a non-profit organization, some quarters usually claim that all the savings of a cooperative are distributed back to the members thus making a cooperative a real non-profit enterprise. As has been stressed, not all the savings of a cooperative are plowed back to the members and so the aforementioned claim of some quarters is entirely groundless and without basis in fact whatsoever.

**(3) General formulae for the distribution of patronage refund**

There are two general formulae currently being used for the distribution of patronage refund:

*Formula 1*

$$\frac{\text{TPR}}{\text{TVB}} \times \text{MVB} = \text{MPR}$$



**Formula 2**

$$\frac{MVB}{TVB} \times TPR = MPR$$

**Where**

TVB = Total volume of business

MVB = Volume of business contributed by the member

TPR = Total amount allocated for patronage refund distribution

MPR = Amount of patronage refund due the member

Of the two formulae, the first is believed more practical and convenient to use since the first process, specifically TPR divided by TVB, results in a constant factor. This constant factor can be used in computing the patronage refund due to each member by simply multiplying the volume of business contributed by each member by the said constant factor.

An illustration of the mechanics of allocating and distributing patronage refund is shown in Appendix B.

**3. Implications of the Principle**

The more important implications of the subject principle are briefly discussed hereunder:

- a. *Installs service and not profit as the principal motivation for cooperatives*

Through this principle, the service motivation completely replaces the profit motivation as the focal point in the sphere of activities of cooperatives. Also through the mechanism of the distribution of savings, the principle enables cooperatives to render service at cost.

- b. *Gives full benefits of membership to the member-users*

The principle demonstrates fully to the members the practical value of

patronizing the services of a cooperative. In the process, a clear distinction is made between the member-users, on the one hand, and the member-owners, on the other. A comparison of the benefits received by the two kinds of members is tabulated hereunder:

| KINDS OF MEMBERS | POSSIBLE BENEFITS |                  |          |
|------------------|-------------------|------------------|----------|
|                  | Services          | Patronage Refund | Interest |
| Member-owners    | None              | None             | Yes      |
| Member-users     | Yes               | Yes              | Yes      |

There are actually three forms of concrete benefits a member can possibly receive from a cooperative. The said benefits, arranged in the order of their preference, are (a) services; (b) patronage refund; and (c) interest on share capital. On the other hand, as pointed out a number of occasions earlier, there are two distinct kinds of members in a cooperative, the so-called member-owners or those members who do not use the services of the cooperative and the so-called member-users or those who actually use the services of the cooperative.

The table shows that the member-owners can possibly receive only one form of benefit, the interest on share capital which is considered the last priority benefit that a member can possibly receive. On the other hand, the member-users can possibly receive all the three benefits as indicated.

- c. *Emphasizes financial stability through strong reserves*

By allocating portion of the savings for reserves, the principle imprints the important role of reserves in placing the financing of a cooperative on a firm and stable basis. Reserves are of course

set up for specific purposes.

d. *Affirms completely the democratic nature and purposes of cooperatives*

A substantial portion of the savings of a cooperative is distributed to the members on the basis of patronage and not on capital contribution. This clear departure from the usual method of distributing savings accentuates the democratic nature and purposes of cooperatives to the full limit. And if it may be pointed out again, this principle once more impresses upon the fact that cooperatives are associations of people and not of capital.

*E. Education Principle*

1. Statement of Principle

As formulated, the education principle reads as follows:

All co-operative societies should make provision for the education of their members, officers, and employees and of the general public, in the principles and techniques of Co-operation, both economic and democratic.

2. Discussion of the Principle

Anchored on the basic proposition that understanding precedes cooperation, the principle asserts the fact that education is an integral part of cooperation. For indeed education is fundamental to all stages of development of cooperation. It is for this reason that education has consistently been included in all versions of the cooperative principles starting with the first set, the "Laws and Objects" which was worked out and handed down by the Rochdale Pioneers. It is also for this reason that pre-membership education is a basic requirement for membership in a cooperative.

The discussion of the principle will focus on the following points: (a) general education plan and program, including the financing thereof; (b) target sectors; and (c) areas of concentration.

a. *General education plan and program, including the financing thereof*

According to the principle, "All cooperative societies should make provision for the education..." This is indeed a firm and definite statement not only of the recognition of the need for education in cooperation but also of the "must" status of education. This means that a cooperative is obliged to have a cooperative education program.

Three basic propositions thrust out prominently in the formulation of responsive plans and programs for education: (a) education is an area of responsibility of the voluntary or cooperative sector; (b) education must be a continuous and long-range program; and (c) specific and adequate funds should be provided for education.

(1) **Education is the main responsibility of the voluntary or cooperative sector**

At the outset, it has to be admitted that education is an activity that properly belongs to and consequently is best spearheaded by the cooperative sector and not by the government sector. This follows the general overpowering rationale that the cooperative sector and no other is in the best position to determine and decide what is best for it. This very basic consideration, it will be observed, is often overlooked mainly because of the usually big scope and magnitude, particularly in terms of financing, of cooperative education. Cooperatives, therefore, have a tendency to play second fiddle to the government cooperative administering agency in this regard. This is of course something which invariably works to the detriment of the cooperative sector in the long run as the thinking and inclination of the two sectors may not exactly run along parallel lines. And so it is imperative that the cooperative sector should always assert itself in the formulation and implementation of education plans and programs and should, under no circumstances, surrender this vital prerogative

to the government sector. Certainly, a practical arrangement can be worked out between the two sectors whereby the cooperative sector will have a large say in cooperative education as a whole although most of the funds may come from the government sector.

**(2) Education must be a continuous and long-range program**

Actually, the principle contemplates continuous education within the framework of a long-range program for all ages, groups or sectors. In fact it is an extremely desirable practice to integrate cooperative education in all levels of a country's educational system, from the primary, secondary and college up to adult education levels. In this way, there will be a total exposure of cooperation in all age brackets. As it is, the only education program that most countries in developing countries can possibly claim as being on a continuing basis, if at all, is that which is confined to the cooperative sector only.

**(3) Specific and adequate funds should be provided for education**

It behooves upon a cooperative to set aside funds specifically for education in adequate amounts. In this regard, it is a customary practice for cooperatives to allocate a certain fixed percentage of its net savings for the purpose. It has to be recognized, however, that education is relatively an expensive process. Consequently, experience shows that the amount of funds that cooperatives are able to raise is usually inadequate to support an effective education program. Under the situation, that is as a means of solving in a way this dilemma, cooperatives usually find it practical to consolidate the meager funds that they have available for use in a common education program usually under the aegis of an overhead organization. In actual practice, however, even such an arrangement does not usually solve the problem of financing that besets the cooperative. And so the government usually

enters the picture and provides various forms of financial as well as technical assistance in different aspects of cooperative education and training. In such a case, for all intents and purposes, cooperative education becomes a joint responsibility of the cooperative and government sectors. There is of course nothing wrong with such a set up. In fact in most cases it is more of necessity provided, of course, that as pointed out earlier, the cooperative sector to which the responsibility for cooperative education properly belongs is given its rightful share in the drawing out and subsequent implementation of the education plans and programs.

It is indeed pertinent to state in this regard that, in the main, cooperative education in practically all developing countries suffers noticeably from two interrelated problems: (a) ineffective education plans and programs and (b) inadequate funds. A common observation is that there is almost a complete lack of a realistic and coordinated program of cooperative education in the countries both in the cooperative and government sectors principally because of the usual absence of a general program of education. The cooperative sector, usually on a cooperative-to-cooperative basis adopts a cooperative education program that does not dovetail with that of the government sector and vice versa. Under the situation, it is not hard to perceive that this disorganized state of the plans and programs of education is a major factor that further aggravates the already serious problem of limited education funds. For indeed, the said funds allotted for education, already limited as they are, can definitely generate more concrete and commendable outputs if only used to support a more effective cooperative education scheme. It may be added in this regard that the gross lack of competent cooperative trainers as well as the great dearth of authoritative cooperative materials are serious problems by any standard. They may therefore be directly linked with the general unsatisfactory state of affairs.

#### b. *Target sectors*

The principle categorically states that cooperative education should be directed to two specific sectors (a) members, officials and employees of a cooperative and (b) the public in general. It can therefore be seen that the coverage of cooperative education is so wide that it includes both those within and without the cooperative endeavor. The logical inference here is that cooperation is an undertaking that requires for its complete success the support and assistance not only of those within its folds but also of the general public. This required condition leads credence to the fact that a cooperative is an association of people whose activities are intended by and large to affect the general welfare and interest of the greater number, if not all, of the people in a community. It is therefore imperative that a favorable climate for cooperation should be created in all the sectors in a community in order that cooperation may be able to generate and receive the needed boost for its success.

#### c. *Areas of concentration*

The principle is very specific on the areas of concentration of cooperative education. These are: (a) principles of cooperation and (b) techniques of cooperation. This implies that cooperative education should encompass all aspects of cooperation both theoretical and practical. The emphasis of education is of course dependent on the specific target groups or sectors, for which reason, various education and training programs have to be designed. For example, the membership as well as the public are expected to be given more exposure to cooperative principles, opportunities and limitations of cooperation, and duties and responsibilities of membership. On the other hand, the officials and employees are bound to receive, for the most part, education and training on management technology and techniques.

### 3. **Implications of the Principle**

The principle has some significant

and far-reaching implications, to wit:

#### a. *Renders imperative the setting up of funds for education which is a non-business activity*

Since it is mandatory for a cooperative to undertake education work, it is incumbent for it to provide funds as adequately as possible for the purpose. As stressed earlier, a fixed percentage of the net savings, as a matter of practice, is allocated for education and this is expressly provided for in the bylaws of a cooperative.

It will be realized in this regard that a cooperative is a business organization which has to provide funds for education which is certainly a non-business activity. This is of course in line with the accepted and valid theory that while it is true that education is a non-business activity, it is nonetheless essential to the success of the business activities of the cooperative. This is actually a new dimension that is added to the financial management of a cooperative.

#### b. *Stresses the need to formulate a realistic education and training program*

It is imperative for cooperatives to formulate a realistic education and training program taking full stock of such factors as (a) the degree or state of understanding of cooperation by the membership and the public in general; (b) the management capability of the cooperative officials and employees; (c) amount of funds available for education; and (d) nature and scope of the general program of education. Such education program, it need not be over-emphasized, should be on a continuing basis under a long-range proposition.

#### c. *Develops a more enlightened and therefore more responsive membership*

The incorporation of education in cooperation is designed to make the membership more knowledgeable and better enlightened on the various aspects of cooperation especially on its philosophy, principles and duties and

responsibilities of membership. Only from such kind of members who are conversant on the what, why and how of cooperation and who understand and accept their duties and responsibilities can a cooperative expect to receive maximum loyalty and support.

d. *Broadens the knowledge and sharpens the skills of officials and employees on the effective management of the cooperative*

The exposure of the cooperative officials and employees to appropriate education and training programs will place the management of a cooperative in competent and capable hands who are fully aware and willing to perform their duties and responsibilities. Likewise, they will have adequate working knowledge of the cooperative principles as well as the business management principles. The proper application of both principles will be a crucial determining factor in determining whether or not a cooperative will be a real success.

e. *Creates a favorable climate for the development of cooperation in the community*

The chances of success of a cooperative is further bolstered with the inception of education on a community-wide scale. Being more in the nature of a community project, a cooperative requires for its total success the complete support and cooperation of all sectors in the community.

f. *Underscores the economic and democratic ideals and values of cooperation*

A very important aspect of education is that it can adequately highlight and demonstrate the economic and democratic posture of cooperation. Proper information is relayed on the possibilities and opportunities as well as the limitations of cooperation as an effective organization in pushing up the economic and social status. It should also be noted that cooperation is an excellent training ground for the understanding and practice of democratic ideals and values. The value of a co-

operative as a viable economic and democratic institution is therefore accentuated to the fullest to thereby elevate the dignity of man and make him a better and more responsible member of society.

## **F. Inter-cooperative Cooperation Principle**

### **1. Statement of Principle**

A full statement of the inter-cooperative principle is presented hereunder:

All co-operative organizations in order to best serve the interests of their members and their communities should actively co-operate in every practical way with other co-operatives at local, national and international levels.

### **2. Discussion of Principle**

The principle actually proceeds from the fact that cooperatives constitute a movement and a system. In a nutshell, the cooperative movement is a deliberate program to unify the efforts particularly of the low-income groups with well-defined social and economic objectives and aspirations. It uses co-operatives, systematically developed into an integrated system, as the basic institutional reform mechanism for the attainment of progress and prosperity and of freedom and dignity. It is apparent therefore that cooperation involves the pooling of efforts not only of individuals but, in a larger sense, of the associations of such individuals. Viewed in this light, it is fundamental that cooperatives of various levels should cooperate with one another; otherwise, if each will act in isolation, there will not be any cooperative movement to speak of.

A general discussion of the purpose and nature of inter-cooperative cooperation will first be made after which the implications of the principle will be presented.

a. *Purpose of inter-cooperative cooperation*

The principle is very clear on the

point that the move for inter-cooperative cooperation of the cooperatives should be geared at serving the best interest of (a) their members and (b) their communities. This is an affirmation of the fact that a cooperative has a farther-reaching motivation than merely serving and promoting the welfare and interest of its membership. In a larger sense, that is a major factor in changing or improving the socio-economic complexion of the community. In this regard, a cooperative should properly be looked upon and treated not as an undertaking of the membership alone but of the entire community. It therefore deserves the support and cooperation of all.

b. *Basic features of inter-cooperative cooperation*

The nature of inter-cooperative cooperation will be discussed briefly in the light of (a) areas of cooperation; (b) forms of cooperation; and (c) levels of cooperation.

(1) **Areas of cooperation**

Based on their activities, cooperation among cooperatives may be pursued along either or both of two general areas, namely: (a) business activities and (b) non-business activities. Incidentally, the non-business activities are more often referred to in cooperatives as "union" activities. In this regard, cooperation may be initiated along such business activities as marketing, supply, credit and the like. On the other hand, cooperatives may mutually assist each other in such non-business or union activities as education, extension and research. And finally, cooperatives may effect a tie-up in both business and non-business activities.

(2) **Schemes of cooperation**

In the main, mutual understanding and cooperation among cooperatives may be effected through either or both of two conventional schemes, namely: (a) membership and (b) linkage of activities. The scheme of membership which is definitely the more effective

of the two, is best exemplified in the very popular pyramidal pattern of cooperatives development.

Under a three-tiered system, for example, cooperatives in the local level are members of cooperatives in the provincial or regional level and the provincial or regional cooperatives, in turn, are members of cooperatives in the national level.

On the other hand, in instances where there are constraints in membership in other cooperatives or simply for practical reasons of expediency, cooperatives usually institute cooperative-to-cooperative coordination of activities through a scheme of linkage of activities or services. For example, an arrangement may be worked out between an agricultural marketing cooperative, on the one hand, and an agricultural credit cooperative, on the other, whereby the agricultural marketing cooperative undertakes to collect whatever loans are granted to its members by the agricultural credit cooperative. The scheme involves the deduction of the amount of loans from the sales proceeds of the products marketed through the agricultural marketing cooperative by the member-borrowers concerned. Incidentally, this linkage of credit and marketing is generally recommended and is actually commonly practiced by agricultural cooperatives in developing countries.

(3) **Levels of cooperation**

The principle states that cooperatives "... should actively co-operate in every practical way with other co-operatives at local, national and international level." This blueprint for worldwide cooperation is currently being observed and implemented in various designs, by practically all cooperative movements in developing countries. In the international cooperative picture, the scene is of course dominated by the International Cooperative Alliance or ICA. The ICA actually provides the vital rallying platform for the unification of the

thinking and efforts of all national cooperative movements in the world.

### 3. Implications of the Principle

There are two noteworthy implications of the workings of this principle that may be cited, to wit:

a. *Focuses the inherent nature and characteristic of cooperation as a movement and a system*

Through this principle, the inherent nature and characteristic of cooperation as a movement and as a system is completely unveiled. As a worldwide movement, cooperatives have a special place for all peoples and nations. Its strength and effectiveness, in fact, its ultimate success, hinges on the massive cohesiveness of cooperatives in serving the needs of peoples working toward the attainment of identical objectives within the framework of cooperative principles. All the cooperatives constitute the movement. It is therefore incumbent on each and every cooperative to actively cooperate, complement and reinforce the others. In fact, to paraphrase a proverbial saying, the cooperative movement will only be as strong as the weakest cooperatives.

b. *Underscores the need for cooperatives to adopt effective strategies for growth and development*

The application of this principle prods cooperators to adopt the most responsive and realistic corporate strategies in order that they may not only survive but, more important, grow in a highly competitive and challenging business world. In this regard, cooperatives are now matching the current trends for growth and expansion of corporations particularly with the use of such strategies as corporation mergers and consolidations.

The various strategies for growth and expansion are presented in Appendix C.

### III. BASIC GUIDELINES FOR THE ORGANIZATION OF COOPERATIVES: STRICT ADHERENCE TO THE "BOTTOM-UP" METHOD OF ORGANIZING COOPERATIVES

Students of cooperation are only too familiar with the two standard methods of organizing cooperatives which are, in more ways than one, diametrically opposed to each other, namely: (a) the "bottom-up" method and (b) the "top-down" method. In the aforementioned methods, the term "bottom" refers to the potential cooperative members. On the other hand, the term "top" denotes all others aside from the membership base or bottom although the usual inference is the government agency concerned. Thus in the "bottom-up" method, the potential members are given the widest participation or involvement in the organization process particularly in the planning phase. In the case, however, of the "top-down" method, the government agency concerned spearheads the organization efforts with minimum participation, if any at all, of the potential members.

The "bottom-up" method is considered both in theory and practice as the best method of organizing cooperatives. It is paradoxical, however, that the "bottom-up" method is often set aside in favor of the "top-down" method. The time factor is normally advanced as the justification for the adoption of the "top-down" method since it normally makes for faster organization of cooperatives. This inclination needs to be thoroughly studied as it is a good case in point of "haste makes waste." Experience clearly shows that under the "top-down" method, while cooperatives are indeed organized faster, they usually fold down and go out of operation at an even faster pace.

A technique in organization which dovetails tightly with the "bottom-up" method is the holding of frequent and continuous consultations or dialogues with the potential members not only before but even during the actual organization process. The general idea is to draw out their attitudes, opinions, views and preferences precisely to establish clearly the two inter-related critical elements in the organization

efforts, namely: (a) there is a *need* for the cooperative and (b) there is a *demand* for it. It is extremely important that there should be positive indications of both the *need* and the *demand* for the cooperative. It may occur that in some instances or situations there is need for a cooperative but there is no demand for it on the part of the potential members. Again in some situations the reverse may be true. There may be a demand for the cooperative although there may not be any need for it. It would indeed be a grave, if not fatal, mistake in this regard to merely assume or take for granted, as unfortunately seems to be the usual tendency, that the two critical elements are always present. This is something that cannot and should not at all cost be left to chance as the organization of a cooperative is definitely a serious undertaking that should not be left to assumption but to established and verified facts.

#### IV. BASIC GUIDELINES FOR THE ORGANIZATION OF COOPERATIVES: RIGHT CHOICE OF THE TYPE OF COOPERATIVE TO BE ORGANIZED

The proper selection of the type of cooperative to be organized is indeed a very crucial step in the establishment of a cooperative. In fact, it can well mean the success or failure of a cooperative.

There is of course no definite rule of thumb which can be used in this regard. This is because the selection of the suitable type of cooperative is subject to a number of factors, the more pertinent of which are: (a) types or kinds of services required; (b) location and size or area of operations; (c) size of potential membership; (d) competitive situations; (e) social and economic status of the potential members; (f) existing customs, practices and traditions; (g) available management talents or capability; and (h) pertinent cooperative laws and regulations.

Basic to the whole process, however, is the proper understanding of the different types of cooperatives including the criteria used in their classification. This will provide the promoters or organizers of

cooperatives with a helpful guide in initiating this delicate task with proper direction.

Outlined hereunder are the different types of cooperatives classified according to specific criteria. The known diversity and overlapping of the activities of cooperatives preclude the classification of cooperatives strictly on firm basis. As it is, there is actually no one permanent and final classification of cooperatives. Indeed much flexibility has to be exercised in categorizing cooperatives according to type. It is believed however that the subject outline can serve as a practical basic guide for organizers of cooperative in distinguishing different types of cooperatives. Particular attention is invited to the fact that the list of cooperatives given under some criteria are only representative examples and by no means complete.

#### A. *Types of Cooperatives Based on Broad Sectors of the Economy*

1. **Agricultural Sector**
  - a. Marketing cooperatives
  - b. Supply cooperatives
  - c. Credit cooperatives
  - d. Production cooperatives
2. **Non-agricultural Sector**
  - a. Consumers cooperatives
  - b. Industrial cooperatives
  - c. Credit union cooperatives
  - d. Service cooperatives

#### B. *Types of Cooperatives Based on Broad Levels of Organization*

1. **First Level** — Primary cooperatives
2. **Second Level** — Secondary or over-head cooperatives

#### C. *Types of Cooperatives Based on Membership*

1. **Federated Type** — membership limited to associations (juridical persons)



2. **Centralized Type** — membership limited to individuals (natural persons)
3. **Combination Type** — membership of both associations (juridical persons) and individuals (natural persons)

**D. *Types of Cooperatives Based on Capital Structure***

1. **Stock Cooperative Corporation** — sells shares of stocks
2. **Non-stock Cooperative Corporation** — does not sell shares of stocks

**E. *Types of Cooperatives Based on Number of Commodities Handled and/or Services Performed***

1. **Single Purpose or Specialized Cooperative** — handles only one kind of commodity or performs only one kind of service
2. **Multipurpose Cooperative** — handles more than one kind of commodity or performs more than one kind of service

**F. *Types of Cooperatives Based on Legal Personality***

1. **Incorporated Cooperative** — duly registered with the cooperative registering office of the government
2. **Unincorporated Cooperative** (also called informal association) — not registered with the cooperative registering office of the government

**G. *Types of Cooperatives Based on Geographical Coverage***

1. **Local Association**
2. **District, Provincial or Regional Association**
3. **National Association**
4. **International Association**

**H. *Types of Cooperatives Based on Nature of Activities***

1. **Business Type** — performs business activities
2. **Non-business or Union Type** — does not perform business activities

**I. *Types of Cooperatives Based on Economic or Business Activities***

1. **Consumers Cooperative**
2. **Producers Cooperative**
3. **Financing Cooperative**
4. **Service Cooperative**

**J. *Types of Cooperatives Based on Degree of Adherence to Cooperative Principles***

1. **Genuine Cooperative** — adheres fully to cooperative principles
2. **Para-cooperative or Pre-cooperative** — adheres only partially to cooperative principles and usually performs no business activities
3. **Quasi-cooperative** — adheres partially to cooperative principles
4. **Pseudo-cooperative** — does not adhere whatsoever to cooperative principles but takes advantage of the benefits or privileges granted to cooperatives.



**CHAPTER IV**

**THE MANAGEMENT  
STRUCTURE OF COOPERATIVES**



## CHAPTER IV

# THE MANAGEMENT STRUCTURE OF COOPERATIVES

*The management structure of cooperatives is made up of three components: (a) the members, (b) the board of directors, and (c) the hired management. The quality of the management of a cooperative is determined by the members themselves. The principal role of the members in management is to lay down the basic foundations for the effective management of their cooperative, the board of directors to manage the cooperative and the hired management to actually manage the cooperative. An imperative to successful management is that the three components should work as a team.*

### I. STATUTORY SANCTIONS FOR COOPERATIVES

The law normally provides for the organization of three basic types of business organization: (a) the single proprietorship, (b) the partnership, and (c) the corporation. Each type of business organization has its own advantages and disadvantages. From the standpoint of financing which affects the choice of the type of organization considerably, the single proprietorship is the most appropriate if one person can put up the required capital. On the other hand, the partnership is the most suitable setup if a number of persons have to put up the necessary resources. If, however, a large amount of capital is necessary, the corporation is definitely the choice. It may be added that creditors are more inclined to service the financing requirements especially those on a long-term basis of a corporation since they are assured of a definite period of its existence which is not the case with the single proprietorship nor with the partnership.

Concerning liabilities, the owners or investors actually assume less risk in a corporation than in the two other forms of business enterprise. The liability of the owners of a corporation is limited only to the capital subscribed in the corporation and creditors cannot go after their personal assets to satisfy the obligations of the corporation. The liability, however, of the proprietor or partners is unlimited and creditors can make claim on their personal assets for the debts of the proprietorship or partnership.

On the matter of government supervision, a corporation is subject to more government regulations than a proprietorship or partnership. In the main, its powers are specific and limited only to those provided by the law.

Finally, with regard to management, there is maximum centralization of control and utmost flexibility of policy both in a proprietorship and partnership. On the other hand, a corporation operates in a manner whereby the function of policy-making is entrusted to the board of direct-

ors and the conduct of the operations assigned to the officers of the firm.

It is now the standard practice throughout the world to organize cooperatives as corporations. As pointed out earlier, however, cooperatives are hemmed in with some peculiar features that clearly make them distinct and apart from ordinary corporations. Consequently, there are tendencies to classify cooperatives as non-profit corporations to distinguish them from the profit corporations. In making this mode of classification, however, it is possible for the profit-oriented enterprises to feel quite offended as it may be construed to imply that it is improper or even unholy for a corporation to make profit. To obviate any possible misunderstanding that may arise from the use of this terminology, a suggestion has been made to give cooperatives as business units the appellation of "cooperative corporations" to distinguish them from the ordinary corporations.

To become a corporate body and gain legal personality, a corporation has to be incorporated under applicable state statute. A cooperative may be incorporated under a specific cooperative law or in its absence under the general corporation law of the country. This involves the filing by the incorporators of the corporation's articles of incorporation, sometimes called the charter, with the appropriate government office. In the case of cooperatives, this may be the Office of the Registrar or the cooperative office of the government. If the articles of incorporation are in order, that is, if they comply with the provisions of the authorizing statute, the office concerned will issue a certificate of registration. The signers of the articles of incorporation, as well as their successors, then constitute a body corporate for the term specified in the articles of incorporation.

By law, a corporation is a legal "person" separate and distinct from the members and officers of that corporation. It is endowed by law with specific rights and privileges. In return, it is legally and socially bound to serve the general welfare of society as a whole. In a real sense, the articles of incorporation is a contract involving four parties: (a) the state, as an entity; (b) the corporation; (c) the stock-

holders or members; and (d) the people as a whole.

It is the responsibility of a corporation to operate in accordance with and within the rights and privileges granted to it by the enabling statute. Its authorization must not be exceeded, especially in transactions considered *ultra vires* or which are contrary to the public good. In all cases, the government has the prerogative and legal authority to cancel all or any of the rights and privileges granted to a corporation and, in extreme cases, even terminate the life of a corporation.

The basic framework of the management of a cooperative corporation follows essentially the same philosophy and pattern as that of any corporation. As a corporate body chartered by the state to act as an agent or to perform a service to its members as patrons, a cooperative corporation requires the services of real persons who will be responsible for managing the affairs of the organization. In the main, the pragmatic approach to the setting up of the usual corporate format for the management machinery may be generally broken down into three related steps:

**Step 1** — The members acting as a body elect the members of the board of directors.

**Step 2** — The board of directors, also acting as a body, then appoints a manager and delegates to him specific management authorities.

**Step 3** — The manager, in turn, recommends to the board of directors the hiring of his staff and performs the functions of management in the day-to-day activities in conformity with the policies promulgated by and the delegated authority of the board of directors.

## II. MAIN COMPONENTS OF THE MANAGEMENT OF A COOPERATIVE

It is the thrust of this portion of the discussion to firmly establish the fact that the management structure of a cooperative is made up of three major components, namely: (a) the members, (b) the board of

directors, and (c) the hired management. Expressed in the form of an analogy, the management of a cooperative may be likened to a three-legged stool, with the members, the board of directors, and the hired management each representing the three legs. The stool is precisely designed to stand on three legs and will topple down in case any of these is removed. Such is also the case with cooperative management. Its usefulness, effectiveness and stability are contingent on the full support of all the three components.

As structured, each of the three components has a specific responsibility of its own in the management of the cooperative. The said responsibility of each of the three main supports of management which is discussed in detail is summarized as follows:

**First Component: The Members** — To provide the basic foundations for the effective management of the cooperative and to be ever alert and vigilant on problems and weaknesses in the servicing of their needs.

**Second Component: The Board of Directors**—To manage the cooperative for and in behalf of the members.

**Third Component: The Hired Management** — To actually manage the cooperative in accordance with the authority delegated to it by the board of directors.

Effective management of a cooperative demands that the abovementioned three components or supports should function as a team. It is, therefore, necessary that the closest possible relationship should be established and maintained among the members, the board of directors and the hired management if they are to function and work together in complete harmony and unity.

### III. THE FIRST COMPONENT OF MANAGEMENT: THE MEMBERS

#### A. *General Statement of the Principal Roles in Management*

The principal roles of the members in management are (a) to provide the basic

foundations for the effective management of the cooperative and (b) to be ever alert and vigilant on possible problems and weaknesses in the servicing of their needs for the purpose of upgrading management efficiency.

The members are expected to exercise great interest and particular concern in the affairs of their cooperative in full accord with the workings of the cooperative principle that democratic control of it should be vested in and exercised by the member-users. The full exercise by the members of democratic control of their cooperative is utterly lacking in the operation of ordinary corporations. And to be sure, this is considered one of the greatest differences in the attitude of the member-users toward their cooperative corporation, on the one hand, and the stockholders toward their corporation, on the other.

#### B. *Specific Management Responsibilities*

Some of the most essential management responsibilities which the members must perforce assume are as follows:

##### 1. **Adopt and Amend Corporate Papers**

Consistent with the thesis that sound organization is *sine qua non* of sound management, the articles of incorporation which gives the cooperative its legal personality should be adopted only after they had been carefully studied by the members. The articles, for example, on the purpose, the number and qualifications of directors and the capital structure should be given the most serious and thoughtful consideration as they form the primary basis for planning the operations. On the other hand, the bylaws which constitute the rules for internal operations should merit an equally comprehensive study and consideration before they are finally adopted.

The management responsibility of the members does not stop with the adoption of their corporate papers. It is

the continuing responsibility of the members to conduct a periodic review and evaluate the objectives and policies set forth in the articles of incorporation and bylaws for the purpose of making them up-to-date and responsive to the changing needs of the cooperative.

## **2. Select and Remove Cooperative Directors**

The democratic control of a cooperative is exercised by the member-patrons both directly and indirectly. The members elect cooperative directors as representatives to carry out for them indirectly the exercise of democratic control in the management of the affairs of the cooperative. Since the cooperative directors represent the members in the major aspect of management, the responsibility of electing competent and qualified cooperative directors rests heavily on the shoulders of the members. The members should realize only too well that it is to their best interest and to that of the sound management of their cooperative that the board of directors should be elected on the basis of personal characteristics, knowledge of cooperation and business proficiency.

One of the truly important natural consequences of having a strong board of directors is that there is almost complete guarantee that it will, in turn, appoint a competent manager. Considering the cooperative management format, it is perhaps quite easy to visualize a chain reaction where a strong board of directors will, in all probability, appoint an equally strong manager, while a weak board of directors will most likely appoint an equally weak manager. And if the situation would be pursued to its logical conclusion, the staff that would be hired by the manager would only be as strong or as weak as the manager himself.

Hand in hand with the right to elect cooperative directors is also the right of the member-patrons to remove incompetent cooperative directors for a cause in accordance with the bylaws of the cooperative. The right to remove direct-

ors should be exercised with the same meticulous care as the right to elect directors, but with more dispatch.

## **3. Patronize the Cooperative**

A member who patronizes consistently the cooperative fulfills his basic responsibility to use the services of the cooperative in meeting his needs. He avails himself of the services of the cooperative at cost and is entitled to receive patronage refund in proportion to the volume of business he contributed to the cooperative. Being such a good member-patron, he has definitely more than earned for himself the right of control, together with the other member-patrons, of the affairs of the cooperative.

In addition, being a valued member-patron makes him a well-informed member. He has a first hand information on the quality of the services being offered by the cooperative as well as its facilities and other resources. He is in close touch with the officials and employees of the cooperative and has personal knowledge of their competence in their respective jobs. He attends regularly all membership meetings and occasionally observes deliberations of the board of directors. Being such a well-informed member, he can be expected to voice his views and opinions on how the cooperative can possibly improve its services to the members.

A member-patron who is a well-informed member is a major asset in the strengthening of the management of a cooperative.

## **4. Prepare for Management Position**

Nearly all cooperative bylaws provide, with respect to the qualifications of directors, that a director should be a member of the association. A corollary provision invariably states that the president and vice president of the association must be members of the board of directors.

In limiting membership in the board of directors to themselves, the members, in essence, have cons-



cientiously imposed upon themselves a usually overlooked vital responsibility in management, that is, to prepare themselves to assume principally the position of cooperative director. It is the responsibility therefore of every interested member-patron to acquire on a continuing basis the necessary orientation and training that cooperative directorship demands. This means that member-patrons who are aspiring for said position should take upon themselves to religiously attend seminars, workshops, institutes and other training programs. Such institutionalized and non-institutionalized management development programs, together with constant exposure to the actual workings of their associations, should provide the member-patrons with adequate orientation and training on both the cooperative and business aspects of their association's operations. It is extremely desirable that training for cooperative directors or at least a substantial portion thereof should be availed of before, and not after, the assumption of such a position. The cooperative will thus always have a ready and rich source of technically prepared cooperative directors who, given the opportunity, will not be entirely new to their position of trust.

Excellent opportunities are also open to member-patrons for employment in the management staff of their cooperative. Most cooperatives have a long standing policy to give priority to its member-patrons in the filling up of staff positions from the manager down. Member-patrons who have an eye to these possibilities will constantly find it to their advantage to take every opportunity to be exposed to the different management development programs. They will then have had sufficient job orientation and training when the opportunity comes.

As has been pointed out earlier, the members have the responsibility of providing the basic foundations for effective management of their cooperatives as democratic institutions. These basic foundations which actually form the

initial basis for planning the whole operations are contained in the articles of incorporation and bylaws of the cooperative as adopted by the members themselves. It is the specific responsibility of the members to conduct a periodic review and assessment of the corporate papers to enhance their relevance and effectiveness to the changing needs and requirements of the economic and social setting.

The members also must assume the responsibility of boosting the efficiency of the management of their cooperative as business service units. The members have clearly manifested their determination to help themselves in overcoming their common economic needs by banding together and forming their cooperative. Consequently, the extent to which each member-patron uses the services of the cooperative is also the extent to which he helps himself. A member who does not patronize the cooperative has reneged in his avowed mission to help himself. The responsibility to patronize the cooperative can only be shirked by a member by closing his eyes to commitment to himself and to the other members of the cooperative. A valued member-patron, it must be underscored, can be expected to exercise his rights of control wisely and intelligently being well informed of the status of the various aspects of operations of the cooperative. Furthermore, since the member-patrons took it upon themselves to make membership in the board of directors exclusive to them, it behooves on each and every member-patron to acquire the necessary skill and know-how that will make for a competent cooperative director.

The member-patrons, which as a body form the base of the cooperative management structure, appear to be overloaded with responsibilities. But it must be remembered that such responsibilities are inherent to the member-patrons of a cooperative. And to harp a familiar theme, individually, their efforts will crumble down from the heavy load of responsibilities. But collectively, their efforts will be able to

shoulder and carry even a heavier load of responsibilities.

#### IV. THE SECOND COMPONENT OF MANAGEMENT: THE BOARD OF DIRECTORS

##### A. *General Statement of Principal Role in Management*

The principal role of the board of directors in management is to manage the cooperative for and in behalf of the members. Under the corporate setup, the board is elected by the members to represent them in the general management of the cooperative corporation. The board of directors in a cooperative represent the members as *patrons* or *users* of cooperative services and not as *investors* as in the case of ordinary corporations.

Also under the corporate setup, all corporate powers, except those specifically conferred on the members, are vested in the board of directors. The responsibilities of the board of directors, however, go much beyond that imposed by legal consideration. It must also take active part in the direction and coordination of the cooperative business.

##### B. *Specific Management Responsibilities*

A list of the more important management responsibilities which are normally assumed and handled directly by the board of directors follows:

###### 1. **Acts as Trustee**

It is a principal legal responsibility of the board of directors to act as trustee for the members. As such, a major concern of the board is the establishment and maintenance of a healthy and stable financial status of the cooperative. This presupposes the judicious management of assets including their proper safeguarding. The financial responsibility, with special emphasis on the members' equity, in-

cludes studies and decisions relating, among others, to investment, borrowings, declaration of dividends, retention of earnings or savings and building up of reserves.

###### 2. **Establishes and Develops Basic Objectives and Broad Policies**

The board of directors is responsible for the setting forth and development of an association's basic objectives and broad policies. The basic objectives define what the association seeks to achieve or the projected long-run results, while policies, which are usually referred to as "line-fences," serve as guides in making decisions.

These basic objectives and broad policies are particularly necessary and relevant in long-range planning. The board of directors should anticipate well in advance the services that will be needed by the members and develop accordingly a realistic long-run plan and program to supply those needs.

###### 3. **Appoints the Manager**

The board is responsible for the selection of a manager who in turn is responsible for the selection of his staff. The board may at all times reserve the right to approve the appointments of key staff personnel.

To emphasize the obvious, the selection of a competent manager who will spearhead the management is one of the most important responsibilities of the board. The strategic role and position of the manager in the whole management scheme makes him the central figure in management. In fact, he is the single person on whom the success or failure of a cooperative is normally pinned.

###### 4. **Delegates Corresponding Authority to the Manager and His Staff**

In connection with the employment of a manager, the board must delegate sufficient authority to the manager and his staff that will support

the smooth and efficient performance of their duties. General statements of the duties of the manager as well as those of the corporate officers are standard features of an association's by-laws. They serve as general bases for the nature and extent of authority that should be delegated to hired management. During the course of the operation, however, the board should always be prepared to further delegate to hired management such additional specific authorities that may be deemed necessary for the effective discharge by the hired management of its functions.

#### 5. Controls the Affairs and Business of the Cooperative

Another important responsibility of the board is to participate actively in the management function of controlling. The board must make continuing comparisons between what is actually achieved against what was intended to be achieved for purposes of determining remedial measures necessary to insure the attainment of desired results. The directors may not fully know how to manage the business of the cooperative themselves but it is necessary that they should know how to gauge the effectiveness of management.

In view of the great importance attached to it, the function of control by the board is discussed in great detail elsewhere in this chapter.

#### 6. Insures Enforcement of Corporate Powers

As a trustee, the board is charged with the responsibility of making certain that the affairs and business of the cooperative are conducted strictly in accordance with the pertinent law and with the articles of incorporation and bylaws. This is a condition precedent for the preservation and maintenance as well as the strengthening of the cooperative nature and character of the cooperative.

Cooperative directors should take

special efforts to be well conversant with the corporate papers and the pertinent law and leave no room for any infraction or violation thereof. Appropriate moves to amend the corporate papers should also be initiated by the cooperative directors by calling the attention of and explaining to the members the need to make such amendments.

#### 7. Requires the Installation of Adequate Accounting System

It behooves upon the board of directors to require the installation of an adequate accounting system by the hired management. It is necessary that the board be provided with accounting information for its effective discharge of its job in line with its trustee role as well as in the effective exercise of its function of control in management. For example, financial statements which give general indications of the overall status and progress of the enterprise are valuable tools that can be used by the board in the proper management of the assets of the cooperative.

The installation of an accounting system is also necessary in order that an external audit of accounts may be properly conducted. The initiation of such an external audit is another responsibility of the board in its capacity as the protector of the fiduciary interests of the members.

#### 8. Maintains Channels of Communication with the Members and the Public

The board of directors should maintain a continuous dialogue with the members. This is basic for the effective functioning of the board as a representative body of the members. The board, therefore, has a special responsibility to maintain an open and systematic channel of communication with the members. The channels should permit the two-way flow of communication, that is, to and from the members.

A similar channel of commu-

nication that is effective in both directions should also be maintained by the board with the public in general. This again is in line with the legal, social and public responsibilities of the cooperative as an incorporated business enterprise to serve the general welfare of society in its totality.

### **C. Authority of the Board and its Sources**

The board of directors is vested with the authority to direct and supervise the affairs and business of the association. With this authority goes the responsibility for the effective management of the association.

This authority which is given to the board as a body and not to the individual directors, emanates from two specific sources, namely: (a) stockholders or members and (b) law.

The basic authority delegated to the board by the members is contained in the articles of incorporation and bylaws of the association. These papers or documents clothe the board of directors with corporate powers. This authority which is derived from the members through the corporate papers is often referred to by some cooperative quarters as the formal authority. The other authority, which is considered the informal authority, comes in the form of trust and confidence gained by the board from the members for creditable performance of its assigned tasks. The board of directors will definitely be able to increase its capacity in measuring up to expectations if, aside from the formal authority, it also receives the so-called informal authority from the members.

In addition, the board of directors is bestowed with authority from a purely legal source. This legal authority comes from the law under which the cooperative is incorporated. Said statute grants specific powers to the board of directors and imposes limitations on the exercise thereof. Some statutes do not give to the board of directors complete reign over the corporation but reserve certain corporate acts to the members.

Generally, therefore, the board of directors enjoys those powers delegated by the members and those which are particularly granted and are not specifically denied to it by law.

### **D. Guides for Selecting Cooperative Directors**

The building up of a strong and well balanced board of directors depends largely on a wise and an intelligent choice of the best available materials from the membership. In passing upon the merits of each potential cooperative director, it is desirable that three criteria should be considered: (a) personal characteristics, (b) cooperative attributes, and (c) business experience.

#### **1. Personal Characteristics**

- a. Willingness to serve the members
- b. Unquestioned integrity and character
- c. Satisfactory educational background and training
- d. Demonstrated capacity for leadership
- e. Recognized ability to work with people

#### **2. Cooperative Attributes**

- a. Sufficiently knowledgeable about cooperative principles
- b. Consistency in patronizing the cooperative business
- c. Consciousness in participating actively in cooperative affairs
- d. Demonstrated perseverance and interest in attending training for cooperative directors
- e. Clear understanding of the legal framework of cooperatives, specifically the corporate papers and the enabling law

#### **3. Business Experience**

- a. Highly successful in managing private business
- b. Adequately equipped with knowledge and understanding of the practical use of accounting reports

particularly the reading and interpretation of financial statements

- c. Ample exposure to the cooperative business activities
- d. Demonstrated competence in evaluating managerial potentials and performance.

It will be noted that the foregoing considerations for the selection of cooperative directors stress the importance of giving due attention to the qualifications of a would-be director as a cooperator in addition to his personal characteristics and business experience. The need for directors with sufficient cooperative orientation in the board of directors cannot be over-emphasized. The general idea is to preclude the possibility of the association being detached from its moorings as a cooperative—an unfortunate development that usually happens under a situation where the cooperative directors are grossly deficient in their understanding of even the fundamentals of cooperation.

The standards as outlined are of course far from complete. But they essentially represent those considered singularly important. They are not intended to be rigid and firm guides for the selection of cooperative directors but rather as bases for approximating the ideal membership in the board of directors.

### ***E. General Guide in Evaluating Board Performance***

The proper selection of cooperative directors is actually only the first step in the development of a competent board of directors. It is not by and in itself a complete guarantee of the effective performance of the board although it is certainly a condition precedent for the creation of a high-caliber board. To be sure the board in the final analysis, has to be judged not by its composition but by its performance.

A list of related questions which are usually used to gauge the performance of the board of directors is presented hereunder.

1. Are the objectives and policies of

the organization clear-cut and realistic?

2. Are the objectives and policies religiously followed?
3. Are the objectives and policies periodically reviewed and changed or revised to keep them attuned to the changing conditions?
4. Are the needs of the members served satisfactorily?
5. Are the members given either (a) better service at lower cost; (b) better service at the same cost; or (c) same service at lower cost?
6. Are the services to the members expanded?
7. Are patronage refunds distributed regularly?
8. Is the members' equity constantly increased?
9. Does the organization have provision for the formation of a strong reserve scheme?
10. Do the board of directors and the manager work harmoniously and effectively as a team?
11. Is an audit of the organization conducted regularly?
12. Do the business, social and government circles in the community respect the organization?

The foregoing general questions are intended to probe into the extent to which the board of directors discharges its various responsibilities in management. Taken collectively, they are therefore reflective of the overall performance of the board.

### ***F. Common Practices in the Structuring and Functioning of the Board of Directors***

There is no set pattern in the structuring and functioning of the board of directors. The practices are influenced by a number of factors foremost of which are: (a) size and type of organization, (b) nature of activities, (c) traditions, (d) personalities, and (e) government laws.

Some common practices may, however, be enumerated if only to provide general insight on: (a) composition, (b) term of office, (c) compensation, (d) meetings, and (e) committees of the board of directors.

## 1. Composition of the Board of Directors

### a. Size

The size of the board of directors which is actually determined by the distribution of membership representation is specified in the cooperative's bylaws. There is no exact formula to go by in determining the size of the board. The following guides, however, are presented in this regard: (a) the number of directors is always odd, regardless of the size of the board; (b) the number of directors tends to increase with the size of the cooperative; and (c) the membership in the board should not be too large to make it unwieldy nor too small to preclude adequate membership representation.

### b. Representation

The equitable representation of the various interests is the ideal situation that must be created in the board of directors if it is to appropriately fulfill its role as trustee of the members. This calls for the devising of a realistic basis for the most equitable representation of the interests of the members in the board.

Ownership representation is more specific in cooperatives than in ordinary corporations. Cooperative bylaws as indicated earlier usually restrict membership in the board of directors, particularly of primary societies and centralized organizations to the members who are not employees of the cooperative. In the case, however, of federated cooperatives, their bylaws are not too restrictive and normally permit the election of directors or even executives of its member-cooperatives.

It is of course not possible for all diverse owner interests to be represented in the board. Most cooperatives achieve owner representation through election of directors on geographic, commodity or service basis.

In most developing countries, the government is represented in the board. Again, it is underscored that to the extent that this government represent-

ation is based on special qualifications of the government directors, the cooperative stands to gain. However, if the government representation is based on a mandatory requirement and selection is limited, it must be viewed as totally unnecessary; it can even prove to be harmful.

## 2. Length of Service

The term of office of cooperative directors normally ranges from one to three years and is usually staggered. Some cooperative bylaws restrict the number of terms a director may serve. In this regard, the term of office of a director should be of sufficient duration so that a cooperative may be able to fully avail itself of the years of experience and training already gained by a director.

It is interesting to note that a survey of farmer cooperative directors in the United States reveals that nearly 85 per cent of the directors were between the ages of 40 and 69 or an average age of 54 years.

## 3. Compensation

It is almost the standard practice in cooperatives to pay their directors a straight fee per board meeting plus travel allowance. As a matter of policy, all compensation or remuneration of the board of directors are subject to the approval of the members. As trustees of the members, the cooperative directors are prohibited from appropriating for themselves any fund of the cooperative.

## 4. Board Meetings

It is almost a standard practice for the board of directors to hold regular meetings every month and special meetings as often as necessary. As a general rule, meetings should be held frequently and long enough to permit the board to make a careful and thorough deliberation of the matters brought to its attention.

## 5. Board Committees

Following the realization that some matters brought to the attention of the board should have the benefit of prior study and consideration, in some cases even requiring detailed investigation and analysis of issues, the board of directors often resorts to the practice of creating special or *ad hoc* committees. Each committee is assigned a vital area of the association's activities in which smaller groups can function more effectively. The work of the various committees is normally only recommendatory and their actions or decisions are subject to the approval of the board except in cases where they have been particularly empowered by the board to make such decisions.

Among the more important committees usually created are: (a) executive committee, (b) finance and budget committee, and (c) audit committee.

### a. *Executive committee*

The executive committee is a standing committee made up of a small membership, say, from three to five, usually authorized in the cooperative bylaws. It is delegated with the authority to act for and in behalf of the board on specific matters, usually emergency in nature, when the board itself is not in session or will take time to be convened. It facilitates action on problems which ordinarily will have to await regular board action. It also enables the board to supervise the management more closely.

Although the executive committee has full authority to act on matters delegated to it, it normally makes a report to the board of directors of all actions it has taken for the board's concurrence or information as the case may be.

### b. *Finance and budget committee*

The finance and budget committee is the powerful and important committee next only to the executive committee. All fiscal matters requiring board action are referred to the committee for study and recommendation. It reviews budgets, fiscal plans and pro-

grams and other accounting information.

### c. *Audit committee*

In some cases, the finance and budget committee also serves as the audit committee. Otherwise the audit committee is a separate standing committee. Its function is to assist the board in the performance of one of its trustee roles, that is, the initiation of the auditing of accounts of the association. In general, the audit committee makes the specification for audit, review of audit report and review of internal accounting procedures.

### d. *Other committees*

Sometimes, the board of directors finds it necessary to create other committees. Such additional standing committees usually created are: (a) membership committee, (b) projects committee, (c) education and information committee, (d) grievance committee, (e) credit committee, and (f) public, labor and employee relations committee.

## V. THE THIRD COMPONENT OF MANAGEMENT: THE HIRED MANAGEMENT

### A. *General Statement of Principal Role in Management*

The manager and his staff, otherwise known as the hired management, are principally responsible for the actual management of the cooperative in accordance with the authority delegated to it by the board of directors. They attend to practically all the details of the functions of management and handle the day-to-day activities.

As mentioned earlier, the manager is the main driving force in management. It is not surprising therefore that most people are inclined to think of the manager as synonymous with management itself. This assumption is of course not correct. Cooperative management as is well-known by now, is a team made up of the members,

the board of directors, and hired management.

### ***B. Statement of Specific Management Responsibilities***

The hired management has certain specific management responsibilities. While these responsibilities are supposed to be assumed by the hired management as a group, it has to be realized that they are all centered on the manager who is the top man in hired management. In all instances, therefore, the manager, instead of the whole hired management, will be the focus of the discussion although in most instances reference to the manager should be construed to denote the entire hired management.

#### **1. Directs and Coordinates the Overall Activities**

A very important, if not the most important, responsibility of the manager in management is to effectively direct and coordinate the day-to-day activities of the cooperative. These activities cover both the business and cooperative aspects of operations. It is precisely this area of management which involves the actual management of the technical operations and men that the real capability of a manager can be truly tested. This calls for the proper alignment and harnessing of all components in the organization including people, facilities and other resources in order that plans may be carried out and projects completed through effective instructions to the subordinates.

The detailed discussion of the directing and controlling functions of management is found in Chapter V.

#### **2. Develops Objectives, Goals and Policies and Prepares Plans and Programs**

These activities, it will be realized, fall under the planning function of management. In the first place, the manager has the responsibility of initiating

the development and eventual establishment of objectives and goals for the purpose of providing the proper orientation of what the association seeks to achieve. And in the second place, the manager has the responsibility of initiating the formulation of appropriate policies in order to identify and give direction to plans and programs and set up the guides for decision-making. Within the framework of the enunciated policies, the manager then prepares the corresponding plans or sequences of related activities which when integrated will comprise the program.

The manager has to work closely with the board of directors in performing this function of management since the board itself is also involved in the planning function. For the recommended coordination of activities of the board of directors and the manager in the planning function, reference is made to Chapter V.

#### **3. Sets up the Organizational Structure and Recruits the Staff**

The designing of an appropriate framework for action and the subsequent recruitment and selection of the necessary personnel complement are well within the province of responsibility of the manager. Again since this organizing function of management is closely related to the association's goals and policies, it is incumbent on the manager to undertake this task in close consultation and collaboration with the board of directors.

The details of the organizing function of management are also found in Chapter V.

#### **4. Controls the Activities**

It is also the responsibility of the manager to be abreast with and be fully informed of the status of the various activities in order that he may be able to determine at any given time or period whether or not the operations are proceeding according to plans. The manager must be always alert in detect-



ing weaknesses in the implementation of a plan or program and be equally alert in immediately instituting appropriate remedial measures or steps to straighten out such defects. This management function of controlling is also shared by the manager with the board of directors and consequently has to be performed in close coordination with it.

### ***C. Authority of the Manager and its Source***

The manager is vested with the specific authority to supervise and coordinate the various activities of the association. This involves the handling of the many details of management and has particular reference to the daily operations of an association.

This authority to manage the association is delegated to the manager by the board of directors on the strength of the authority given to it by the members. As mentioned earlier, the broad statement of the management authority delegated by the board of directors to the manager appears normally in the association's bylaws.

### ***D. Guides for Selecting Managers***

In selecting a manager, it is desirable that particular attention be given to the following considerations:

1. **Personal Characteristics**
  - a. Willingness to serve the needs of the members as manager
  - b. Unquestioned integrity and character
  - c. Sufficient academic preparation — preferably a college degree holder in business or related fields and must have attended some courses on cooperation.
  - d. Excellent leadership
  - e. Highly innovative spirit
  - f. Sufficient knowledge and full appreciation of the value of the role of human relations in business
  - g. Keen interest in professional advancement

### **2. Cooperative Attributes**

- a. Full belief in and sincere sympathy to cooperation.
- b. Thorough understanding of cooperative principles
- c. Adequate practical experience as a cooperator
- d. Ample training on the theoretical and practical aspects of cooperation
- e. Thorough familiarization with the basic differences between the organization and management of a cooperative corporation and that of an ordinary corporation
- f. Complete familiarization with the contents of the corporate papers and the provisions of the appurtenant cooperative laws or statutes.

### **3. Business Experience**

- a. Acknowledged success in private business
- b. Demonstrated competence in running a business enterprise
- c. Adequate experience in manning a cooperative
- d. Thorough skillfulness in the use of various management tools and techniques in relation to the functions of management.

The foregoing enunciated bases for selecting a suitable person for the position of manager may appear quite idealistic. The point cannot be over-emphasized, however, that the manager holds the major key to the success of a cooperative and no effort should be spared in shopping for the right man for the position. There is indeed no substitute for competence in a cooperative manager and it cannot be gainsaid that a capable manager is one precious commodity that one cannot afford not to be very selective. Also, it is considered a grave mistake to hire the services of a manager on the basis of a lower salary asked. A cooperative should be prepared to give a competitive salary to a manager who can prove equipped for the task. It should be realized that an incompetent manager is the worst investment that any business enterprise, more particularly a cooperative, can ever make. An incompetent manager is indeed a luxury that nobody can afford.

### *E. Term of Office*

The period of employment of managers may generally be classified into two: (a) fixed and (b) not fixed. Those employment which are covered by management contracts are fixed in nature while those not covered by management contracts are not fixed. Since jobs covered by management contracts are more secure, managers would normally prefer to be employed with the benefit of management contracts.

In actual practice, however, the services of nearly all managers of primary societies and even of overhead organizations are seldom covered by management contracts. Under this situation, the employment of such managers are in essence at the pleasure of the board of directors. Those cooperative managers, however, see no reason to feel insecure in their jobs despite the lack of the pertinent management contracts since experience shows that good performance is the best security for their jobs. The services of those managers who have demonstrated their capacity and competence to operate cooperatives successfully are always given due recognition by boards of directors and their services are always retained and consistently sought.

Nonetheless, professional cooperative managers, for clearly understandable reasons, prefer that their services, which are usually for a specified period and with a fixed compensation, be the subject of a management contract. In general, the period of the management contract ranges from two to five years with the usual termination clause in case of failure of any of the parties concerned to comply with its contractual obligation.

### *F. Compensation*

It is more or less the standard practice for managers to receive a fixed monthly compensation plus some allowances. Unlike in ordinary corporations, there is no profit-sharing scheme for employees of cooperatives.

## **VI. RELATIONSHIP OF THE BOARD OF DIRECTORS AND THE MANAGER IN THE MANAGEMENT OF A COOPERATIVE.**

Among the three components of management, the relationship between the board of directors, on the one hand, and the manager, on the other, is definitely the most difficult to establish. The rather usual vagueness in the delineation of the responsibilities and activities of each component stems from the fact that the board of directors and the manager, representing the hired management, are both concerned with the operations of the cooperative and in discharging the functions of management, namely: (a) planning, (b) organizing, (c) directing, (d) coordinating, and (e) controlling.

An attempt is made to place in proper perspective the working relationship between the two aforementioned components of management on two scores: (a) based on the five functions of management and (b) guiding rules to establish their relationship.

### *A. Specific Responsibilities of the Board of Directors and the Hired Management Defined*

For a better understanding and appreciation of the specific activities of the board of directors, on the one hand, and the hired management—the manager in particular—on the other, their respective responsibilities based on normally standard situations are outlined in relation to the five functions of management in Exhibit IV-1.

To be sure, Exhibit IV-1 is intended merely to show the main lines that delineate the areas of responsibilities of the two sectors of management. In some instances, it may be found necessary to draw firmer distinguishing lines. The capulated presentation, it is believed, can very well serve as a practical frame of reference that can be used as basis for any such further refinements.

It will also be noted that the informa-

tion contained in the subject exhibit is presented in brief and compressed form. This is understandable since it is designed to simply complement the earlier discussions on the subjects. Its real value lies when it is considered hand in hand with the pertinent earlier discussions.

### ***B. Suggested Rules for Delineating the Activities of the Board of Directors and the Managers***

As the respective responsibilities of the board of directors and the manager in each of the functions of management are closely examined and compared, some definite grouping patterns of responsibilities are bound to come out prominently. This systematic alignment of the responsibilities actually conform with some suggested guiding rules for clarifying the specific areas of responsibilities of each management component. The said helpful rules are briefly outlined as follows:

#### **1. Idea Decisions Versus Action Decisions Rule**

An idea decision is said to be one that involves approval of a proposed performance or plan that prepares the organization for systematic action. It motivates action that tends to have long-run implications and consequences. On the other hand, an action decision specifies the behavior of an organization and results in definite action.

Making idea decisions, sometimes referred to as directing decisions, is the responsibility of the board of directors. On the other hand, the making of action decisions, also known as operating decisions, is in the province or responsibility of the manager.

Applying this rule now to specific responsibilities, decisions on long-range objectives and goals are the responsibility of the board. However, the making of the corresponding plans and programs which involves decisions related to how and when the objectives and goals are to be attained is the responsibility of the manager.

#### **2. Time-period Rule**

This uses the length of time as the criterion in determining areas of management responsibility. Under this simple rule, all long-run decisions are the responsibilities of the board of directors while all other decisions, such as short-run or intermediate as well as immediate decisions are the responsibilities of the manager. Decisions such as the setting up of long-range objectives and goals, the development of a capital formation scheme and the putting up of fixed facilities and the establishment of permanent management development institutions are long-range in nature and are therefore responsibilities of the board of directors. On the other hand, decisions that pertain to short-range commitment of resources, setting up of specific goals, preparation of work programs and the like are assigned to the manager.

#### **3. Trusteeship Rule**

This rule is anchored on the role that the board of directors performs as trustee for the members. As a trustee, the board of directors has to perform for and in behalf of the members such things as the proper management of the members' equity, arrangement for external audit, establishment of effective controls and development of a stable reserves system. These are all considered management responsibilities of the board of directors and these responsibilities, being inherent on the board of trustees, cannot be delegated. In the main, all other matters which are outside the scope of the trustee role of the board of directors are categorized as responsibilities of the manager.

Since, as already emphasized earlier, it is futile exercise to compartmentalize in absolute terms the respective management responsibilities of the members, the board of directors and the manager (especially of the last two), some occasional breakdown in their relationship are but to be expected. A

EXHIBIT IV - 1

DELINEATION OF RESPONSIBILITIES OF THE BOARD OF DIRECTORS AND THE MANAGER

| Particulars  | Responsibilities of the Board  | Responsibilities of the Manager  |
|--|--|--|
| <p><b>A. Basic Responsibility and Authority</b></p> <ol style="list-style-type: none"> <li>1. Basic responsibility</li> <li>2. Sources of authority</li> <li>3. Claim to office</li> <li>4. Line of responsibility</li> </ol>                      | <p>To manage the cooperative.</p> <p>Direct authority from the members and from the law.</p> <p>Selected by the members.</p> <p>Directly responsible to the members.</p>   | <p>To actually manage the cooperative.</p> <p>Delegated authority from the board of directors.</p> <p>Appointed by the board of directors.</p> <p>Directly responsible to the board.</p>   |
| <p><b>B. Specific Responsibilities</b></p> <ol style="list-style-type: none"> <li>1. Planning function               <ol style="list-style-type: none"> <li>a. Long-range plans</li> <li>b. Short-range and immediate plans</li> </ol> </li> </ol> | <ol style="list-style-type: none"> <li>1. Interprets organizational objectives and sets goals.</li> <li>2. Formulates and adopts policies.</li> <li>3. Approves commitment of resources including finances, manpower and facilities.</li> <li>4. Establishes managerial development and training program to perpetuate personnel succession in key positions.</li> <li>1. Approves goals, policies and programs.</li> <li>2. Approves the budget.</li> </ol> | <ol style="list-style-type: none"> <li>1. Prepares detailed plans and programs to attain objectives and goals.</li> <li>2. Assists in the development of and implements approved policies.</li> <li>3. Assists in the development of and implements approved policies.</li> <li>4. Assists in the development of and implements approved policies.</li> <li>1. Sets goals and prepares policies, plans, and programs.</li> <li>2. Decides commitment of</li> </ol> |

| Particulars                             | Responsibilities of the Board   | Responsibilities of the Manager  |
|---|---|--|
| 2. Organizing function<br>a. Structural | 1. Approves organizational structure and job descriptions.  | resources and the organization and control of these resources including the preparation of the budget.<br>1. Prepares organizational structure and job descriptions. |
| b. Staff                                | 2. Appoints manager and approves appointments of key personnel.   | 2. Recruits and recommends appointment of key personnel and hires other subordinates.  |
| 3. Directing function                   | Not involved in direct management nor engaged in operations.  | Directs all activities of the cooperative.   |
| 4. Coordinating function                | Coordinates activities of the board.  | Coordinates the functions of all the resources of the cooperative.   |
| 5. Controlling function                 | 1. Reviews objectives and goals and determines need for revision to make them current with emerging trends. | 1. Determines effectiveness of policies, plans, and programs in pursuing objectives and goals.   |
|   | 2. Conducts general review and evaluation of extent of compliance with and effectiveness of policies.       | 2. Makes detailed evaluation of status of short-range and immediate commitment of resources.   |
|   | 3. Makes general measurement and comparison of actual achievements against projections in operations.       | 3. Conducts detailed periodic measurement and comparison of actual results against expected results of operations.   |
|   | 4. Assessess general status of long-range commitment of resources   | 4. Takes immediate positive action to correct problems and weaknesses in the management and operations.  |
|   | 5. Evaluates general progress and effectiveness of managerial development and training scheme.              | 5. Provides the board with all information and reports, usually general or broad in nature, necessary for its efficient discharge of its controlling functions.      |

representative list of some of the common causes of the strained relationship among the components of the management team highlights the following: (a) failure of the board of directors to establish clear-cut objectives and goals; (b) assumption by the individual cooperative directors or by the board itself of the management prerogatives of the manager and vice versa; (c) employment of the close relatives of the cooperative directors and manager which is plain nepotism; (d) tendency of the cooperative directors as well as the manager to devote more time to the minor and not to the more important details of their responsibilities; (e) electioneering by the manager during the election for directors; and (f) failure of the manager to provide the board with complete and accurate information. However, problems and weaknesses of this nature are really bound and are expected to happen. What is really important is to detect and arrest problems at an early stage before they can do any real harm to the association.

There are, of course, graver problems which can be considered as extreme cases of the malfunctioning of

the cooperative management system. One such problem is the institution of a "one-man" rule in a cooperative as a result of the conversion of cooperative directors into "yes" men of the manager or the president, as the case may be, thus reducing the board into a mere rubber stamp of the wishes of just one man. Another is when the manager and the board of directors connive in the commission of anomalies thereby making a mockery of the trustee role of the board.

All these negative outgrowths of the two-sectoral management relationships can certainly be neutralized and suppressed. Firstly, by the conscious efforts of every member of the management team to understand in full the nature and extent of the management responsibilities of each member. Secondly, for each of them to respect the rights and responsibilities of the others. And then finally, for them to discuss frankly and openly all questions involving management responsibilities when they arise and seek to arrive at decisions which are mutually beneficial and satisfactory to all.

**CHAPTER V**

**THE SPECIALIZED FIELD  
OF COOPERATIVE MANAGEMENT**





## CHAPTER V

# THE SPECIALIZED FIELD OF COOPERATIVE MANAGEMENT

*A practical definition of cooperative management is suggested and its importance indicated. Three peculiarities of cooperative management are highlighted: (a) to provide its members with more economical and efficient services; (b) to recast the pattern of distribution of savings; and (c) to place the control of a cooperative in the hands of its member-users. The five functions of management, namely: (a) planning, (b) organizing, (c) directing, (d) coordinating, and (e) controlling are discussed briefly.*

### I. DEFINITION AND IMPORTANCE OF COOPERATIVE MANAGEMENT

#### A. *Cooperative Management Defined*

Cooperative management may be defined as the efficient and effective utilization of the resources of a cooperative as a business organization for the purpose of serving the needs of its members within the context of the accepted cooperative principles.

This definition of cooperative management, which is quite different from those in circulation, was formulated precisely with the intent to stimulate immediate awareness to two very pertinent guidelines for operations. In the first place, it fixes the overriding objective to which all efforts in a cooperative should be directed, that is, to serve the needs of its members. And in the second place, it clearly suggests that the conduct of all activities must be governed jointly by two sets of principles namely: (a) cooperative principles and (b) business management principles.

While the objective of a cooperative

may be a common knowledge and clear at the time of its organization, particularly when it is a real concrete outgrowth of the desire of the members to help themselves in satisfying their common needs and interests, the vision may become increasingly obscure and hazy as the cooperative becomes larger and older. In due time the employees and even the manager may have to be reoriented on the real objective of the cooperative as they become more and more preoccupied with their activities. Indeed, the cooperative becomes a farce and all efforts can be considered naught when the management loses sight of its basic objective of serving the needs of its members.

The foregoing definition of cooperative management also impresses upon the fact that cooperatives are in reality business organizations which are particularly designed to operate within the framework of cooperative principles.

#### B. *Need for Sound Cooperative Management*

Among the many reports of failures of cooperatives, definitely the most authori-

tative was the report entitled *Farmer's Cooperative Discontinuances* by W. W. Cochrane and R. H. Elsworth of the Farm Credit Administration, United States Department of Agriculture dated June 1943. The said report, involving 14,655 associations, covered the period from 1863 to 1939, inclusive, a span of 76 years.

In the study, 11,272 reasons for discontinuances were classified and the frequency for each indicated as follows: (a) difficulties in the field of management, a frequency of 2,234 or 19.8 per cent; (b) difficulties in the field of membership, 2,220 or 19.7 per cent; (c) natural or unavoidable cause, 1,233 or 10.9 per cent; (d) insufficient business for efficient operation, 1,161 or 10.3 per cent; (e) financing and credit difficulties, 1,097 or 9.7 per cent; (f) transportation problems, 1,020 or 9.0 per cent; (g) oppositions from competing enterprises, 1,003 or 8.9 per cent; (h) declining prices, 614 or 5.4 per cent; (i) consolidations or mergers, 361 or 3.2 per cent; (j) technological changes, 357 or 3.1 per cent; and (k) miscellaneous reasons, 218 or 1.9 per cent.

A detailed breakdown of the 2,234 cases of "difficulties in the field of management" which was the main reason advanced for the failures follows: (a) ineffective management, 1,290 cases or 57.7 per cent; (b) high overhead, 224 or 10.0 per cent; (c) inadequate accounting and auditing, 99 or 4.0 per cent; (d) dishonest officials, 73 or 3.3 per cent; (e) one-man organization which failed without him, 60 or 2.7 per cent; (f) speculation, 45 or 2.0 per cent; (g) too high operating cost, 30 or 1.3 per cent; (h) poorly located plant, 30 or 1.3 per cent; and (i) others, 2 or 0.1 per cent.

## II. PECULIARITIES OF COOPERATIVE MANAGEMENT

Cooperative management as a specialized field has its own peculiarities that stem from some of the specific objectives or goals of cooperative corporations which are different from those of ordinary corporations. These objectives are inherent in cooperatives and actually give substance and validity to the cooperative principles.

In this regard, it is felt that the novel objectives of cooperatives which, as previously stated, are by themselves the peculiarities of cooperative management can best be isolated and defined in bold relief by comparing some of the basic features of a cooperative corporation with those of an ordinary corporation. The contrasting features of the two types of corporations are outlined in the following Exhibit V-1.

The specific objectives of cooperatives which, as emphasized earlier, actually represent the peculiarities of cooperative management are discussed hereunder. It is stressed that they are closely related to one another; one objective strengthens and reinforces the other.

### A. *To Provide its Members with More Economical and Efficient Services*

This paramount objective of a cooperative is actually a protest against the apparent excessive costs and wastes of the other methods of doing business. Consequently, compared with the other business organizations, a cooperative should be able to provide its members any of the following: (a) better service at lower cost; (b) the same service at lower cost; or (c) better service at the same cost. Otherwise there is absolutely no reason for its existence. The members might just as well not organize such a cooperative and instead just continue doing business with the existing non-cooperative entities. The various facets of the cooperative principles, it will be observed, are all designed to make the cooperatives viable instruments of service capable of meeting headlong the problem of economic efficacy and social economy.

The all-important task of making cooperative business more economical and efficient is a firm commitment that the management of cooperatives cannot shirk from. It is duty-bound to develop a cooperative into a paragon of business efficiency with the proper blending of accepted and effective business management practices. And in the process, it is obvious that the management of cooperatives should not merely duplicate or imitate the services being rendered by the ordinary corporations. It should be able to present a different

EXHIBIT V - 1

COMPARISON OF AN ORDINARY CORPORATION AND COOPERATIVE CORPORATION

| Particulars                                  | Ordinary Corporation                       | Cooperative Corporation  |
|--|--|--|
| 1. Legal basis of organization               | Corporation law                            | Usually specific co-operative law  |
| 2. Primary purpose/motivation                | To make profit                             | To serve the needs of the members at cost  |
| 3. Basic requisite for membership/ownership  | Ability or capacity to buy shares of stock | Can make use of the services of the cooperative and willing to accept responsibilities of membership |
| 4. Patrons/customers                         | Generally non-owners or the public         | The members  |
| 5. Basis of voting                           | Shares of common stock                     | "One member, one vote" in primary societies  |
| 6. Components of management                  | Board of directors and hired management    | Members, board of directors and hired management   |
| 7. Principles governing operations           | Business management principles             | Business management and cooperative principles   |
| 8. Rate of interest on share capital         | No limit                                   | Limited and conforms to government regulation  |
| 9. Basis for distribution of savings/profits | Shares of stock                            | Patronage or volume of business contributed by the members   |
| 10. Educational program                      | Practically none                           | Continuing cooperative education program for those within and outside the movement.                  |

business image by introducing new and innovative business practices and strategies with a view to improving the services it caters to its members. In fine, it is and should be the continuing mission of cooperative management to make cooperatives *innovators* and *pacesetters* in their respective fields.

***B. To Recast the Pattern of Distribution of Savings (Profits) by Making Patronage and Not Capital as the Residual Claimants of the Savings***

This marked departure from the conventional theory of distribution of savings

in cooperatives wherein the volume of business contributed by a member-patron and not the amount of capital contributed by a member-owner is made the basis of distribution of the savings of a cooperative, has led to the emergence of the cooperative concept of rendering service at cost to the members. This is of course in accordance with the cooperative principle on the distribution of savings or surplus.

The philosophy behind this modified theory of distribution of savings which recognizes the fact that in a cooperative a premium should be placed on patronage over that of capital also dictated the need

for another principle whose workings complement the aforementioned principle on the distribution of savings and fully supports the revised distribution theory. Reference is made to the principle which sets a ceiling on the rate of interest that may be allocated to share capital.

In order to effectively pursue this objective and give full meaning and substance to the two subject principles involved, it is incumbent on cooperative management to adopt and institute such measures as may be deemed necessary in the premises. One area in management which definitely should be given major emphasis is the installation of a rigid system of cost allocation and control. A basic requisite of this is that the entries in the books of accounts should be complete, accurate and up-to-date and that the transactions of each and every member-patron should be properly recorded in individual ledger cards. Also, this requires a realistic pricing policy that will govern the general dispensation of goods and services.

### *C. To Place the Control of a Cooperative in the Hands of Its Member-Patrons*

This objective of cooperative management seeks to give the power of control in a cooperative to the mass base of member-patrons, as in a real democracy, and to preclude the tendency to concentrate the power of control in a few as when said control is identified with the number of shares of stocks owned by the members. In brief the bone of contention is that a cooperative should be controlled by the members as "users" or "patrons" and not as "investors." The most widely known cooperative practice of "one member, one vote" was formulated as a precise guideline in meeting this objective.

Again from the viewpoint of cooperative management, the fact that the power of control resides with the member-patrons should provide distinct clues and suggested actions that should shape and guide their thinking and efforts. There is a pressing

need for cooperative management to work out a program that provides for a free exchange of communication between the members, on the one hand, and the board of directors and hired management on the other. In order that the member-patrons may be able to exercise effectively their power of control and participate actively and intelligently in the management of their cooperative, they should be constantly and regularly informed and apprised of the various aspects of its management and operation. They should particularly be kept abreast of the status of the different operations including the problems being encountered, the financial condition and the projected plans and programs. On the other hand, the cooperative management should have an open and continuous dialogue with the members and encourage them to air their views, opinions and thinking on any and all matters of common interest and concern. The promotion of this vitally important feeling of involvement of the member-patrons in the affairs of their cooperative will of course be completely fruitful if the voice of the member-patrons will not only be heard, but more important, heeded in meritorious cases.

### III. FUNCTIONS OF MANAGEMENT

Most authorities categorize the functions of management into five: (a) planning, (b) organizing, (c) directing, (d) coordinating, and (e) controlling. They can be conveniently identified by taking the first two letters of each function and placing them together to form the acronym "Plordico-co."

The management of all business organizations, without any exception and regardless of the structural classification and management level, have to plan, organize, direct, coordinate and control their activities. These five functions are common to all management and they form or represent the chain that holds the key to successful management. Each has to be performed to an acceptable level or degree of efficiency.

## **A. Planning Function**

### **1. Definition and Scope of Planning**

Planning is usually defined as “the thoughtful determination and systematic arrangement of the factors that will be required in the successful operation of an enterprise.” Specifically, it is determining in advance: (a) what shall be done; (b) why it should be done; and (c) how and by whom should it be done.

In a real sense, planning is the starting point or genesis of any business enterprise. It is a primary requisite to the other management functions. It covers the whole range of activities from the defining of the overall objectives to the setting forth of specific target goals and to the planning of the corresponding work programs including the formulation of the appurtenant policies, procedures, practices and strategies.

### **2. Importance and Uses of Planning**

The importance and uses of planning may be briefly stated as follows:

- a. Planning pinpoints the long-run objectives and the short-run goals of the business enterprise in order that the management team will be made aware of the expected product of their total efforts.
- b. Planning determines the needed and the proper coordination of vital support components in terms of personnel, facilities, and financing for the effective pursuance of the objectives and goals.
- c. Planning identifies the pertinent work programs and alternative courses of action with the package complement of relevant policies, procedures, practices and strategies.
- d. Planning establishes the different bases for and area of coordination of both efforts and facilities for the purpose of achieving maximum results.

e. Planning devices a system of control and sets the corresponding standards so that any undesirable deviation of the actual from the projected results can immediately be corrected.

### **3. Responsibility for Developing Plans and Some Planning Tools and Techniques**

Being a function of management, planning in a cooperative should logically be the combined responsibility of the three components comprising the management team. An ideal plan, therefore, is one that represents the collective thinking and efforts of the management team.

In actual practice, however, the involvement and participation of the members in planning is confined to the identification of the general objectives and goals of their cooperative. On the other hand, the contribution of the board of directors is normally limited to the initiation of long-run objectives. And so it is evident that the heavy load of responsibility in planning rests with the hired management.

It is pointed out in this regard that the economic survey which is a basic requirement in the organization of a cooperative, provides a wealth of vital facts and information which are extremely helpful in planning. On the other hand, the cooperative's articles of incorporation and bylaws embody the objectives, capital structure and basic rules governing the internal administration of a cooperative, all of which are essential information in planning.

The management tools which are particularly helpful to effective planning are: (a) balance sheet, (b) statement of operation, (c) cash flow statement; (d) budget, (e) break-even point analysis, and (f) ratio analysis.

### **4. Principles of Planning**

There are some tried and tested principles of management which if properly observed and followed could be

expected to provide a fairly good foundation for a plan:

- a. Define and classify the long-run and short-run objectives and goals and establish a system of priorities for their accomplishment.
- b. Identify expected obstacles or impediments to the attainment of the objectives and goals and provide for their possible remedial measures.
- c. Pinpoint alternative courses of action to achieve objectives and goals and explore the possible consequences or implications of such alternative courses of action.
- d. Determine personnel, facilities and financial requirements.
- e. Fix a time schedule for specific periods or stages of work.
- f. Isolate limiting factors.
- g. Devise a system of determining and evaluating progress and results.
- h. Determine the administrative requirements which have to be met to secure approval of the program and to set it in motion.

The foregoing principles of planning, it is stressed, actually correspond to the so-called scientific method of planning. In contrast to the two other methods of planning, namely: (a) the trial and error planning and (b) the initiative planning, the scientific method of planning is based upon a logical gathering, interpretation and analysis of facts.

## **B. Organizing Function**

### **1. Definition and Scope of Organizing**

Organizing is commonly referred to as "the grouping of activities and the fitting together of people in the best possible relationships as to get work done effectively and economically, and to help achieve the objectives and goals of the enterprise."

Included in the organizing activities

are: (a) recruitment and development of personnel; (b) outlining and establishment of relationships between and within the various levels of management; (c) installation of the various procedures, methods and systems; and (d) procurement of the necessary tools, equipment and supplies.

Viewed in its proper perspective, organizing has two distinct but closely related aspects: (a) organizing the business structure which refers to the outlining of the structures of work, and (b) organizing the staff which involves the selection and assignment of persons. Only the first aspect of organizing will be discussed here since there are many excellent materials on the second aspect of organizing the staff which actually falls within the realm of personnel management.

### **2. Organizing the Business Structure**

The organizational structure is in reality a management tool or strategy that makes possible the fitting together of various people of the organization into a well-coordinated working team. Commonly presented in the form of an organizational chart, the organization structure serves many important uses: (a) it helps to coordinate the efforts of the different employees; (b) it provides communication channels between the different levels of management; (c) it facilitates the exercise or delegation of authority; and (d) it assists in the assigning of responsibility and enforcing accountability.

#### **a. *Types of organization structure***

The different organization structures are grouped into three: (a) line structure, (b) functional structure, and (c) line and staff structure. The line and staff structure is the predominant type and practically all cooperatives have adopted the said organizational structure.

#### **(1) Line structure**

In the pure line structure, the head of an operating unit has the authority over all the activities in his unit. Each

unit, which represents a major line of activity of a cooperative, as for example, marketing of grains or procurement of farm inputs, is essentially a complete outfit by itself. It is provided with all administrative and accounting support, and operates and pursues its purposes of the unit on its own without the help of specialists. Under this setup, the unit head is responsible only to his immediate supervisor.

This type of organizational structure has its advantages as well as disadvantages. Among its advantages which may be cited are: (a) responsibility is easily pinpointed since the authority of the head of an operating unit is undivided and he therefore assumes sole responsibility for the efficient functioning of his unit; (b) decisions are made faster since the decision-making process is centralized in the executive; and (c) it is easily understood because there is only one line of authority and responsibility that passes through each person, one on top and one below him.

On the other hand, the principal disadvantage of the pure line structure is the usual difficulty of locating a line unit head with sufficient background and training to cope with the usually multifaceted activities of the line function. It will be realized in this regard that the line executive should be an all-around man, nay, a "jack of all trades."

## (2) Functional structure

In the case of the functional structure which, incidentally, is considered impractical and therefore has never gained acceptance in business enterprises, a unit head has authority for only one specific function and he is responsible to a composite corps of specialists belonging to various specialized units of their own. The whole organization is, therefore, built around specialized effort, specialized direction and specialized control.

The functional structure is firmly anchored on specialization and this specialization is the principal advantage. This advantage, however, is greatly

outweighed by the unclear and usually conflicting lines of authority bisecting one subordinate to several specialized supervisors giving rise to widespread confusion in the whole organization. For this reason, the pure functional structure has not gained any inroad in actual practice. Its only value, it seems, lies in promoting proper understanding of the "line and staff" form of organization structure.

## (3) Line and staff structure

There are two classes of unit heads in the line and staff structure, the line unit heads on the one hand, and the staff unit heads, on the other. The units of the line heads pursue the major lines of activities of the organization while the units of the staff heads advise and assist the units of the line executives in their activities. It will thus be realized that the line and staff structure is a combination of the line and functional structures.

Under this setup, all the units, whether of the line or staff heads, have their own complete and separate authority. In relation to each other, however, the staff group serves only as an "advisory" staff for the line group. It therefore has no authority to direct or control the line group. In this sense, the line and staff structure retains and harmonizes the most desirable features of the pure line structure and the pure functional structure, specifically the individual authority in the pure line structure and the services of specialists in the pure functional structure.

The practical use and value of this type of organizational structure is acknowledged and it is the most predominant type of structure now in use in all forms of business enterprises. It may be mentioned that the military is one of the great exponents of the line and staff organizational structure.

## C. Directing Function

### 1. Definition and Scope of Directing

In the main, directing is "getting work done through others." It refers to

the detailed day-to-day activities of an executive in relation to his subordinates to the end that working as a team, an executive and his subordinates can obtain the best possible results in the execution of particular plans and projects. Directing, which is considered one of the most intricate functions of management, also includes personnel development. Necessarily, effective executive direction probes deep into the field of human relations and therefore heavily leans on the growing science of psychology and sociology as applied to business situations. In this regard, cooperative management, more than any other specialized field of management, needs for its success a liberal infusion in its system of some vital aspects of psychology and sociology.

A meaningful and masterful summing up of the proper norm of conduct and attitude that should be adopted by an executive if he desires to get best results done through others may be glimpsed from the following excerpt from *A Guide to Modern Management for Cooperatives*, a publication of the Cooperative League of the United States (CLUSA):

“The modern executive must give thought to people, to their interests, to their wants, to their needs for expression and to providing them with a reasonable degree of satisfaction and happiness in and through their work. The modern executive regards each person as a unique individual different from each other person. Through individual contacts he finds out what makes each person tick; he demonstrates a sincere personal interest in individuals; he makes people feel secure; he appeals to positive gains and interests rather than to fears; he gives recognition for good performance so men set high standards for themselves and seek to maintain such standards. He asks his assistants and subordinates for suggestions, and gives them credit — his whole staff helps him improve

operations. He makes persons want to reach for and take responsibility rather than let the boss do all the worrying. He sets up the challenge of tomorrow being better than today — helps men see opportunity ahead instead of mere routine and monotony and give more of themselves in making reality out of tomorrow’s possibilities.”

## 2. Types of Directing

The three common types of directing are: (a) authoritarian type, (b) persuasive type, and (c) leadership type. Each of these three types of leadership is discussed briefly.

### a. *Authoritarian type*

In the authoritarian type which is the most rigid and stiff type of directing, the executive simply tells, orders and commands. The status of his subordinates is reduced to that of mere receivers of instructions from the top and no more.

### b. *Persuasive type*

Under this type, the executive strives to make his subordinates appreciate and accept the idea and, in turn, instills and spurs the desire to do their work well. Instead of being simply dictated upon, the subordinates are persuaded to maximize their work efficiency.

### c. *Leadership type*

The leadership type which is an adaptation from the concept of consultative management does not only persuade but goes to the extent of consulting subordinates on how they can further improve their work performance. Experience has proven that the leadership type of directing provides the vital motivation for the employees to exert themselves to the limit in their particular jobs. In short, they become more productive employees. Predictably, the employees respond and measure up to expectations when they are considered and treated as human beings with feelings, interests and aspirations of their own and not merely as cogs in a machinery.



### 3. Successful Practices in Direction

Executives can seek refuge in a number of tested and proven practices to achieve effective direction. The successful practices in direction are here presented and briefly discussed:

a. *Determine the specific jobs that should be done (what shall be done)*

It is said that effective executive direction starts with a clear design of work projects. The process of job determination which is considered the foundation of effective executive direction, seeks to pinpoint and define the specific jobs which are considered necessary for the successful pursuance of plans and programs.

In determining the various required jobs, an executive can avail himself of any or all of three steps: (a) *procedural* and *job studies* which generally refer to method improvement and simplification; (b) *analysis charts* which are quite sophisticated and offered as a special subject in industrial engineering, show the relationship between events and people or products or a combination of such relationships; and (c) *specific work assignment* which usually partakes of the preparation of standard practice specifications to avoid the issuance of similar instructions for those managerial and technical jobs that are done repetitively.

b. *Identify individual assignments for specific jobs (who will do it)*

In selecting the right person for the job, an executive has to resolve two major considerations in taking alternative courses of action: (a) which individual in the staff is the most technically qualified for the job and (b) which individual, although less qualified, can be picked for the job for training purposes in furtherance of the long-range personnel development program.

c. *Prepare clear and effective orders, instructions and information (what shall be done and why it should be done)*

This is a critical step and the need for issuing clearcut orders, instructions

and information cannot be overemphasized. In this regard, it may be stressed that it is considered a sound practice to advise the employees not only on what should be done but also why it should be done. This explains the need for supplementing orders and instructions of the "what" aspect with an appropriate information of the "why" aspect.

On the matter of issuance or giving of orders, instructions and the attendant information — an area which is very vulnerable to confusion and friction among the employees and between the department — it will do well for an executive to give particular attention to the following two rejoinders: (a) the *order-giving* should be made to conform with the needs and circumstances of the situation and (b) the *order, instruction and information* should be viewed as *attitude-influencing* as well as of training value, or in short, the executive must assume the role of teacher in giving orders. In this regard, the order-giving should be directed by the following facets: (a) *organizational aspects*, that is, correct and recognized flow channels; (b) *relation to purpose*, that is, how urgent it is to get the job done and how detailed the orders have to be; (c) *relation to individuals involved*, that is, as to their technical competence as well as to their peculiarities and sensitivities; and (d) *relation to control*, that is, closely supervised projects require detailed written orders.

d. *Establish standards of performance and control points for each person*

Another contributory practice to the success of executive direction is the setting up of two corollary measures: (a) standards of performance for a project and (b) control points. Project standards, which serve as measuring devices for making comparisons between actual performance or results against projected performance, can be structured in terms of: (a) *time*, that is, deadline may be set for completion of projects or their specific stages; (b) *quality*, that is, nature of executive

judgement expected of subordinates or degree of cooperation expected from a group; (c) *quantity*, that is, specific number to be completed within a given time; and (d) *cost, expenses and outlays*, that is, cost per unit budget allocations and authorized expenditures.

On the other hand, control points which denote where and when the progress of a project will be checked can be established based on: (a) *time*, that is, checking time are definitely scheduled; (b) *major points of difficulty*, that is, expected problem areas are identified and progress of work is checked upon reaching those points; (c) *major stage or part of the project*, that is, partial evaluation of the projects is made upon completion of each major stage or part of the project; (d) *geography or place of work*, that is, progress of work is checked as it passes through various hands; and (e) *project standards*, that is, evaluation of work progress based on various quantitative or qualitative standards.

e. *Provide for proper relationships with other executives and organizations*

To be fully effective in directing, an executive should enlist the maximum cooperation of the other executives and departments. Without such cooperation, the executive himself and the entire organization will fare very much lower than expectations and eventually fail. There are two known avenues open for generating cooperation in the entire organization: (a) good organizational planning and (b) frequent interdepartmental meeting.

Under good organizational planning, it is desirable that there should be complete job description for each executive position and for each department. Every executive will thus be in a position to pinpoint his exact status, including his authority and responsibilities in relation to others. Hand in hand with good organizational planning, the holding of interdepartment meetings frequently or regularly can be

expected to foster closer understanding and cooperation among the different sectors in the organization. Common problems can be ventilated, discussed freely and openly. The interdepartment meetings can be a valuable tool for developing interdependent understanding and cooperation when properly conducted.

f. *Maintain a systematic program of overall communication*

Apart and aside from the successful practice of preparing clearcut and effective orders, instructions and information, effective executive direction demands the maintenance of a systematic program of communication that shall cover the entire organization. Specifically, what is envisaged in a three-way communication is compartmentalized as follows: (a) communications from the top echelon down through the organization; (b) communications from the lower echelon to the top of the organization; and (c) communications across organizational lines.

This three-way communication whose path traverses and links all the sectors in the organization vertically and horizontally is vital in generating interactions among the various sectors regarding problems, needs, opportunities, ideas and motivations. It cannot be gainsaid that such interactions provide valuable basis for an effective direction of efforts by executives.

g. *Design a built-in system for the development of the managerial capabilities of the subordinates*

It is the essence of this practice that while directing, an executive is under obligation to develop the managerial capabilities of his subordinates. The basic assumption is that the two processes of directing and instructing should go hand in hand. They are considered intertwined with one another and inseparable.

The concept of learning through experience is particularly applicable in

this regard. Experience is regarded as one of the most effective teachers and developers of individuals. As he directs the activities of subordinates, an executive should impress upon his subordinates the good viewpoints and effective habits that can be learned and gained from experience. In fine, the combination of the directing and instructing processes, properly applied with utmost patience and tact, will ferret out and develop the erstwhile hidden and dormant management talents of the subordinates.

**h. *Adopt a practical program of self-management***

It is the thesis that an executive can effectively carry out the job of directing if he himself makes a systematic planning of his work and time. The executive, it is contended, has to set the best example on how one can make the most propitious use of time and efforts principally by distributing his work load in accordance with specific time schedules which may be daily, weekly, or monthly. This in brief is self-management, the need for which has often been overlooked by the executives themselves in the maze of their multifarious activities, but which is of incalculable value in the effective discharge of the management function of directing.

**4. Main Pitfalls in Directing**

After discussing those practices which make for effective executive direction, it is felt logical to shift the discussion to those practices which tend to give the opposite results. A complete picture of the situation will thus be presented giving a clear perspective of the contrasting situations.

The impediments to effective executive direction which must be avoided are: (a) inadequate orientation on the managerial functions; (b) overzealousness in doing everything; (c) failure to make subordinates conscious of their responsibility; and (d) wrong perspective of superior-subordinate relationship.

**a. *Inadequate orientation on the managerial functions***

It has been observed that this situation usually arises when a purely technical man is elevated to an executive position more as a reward for being a good follower or subordinate rather than on the basis of executive ability. Although already discharging an executive position, the new appointee by force of habit and unable to differentiate between an executive and a technical expert, concentrates more on his specialized expertise instead of attending, as he should, to the management functions. A situation then develops where an executive fails to do the work he is supposed to do and soon finds it an ordeal to break away from this erroneous pattern.

In this regard, a very pertinent observation is quoted in full:

“If an executive is really to be effective, he must be an executive in deed as well as in name. If he is to play his proper role on the team, he must specialize on managerial functions and not on functions of subordinates. His real value is in making managerial decisions, not technical decisions. He can do the best job of making technical designs only if he has good technical assistants. He can't be a technical expert in everything. He can be an expert manager.”

**b. *Overzealousness in doing everything and failing to delegate authority***

The tendency to do a job by oneself and refrain from delegating work and authority to subordinates is another serious obstacle to effective executive direction. It is indeed permissible for an executive to handle really important jobs. But this should be done only occasionally and not as a matter of habit. For then, in the long run, he will be a principal party in undermining his effectiveness as well as the entire department concerned.

In an effort to justify the reluctance to delegate authority to the subordinates, the executive often claims that he has no confidence in his subordina-

tes. It is claimed that he would rather do the job himself instead of taking the risk of assuming responsibility for the performance of an incompetent subordinate. This argument begs logic since it is tantamount to correcting a mistake with another mistake. For if the problem lies with the subordinates who are incompetent, the solution is for the executive to train and educate the subordinates and certainly not for him to do their jobs. Such an executive should definitely devote and direct more of his time and efforts to the building of an effective organization so that he would not be compelled to do the work that he is afraid to delegate.

In the final analysis, an executive who builds the competence of his subordinates and learns to delegate authority in effect avoids being overloaded with activities alien to his executive position, builds up the confidence of subordinates and increases the effectiveness of the team of which he is the leader.

c. *Failure to gain the loyalty and support of the subordinates*

A common complaint of executives which is symptomatic of a serious problem involving cooperation in general is that they could not seem to prod the subordinates into doing what they are supposed to do. The crux of the problem, it seems, relates to the use of the executive of his authority in getting results from the subordinates.

Fundamentally, the authority vested in an executive carries with it the right to give orders and to obtain compliance with his orders. The authority is delegated to him from above, specifically from the board of directors. While the authority delegated from above is sufficient for the purpose of giving orders, the matter of whether the said orders will be complied with or not is another story and is well beyond the right to give orders. This underscores the need for such an authority delegated from above to be supplemented by an authority earned from the subordinates. It must be stressed that the authority from the subordinates cannot

be delegated as a matter of right; rather it has to be gained and earned. In other words, the willingness to cooperate and follow orders have to be developed as a voluntary gesture on the part of the subordinates. It is like winning a vote of confidence from the subordinates.

In order to gain the loyalty and support of the subordinates, a manager should first of all be skilled and, secondly, be fair and alert to the needs and problems of the subordinates. It is imperative that the manager should possess and, more important, practice those attributes on a voluntary basis and without being asked to. The usual half-hearted cooperation being extended by the subordinates can then be expected to bloom into full cooperation from the hearts of loyal and dedicated subordinates.

d. *Vague perspective of superior-subordinate relationship*

This other major impediment to effective executive direction stems from the usually overlooked need to accept the so-called informal resistance of subordinates within the realm of the illogical aspects of motivation. In a real sense, subordinates are not satisfied with the usual logical explanations of the why's and how's of doing a job. It has to be realized that there exists informal relationships between the executive, on the one hand, and the subordinates, on the other, and that they have conflicting belief systems that borders on suspicion and antagonism.

To reduce the suspicion and antagonism of the subordinates when they are not yet deeply entrenched, it will definitely do well to consider the following recommendations of a management authority.

“(1) Give information to subordinates in advance of — not only after — situations or problems or jobs involving potential conflict.

“(2) Explain reasons for actions fully and without a condescending manner. The explanations should give consideration to the viewpoints of the subordinates as well as those of the management.

- “(3) Seek the active cooperation of the subordinates in solving mutual problems and in devising plans and projects. Such participation — of which consultative management is an example — allays the fear of subordinates and assures them that they are significant, important and needed.
- “(4) Avoid as much as possible negative leadership and earmarks thereof because fear breeds fear.”

#### **D. Coordinating Function**

##### **1. Definition and Scope of Coordinating**

By common definition, coordinating is the harmonious and effective fitting together of the components of an organization including people, facilities and other resources to accomplish a unified planned approach toward a predetermined goal or objective. It is a form of integration of activities that involves “building and maintaining harmonious adjustments, promoting synchronized functioning, and creating sound working relationships.”

The management function of coordinating encompasses four specific areas: (a) plans, (b) individual assignments, (c) organizational units, and (d) external activities. It is vitally essential that there should be unity of actions and purposes in these four areas.

##### **2. Specific Areas of Coordination**

###### **a. Plans**

Coordination is an indispensable aspect of planning. Every plan, without any exception, provides for a scheme or a strategy for coordination. Consequently, it is a fact that coordination begins when plans are made and not after the plans are already prepared. Coordination has to be planned well in advance before actual implementation of the plan takes place otherwise the success of an endeavor is bound to be

imperilled. Executives should have beforehand a clear idea of the plan of coordination in various phases of their activities and every preparation should be made to insure that everything shapes into a harmonious and coordinated pattern.

###### **b. Individual assignments**

The systematic unification and translation of individual efforts into one solid team endeavor is one of the basic ingredients of effective coordination. This means that independent individual actions should always be subservient to cohesive team action as well as to team spirit. This calls for providing the individuals all motivations to promote oneness of action and purpose irrespective of their assignments or positions in the organization.

###### **c. Organizational units**

The interdependence of the various units in an organization makes coordination a must if it is desired to produce maximum results. This involves the preparation of realistic and responsive systems, procedures, methods and processes that will integrate the activities of the different organizational units.

###### **d. External activities**

Coordination also includes the fitting together of the activities of the organization with those of other institutions and people over which the cooperative has practically no control. These include the local and national governments, banks and private firms with which the cooperative is doing business and also the general public. An organization is not intended to operate in isolation, particularly a cooperative which is a movement of the people.

The relations with those external agencies and people have to be well coordinated also. This calls for a considerable knowledge of laws and regulations of the business and banking world and also of human relations. This is more of a management by negotiation instead of by direction.

### 3. Characteristics and Elements of Coordination

The basic characteristics and essential elements of coordination are self-explanatory and are therefore only briefly discussed here.

There are three basic characteristics of coordination: (a) *timing*, that is, coordinated timing is crucial to effective coordination particularly in production processes; (b) *appropriateness*, that is, the judicious and wise choice of people, facilities and other resources especially in case of changes or modifications in plans; and (c) *flexibility*, that is, coordination must continue in the face of changing trends and conditions which may affect the original plans and projections.

On the other hand, the major elements of coordination are presented as follows: (a) *communication*, that is, each segment in the organization should know what is going on, what is intended and what is expected—a vital aspect where it is essential to maintain an interchange of information and ideas as well as to build understanding; (b) *motivation*, that is, the proper working of the desire and determination of the people to contribute out of their own will and volition for the good of the organization; and (c) *control*, that is, coordination must be sensitive, be properly directed and provide an audit of coordination.

## E. Controlling Function

### 1. Definition and Scope of Controlling

Controlling is “the process of getting plans followed according to specification, evaluating results, and taking remedial action to prevent unsatisfactory results.” It is the management function through which periodic measurements or comparisons are made between the actual performance of an organization against the expected performance under the plan of operations.

Its basic objective is to “assure that performance conforms to plans.”

In other words, to keep the business on proper course. Contrary to the common impression, control is not restrictive but corrective. It is a positive and not a negative function of management. In a management sense, the emphasis in control is planning, measuring and comparing.

### 2. Purposes of Control

The four basic purposes of control are: (a) to determine progress in achieving plans; (b) to predict trends and forecast results; (c) to determine what remedial action is necessary to overcome recurring problems; and (d) to provide information for improving future and related plans and for replanning.

### 3. Methods of Control

The various methods of control may be broadly classified into (a) formal and (b) informal methods. They may be used either singly or in combination with each other. Most organizations put reliance on the combination of the two methods.

#### a. Formal method of control

The formal method of control makes use of factual information such as statistics and written reports. Procedures and systems are usually involved. Facts may be found in written statements of objectives and policies, statistics, special reports, operating results, financial ratios, employee records, stockholders' or members' complaint, employee performance and cost data, just to cite some. These data are used in measuring and comparing performance.

#### b. Informal method of control

The informal method of control relies not so much on written factual information as on observations, inspections, meetings, conferences, conversations and oral reports. Informal controls have been found very effective most especially in the well-managed organizations where the functions of planning, organizing, directing, and

coordinating have been accomplished to a high level of efficiency.

*c. Steps of control*

There are four basic steps involved in almost all controls irrespective of the types of specific controls. Presented in the order that they should be considered, the said steps are: (a) establish criteria; (b) check and report; (c) indicate remedial action; and (d) record information.

**(1) Establish criteria**

Control criteria are established more on the basis of specific goals instead of broad objectives. Such criteria should be established systematically if they are to serve their purpose of measuring or indicating a point standard. In this regard, it has been observed that there is partiality on the use of the so-called *principle of key performance areas* and the related *principle of key indicators*. Both principles which seek to limit or confine control to a selected number of vital areas have been found of immense practical value, especially on the part of the board of directors.

**(2) Check and report**

With the criteria established, the next step involves first, checking of each indicator point to get the necessary status information and, secondly, reporting the information gathered in the prescribed form.

Information may be gathered either directly through personal contacts or indirectly through written reports or through a combination of both methods. The type of report that is found effective in reporting findings is one that uses the principle of exception, that is, a report which advises that "all is well except."

**(3) Remedial action**

The initiation of remedial action is a part of control. Remedial action actually involves changes in any one or all of the following three specific phases: (a) performance, (b) plans, and (c) conditions.

Corrective action in performance which reflects knowledge, skills and attributes may take the form of training, reassignment of personnel, improved direction and the like. Changing plans, on the other hand, includes revision of schedules, modification of prices, improved handling of products, better transport facilities and the like. Slow deliveries, lack of equipment and insufficient personnel are some of the reasons for changing conditions.

**(4) Recording information**

This last step involves the recording of all vital information learned or discovered for future use and guidance. It is important that such recorded information be always available for review especially for purposes of future planning.





**CHAPTER VI**

**COOPERATIVE MANAGEMENT PRINCIPLES,  
TECHNOLOGY AND TECHNIQUES:  
COOPERATIVE MARKETING MANAGEMENT**



## CHAPTER VI

# COOPERATIVE MANAGEMENT PRINCIPLES, TECHNOLOGY AND TECHNIQUES: COOPERATIVE MARKETING MANAGEMENT

*A new dimension in agricultural cooperative marketing is introduced with the conceptualization of its two real aspects within the context of the marketing concept, namely: (a) marketing aspect and (b) supply aspect. Special efforts are exerted to enhance proper understanding of the pooling method of cooperative marketing which is unique to cooperatives. The other common methods of handling members' produce such as—(a) outright purchase for cash and (b) selling on individual account—are also featured. A thought-provoking dissertation on commodity exchanges and futures trading, with emphasis on hedging, is injected into the mainstream of current interest on their possibilities.*

### I. NATURE AND SCOPE OF AGRICULTURAL COOPERATIVE MARKETING

#### A. *Definition of Agricultural Cooperative Marketing*

Agricultural cooperative marketing which is a specialized field of agricultural marketing may be defined as the performance of services that direct the flow of products and services from the farmers to the consumers or users, for the purpose of satisfying the needs of the consumers and attaining the objectives of the cooperative within the framework of the cooperative principles.

As used in the definition, the term *services* has particular reference to the functions performed on or for a product which in one way or another alters or changes its time, place, form, possession or

characteristics. It should be stressed that each of the series of related services involves cost and therefore results in a service-by-service increase in the value of a product. Viewed from this perspective, these services are in truth and in fact business services and should be properly treated as such. Depending on the marketing functions that will be performed, the services may involve the physical handling of a product as in transporting; or they may not involve the physical handling of a product as in financing and risk-taking.

The term *direct* in the definition connotes the specific pattern of action that the services should assume. It is viewed purely from the management standpoint and has particular reference to the management function of directing. It clearly impresses upon the fact that marketing directs or that the basic task of a marketing manager is one of continuous directing. The narrowing down of the specific nature and character-

istic of the business services to the basic management function of directing is founded on the proposition that the market or the consumer and not the farmer should determine the kind of products that should be produced or sold. It fully subscribes to the precept that it is within the task of the marketing manager to work for and direct the production of farm products that *will sell* and not simply those that *might sell*.

The enunciated purpose of agricultural cooperative marketing of "satisfying the needs of the customers" bares open the fact that the contribution of agricultural cooperative marketing should logically *start* and *end* with the customers. It establishes the basic orientation of agricultural cooperative marketing — that is, it should be customer- or market-oriented and not production-oriented. And as previously stressed, this is the basic reason why the services in marketing fall squarely within the particular province of the directing function of marketing management.

The phrase in the definition "attaining the objectives of the cooperative within the framework of the cooperative principles" means that the specific goals and objectives of a cooperative should be first set forth and clearly defined. With such goals and objectives properly projected, there will then be a firm basis for evaluating the results of actual performance and determining any performance gap and eventually pinpointing problem areas. The phrase also stresses that all the while the conduct of the entire marketing process should be one of strict adherence to the cooperative principles.

Viewed in its totality, it will be realized that, in the main, agricultural cooperative marketing is indeed one continuous complete system. And that when the various services are properly coordinated and effectively pursued, the whole of the system is greater than the sum of its parts.

### ***B. Approaches to the Study of Agricultural Cooperative Marketing***

To be really meaningful and purposeful, the study of agricultural cooperative

marketing should perforce be conducted in a systematic and orderly manner. Of the various suggested approaches to its study, three approaches have been found to be the most effective and are traditionally employed. These are: (a) the commodity or product approach, (b) the institutional approach, and (c) the functional approach.

#### **1. The Commodity or Product Approach**

In the commodity approach, the study of agricultural cooperative marketing revolves principally around the agricultural products. For example, the study may center on palay or rice paddy, corn, fruits, vegetables or poultry or livestock products. It will be realized that under this approach, the description and analysis of marketing tend to be specific to a particular commodity. This may seem desirable when the study is confined to only a few products. On the other hand, the study may prove to be time consuming when it involves many products. Also, it usually presents a fragmented picture of marketing.

#### **2. The Institutional Approach**

In the institutional approach, agricultural cooperative marketing is studied using as focal points the various marketing institutions. The study thus probes into the operations of the retailers, wholesalers, truckers, warehousemen, processors and other marketing agencies. Incidentally, these marketing agencies are more commonly referred to as middlemen. As middlemen, those agencies that take title of ownership of a product are called *merchant middlemen* while those who do not take title of ownership of a product are classified as *agent middlemen*.

This study may also emphasize the role of the different agencies as marketing or distribution channels. In which case, a salient aspect of the study should touch on the categorization of the marketing channels based on the number of levels, starting with the producer to consumer marketing channel

as a two-level marketing channel, which is the shortest of the marketing channels. The presence of an intervening agency, say for example a broker, makes the marketing channel a three-level marketing channel. The length of the marketing channels is therefore determined by the number of levels.

Just like the commodity approach, the use of this approach in the study of agricultural cooperative marketing results in quite a limited and specific description and analysis. This approach should, however, hold a special place in cooperative study because cooperatives are certainly marketing institutions themselves and a study of the operations of other closely aligned marketing institutions should be a paramount concern of cooperatives.

### 3. The Functional Approach

In the functional approach, the study of agricultural cooperative marketing uses as common frame of reference the various functions of agricultural marketing. Under this approach, the agricultural marketing processes are broken down into the different functions.

The marketing processes and functions are commonly classified as follows:

- A. Exchange process
  - 1. Buying function
  - 2. Selling function
- B. Physical process
  - 1. Transporting function
  - 2. Storing function
- C. Facilitating process
  - 1. Financing function
  - 2. Risk-taking function
  - 3. Standardization function
  - 4. Marketing information function

In this regard, Edmund D. McGarry, in his study entitled *Some Functions of Marketing Reconsidered*, suggested a modification of the usual way of presenting the marketing functions

in order to make them more understandable, to wit:

- “1. Contactual (Breyer) — the searching out of buyers and sellers
- “2. Merchandizing (Alexander) — the fitting of the goods to market requirements
- “3. Pricing — the selection of a price high enough to make production possible and low enough to induce users to accept goods
- “4. Propaganda — the conditioning of the buyers or sellers to a favorable attitude toward the product or its sponsor
- “5. Physical distribution — the transporting and storing of the goods
- “6. Termination — the consummation of the marketing process”

The aforementioned presentation of McGarry of the marketing functions in sequential steps is believed more descriptive of the different functions involved and makes for an easier understanding and comprehension of the marketing process.

It is important to point out that any marketing process, whether it is simple or complex, involves the performance of marketing functions. The marketing functions may be handled by one agency or several agencies but they must nonetheless be performed. A farmer may, for example, grade or classify his produce in the farm, hire a trucker to haul his produce from the farm to town, then sell it to a wholesaler. The wholesaler in turn stores the produce and waits for a better price before finally selling the produce, in the process assuming all the risk of any price fluctuation. The marketing process here is completed with the farmer performing the marketing functions of grading and selling, the trucker that of transporting and the wholesaler that of buying, storing, financing, risk-taking and selling.

The point being stressed here is that

even if the farmer decides to join a cooperative and let the cooperative handle all or some of the marketing processes for him, the cooperative or the farmer will just the same have to perform the marketing functions involved such as grading, hauling, storing, financing, risk-taking and selling. In other words, it is not a question of whether or not the marketing functions shall be performed. Rather, it is a question of who will perform the marketing functions.

Under this premise, it should be realized that regardless of the approach that will be employed in studying agricultural cooperative marketing, whether it be the commodity approach, the institutional approach or the functional approach, it is unavoidable to take up the marketing functions as they have to be necessarily taken into account and have to be performed. They will have to enter the picture. It is for this reason why the functional approach, although considered to be highly theoretical and therefore more difficult, is recognized as the most helpful among the three approaches.

It is well to emphasize at this juncture that the choice of the proper methodology for the study of agricultural cooperative marketing depends on a number of factors. A major consideration, for example, is the purpose of the study. Another determining factor is the nature and scope of the study. Still another controlling factor is the availability of adequate marketing management expertise to conduct the study. And finally, the size of the budget for the purpose is crucial to the choice of the type of approach that should be adopted.

It should also be borne in mind in this regard that the study of agricultural cooperative marketing can employ either a single or multiple approach. There is actually no firm restriction on the number as well as on the type of approaches that can be utilized for the study.

## II. TWO ASPECTS OF AGRICULTURAL COOPERATIVE MARKETING

### A. *Basic Concepts of Agricultural Cooperative Marketing Management*

Efforts in agricultural cooperative marketing management, just like all management efforts, will have to gravitate around a certain predetermined orientation. Otherwise, there will be a very glaring lack of common direction in the performance of the various tasks of marketing management.

The orientation of agricultural cooperative marketing management may be logically drawn from three pervading concepts: (a) product concept, (b) selling concept, and (c) marketing concept. A fourth concept which some suggest should be appropriately called societal marketing concept is actually an innovation of the marketing concept and will thus be treated as part of the marketing concept itself.

#### 1. The Product Concept

As an agricultural cooperative marketing management orientation, the product concept, which is the oldest guiding concept for producers, assume that customers are sufficiently conditioned to buy good products which are reasonably priced and that very little marketing effort is required to make the necessary sales. Briefly stated, this concept holds that a good product will sell by itself.

It will be deduced that the product concept, the main thrust of which is the concentration of the efforts of the producers to produce fair-priced quality products, is built around two premises. For one thing, it presumes that the customers can ably distinguish competing quality products. For another, it grants that the customers can readily relate the quality of the products with the price. By any standard, these premises have lost their validity in the light of the present marketing situations.

A clear indication that the product concept has outlived its usefulness is

the fact that the present orientation of agricultural cooperative marketing management has practically veered away from it. The adoption of the orientation based on the product concept by any present-day cooperative marketing management simply means that it wants to go against the tide of the current marketing trends and that it is apparently inviting disaster in its operations.

## 2. The Selling Concept

The selling concept holds that customers are not normally inclined to buy the products of the cooperative and have to be induced to do so through substantial marketing or selling effort. In short, it is assumed that the products of a cooperative are *sold* and not *bought*.

The selling concept, under which the main task of marketing management is to maximize sales through hard-driving marketing or selling efforts, is anchored on three premises. The first premise is that left alone to themselves, the customers will not buy enough of the cooperative products. The second premise is that the customers can be prodded to buy through aggressive marketing efforts. And the third premise is that customers will perhaps continue to buy the cooperative's products or become permanent customers, and if they don't, to sell to new customers which are plentiful anyway.

From the foregoing premises, it will be realized that in practicing the selling concept, the cooperative marketing management is evidently imbued with the primary concern of making sale with customer satisfaction merely secondary. The central orientation in the selling concept, it is again stressed, is to employ effectively sales-stimulating techniques and that to make sales is the first and foremost consideration.

The selling concept, incidentally, is commonly practiced by some manufacturing concerns where the so-called power selling is considered essential for the successful conduct of their marketing activities. Automobile manufact-

uring companies are perhaps the greatest exponent of the selling concept.

## 3. The Marketing Concept

The marketing concept presupposes that basically marketing consists of two phases: (a) determination of the needs, wants and values of the customers in a target market and (b) adopting the cooperative to deliver the products desired by the customers more effectively and efficiently than the existing middlemen. The marketing concept, it should be emphasized, recognizes fully the sovereignty of the customers, a time-honored economic theory. It wants to look at agricultural marketing as merely the production and selling of products which the consumers want.

The marketing concept is hemmed in by several interrelated considerations, namely: (a) the attainment of the goals and objectives of a cooperative is tied up with the success of its program of delivering customer satisfaction; (b) the cooperative should have a marketing research program in order to determine the specific wants, needs, and preferences of the customers; and (c) the cooperative must deliver the needs of the customers through an effective and efficient integrated marketing scheme.

### B. *Conceptualization of the Two Aspects of Agricultural Cooperative Marketing*

Farming as a business enterprise normally demands from the farmers two vital decisions which fall squarely within the area of marketing involving (a) the buying or procurement of farm inputs such as seeds, fertilizers, pesticides, etc. and (b) the selling of farm products. In the final analysis, these two marketing decisions are reflected in the statement of operation of the farm business of a farmer this way: all purchases of farm inputs are classified as expenses, on the one hand, while all sales of farm products are considered as revenue, on the other. A farmer who religiously keeps track of his farm expense and revenue items will therefore have a firm

basis for evaluating the soundness of his two-faceted marketing decisions. It is the common observation, however, that in general the farmers are more concerned with what they are getting from the sales of their farm products than on what they are paying for their farm inputs. Stated in more categorical business terms, it is apparent that, in the main, farmers pay more attention to their revenue than to their expenses. This faulty, or to be more specific, this unbusinesslike orientation of most of the farmers understandably works to their great disadvantage more so when it is considered that farmers are exposed to a more difficult market in the buying of farm inputs than in the selling of farm products. It is very significant to take note of the fact that in contrast to manufacturing firms, farmers normally buy their farm inputs or raw materials on a retail basis but sell their farm products on a wholesale basis.

It will perhaps be immediately realized in this regard that the marketing concept orientation in agricultural cooperative marketing management which envisages a broader span of marketing to include production itself can provide the framework that will assist and guide the farmers in making more effective marketing decisions in the buying of farm inputs as well as in the selling of farm products. In this sense, the marketing concept, both from the theoretical and practical standpoints, can be claimed to be strongly supportive of the breaking down of cooperative marketing management in two closely intertwined, as they are in fact inseparable, aspects: (a) the procurement of farm inputs and (b) the selling of farm products.

A very relevant observation in this regard should be noted with great interest. At present, practically all, if not all, agricultural marketing cooperatives are engaged in the business of procurement of farm inputs. These types of agricultural cooperatives are popularly referred to as agricultural marketing and supply cooperatives. The needs and wants of their members leave no alternative to the agricultural marketing cooperatives but to extend their activities to the buying of farm inputs or

supplies. It will be realized that this development actually brings the operations of agricultural cooperatives, knowingly or unknowingly, into the very root of the marketing concept.

At this juncture, it is felt that a patently clear picture of the total scheme of agricultural marketing, particularly in the light of the marketing concept, may be visualized with the help of the following diagrammatic illustration (Exhibit VI-1). In order to accentuate its practical value, the illustration highlights the plight of the farmers under two contrasting situations—one in which the farmers buy their farm inputs and sell their farm products on their own and without the benefit of a cooperative (Scheme I); and the other in which they buy their farm supplies and sell their farm products with the benefit of a cooperative (Scheme II). In this way, the specific role that an agricultural marketing cooperative can perform to help alleviate the miserable plight of the farmers may be fully pinpointed and demonstrated.

It will be noted in the illustration that there are three sectors which are actually involved in the broad spectrum of agricultural marketing, namely: (a) the farmers or producers, (b) the consumers or users, and (c) the suppliers of farm inputs.

The farmer sector which represents the heart of the agricultural marketing system constitutes the production system. Under the situation where the farmers elect to pursue their farming activities mainly on an individual basis, the production system suffers from at least three major handicaps: (a) high cost of farm supplies, (b) production-oriented system, and (c) generally low production and productivity. These handicaps coupled with the usual perishability, seasonality and bulkiness of farm products and the normally disorganized system of moving the products to the customers are contributory factors to the usual low returns that the farmers get from their farming business.

The marketing aspect which encompasses all services performed in the flow of farm products from the farmers to the consumers or users is represented in the illus-



tration by the various participating institutions or agencies. The consumer market is represented as the largest and final market. Also shown are the so-called intermediary markets: (a) producers market, (b) resellers market, (c) government market, and (d) export market. Linking the farmers with the different markets are the marketing channels of varying lengths depending on the number of levels in each marketing channel.

On the other hand, the supply aspect covers all activities relative to the procurement of farm supplies by the farmers from the suppliers. The illustration shows that there are two general types of suppliers that commonly serve the farm input requirements of the farmers: (a) the wholesalers and (b) the retailers. Accordingly, this means that there normally exists two price structures in the farm supply business: (a) the wholesale price and (b) the retail price. The wholesale price is of course lower than the retail price.

An entirely new complexion is created in the illustration by incorporating an agricultural marketing cooperative in the picture (Scheme II). The grouping of the farmers into an agricultural marketing cooperative brings with it several expectations.

In the production system, which is actually the province of the farmer sector, the agricultural marketing cooperative is expected to change the system's orientation from that of producers to that of consumers. This involves the proper determination and monitoring of the needs and wants of the customers. In addition, the agricultural marketing cooperative can very well provide a number of essential services especially in the areas of farm management and credit thus pushing production and productivity to a higher level.

On the other hand, in the marketing aspect, the agricultural marketing cooperative is expected to introduce innovations in the performance of some marketing services which are calculated to make the scheme more efficient and effective. In deciding to handle any of the marketing services at present being performed by middlemen, the agricultural marketing cooperative should be thoroughly convinced

of its capability to render either (a) better service at less cost or (b) better service at the same cost or (c) the same service at less cost. These are the only options open to an agricultural marketing cooperative in this regard and unless it can live up to any of these considerations, there is no justification whatsoever for it to embark on any of the marketing services or, for that matter, for it to be organized in the first place. Such a move will definitely serve no useful purpose and it will just be another of those futile and costly ventures.

And finally in the supply aspect, the farmers through their marketing cooperative can possibly purchase their farm inputs this time from their cooperative and no longer from the retailers as they used to. A substantial reduction in the cost of farm inputs can therefore be realized representing the difference between the wholesale price and retail price of a farm input. Furthermore, there are other excellent opportunities that can be considered in the supply aspect. For example, the marketing cooperative can look into the possibility of buying fertilizers and pesticides in large quantities or in bulk at discounted prices. Pesticides can be bought by the gallon and then packed or bottled in smaller quantities in accordance with the usual requirements of the farmers. Also, the marketing cooperative may attempt to do its own mixing of fertilizers and pesticides with the use of formulations which are more suitable to the needs of the farmers and of the soil. In the case of mixing fertilizers, the formulation can be based on the specific requirements of the soil as indicated or recommended in the soil analysis. In this way, fertilizers and pesticides which are cheaper and more effective will be made available to the farmers. Furthermore, the marketing cooperative may seriously consider the establishment of a seed farm to take care of the seed requirements of its members. The farmer-members will then have a regular supply of seeds of the right quality and sufficient quantity at the right time at a possibly cheaper price.

Predictably, the attainment of these expectations in the establishment of an agricultural marketing cooperative will ulti-

## SCHEME II: EXPECTED SITUATION WITH A COOPERATIVE (GROUP ACTION)

### A. Supply Aspect of the System

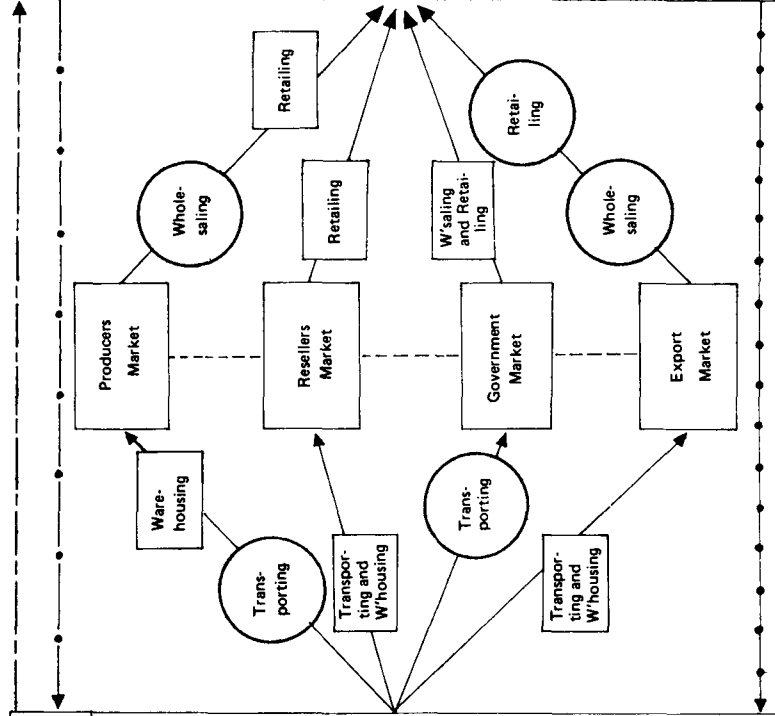
| 1. Suppliers Sector |   |
|---------------------|---|
| Farm Inputs         | Kinds of Suppliers                                |
| Seeds               | 1. <u>Cooperatives</u>                            |
| Fertilizers         | (wholesale price)                                 |
| Pesticides          | <u>Opportunities:</u>                             |
| Feeds               | a. bulk buying of inputs;                         |
| Sprayers            | b. farm mixing of fertilizers and pesticides; and |
| Others              | c. establishment of seed farms                    |
|                     | 2. <u>Ordinary Suppliers</u> (retail price)       |

### B. Marketing Aspect of the System

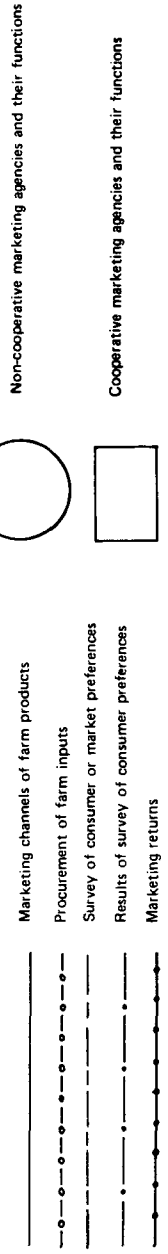
#### 2. Farmers (producers) Sector

| Expected Characteristics of Innovative Production System |
|--|
| o Consumer- or market-oriented system                    |
| o Higher production and productivity                     |
| o - scientific method of farming                         |
| o - better quality and cheaper inputs                    |
| o - light post-harvest losses                            |
| o Adequate and timely credit                             |
| o Higher marketing return                                |
| <u>Net result:</u>                                       |
| Higher farm income                                       |

#### 3. Consumers Sector

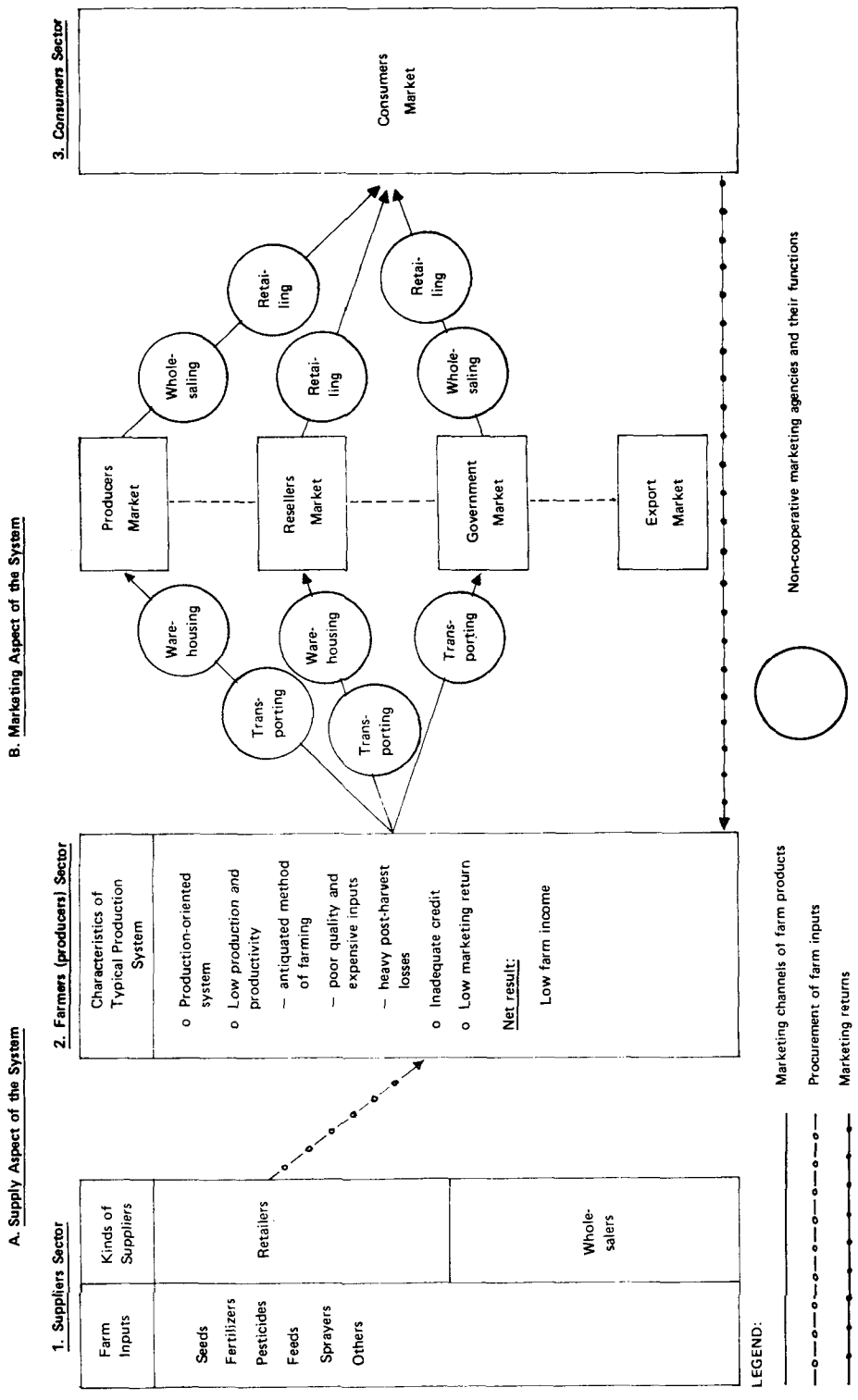


LEGEND:



**EXHIBIT IV - 1**  
**DIAGRAMMATIC SCHEMES OF THE AGRICULTURAL MARKETING SYSTEM**  
**DEPICTING A WITH AND WITHOUT A COOPERATIVE SITUATION**

**SCHEME I: TYPICAL SITUATION WITHOUT A COOPERATIVE (INDIVIDUAL ACTION)**



mately mean higher returns and therefore more profitable business for the farmers.

### III. THE POOLING METHOD OF CO-OPERATIVE MARKETING

#### A. *Definition of Pooling, Its Objectives and Basic Features*

##### 1. Definition of Pooling

Pooling is a method of cooperative marketing that is unique to cooperatives whereby the products of the members are physically commingled and sold collectively during a particular period and then paid, usually in accordance with established grade, an average price derived after deducting the total expenses from the sales proceeds.

Immediately there are two things that can be deduced from the foregoing definition of pooling. In the first place, pooling is a method of cooperative marketing. As such, it is regarded as a novel marketing scheme that is indigentous to cooperatives. Precisely because it is considered a distinctive cooperative practice, pooling is sometimes erroneously considered as cooperative marketing itself. Aptly stated, the fact is all poolings are cooperative marketing schemes but not all cooperative marketing schemes are poolings. Another misconception that may be cited in this regard is that many are inclined to regard a "pool" as synonymous to a cooperative. This impression has of course to be corrected for while it can be generally claimed that all pools are cooperatives, it cannot equally be claimed that all cooperatives are pools.

The other thing that can be gathered from the definition of pooling is that, in the main, it has three distinct features: (a) the products are physically commingled; (b) the sales receipts or proceeds are lumped together and the net returns are distributed proportionately to the participating members on the basis of an average price; and

(c) the expenses, both fixed and variable, are all treated in common. In the light of the aforementioned general features of pooling, it will be realized that pooling is basically an averaging process.

##### 2. Objectives of Pooling

As a novel marketing practice of cooperative creation or orientation, pooling is especially geared to effectively pursue the following set of closely related objectives:

###### a. *To diffuse the marketing risks among the participating members in the pool*

Marketing is fraught with risks at every turn. Risks of price fluctuations, proper choice of the most advantageous market, precise meeting of delivery periods, and handling losses, among others, are normally assumed by individual members in marketing. Pooling, however, seeks to shift the various risks in marketing from an individual to a collective basis. Under this scheme, all risks attendant to the marketing of the products in a pool are absorbed equitably by all the pool members.

###### b. *To enable management to work out a realistic and systematic marketing program*

Under pooling, the marketing of all the products is placed under the discretion of the management. With such a substantial leverage in terms of adequate volume, the management is in a position to map out a well-laid-out marketing program, more specifically, a systematic schedule of an orderly unloading of the products, including the development of new market outlets. Pooling also places the management in a strategic position to bargain more effectively for higher prices since the time period of the pool is usually long enough as to give management sufficient withholding power to transactions.

###### c. *To effect economies in distribution*

Pooling enables a cooperative to operate on a relatively large scale. Thus, it can avail itself of economies

of scale in the various stages of distribution. The volume handling of the products in a pool will obviously result in the desirable spreading of costs of such vital marketing activities as grading, packing, hauling, processing, etc. all of which can be translated ultimately in terms of lower per unit cost.

### 3. Basic Characteristics of Pooling

The general profile of pooling is briefly outlined as follows:

- a. The three items which are pooled in particular are: (a) products, (b) expenses, and (c) sales receipts.
- b. Pools are set up for particular products and their scope is normally specified as to (a) grade, (b) area covered, and (c) length of period.
- c. The legal authority to engage in pooling is expressly given to the cooperative by the members either in the bylaws or in the members' contracts. Under said authority, the management of the cooperative assumes full control of the marketing of the pooled products.
- d. The products in a pool are paid a uniform average net price, usually on a per grade basis, after all of them had been sold. In some cases, however, pool members are given advance partial payments.

## B. Nature and Scope of Pooling

### 1. Main Components of Pooling

Basically there are three things that can be pooled: (a) products, (b) expenses, and (c) sales. The pooling of each will be discussed briefly:

#### a. Products

There are two main classifications of products: (a) those that must be physically commingled and (b) those that may be handled separately.

The best examples of those products that must be commingled in order that they may be handled economically are milk which will be processed into cheese and cream which

will be made into butter. These products which are normally delivered to the cooperatives in small quantities are mixed together and therefore lose their individual identity. Depending on the desire of the members, a cooperative may handle these products in three different ways: (a) buy them outright; or (b) sell them for the account of the member; or (c) pool them with respect to sales. The point being stressed is that the fact that a product is physically commingled does not necessarily mean that it has to be pooled.

Such products as rice and corn in sacks, fruits and vegetables in crates or basket; and livestock and poultry products are examples of those that belong to the second category. Although they are handled separately since their identity can be preserved, these products may be included in the pool.

It is of no particular concern in pooling whether or not the products of the members are physically mixed with one another. The important thing in pooling is whether in the sale of the products and in the distribution of the sales receipts therefrom, the said products are considered as one pooled lot or as separate, individually owned lots. In other words, the important factors in pooling are: (a) the method of sale and (b) allocation of sales receipts.

#### b. Products and sales receipts

The pooling of the sales receipts and the distribution thereof after the expenses and other deductions are effected is considered the main pooling feature. The significant features of the three distinct practices usually followed in this regard are outlined in Exhibit VI-2.

The first practice which is being followed by a considerable number of local cooperatives actually offers no incentive to those producers of high quality products since there is only one set price for all the ungraded products. Predictably, producers are easily induced to sell their high quality products to competitors on the basis of attractive price incentives.

EXHIBIT VI - 2

SIGNIFICANT FEATURES OF THE DISTINCT PRACTICES EMPLOYED  
IN THE POOLING OF PRODUCTS AND SALES RECEIPTS

| Practice        | Pooled Products | No. of Pools                 | Mode of Settlement to the Members   |
|-----------------|-----------------|------------------------------|---|
| First Practice  | Ungraded        | One                          | One average price   |
| Second Practice | Graded          | One for all grades           | Fixed price differential for each grade   |
| Third Practice  | Graded          | Separate pool for each grade | 1. Actual net price received for each pool; or<br>2. Fixed price differential for each grade. |

The second practice of using a fixed price differential for the payment of graded products sold under one pool is practically no longer being used. This practice is more or less a compromise arrangement intended to offer a little premium price for high quality products in those cases where a substantial quantity falls under one grade and only a sprinkling of the other grades.

The third practice involving the creation of a separate pool for each grade of the products and paying them on the basis of the actual net price received for each pool is considered the ideal arrangement in pooling. While in some cases payment is based on a fixed price differential, this mode of settlement is beset with difficulties since it requires an accurate forecasting of the cost-price situation for each grade.

c. *Products, sales receipts and expenses*

It is normally a standard practice to pool expenses regardless of the method of cooperative marketing employed. This is because the actual marketing costs per unit of goods sold or handled cannot be determined accurately.

In the main, expenses may be classified into: (a) variable and (b) non-variable or fixed expenses. All expenses which are directly related to the hand-

ing and selling of the pooled products such as packing cost, labor charges, transportation charges, commission, etc. are considered variable expenses. On the other hand, all expenses of a general character such as salaries, rent, taxes, depreciation, etc. are considered non-variable or fixed expenses.

As a matter of practice, since as mentioned earlier, it is hard to determine the exact cost of marketing, the expenses are assessed either as a percentage of a value or a flat fee per unit. This type of assessment produces varying effects depending on the quality of the products. To those producers of high quality products, the use of the assessment based on the percentage of value ultimately means a higher assessment of expenses since the quality products are sold at higher prices. On the other hand, for the producers of lower quality products, the assessment based on physical unit may appear quite severe.

2. **Plan of Organization of Pools**

a. *Primary grouping of pools*

Pools are organized primarily along commodity lines. Thus, depending on the products they are dealing with, cooperative marketing associations may set up a rice or palay pool, corn pool, egg pool, onion pool, etc. Pools may be

organized in the different organizational levels—from the local to the national level—and a cooperative may have more than one pool.

b. *Bases for pool planning*

In setting up commodity pools, full consideration must be given to a set of factors: (a) number of grades, (b) area to be covered, and (c) length of pool period.

(1) **Number of grades**

The two main controlling factors in making decisions on the pools are (a) the number of grades should conform with those recognized by the buyers in the market and (b) pools should be limited to the number of grades that can be economically handled by the cooperative. It is, of course, desirable from the viewpoint of increasing the chances of spreading the benefits of pooling to the members equitably, to have as many grades as possible. However, it is vital to the success of pooling that the number of grades be limited not only to those that have already been established in the market but also to those which will permit the economical operation of each grade.

(2) **Area to be covered**

In determining the geographical coverage of pools, a sound practice is to have separate pools for those areas which have distinct peculiarities in quality of products and trade preferences. In other words, each homogenous area in terms of quality of products, trade preferences and other local considerations should have a separate pool. The rationale behind this arrangement of creating separate pools for each distinct area is to enhance the equitable treatment of the members of the entire cooperative. While this may seem to favor the creation of small area pools, each area pool, regardless of its size, should be able to avail itself of economies of scale in the efficient discharge of the various marketing activities and that its operations should dovetail tightly with and not complicate the management's marketing program.

(3) **Length of pooling period**

Pools are of varying durations ranging from a single-shipment pool to an annual pool. Again, the rationale here is to foster the equitable treatment of the members in relation to the sales receipts.

In general, the length of the pooling period is influenced by a set of inter-related factors: (a) the seasonal nature of crop production; (b) the perishable nature of most agricultural products; (c) the usually erratic price behavior of agricultural products in the market; and (d) the availability of storage and processing facilities. To be sure, it is imperative for the management to be thoroughly familiar with the patterns of supply and demand for particular crops in order that it may be able to set the appropriate length of pooling period that will yield the highest net returns for the pool members.

C. *Pooling Illustrated*

Presented in Exhibit VI-3 is an illustration of how a typical pooling works with particular emphasis on the method of computing the average pool prices. The illustration shows the participation of only five farmers in the pool and therefore actually represents only a portion of the entire pool. However, the total figures for the entire pool are shown.

D. *General Criteria and Requisites for Successful Pooling*

1. **General Criteria for Success**

The success of the operation of a pooling plan can be appropriately measured in terms of the following:

a. *Equitable treatment of the pool members*

This has particular reference or relevance to: (a) equitable distribution of marketing risks and (b) equitable prorating of the expenses among the pool members.

EXHIBIT VI - 3

ILLUSTRATION OF THE MECHANICS OF THE POOLING  
METHOD OF COOPERATIVE MARKETING

| Particulars                             | Palay/Rice Pools                |                                  |                                  |
|---|---------------------------------|----------------------------------|----------------------------------|
|   | Variety "A"                     | Variety "B"                      | Variety "C"                      |
| <b>A. Pooling of Product—<br/>Palay</b> |                                 |                                  |                                  |
| Farmer Jose                             | 500 kilos                       | 2,000 kilos                      | —                                |
| Farmer Juan                             | 2,000 "                         | 1,500 "                          | 4,000 kilos                      |
| Farmer Mario                            | —                               | 3,000 "                          | 8,000 "                          |
| Farmer Antonio                          | 2,500 "                         | 1,000 "                          | 1,500 "                          |
| Farmer Pedro                            | 1,000 "                         | 5,000 "                          | —                                |
| <b>Total</b>                            | 150,000 kilos                   | 250,000 kilos                    | 200,000 kilos                    |
| <b>B. Pooling of Receipts—<br/>Rice</b> |                                 |                                  |                                  |
| (Based on 65% milling recovery.)        | 5,000 k. @P2.07                 | 15,000 k. @P2.05                 | 10,000 k. @P2.06                 |
|   | 20,000 k. @P2.10                | 50,000 k. @P2.09                 | 30,000 k. @P2.09                 |
|   | 10,000 k. @P2.05                | 10,000 k. @P2.07                 | 5,000 k. @P2.05                  |
|   | 35,000 k. @P2.09                | 60,000 k. @P2.10                 | 60,000 k. @P2.10                 |
|   | 27,500 k. @P2.06                | 5,000 k. @P2.04                  | 5,000 k. @P2.07                  |
|   |                                 | 22,500 k. @P2.08                 | 20,000 k. @P2.09                 |
| <b>Total</b>                            | 97,500 kilos<br>for<br>P202,650 | 162,500 kilos<br>for<br>P338,950 | 130,000 kilos<br>for<br>P271,700 |



| Particulars   | Palay/Rice Pools     |                 |                      |                 |                      |                 |
|---|----------------------|-----------------|----------------------|-----------------|----------------------|-----------------|
|   | Variety "A"          |                 | Variety "B"          |                 | Variety "C"          |                 |
| <b>C. Pooling of Expenses</b><br>(Based on 15% of sales receipts covering fixed and variable expenses such as milling, transporting, storing, drying, etc., plus margin.) | P202,650<br>x 0.15   |                 | P338,950<br>x 0.15   |                 | P271,700<br>x 0.15   |                 |
| <b>Total</b>  | P 30,397.50          |                 | P 50,842.50          |                 | P 40,755.00          |                 |
| <b>D. Liquidation of Palay Deposits</b>   |                      |                 |                      |                 |                      |                 |
| <b>1. Average (liquidation) price</b>   |                      |                 |                      |                 |                      |                 |
| Net sales receipts  | P172,252.50          |                 | P288,107.50          |                 | P230,945.00          |                 |
| Total palay deposits  | 150,000 kilos        |                 | 250,000 kilos        |                 | 200,000 kilos        |                 |
| Ave. price per kilo   | P 1.1484             |                 | P 1.1524             |                 | P 1.1547             |                 |
| <b>2. Amount Received per Farmer</b>  |                      |                 |                      |                 |                      |                 |
| <b>Farmer</b>   | Palay deposited (k.) | Value           | Palay deposited (k.) | Value           | Palay deposited (k.) | Value           |
| Farmer Jose   | 500                  | P 574.20        | 2,000                | P2,304.80       | —                    | —               |
| Farmer Juan   | 2,000                | 2,296.80        | 1,500                | 1,728.60        | 4,000                | P4,618.80       |
| Farmer Mario  | —                    | —               | 3,000                | 3,457.20        | 8,000                | 9,237.60        |
| Farmer Antonio  | 2,500                | 2,871.00        | 1,000                | 1,152.40        | 1,500                | 1,732.05        |
| Farmer Pedro  | 1,000                | 1,148.40        | 5,000                | 5,762.00        | —                    | —               |
| <b>Total</b>  | <b>150,000</b>       | <b>P172,260</b> | <b>250,000</b>       | <b>P288,100</b> | <b>200,000</b>       | <b>P230,940</b> |

### b. *Operating efficiency*

This is a test of the management capability with respect to: (a) effective and full control of the marketing processes; (b) power to bargain advantageously; and (c) proficiency in reducing costs of operations.

## 2. **Requisites for Successful Pooling**

From the welter of past experiences in pooling operations, the following success factors have been isolated:

- a. Members must be treated equitably.
- b. Products must be carefully graded in accordance with established grades in the market.
- c. Each grade must have sufficient volume of products to support economical operations.
- d. Periods of pools must be of reasonable length.
- e. Areas covered by pools must be limited to the proper size.
- f. Costs must be allocated equitably.
- g. Payments must be made promptly and accurately.
- h. Financing of the pooled products must be adequate.
- i. Marketing of the products must be orderly and systematic.
- j. Accounting system must be up-to-date and accurate.

## IV. **OTHER METHODS OF HANDLING MEMBERS' PRODUCE**

Aside from pooling, cooperatives customarily handle the products of the members in two other ways: (a) outright purchase for cash and (b) selling for individual account.

### A. *Outright Purchase for Cash*

Under this arrangement, the members' products are bought outright and paid for in cash by cooperatives immediately upon delivery. The local market price on the date of delivery of the products is invariably used as basis for making cash payments. A significant feature of this method of out-

right purchase is that the cooperative assumes the risks of price fluctuations as soon as it purchases and obtains title to the products of the members.

The more or less conventional arrangement in newly organized cooperatives is in essence a carryover of a practice to which the members have been accustomed to even before the inception of their cooperative and which may be primarily attributed to their dire need for immediate cash right after harvesting their products. This marked preference of the members for the immediate settlement for cash for their deliveries also stems from the usual over-concern of the members for the safety of their products once they are placed in the hands of their cooperatives.

Among the advantages of this practice may be cited: (a) the farmer-member receives full payment in cash immediately upon delivery of his products; (b) the association is able to match the existing practice of competitors of paying cash for the purchase of farmer-members' products; (c) the management of the cooperative, particularly those whose previous training and experience in private business is cash buying, encounter not much difficulty in employing this system; (d) the cooperative can boost its volume of business more readily; and (e) the bookkeeping job is less voluminous compared to that of the pooling arrangement.

To be weighed against the said advantages are the following disadvantages of the subject outright purchase for cash system: (a) the cooperative assumes considerable additional risks in marketing, especially during periods of sharp price fluctuations since the ownership of the products is transferred from the individual members to the cooperative; (b) the cooperative has to provide more working capital and greater financial resources than is normally necessary since more funds will be tied up in inventory while waiting for better prices; (c) the manager has to be exceptionally alert and well informed of the market prices; and (d) it contravenes a basic concept in cooperation in the sense that the agency relationship between the cooperative and the members is unduly trans-

formed into one of a buyer and seller relationship with all the possible resultant disorientation in the program outlook and understanding of cooperation.

### **B. Selling for Individual Account**

In this system, where the products of the members are sold under their individual account, the identity of the individual products of the members is maintained and the member retains the option to determine when and how much his product should be disposed of. For its services, the cooperative receives a fixed handling commission or fee. After deducting the expenses including the charge for commission or fee, the sales proceeds are returned to the individual members concerned.

Unlike in the outright purchase and cash payment method, the members and not the cooperative takes the risk from price changes from the time the product is delivered up to the time it is sold. In this particular case, the cooperative assumes its rightful role as the agent of the members.

This system has several advantages, to wit: (a) the cooperative takes less risks since it does not take title to the members products; (b) the cooperative requires not much working capital and financial resources since the products of the members are not paid by the cooperative out of its own funds; (c) the members with quality products can possibly receive a premium price; and (d) it is a more practical arrangement than pooling in the case of those cooperative making daily sales of products in small quantities.

The principal disadvantages of the system are: (a) it is a disorganized and unsystematic method of selling since the cooperative does not have control of the marketing of the products and therefore cannot work out a well-laid marketing program; (b) it sometimes results in increased marketing costs to the members; and (c) it entails a voluminous bookkeeping job.

## **V. COMMODITY EXCHANGES AND FUTURES TRADING**

The various highly significant technological innovations in production, improve-

ment in market organizations, and advances in marketing procedures and practices all tend to bring most developing countries closer and closer, perhaps sooner than earlier expected, to the era of commodity exchanges and futures trading. In which case, practitioners of marketing management will necessarily have to draw heavily from the vast experiences of the United States which has long pioneered in the highly specialized field of commodity exchanges and has developed the practice of hedging to a high degree of efficiency. It ought to be emphasized that in the United States, the farmers and their cooperatives, although at first hesitant to trade in commodity exchanges primarily because of lack of appreciation and understanding of the benefits of trading in commodity exchanges and their methods of operation are now, to their big advantage, making full use of the services and facilities of commodity exchanges.

### **A. Commodity Exchanges Defined**

A commodity exchange may be defined as a terminal market organized mainly by producers, dealers, processors, speculators and consumers for the chief purpose of providing the necessary services and facilities for futures trading of specific commodities, together with the rules and regulations appurtenant thereto, on the basis of a standardized futures contract which permits the operation of a price-insuring scheme known as *hedging*.

The definition underscores the basic organizational and operational features of a commodity exchange. First, a commodity exchange is a terminal market with a multisectoral membership. Second, the main function of a commodity exchange is to provide such services and facilities as are necessary for the futures trading of particular commodities including the pertinent rules and regulations. Third, the basic instrument in futures trading is a standard futures contract. And fourth, the novel price-insuring process in futures trading is called *hedging*.

At this juncture, it is high time to thresh out two things on the use of terminology in this discussion. In the first place,

the terms commodity exchange and exchange market, which are synonymous, will be used interchangeably. Secondly, the two distinct types of commodity markets will consistently be referred to as commodity exchange or exchange market, on the one hand, and physical market, on the other. This clarification of terminology is necessary precisely to avoid possible misinterpretation of terms in this discussion since exchange markets are also known and referred to in some other materials by such other terms as *contracts*, *paper* or *futures market*. In like manner, physical markets are sometimes denoted as *cash*, *spot* or *actual markets*.

### ***B. Relationships Between Physical Market and Exchange Market***

It is keenly felt that a basic requisite to the proper understanding and appreciation of an exchange market is a thorough perception of the relationship between a physical market and an exchange market. For this purpose, the discussion will be centered on two general essential points: (a) the exchange market and physical market are two separate and distinct types of commodity markets and (b) the exchange market is an outgrowth of the physical market.

#### **1. The Exchange Market and Physical Market are Two Separate and Distinct Types of Commodity Markets**

The basic fact stands that the physical market and the exchange market are two entirely different types of commodity markets. One performs a function which is different from the other. The said functions are, however, closely related and interlinked, such that it can be said that one market supports the other. The economic functions of exchange markets are dealt with at length in the ensuing discussion and a perusal thereof will greatly assist in discerning the functions of the two markets.

For the present, however, it will perhaps suffice to point out the sharp

contrasting motives of traders in each market. In the physical market, which deals in contracts for both spot and futures deliveries, the fundamental purpose of traders is to make or take actual delivery of the specific commodity at the fixed contract delivery time or period. On the other hand, in the exchange market, which properly deals in contracts for future delivery of a commodity, the fundamental purpose of the traders is not to make or take actual delivery of the commodity but rather to merely cancel out every purchase contract by an offsetting sales, and vice-versa, thus avoiding actual commodity deliveries and setting all difference by cash payments.

#### **2. The Exchange Market is an Outgrowth of the Physical Market**

In point of development, physical markets come into being much ahead of exchange markets. It is an accepted fact that the organization of physical markets is a condition preceding the setting up of exchange markets. In view of the foregoing, it is a well-recognized notion that exchange markets are derivatives of physical markets. And as such, exchange markets are certainly not intended to supplant or replace physical markets. On the contrary, exchange markets are contemplated to perform such other functions which physical markets are definitely incapable of doing.

The inception of exchange markets, however, is an offshoot of the desire to remedy certain basic defects of physical markets which may largely be attributed to two factors: (a) the unregulated supply of commodities and (b) the absence of assurance of delivery and payment at contract time. On the first point, normally, either uneven or insufficient supply of commodities results in (a) adverse price fluctuations in futures trading transactions because of an uneven supply and (b) failure to satisfy large volume transactions due to insufficient supply situations. On the second point, the faithful compliance, either by the buyer or seller, of contractual

obligations is not fully guaranteed particularly of the delivery of the commodity at contract time and also payment at contract time.

### C. *Economic Functions of Commodity Exchanges*

As mentioned earlier, the organization of commodity exchanges was precipitated by the inability of physical markets to cope with the essentials of futures trading. With such a rationale, commodity exchanges were particularly designed to be veritable insurance devices whose services mainly revolve around a *price-insurance* as well as a *credit-insurance* mechanism which, on the one hand, guarantees against infringement of legal obligations as regards deliveries at contract time and payments of contract price, on the other.

As conceived, commodity exchanges encompass a wide range of economic functions. In this regard, Julius B. Baer and Olin Saxon, in their book *Commodity Exchanges and Futures Trading*, broadly outlined the economic functions of commodity exchanges as follows:

#### “1. The Insurance Function

- (a) The exchange provides liquidity and relative price stability through a broad and continuous market, made possible because of large funds of speculative capital not otherwise available.
- (b) The machinery of the exchange establishes a means of protection (for those who desire it) against adverse price changes through a process known as *hedging* — an insurance device that is available to all producers, traders, and converters.
- (c) The machinery of the exchange clearing house furnishes to all buyers and sellers of exchange contracts a sure method of guaranteeing that both deliveries at contract time and payment therefor at contract price will be made, regardless of changes in market prices after the contract is made and regardless

of the insolvency of either contracting party at the time of delivery under contract.

#### “2. The Financing Function

- (a) A continuous market and the ready transferability of standardized commodities by means of negotiable warehouse receipts give the commodity a high degree of liquidity.
- (b) Liquidity of the commodity is an encouragement to more liberal loans by bankers and is a safeguard to them.
- (c) Ability to finance commodities readily and to insure against adverse price changes or defaults on contracts enables producers, dealers, and manufacturers to operate successfully on smaller profit margins to the benefit of the consumer.

#### “3. The Price Registration Function

- (a) Joinder of markets by telegraph, telephone, radio, and cable focuses all price influences on the commodity exchange; all (domestic and foreign) futures markets in the same commodity are thus linked together and made one broad world markets.
- (b) The presence of a large volume of risk-bearing speculation insures that every known influence bearing upon prices will be given careful consideration and weight.
- (c) Interpretation of news by producers, dealers, manufacturers and speculators assures a degree of anticipation of future trends and events that would otherwise be possible.

#### “4. The Publicity and Information Function

- (a) Exchanges gather from all available sources and make public in an unbiased manner statistics of present and potential supply, transportation, current consumption and potential demand which are useful in estimating price trends and changes.

- (b) Daily publication throughout the world of a record of volumes and prices of all exchange transactions in contracts for future delivery informs all interested parties, not only of present prices, but also of future trends.
- (c) On the basis of widespread publicity of all future quotations, dealers, producers and manufacturers are enabled to make their purchases and sales with a higher degree of certainty and confidence.

“5. The Regulatory Function

- (a) Exchanges gear large speculative funds of capital into their insurance machinery and regulate speculation so as to prevent abuses and provide for its conduct along orderly lines in the public interest.
- (b) Exchanges develop uniform or “basis” contracts which, with their standards of inspection, weighing and grading, contribute to the certainty, efficiency, and uniformity of practices in each trade.
- (c) Exchanges establish and enforce, usually through compulsory arbitration procedures, rules and regulations governing the settlement of all disputes arising out of transactions on the exchanges, thus providing quick, cheap, and efficient settlements by experts, without the need for recourse to the courts; they establish codes to maintain the ethical conduct of business by their members and enforce them through their own sanctions and penalties.”

***D. Conditions Essential for Futures Trading in Commodity Exchanges***

The numerous and outstanding multi-sectoral benefits that commodity exchanges offer coupled with demonstrated efficacy of their operations, especially in the United States, have since catalyzed serious moves to adopt and transplant the scheme in different countries. Because of its special adaptation, however, a commodity exchange in the United States can-

not simply be carbon-copied and be set up with guaranteed success in any other country.

It is well recognized in this regard that the efficient functioning of futures trading which is the main activity in commodity exchanges is contingent on a set of factors. Fortunately, based on experiences of the most successful commodity exchanges, the conditions which are essential for the effective organization and operation of futures trading in commodity exchanges have been identified and defined. These are: (a) adaptability of the commodities; (b) availability of large speculative funds; (c) validity of futures contract; (d) existence of clearing house; and (e) inviolability of warehouse receipts.

***E. Hedging***

***i. Hedging Defined***

In a nutshell, hedging is a trading practice which is unique to commodity exchanges involving two opposite transactions in the physical and exchange markets; specifically, a sale of a commodity in the physical market is offset by a purchase of a futures contract in the exchange market while, on the other hand, a purchase of a commodity in the physical market is matched by a sale of a futures contract in the exchange market also for an equal quantity of the same commodity, for the purpose of minimizing price and credit risks in dealing on commodities with parallel price movements in the physical and exchange markets.

An identification and a brief discussion of the salient aspects or features of hedging which can be gathered from its foregoing definition will enhance better understanding of hedging, to wit:

- a. *Hedging is a trading practice that is unique to commodity exchanges*

Hedging is actually a creation of and is practiced only in commodity ex-

changes. The practice of hedging has been so popularized in commodity exchanges that the two terms, hedging and commodity exchanges, although definitely referring to two different things, are invariably used interchangeably.

b. *Hedging involves two counter-acting transactions in two distinct markets, the physical market and the exchange market*

In hedging, there are actually two opposite transactions: a sale against a purchase of an equal quantity of a commodity and vice-versa that takes place in two different markets, the physical market, on the one hand, and the exchange market, on the other.

c. *Hedging is done through the instrumentality of a futures contract*

Hedging is effected through the use of the so-called futures contract. In the main, a futures contract is a contract of sale of stipulated amount of a specific grade of same commodity at a fixed price at a fixed date. The use of the futures contract which conforms strictly with the rules and regulations of the commodity exchange both in form and content particularly in the standardization of commodities facilitates the operation of hedging.

d. *Hedging is intended to minimize price and credit risks*

The real purpose of hedging as indicated in the definition is to minimize price and credit risks. It is for this reason that the hedge is usually referred to as price or credit insurer. Since hedging restrains speculative risks, it follows that there should be no room for speculative profits in hedging.

e. *Hedging is particularly applicable to those commodities with parallel price movements in the physical and exchange markets*

A condition contingent to hedging is that the commodities involved should have parallel or the same price movements in the physical and exchange markets. Otherwise, hedging will not be able to provide the protection from severe price and credit risks. Actually,

hedging operates under the theory that prices in the physical market and those in the exchange market tend to increase or decrease together at practically the same rate. Consequently, the basic assumption is that a loss or gain in a transaction in the physical market is offset by a gain or a loss in the exchange market and vice-versa.

## 2. General Workings of Hedging

The general workings of hedging showing the two principal groups which indulge in hedging, the specific price and/or credit risks protection sought and the general hedging transactions are presented in tabulated form in Exhibit VI-4.

## VI. PRICING, MARKETING INFORMATION AND MARKETING RESEARCH

### A. Pricing

Under the concept of "full-cost pricing," the selling price is computed by charging to the product all relevant costs involved in the performance of the buying and selling activities and adding to this a reasonable margin, figured usually as a percentage of cost. The relevant costs are actually full costs which include all the variable and fixed costs. Variable costs, of course, are those that vary directly and proportionately with volume. Examples are direct labor, direct material, power costs and supplies. On the other hand, non-variable costs, sometimes also called fixed costs, refer to those costs that do not vary all with volume. Depreciation of buildings and facilities, insurance, rent and administrative expenses belong to this category.

After accomplishing the first step of computing the initial estimate of the selling price, the management can then make some adjustments as may be deemed appropriate and necessary within the framework of the cooperative's basic pricing policy. Such price modifications may take the form of revising costs as well as changing margins in order that the selling price may, for example, be competitive or be attractive to the members.

EXHIBIT VI - 4

GENERAL WORKINGS OF HEDGING

| G r o u p   | Specific Price/<br>Credit Protection<br>Desired   | General Hedging<br>Transactions  |  |
|---|---|--|--|
|   |   | Physical<br>Market   | Exchange<br>Market   |
| <p>1. <u>The Longs</u></p> <p>Include those who have physical possession or control of a specific commodity at the time of its sale either in the warehouse under contract or in the field such as farmers or producers, marketing agencies such as cooperatives, suppliers of raw materials and manufacturers or processors who purchase and stock their raw materials in advance.</p> | <p>1. Difference between the farm gate price and the market price of the commodity.</p> <p>2. Difference between the price of raw materials at the time of purchase and at the time they are manufactured or processed.</p>   | <p><u>Transaction 1</u></p> <p>Own or control the specific commodity.</p>                | <p><u>Transaction 2</u></p> <p>(The Hedge)<br/>Short sale of futures contract of an equivalent amount.</p> |
| <p>2. <u>The Shorts</u></p> <p>Include those who do not have physical possession or control of a specific commodity at the time they entered into contracts for the forward sale of the commodity or products manufactured therefrom such as manufacturers or processors who do not stock raw materials and exporters who sell commodities that they do not own.</p>                    | <p>1. Difference between the price of the raw materials at the time of the forward sale of the materials or their products and at the time of their manufacture into finished products.</p> <p>2. Difference between the price of a specific commodity at the time of its forward sale and at the time of its actual delivery to the buyer.</p> | <p><u>Transaction 1</u></p> <p>Short sale of the specific commodity or its products.</p> | <p><u>Transaction 2</u></p> <p>(The Hedge)<br/>Purchase of a futures contract of an equivalent amount.</p> |



It is believed absolutely necessary for the management of the cooperative to know and be able to allocate all the costs involved in the buying and selling processes if it is to render service-at-cost to the members in furtherance of a foremost cooperative principle. To be emphatic on the point, a cooperative that cannot adopt the full cost pricing concept for the reason that it does not know what its full costs are will definitely not be able to serve its members at cost, hence it is bound to encounter difficulties and uncertainties in operation.

## B. *Marketing Information*

Marketing information involves the collection, compilation, analysis, interpretation and dissemination of current and long-run data and information with respect to the demand and supply situations. It touches on the vital aspects of production, consumption, prices, stocks, importations, exportations and the like which producers, traders and consumers alike will find particularly useful in making their respective decisions.

With the introduction of the market-oriented concept of marketing management, marketing information becomes increasingly relevant and vital to an efficient functioning of the marketing system. For one, cooperatives have begun to awaken to the stark realization that to be able to secure maximum market returns for the produce of their members, it behooves on them to sharpen the use of marketing information.

### 1. *Types of Marketing Information*

Based on period covered, marketing information is broadly classified into: (a) short-term, (b) medium-term, and (c) long-term marketing information.

#### a. *Short-term marketing information*

This type of marketing information contains current data and information on prices and volumes of specific quantities of products actually traded or being offered in selected market outlets. It is intended to provide alter-

native choices on where and when to buy or sell said products and it has particular relevance to those products which are ready to be marketed.

As a matter of practice, this type of information is commonly obtained directly from the usual market outlets and traders. To be sure, time is of great essence in this short-term marketing report. It is usually rendered on a daily basis and any information that is one week old has practically of no more value to the users. It must be dispatched with the least possible delay and is usually supplied daily by radio, teletype or by the press.

#### b. *Medium-term marketing information*

The medium-term marketing information is concerned with the buying and selling of products in the coming few months, of say, six to nine months. In addition to reporting the current transactions, this type of information focuses likely projections of future prices of particular quality or grade products based principally on an analysis of the expected supply and demand situation. It takes into full account the possible impact on prices of expected changes in government policies and the import-export movements of products.

#### c. *Long-term marketing information*

The long-term marketing information, which is the most sophisticated of marketing reports, deals on both marketing and production information relating to long-run trends on food prices and expected crop yields. Its purpose is to assist producers decide on alternative production planning and investment opportunities or possibilities for the years ahead. Because of the long period it covers, the long-term marketing information is often referred to as situation and outlook report. Among all countries, the United States has developed this type of marketing information to a highest degree.

### 2. *Sources of Information*

The most extensive and comprehensive marketing information is provided

by pertinent government agencies. Marketing information services are collected and disseminated in various forms by specialized government offices usually operating under the agriculture department.

In some developed countries, there are specialized private and government agencies that handle this type of service for their subscribing customers. Also, some trade organizations offer some marketing information to their affiliated firms and to the public in general.

### 3. Some General Positive Elements of Marketing Information

A random enumeration of some of the acknowledged desirable features of a useful marketing information are briefly outlined as follows:

- a. The price data should be specific as to grades or qualities of products.
- b. The collection of marketing information should, as much as possible, be entrusted to well-trained personnel who are provided with sufficient funding support in order to insure that the said marketing information will be accurate and reliable.
- c. It is desirable that the marketing information be worded and expressed in terms which can easily be understood and interpreted by the end-users.
- d. An educational program must be conducted for the users of the marketing information for the purpose of insuring the wise and effective use of all data and information.

## C. Marketing Research

### 1. Definition and Purpose of Marketing Research

Marketing research may aptly be defined as the systematic, objective and comprehensive compilation, analysis

and evaluation of such data and information which are deemed useful to marketing executives for the efficient performance of their respective activities. Viewed in the light of the evaluation of the marketing function itself, marketing research assumes a position of great importance in marketing management since it makes possible the determination and measurement of both quantitative and qualitative aspects of the wants, desires and preferences of consumers.

It is not too premature to emphasize in this regard that marketing research, as in the case with other researches, is limited only in narrowing down the number of alternatives and minimizing uncertainties in the decision-making process. Marketing executives are cautioned against considering the results and findings of research studies as decisions in and by themselves. Decisions will still have to be made and this is the responsibility of the marketing executives.

### 2. Uses or Application of Marketing Research

Marketing research is considered an effective tool in planning, organizing and controlling functions of management. In planning, marketing research is a useful practical tool in assessing market opportunities such as: (a) estimating the market potential or measuring the quantity of a particular product that would be sold in a specific market for a specified period of time; (b) estimating demand level and the magnitude factors; and (c) sales forecasting. It also aids in project studies particularly in looking into: (a) opportunities for new products; (b) developing and testing new products; (c) determining product, performances; and (d) testing package design and color. In addition, marketing research has its value in consumer and distribution studies and pricing.

In organizing, marketing research can be of immense assistance in: (a) determining sales territories; (b) performing sales analysis; (c) appraising salesmen's performances; and (d) selecting the proper channels of distribution.

On the other hand, marketing research can conveniently be employed in the effective evaluation and control of marketing effort in such specific areas as: (a) assessing market position; (b) comparing actual performance against established standards; (c) advertising research; and (d) distribution cost analysis.

### **3. Some Techniques Commonly Employed in Marketing Research**

Some of the methods or techniques at present commonly used in marketing research are: (a) market survey, (b) statistical approaches, (c) paired comparison tests, (d) split-run techniques, (e) store audits, (f) distribution cost analysis, (g) consumer panels, and (h) operations research techniques applicable to marketing research such as linear programming, Bayesian decision theory of simulation and PERT/CPM.



**CHAPTER VII**

**COOPERATIVE MANAGEMENT PRINCIPLES,  
TECHNOLOGY AND TECHNIQUES:  
COOPERATIVE FINANCIAL MANAGEMENT**



## CHAPTER VII

# COOPERATIVE MANAGEMENT PRINCIPLES, TECHNOLOGY AND TECHNIQUES: COOPERATIVE FINANCIAL MANAGEMENT

*The pragmatic value of the basic philosophies and concepts of cooperative financial management is accentuated as they are actually applied in the different areas of concern. The common methods of raising capital are conveniently categorized into loan capital and equity capital. A central feature is an exceedingly detailed discussion of the revolving fund capital plan designed at establishing firmly the real significance and value of this novel cooperative financing scheme. The principal financial statements, the multiple ratio analysis of financial statements, and the break-even point analysis constitute the main framework of discussion of the management uses of accounting reports.*

### I. THE ROLE OF FINANCIAL MANAGEMENT IN A COOPERATIVE ENTERPRISE

In general, a cooperative needs capital for three principal purposes: (a) organization expense, (b) working capital, and (c) long-term investments. The common situation is that while a cooperative is usually able to raise sufficient funds to take care of organization expense, it is hardly able to provide enough additional funds either for of the funds is given to long-term investments placing the cooperative in a difficult situation where it has facilities that it could not operate because of lack of working capital. Clearly, from the original instance, two intertwined significant characteristic of the funding scheme of coopera-

tives emerge: (a) inadequate capital and (b) unsound management of funds. The problems of financial management in cooperatives mainly revolve around these two critical areas.

On the problem of inadequate capital, it is accepted that even at the early stage of its operations, a cooperative normally suffers from the severe operating constraint of lack of sufficient capital. Consequently, it is hard pressed to look for outside or external financing to beef up its initial operations. This observation, it will be realized, exposes a naked and hard truth — that a typical cooperative in developing countries is so undercapitalized from the very start that it has to avail itself of outside financing; otherwise, it will hardly be able to go far beyond its organizational stage.

Fully aware of this serious predicament confronting cooperatives in general, practically all cooperatives development

programs in developing countries provide a package of financial assistance mostly in the form of loans from both government and private agencies precisely to support the growth and development of cooperatives from their infant stage.

Hand in hand with this critical problem of undercapitalization is perhaps an even more critical problem of inefficient and ineffective utilization of capital which in a cooperative is indeed a very scarce resource. In this regard, the ever-increasing demand for expanded and better services by the members of cooperatives coupled with the growing complexity, not to mention the highly competitive nature of current business, are pressing imperatives. They should prompt the management of cooperatives to acquire and make full use of knowledge as well as skill and understanding of financial management sufficient enough to propel the cooperatives to satisfy the needs and demands of their members.

The key role which financial management is expected to play in the overall attainment of the goals and objectives of cooperatives in the wake of such a situation thus comes into sharp focus. As used here, the term cooperative financial management encompasses two distinct but closely related activities corresponding to (a) sources of funds and (b) uses of funds. The point is stressed that from the management standpoint, the determination of the *sources of funds* specifically involves *financing decisions* while that of *uses of funds* relates to *investment decisions*. A clearer identification and distinction of these two vital decisions is reserved momentarily for the succeeding discussion of the balance sheet where it will be seen that the assets side actually represents the uses of funds or investment decisions while the liabilities and members' equity side shows the sources of funds or financing decisions.

## II. BASIC PHILOSOPHIES AND CONCEPTS OF COOPERATIVE FINANCIAL MANAGEMENT

The financial management of cooperative corporations, on the one hand, and

that of ordinary corporations, on the other, is an interesting study in contrast. Their underlying philosophies and concepts are in many respects diametrically opposed to one another. These contrasting features may largely be attributed to and are outright manifestations in cooperative financial management of two main factors which distinguish cooperative corporations from ordinary corporations, namely: (a) the basic motivation of cooperatives of service to the members and (b) the workings of the cooperative principles.

The basic orientation of cooperative financial management and for that matter of cooperatives in general flows from the often emphasized fact that service and not profit is the prime motivation behind the organization of cooperatives. And as pointed out earlier, this service over profit motivation in cooperatives, contrary to the common notion or thinking, has a meaning and implication in actual operations that has only a little relevance to the practice of cooperatives of rendering service to its members with just little savings or profit in pursuance of the service-at-cost principle. This again is a grossly off-target conception of the service orientation of cooperatives.

The real implication of this service over profit motivation in cooperatives lies in its role as the overriding consideration in making alternative choices of the specific types of service that a cooperative should handle taking into account the meager financial resources available for the purpose. In the actual implementation in the specific field of cooperative financial management, this means that the main criterion that should be used in evaluating the feasibility of a service-oriented project is the need by the members of such service and not its profitability. It may occur, therefore, that a service activity which the feasibility study shows may not be the most profitable will have to be handled by a cooperative precisely because it is the type of service that is needed most by the greater number of its members. This is actually what is meant when it is said that in cooperation, the service motive precedes that of profit. On the part of the management of a cooperative, this particular case is more of an



investment decision rather than merely a price decision. Incidentally, the suggested practice of gauging the feasibility of a cooperative project both from the cooperative and business standpoint is based on this precept.

The cooperative principles and practices collectively represent the main factor to which the peculiarities of cooperative financial management may be attributed. A brief discussion of the more pertinent first four cooperative principles as reformulated in 1966 by the ICA is presented hereunder specifically as they affect the nature and character of the financial management of cooperatives.

The first cooperative principle on membership has two clear implications on the financial management of cooperatives: (a) it enables a cooperative to assemble capital by bringing into cooperatives as large a number of people as possible subject only to some restrictions and (b) it fixes principally on the members of a cooperative the responsibility of financing their cooperative. The common practice in cooperatives of setting a low par value for shares of stocks is principally intended to make it easy for potential members to comply with the usual minimum requirement for membership of owning at least one share of stock.

The second cooperative principle on democratic administration which provides for the democratic control of a cooperative by its member-patrons or member-users, in essence, actually implies that the member-users ought to finance their cooperative in proportion to their use of its services. This implication is a very significant peculiarity of cooperative financial management and is indeed an invaluable guideline for cooperative finance managers in determining the appropriate method of cooperative financing that will serve the purpose.

The application of the limited interest on capital principle, on the other hand, which places a maximum limit on the rate of interest on share capital has the following far-reaching effects and significance on cooperative financial management: (a) share capital is considered only as a tool to enable a cooperative to render the necessary services to its members and (b) the

cooperative is provided with capital at a cheaper cost. The inviolability of this principle, as mentioned earlier, is now being questioned by many cooperative quarters principally on the ground that the fixing of a ceiling on the rate of interest on share capital is a deterrent for members to put in additional investment in their cooperative. On the part of those managing the finances of a cooperative, this apparent problem area should be viewed as another of those challenges for it to seek ways and means to overcome this apparent handicap.

Strictly from the standpoint of cooperative financial management, the operation of the disposal of savings principle has the following significant effects: (a) theoretically services have to be rendered at cost and (b) any savings have to be distributed to the members on the basis of patronage.

The whole situation, it will be realized, underscores the need for cooperatives, specifically the finance managers, to install a realistic members' equity financing scheme in which the required level of capital requirement will be maintained at all times.

Taken altogether, the foregoing peculiarities of cooperative financial management clearly delineate it from the financial management of ordinary corporations. In a way, it can be claimed that the financial management of a cooperative is more complex than that of an ordinary corporation. But it is incontrovertible that the successful financial management of a cooperative can be attained not by sidetracking these complexities but rather by meeting them headlong and battering them down.

### III. METHODS OF RAISING CAPITAL

Different methods of obtaining capital are available to cooperatives. The choice of the method or methods of generating capital is best left at the discretion of individual cooperatives because of the variable conditions or situations under which each cooperative operates.

The capital in a cooperative corporation as well as in an ordinary corporation may be broadly classified into two accord-

ing to source, namely: (a) equity capital and (b) loan capital (also called debt or borrowed capital). Equity capital refers to the capital contributions provided by the cooperative members themselves. On the other hand, loan capital represents the borrowings made by a cooperative from outside creditors. Both types of capital, it is stressed, are presented in the liabilities and members' equity side of a cooperative's balance sheet. The loan capital is specifically shown in the liabilities portion while the equity capital is in the members' equity column. It was deemed best to categorize the various methods of raising capital under the two types of capital firstly, because of the heavy emphasis and reliance which cooperatives normally place on equity capital and secondly, because there is a great deal of difference between the two types of capital in point of use and cost.

The common methods resorted to by cooperatives to generate capital are presented hereunder:

#### A. Equity capital

1. Sale of shares of stock
2. Collection of members' capital contribution
3. Deferment of distribution of patronage refund
4. Collection of retains
5. Accumulation of reserves

#### B. Loan capital

1. Borrowings
2. Deferred payment
3. Trade credit
4. Sale of bonds or debentures
5. Donations, grants, gifts, etc.

The different methods of raising capital are discussed separately as follows:

#### A. Equity Capital

##### 1. Sale of Shares of Stock

Particular attention is invited to the fact that there are two major classes of stocks issued by a stock cooperative corporation, namely: (a) common stock and (b) preferred stock. The basic stock is the common stock. A cooperative corporation can therefore issue either the common stock only or both

common and preferred stocks. It cannot, however, issue only preferred stock.

It is pertinent to point out at this juncture that the capital arising from the sale of shares of stock, whether common or preferred, is what is commonly referred to as "share capital." This is actually the type of capital alluded to in the third cooperative principle as entitled to only a limited rate of interest. A distinction has therefore to be made between equity capital, on the one hand, and share capital, on the other, in the sense that share capital is only a part of equity capital. In other words, share capital is only one of the forms of equity capital.

##### a. Common Stock

In order for one to become a member of a capital stock cooperative corporation, he is required to purchase at least one share of stock. A share of stock actually represents a unit of interest in the cooperative corporation and its right to participate in its corporate business. A shareholder is therefore an owner of a cooperative corporation with proprietary interest and has the right, among others, to vote and be voted on. A stock certificate is the document issued to shareholders as the evidence of the ownership of shares of stock. The stock certificate which is issued only against fully-paid shares of stock should not be confused with the shares of stocks themselves.

As averred to earlier, a common stock is a form of share capital and is therefore entitled to receive, if any, interest that is limited.

Among the more significant practices with regard to the sale of shares of common stock resorted to by cooperatives designed at pursuing to the maximum the underlying philosophy and spirit behind the cooperative principles may be cited:

##### (1) Low par value of shares of common stock

It is a customary practice to peg such a low par value to the shares of

common stock that they are easily within the reach of anybody who wants to be a member of a cooperative. In this way, a cooperative can attract as many members as possible and thereby create a wide base of membership. The par value of the shares of common stock in secondary or overhead societies whose members are associations or juridical persons is of course higher than that of in primary societies whose members are individuals or natural persons.

#### **(2) Liberal payment scheme for shares of common stock**

In a corollary move to the fixing of a low par value for shares of common stock, cooperatives usually allow payment of shares of common stock through several ways: (a) full cash payments; (b) partial cash payment; (c) accomplishment of promissory note; and (d) application of patronage refund and/or retains. The institution of such liberal and convenient alternative payment schemes undoubtedly makes it easier for one to become a member of a cooperative.

#### **(3) Limited shareholdings**

Designed at plugging any further possibility of capitalistic control of a cooperative corporation, it is a common practice in cooperatives to set a maximum on the number of shares of common stock that one can purchase. This practice, together with the imposition of limited interest on share capital and the low par value of the shares of stock are definitely concrete measures intended to prevent cooperatives from falling into the control of a moneyed few, to dispel the idea that capital contributions in a cooperative are investment opportunities and to spread the ownership of a cooperative into as many members possible.

#### **(4) Apportionment on a pro-rata basis of the sale of shares of stock**

Still another common practice in many cooperatives is the prorating of the sale of shares of common stock

according to the use of the services of a cooperative by its members. The number of shares of stock the members are allowed to purchase is usually apportioned by brackets which are pro-rated based on any of the following: (a) size or area of farm; (b) volume of production; (c) number of fruit trees; and (d) size of herd of cattle or flock of chicken.

#### **b. Preferred Stock**

It is a very popular practice among cooperatives to sell or issue preferred stock in addition to common stock. This method of raising capital needs is normally employed in order to provide the friends and sympathizers of cooperatives who are not usually qualified to buy common stock the next best alternative to help boost the capitalization of a cooperative.

As in the case of the common stock, there is a ceiling on the interest that a preferred stock is entitled to receive. This ceiling on the rate of interest on preferred stock as a form of share capital is, however, usually higher than that of the common stock. Also, just like the common stock, the preferred stock bears the risks of the business operations of a cooperative. In other words, it also partakes the form of a risk capital.

On the other hand, a share of preferred stock, as a general rule, is not vested with the right to vote or be voted on. Consequently the control of a cooperative is maintained by the common stock holders even if the preferred stocks are held by non-members.

A share of preferred stock, in addition to being entitled to higher rate of interest than that of the common stock, has some specified priorities or preferences. Customarily, a share of preferred stock enjoys priority over that of the common stock on two scores: (a) as to the assets of the cooperative in case of dissolution or liquidation and (b) as to interest.

From the foregoing, it will be realized that the effectiveness of the sale of preferred stocks depends largely on the

efficiency of operations of a cooperative, since as mentioned earlier, a preferred stock is actually a risk capital. It will likewise be recognized that the capital generated from the sale of preferred stock is more costly to use than that derived from the sale of common

stock because of the higher interest rate it commands.

The following comparative exhibit is intended to highlight further the basic differences between the common stock and the preferred stock.

EXHIBIT VII - 1

COMPARATIVE EXHIBIT OF THE COMMON AND PREFERRED STOCK

| Kind of Stock | Voting Right         | Rate of Interest | Priority on Assets on Liquidation | Priority on Interest             |
|---------------|----------------------|------------------|-----------------------------------|----------------------------------|
| 1. Common     | With voting right    | Limited          | Next priority to preferred stock  | Next priority to preferred stock |
| 2. Preferred  | Without voting right | Limited          | Priority over common stock        | Priority over common stock       |

A particular issue is focused here on the issuance of stock certificates. As previously stated, a stock certificate is the evidence of ownership of a share or shares of stock and as a matter of practice is issued only against fully-paid shares of stock. Since from the technical standpoint, interest on share capital can and should only be given to shares of stocks which are fully-paid, the issuance of stock certificate is, for one, linked with the distribution of interest on share capital in the sense that only holders of stock certificates are entitled to receive interest on share capital. For this reason, it is to the best interest of the cooperative as well as of the members that the corresponding stock certificates be issued to the members as soon as practicable.

A major problem in this regard revolves around the common practice in cooperatives of applying payments of members for shares of stock as partial

payments for the total number of subscribed shares of stock and not as full payment for individual shares of the subscribed shares of stock. Technically, therefore, no stock certificate can be issued to the members concerned until such time that the total number of subscribed shares of stock has been paid in full. And as a consequence, such members cannot be given interest on share capital, a situation which is very hard to explain to the members concerned and can easily become a possible cause for serious misunderstanding with them.

Cooperatives usually manage to remedy the dilemma by resorting to the practice which is technically called issuing of stock certificate by block whereby a cooperative issues a stock certificate for every fully paid subscribed share of stock without the member concerned losing the option to purchase the full subscribed shares of

stock. However, it is very important that the prior specific authority of the government cooperatives office concerned be secured before any issuance of stock certificate by block is made. On its own, a cooperative does not have the power or authority to issue stock certificate by block unless such a power or authority is expressly provided in the pertinent cooperative law.

## 2. Collection of Members' Capital Contribution (for non-stock cooperative corporations)

A cooperative corporation may be organized either as a stock or a non-stock corporation. The choice of the particular type of corporation to be organized is more a question of preference of the organizers or it can be pursuant to some legal mandates. At any rate, it should be emphasized that the type of corporation, whether stock or non-stock, does not have any bearing whatsoever on the amount of capitalization which is required by a cooperative. The usual impression that a stock corporation requires more capital than a non-stock corporation is completely erroneous and without basis in fact. The truth of the matter is that in some instances, a non-stock corporation may need larger capital than a stock corporation. The amount of capital required is one that is determined by the magnitude of operations.

It is significant to note that despite the current widespread bias and partiality to the organization of cooperatives as stock corporations as shown by the preponderance at present of stock cooperative corporations, there are still some sectors who steadfastly maintain that cooperatives should be appropriately organized as non-stock corporations. They contend that stock corporations are creations of and are particularly suited to capitalists. They claim that by organizing a cooperative as a stock corporation, a cooperative is actually exposed and subjected to the capital-centered concept and workings of a stock corporation—the very things which cooperatives are seeking to re-

cast. The division of the capitalization of a stock corporation into stocks and the subsequent sales of shares of stocks, it is pointed out, is a practice that tends to open the corporation to capitalistic control. In contrast, it is inferred that the collection of members' capital contribution in a non-stock corporation which is firmly based on and in proportion to the use by the members of the services of cooperative enables the members to have equitable contribution in the capitalization of the cooperative.

Again, the fact is underscored, that the collection of members' capital contribution is a method adopted by non-stock cooperative corporations to raise necessary capital. While a stock corporation sells shares of stock to raise its capital needs, a non-stock corporation, in lieu of selling shares of stocks which it does not have, collects capital contribution from the members in some other forms. Such members' capital contributions are, as mentioned earlier, conveniently based in proportion to the use by the members of the services of a cooperative. The members' capital contribution are not only fixed but they are also collected on a regular basis.

The members' capital contribution in a non-stock corporation should not of course be confused with the membership fees. The members' capital contribution, as its name indicates, is a contribution by the members to the capitalization of their cooperative. On the other hand, membership fees are considered and treated as an income of a cooperative. They are actually requisites for membership in a cooperative and both stock and non-stock cooperative corporations usually collect membership fees.

## 3. Collection of Retains

One of the most effective ways of boosting members' contribution to the equity capital is through the collection of *retains*. Retains, which are also called capital retains, may be described as authorized fixed deductions usually

on a per unit basis from the sales proceeds of products sold to or through a cooperative marketing association. As an example, a marketing cooperative may adopt a policy to deduct retains in the fixed amount of P0.20 per cavan of palay (50 kilos) sold to or through the cooperative.

The more salient characteristics of retains are outlined hereunder:

- a. Retains are authorized deductions and are therefore collected on the strength of an approved policy of a cooperative.
- b. They are deductions usually based on the standard unit of measurement or packaging of a product, say, in cavans, bushels, crates, bales, baskets, etc. Retains are also sometimes collected based on a certain percentage of the sales proceeds.
- c. Retains are deducted from the sales proceeds and therefore after the products have been sold.
- d. The amount of retains is fixed and pegged at a reasonable level in order that the members will not be unduly burdened by the continuous deductions thereof.
- e. Revolving fund certificates, shares of stock, or certificates of indebtedness may be issued against collected retains or they may be used to build up reserves depending upon the policy of a cooperative.
- f. The collection of retains is practiced exclusively by marketing cooperatives.

Collection of retains is recognized as an effective way of augmenting equity capital which the members find convenient and not burdensome since the amount of retains is usually small. Furthermore, the retains are collected after the products have been sold.

The relatively small amount of retains collected per unit is made up by the quantity or volume of the marketed products. In other words, reckoned in terms of the large volume of products

handled by a marketing cooperative, the amount collected in retains eventually adds up to a substantial sum. Marketing cooperatives in developing countries can draw a good example from the successful experience of marketing cooperatives in the United States in utilizing to the maximum the scheme of collection of retains to bolster their equity capital.

#### **4. Deferment of Distribution of Patronage Refund**

The deferment of the distribution of patronage refund is considered a standard practice in cooperatives to increase the equity capital contribution of the members. The magnitude of equity capital can be visualized when it is considered that the biggest portion of the yearly savings or surplus of a cooperative is allocated for patronage refund.

Depending on the policy of the cooperative, the whole or a portion of the patronage refund (in the case of the latter, usually 50 per cent due the members) is withheld by the cooperative. The amount withheld by the cooperative is credited to the members concerned against which amount the corresponding certificate of stock, revolving fund certificate or certificate of indebtedness is duly issued in accordance with the policy of the cooperative.

#### **5. Accumulation of Reserves**

The setting up of reserves is one of the ways of generating capital which is strongly advocated in cooperatives. It has been observed that the cooperatives with stable financial structure are invariably those which have been able to build up and accumulate substantial reserves.

As its name suggests, a reserve is a type of fund set aside to take care of specific financial exigencies particularly with respect to future operations to thereby prevent any possible harmful impairment or depletion of capital that is being currently used in the operations. Since they conveniently serve as back-up funds mainly to cushion the

impact of any financial reverses, reserves are popularly alluded to as "shock absorbers" of the business.

The fact must be impressed that reserves are in the nature of permanent capital the composition of which is made up of contributions not only of the current members but also the former members of a cooperative. This nature and character of reserves have subsequently given rise to four long-standing important practices in cooperatives with respect to the treatment and disposition of reserves. A first practice is that reserves are considered as fully owned by a cooperative. In other words, they are unallocated funds and therefore the members of the cooperative have no individual claims against reserves. A second practice is that in the event of liquidation of a cooperative, any unused reserves are not distributed back to the members. Instead they are normally donated to appropriate community projects in order that as large a sector may become beneficiary of the said remaining funds. A third practice is that no revolving fund certificates are issued against reserves since reserves are cooperative funds. And finally, as fourth practice, reserves do not earn interest. For this reason, reserves are considered the cheapest form of equity capital.

It will be realized that this treatment of reserves as cooperative funds is firmly anchored on the accepted precept that in a cooperative no member should gain at the expense of another. Since as has been previously stated, reserves are actually accumulated contributions of all the members of a cooperative from the time of its inception, then it is but proper that the current members of a cooperative should not divide among themselves funds which did not come solely and merely from their contributions. It may also be emphasized in this regard that should the reserves be allocated to individual member equities, such an arrangement may possibly provide the strong motivation for the members of even viable

cooperatives to move for its voluntary liquidation as soon as substantial amounts of reserves have been accumulated. In which case the individual members are bound to derive substantial benefit from the voluntary liquidation of the cooperative.

a. *Common kinds and uses of reserves*

It is a standard practice in cooperatives to set up reserves for specific purposes. Among the most common kinds of reserves and their uses may be mentioned:

(1) **Valuation reserves** — intended to pay off losses from bad debts and also to cover depreciation or obsolescence of fixed assets such as land, buildings, equipment, etc.

(2) **Liquidity reserves** — earmarked to absorb losses from operations and to meet extraordinary contingencies and liabilities in general.

(3) **Capital reserves** — designed to provide funds for working capital and also for fixed investment and to retire various forms of capital contributions such as common and preferred stocks and revolving fund certificates.

b. *Amount of reserves*

There is actually no prescribed formula for determining what should be the proper amount of reserves. In practice, the amount of reserves varies not only by individual kinds of reserves but also by individual cooperatives.

It is widely recognized, however, in this regard that the following set of three factors render it essential for a cooperative to have larger amounts of reserves: (a) the highly competitive nature of the business operations; (b) the sharp price fluctuations of the products being handled; and (c) the extremely risky nature of the operations.

c. *Methods of building up reserves*

Reserves are in general built up from the business operations of a cooperative. Conventionally, therefore, reserves may be raised either from the

undistributed savings or from the collection of retains or from both. Experience has amply shown, however, that the building up of reserves from savings is quite a slow process. Consequently cooperatives are more inclined to use the authorized deductions or collection of retains for a more effective and expedient accumulation of reserves.

It should be emphasized that the kinds, the amounts, and the methods of building up reserves have to be clearly specified in the bylaws of a cooperative since reserves are matters of general concern to the members. It is important and necessary that the raising of capital through accumulation of reserves be fully discussed and explained to the members particularly during the organizational meetings.

## **B. Loan Capital**

### **1. Borrowings**

Definitely the method of raising capital that is best known to cooperatives is borrowings. The usually limited amount of equity capital that cooperatives can manage to raise at the time of inception makes borrowing virtually a standard practice they resort to in order to give their operation a respectable initial boost.

Fully cognizant of this traditional grave problem of cooperatives, framers of national cooperatives development programs particularly in developing countries invariably include financing as a major program component. Understandably, the bulk of the financing and credit support to cooperatives and their members is provided by the government pursuant to its cooperatives development program in relation to the overall national goals and objectives. To cite a case in point, the field of agricultural credit can be considered as fully in the hands of the government in developing countries and it is apparent that no developing country has a real agricultural cooperative credit system to speak of.

Governments channel financial

assistance to cooperatives through various schemes mostly on an institutionalized basis. One such scheme is the establishment of a government-owned specialized financing institution for cooperatives. Another method is the setting up of special funds for cooperatives development under the administration of the government cooperative agency or an appropriate national cooperative organization. Still another device is through exposure, either in the form of equity or loan capital, in national organization of cooperatives or agricultural credit institutions. There is therefore a country-to-country difference in the system of financing cooperatives.

In Japan, for example, the principal cooperative financing institutions on the national level are the Central Cooperative Bank for Agriculture and Forestry and the National Agricultural Forestry and Finance Corporation. The Central Cooperative Bank is a federation of cooperatives. On the other hand, the Finance Corporation handles most of the government funds for agriculture and makes long-term loans to individuals and organizations whose credit needs cannot be served by the Central Cooperative Bank. In the case of Taiwan, the Taiwan Land Bank, a government-sponsored institution, and the Cooperative Bank of Taiwan, a federation of cooperatives, are the two banking institutions that cater to the financing and credit needs of the farmers associations and their members. Korea has a rather peculiar setup in the sense that the key financing agency in the national level is the National Agricultural Cooperative Federation or the NACF. Aside from financing, NACF is also handling agricultural supply, marketing and processing activities. The government of Thailand has a government institution called the Bank for Agriculture and Agricultural Cooperatives. In the Philippines, financial assistance to cooperatives is provided mainly through the Cooperative Development Loan Fund or CDLF which is administered by the government and through



the Agricultural Credit Administration or ACA, a government-owned financing agency. Cooperative rural banks which are mainly federations of barrio-level pre-cooperatives called Samahang Nayons are in their own limited way serving the financing and credit needs of agricultural cooperatives and their farmer-members.

In the main, cooperatives have access to various types of loans, both long- and short-term, ranging from loans for working capital to fixed investments. As a matter of policy, loans to cooperatives are normally granted under liberal terms and conditions. A form of service that usually goes with the loans is assistance in the preparation of feasibility studies. Cooperatives should find it to their advantage to avail themselves of this type of technical assistance since it promotes the cementing of the desirable financing institution-client relationship and the exploitation of all possible areas of mutual understanding and assistance between them especially on the maximum utilization of the loans and the sound programming of loan repayments.

## 2. Deferred Payment

Deferred payment which has particular reference to the payment of products after they are sold is a long-standing practice among marketing cooperatives. As a distinguishing feature of cooperative marketing, deferred payment is not exactly a form of loan capital but has the effect of making the member-patrons finance their cooperatives indirectly and on a pro-rata basis. Cooperatives are therefore provided with the necessary financing cushion from the time the products are received until they are sold and are relieved of the financial burden that such transactions normally involve.

A point of caution that cooperatives should strictly observe in this regard is that they should strive at all times to keep or maintain the trust and confidence of the member-patrons by settling the said accounts which are

actually in the form of trust accounts in accordance with the customary practice. The practice of deferred payment is anchored on trust and every effort should therefore be exerted not to destroy the said trust placed on the cooperative by the member-patrons.

## 3. Trade Credit

A common but not too well understood practice of increasing the volume of business is through the use of trade credit. According to its more accepted definition, trade credit is the ability of the trading firm such as a cooperative to secure goods for sale in exchange for a promise to pay at some specific future time. This ability takes the form of a line of credit used for the purpose of buying goods.

In the specific case of agricultural supply cooperatives, the operation of trade credit will principally apply to their ability to secure a line of credit from suppliers for the purchase of such farm inputs as fertilizers and agricultural chemicals.

In the trade credit transaction between the supplier, on the one hand, and the agricultural supply cooperative, on the other, the credit relationship between the two is usually established and defined in the terms of sale. There is of course no such thing as uniformity of terms of sale in any particular industry or for that matter among farm input suppliers. Normally, the terms of sale as well as the price are fixed by the suppliers although they are usually subject to the agreement of both parties. In this regard, the management of cooperatives should pay particular attention to the nomenclature of the terms of sale in order that they may be able to consider intelligently possible alternatives.

For example, it should be realized that the abbreviated terms E.O.M. (end of month) and M.O.M. (middle of month) are very important dating terms as they actually grant an extension or dating in addition to the credit period of the terms of sale. Under the E.O.M. arrangement, all purchases made on or

before the 15th of the month are grouped and dated on the 15th of the month. In both cases, it will be realized that it is possible for the cooperative to secure a maximum extension of 15 days in the credit period.

Moreover, the management of co-operatives should be meticulous in going over the two options usually given by suppliers on the time and amount of payment. For example, a cooperative may receive a quotation of P100 for certain agricultural chemicals with terms of 5 per cent discount if paid within 10 days or due net in 60 days. The said terms are customarily indicated as 5/10 net 60. From the foregoing, it will be noted that the supplier actually makes two distinct valid offers for the sale of the same agricultural chemicals, to wit:

- First offer** - P95 payment due in 10 days
- Second offer** - P100 payment due in 60 days

In the subject illustration, it will be realized that the actual worth of the agricultural chemicals is P95 and not P100. The terms can be interpreted to mean that the supplier is willing to give the cooperative a cash discount of P5 if payment is made within 10 days. In case, however, of failure to pay within 10 days, the supplier will charge the cooperative P5 for the use of the P95 for 50 days and for the credit risk involved. In effect, therefore, if the cooperative fails to exercise the first option, the P5 is the price it would have to pay for P95 from the supplier for 50 days. A simple computation will show that for the use of the supplier's money of P95 for 50 days, the cooperative will pay P5 which is equivalent to a rate of 5.26 per cent for 50 days or 38.39 per cent for 365 days. Assuming that the cost or worth of money to be 12 per cent per annum, the cooperative, in the given situation, will actually be paying 26.39 per cent more than the value of money for the privilege of being financed by the supplier. Faced with such a situation, the

cooperative may consider the possibility of paying the agricultural chemicals in cash either out of its own or from borrowed funds.

#### 4. Sale of Bonds and Debentures

Another possible way by which co-operatives can acquire loan capital is through the sale of bonds and debentures. The use of this method is, however, extremely limited since only those large cooperatives with well-established credit and with substantial assets enough to guarantee the payment of the bonds and debentures are in a position to float such issues.

Bonds and debentures which are practically identical instruments, except that debentures have shorter period of maturity, have fixed period of maturity and fixed rate of interest. They are issued in different denominations. Bonds and debentures enjoy preference on the assets of an association in case of liquidation.

#### 5. Donations, Grants, Gifts, etc.

Some cooperatives are able to raise funds out of donations, grants, gifts and the like. Such countries as the United States, Sweden, West Germany, Denmark, Canada and others where cooperatives have attained a high degree of stability have long initiated various programs of assistance for cooperatives in developing countries. Most donations, grants and gifts are usually given for specific purposes, mostly in relation to cooperative education and training activities.

### IV. THE REVOLVING FUND CAPITAL PLAN

The incessant and untiring efforts of co-operatives to work out a financing scheme that would completely conform with the established philosophies and concepts of cooperative financing finally culminated in the formulation of the revolving fund capital plan. As a financing scheme, the re-

volving fund capital plan is indigenous to cooperatives. It is as distinct and peculiar to cooperatives in the area of cooperative financing as the pooling method is in the area of cooperative marketing. It can therefore be surmised that only cooperatives employ the revolving fund capital plan although not all cooperatives have yet taken advantage of its use.

#### *A. The Revolving Fund Capital Plan Described*

The revolving fund capital plan may be described as a distinctly cooperative system of financing wherein a revolving equity capital fund is created out of the capital contributions of the member-users, usually in the form of (a) authorized deductions or retains, and (b) undistributed patronage refunds. Once the predetermined capital requirement of the cooperative has been raised, the earlier capital contributions of the member-users to the revolving equity capital fund are retired periodically on a first-in, first-out basis, by the latest capital contributions of the member-users, maintaining at all times the level of the revolving equity capital fund to that of the cooperative's capital requirement.

In the main, there are two significant things that can be deduced from the foregoing description of the revolving fund capital plan. In the first place, it underscores the fact that the revolving fund capital plan is a financing scheme that is unique and peculiar to cooperatives. And in the second place, it provides a general insight into the most essential working features of the revolving fund capital plan, namely: (a) the revolving equity capital fund, as its name suggests, is in the nature of contributions of the member-users to the capitalization of the cooperative; (b) the two principal sources or forms of capital contributions of the member-users are the authorized deductions or collections of retains and the undistributed patronage refunds; (c) the preset capital requirement of the cooperative has to be fully raised first before any capital contribution of the member-users is retired; (d) the retirement of the capital contributions of the mem-

ber-users shall be in accordance with a pre-arranged period and shall be on a first-in, first-out basis; and (e) the capital requirement of the cooperative shall, in all cases, be maintained.

#### *B. The Underlying Concepts of the Revolving Fund Capital Plan*

The revolving fund capital plan has been formulated using as guidelines certain basic concepts of cooperative financing. The recognition and acceptance that is at present accorded to the plan may be attributed mainly to its substantial, if not complete, attunement to the said basic guiding concepts thus making it truly effective in contributing to the attainment of the objectives of a cooperative in full observance of the cooperative principles.

The real value and effectiveness of the plan are drawn from the following inter-related basic concepts in cooperatives, in general, and cooperative financing, in particular:

1. Financing of a cooperative must, as much as possible, be limited to its current member-users.
2. Financing of a cooperative must, as far as practicable, be shouldered equitably by the member-users in proportion to their use of its services.
3. The democratic control of cooperative must be vested in and exercised by mainly, if not exclusively, its member-users.

It will be realized that the foregoing very basic and important concepts are all interwoven tightly into the plan, something which no other financing plan can rightfully claim, precisely because of the following key aspects of the said plan which had been pointed out earlier:

1. The revolving equity capital fund has as principal sources the collection of retains and the deferment of distribution of patronage refund. At this stage it is possibly superfluous to state that these two sources are not only generated out of the use of the services of the cooperatives by its current

member-users but equally important, the amount of capital contribution of the member-users are in proportion to the extent of their use of its services or to the volume of business transacted by each member-user. Thus, the financing of the cooperative is restricted to its current member-users and in accordance with their patronage of its business operations or services.

2. The earlier capital contributions are retired by the latest contributions of the member-users on a first-in, first-out basis. By virtue of this scheme, it can be visualized that there will be a periodic phasing out of the membership from the cooperative of the inactive members or simply member-owners since under the setup, only those members who actually patronize the cooperative will have, at all times, capital contributions to the revolving equity capital fund. On the other hand, the membership in the association of habitually inactive members will be automatically terminated as soon as their capital contribution to the revolving equity capital fund shall have been retired or paid back. Consequently, the revolving equity capital plan has that built-in mechanism which can pave the way for the desirable exercise of democratic control of a cooperative only by those members who are actually and currently living up to their avowed primordial duty and responsibility of patronizing their cooperative. This is actually the contemplation of the democratic control principle in cooperatives since what is envisaged really is democratic control of a cooperative by the member-users or member-patrons. Also it may be mentioned that the plan is a realistic and practical approach to the solution of the common problem of mustering quorum during meetings in the case of those cooperatives which carry in their roster of membership a substantial number of inactive members.

### *C. General Schemes of Revolving Fund Capital Plan*

As currently being universally used by cooperatives, the plan partakes of three general schemes:

**Scheme 1** — Full operation of the revolving fund capital plan in a stock cooperative corporation.

**Scheme 2** — Partial operation of the revolving fund capital plan in a stock cooperative corporation.

**Scheme 3** — Full operation of the revolving fund capital plan in a non-stock cooperative corporation.

Contrary to the common prevailing impression, the revolving fund capital plan can be adopted not only in non-stock cooperative corporations but also in stock cooperative corporations. Its operation in stock cooperative corporations can be considered as more complicated than in non-stock cooperative corporations. This is particularly true with regard to Scheme 2 above which actually is a combination of the conventional system of financing and the revolving fund capital plan. In the case of non-stock cooperative corporations, experience shows that they either adopt the plan completely or not at all. There are only a few reported cases of what may be termed as partial operation of plan in a non-stock cooperative corporation.

The basic difference between Schemes 1 and 2 is that in Scheme 1, the stocks are also revolved while in Scheme 2, the stocks are not revolved. The main disadvantage of Scheme 2 which can immediately be deduced is that the membership in a cooperative may not be reduced and confined strictly to the current active member-users. This is because as long as a member holds at least one share of stock, then he is considered a member of the cooperative although under the category of plain member-owner. To employ the plan under Scheme 2 will perforce vitiate the very essence of the basic concepts of cooperative financing as enunciated earlier since membership in a cooperative will always be

a dilute of active and inactive members with all its undesirable implications.

#### ***D. Types of Revolving Equity Capital***

The usual components of equity capital in a cooperative are: (a) capital stock or membership certificate as the case may be, (b) authorized deductions or retains, (c) undistributed savings, and (d) reserves. Except for the reserves which as pointed out earlier are unallocated funds owned by the cooperative itself, the other items in the equity capital portion of the balance sheet can be revolved. It is of course at the discretion of a cooperative whether to revolve any or all of the said accounts. Therefore, although the capital stock, the authorized deductions of retains, and the undistributed savings can all be revolved, it is up to the cooperative to decide which of the items will be of revolving nature.

Specifically for each account to be revolved, the following evidence of ownership or claim against a revolving equity capital is issued by a cooperative to the members concerned:

1. **Common or preferred stock** – revolving stock certificate
2. **Members' capital contribution** – revolving fund certificate
3. **Authorized deduction and/or undistributed patronage refund** – either revolving fund certificate or certificate of indebtedness.

Particular attention is invited to the fact that in actual practice, a revolving equity capital or to be more specific, a revolving stock certificate, a revolving fund certificate or a certificate of indebtedness: (a) may or may not bear interest and (b) may or may not have fixed period of maturity. These considerations are subject to the policy of the cooperative.

There is, however, a general tendency among cooperatives during the early stage of their operations when the confidence and trust of the members have yet to be completely gained to issue revolving fund

certificate with both fixed rate of interest and date of maturity. There is of course a decided advantage for the board of directors to be able to exercise sufficient flexibility in determining how much rate of interest should be given to a revolving equity capital as well as when it should be retired. Vested with such a discretion, the board of directors will be able to prevent any undue impairment or dislocation of the capitalization of the cooperative by not declaring any interest or retiring any revolving equity capital in a situation where the cooperative may not be in a financial position during a particular period to meet such obligations or commitments.

#### ***E. Sources of Revolving Equity Capital***

The principal sources of the revolving equity fund may be categorized under two self-explanatory headings as follows:

1. **Direct contributions**
  - a. Purchase of shares of stocks (for stock corporations)
  - b. Payment of members' capital contribution (for non-stock corporations)
2. **Indirect contributions**
  - a. Authorized deductions or retains
  - b. Undistributed patronage refund

It will be noted that any potential or current member of a cooperative can contribute directly to the revolving equity fund through the simple process of either purchasing shares of stocks, in the case of a stock cooperative corporation, or paying members' capital contribution, in the case of non-stock corporation.

On the other hand, a member can only make the so-called indirect contribution to the revolving equity fund by using the services of his cooperative. This is because authorized deductions and undistributed patronage refunds are both outcomes of actual participation in the cooperative's business operations. In other words, only those members, in the case of a marketing

cooperative, who had marketed their products to or through their cooperatives can be subjected to the collection of retains and can be entitled to receive patronage refund.

Based on the foregoing, it should be clearly apparent that the more preferable sources of revolving equity capital are those classified as indirect contributions, specifically, authorized deductions and undistributed savings inasmuch as both are tied-up or linked up with patronage. If it is desired, therefore, to derive the fullest benefit from the revolving fund capital plan, the proper direction and concentration of efforts should be in the building up and strength-

ening of the revolving equity capital out of the contributions of the members as a result of their patronage of the cooperative. This is actually the ideal setup in the revolving fund capital plan toward which attention should be firmly focused.

The following Exhibit VII-2 is aimed at presenting in a nutshell the more salient facets of the various schemes of operating the revolving fund capital plan and the types and sources of revolving equity capital. It is hoped that a better perspective more particularly of the interrelationship among the essential aspects of the revolving fund capital plan will be visualized.

**EXHIBIT VII - 2**  
**SALIENT FEATURES OF THE VARIOUS**  
**SCHEMES OF THE REVOLVING FUND CAPITAL PLAN**

| Scheme   | Types of Revolving Equity Capital  | Sources of Revolving Equity Capital  |
|--|--|--|
| Scheme 1 — Full operation of the plan in a stock cooperative corporation     | <ol style="list-style-type: none"> <li>1. Revolving stock certificate</li> <li>2. Revolving fund certificate or certificate of indebtedness</li> </ol> | <ol style="list-style-type: none"> <li>1. Purchase of shares of stock (direct contribution)</li> <li>2. Authorized deductions and/or undistributed patronage refund (indirect contribution)</li> </ol>               |
| Scheme 2 — Partial operation of the plan in a stock cooperative corporation  | <ol style="list-style-type: none"> <li>1. Revolving fund certificate or certificate of indebtedness</li> </ol>   | <ol style="list-style-type: none"> <li>1. Authorized deductions and/or undistributed patronage refund (indirect contribution)</li> </ol>   |
| Scheme 3 — Full operation of the plan in a non-stock cooperative corporation | <ol style="list-style-type: none"> <li>1. Revolving fund certificate</li> <li>2. Revolving fund certificate or certificate of indebtedness</li> </ol>  | <ol style="list-style-type: none"> <li>1. Payment of members' capital contribution (direct contribution)</li> <li>2. Authorized deductions and /or undistributed patronage refund (indirect contribution)</li> </ol> |

## ***F. Illustration of the Mechanics of Operation of the Revolving Fund Capital Plan***

Predictably, an illustration of the mechanics of operation of the revolving fund capital plan (Exhibit VII-4) will help immensely in infusing a better understanding and appreciation of this novel cooperative financing scheme. This illustration has been so designed, however, that it also focuses attention to some of the more vital aspects of cooperative financing which had been particularly stressed in the earlier discussions. For example, the illustration also seeks to underscore the pressing need for setting up and maintaining a strong reserves position. The value of reserves as a convenient reservoir of funds which can be made immediately available to overcome financial handicaps or difficulties is clearly demonstrated in the subject illustration. In addition, the effectiveness of the collection of retains as a method of raising revolving equity capital, on the one hand, and for building up reserves, on the other, is likewise prominently featured in this illustration.

With its sufficiently broadened scope and with its close simulation of the actual condition, the subject illustration, it is strongly felt, can truly be meaningful and serve a real valid purpose not only in providing a clearer and more incisive insight into the practical workings of the revolving fund capital plan but also in unveiling a realistic and workable pattern of approach in formulating a comprehensive package program of cooperative financing.

### **1. Assumptions**

This illustration of the revolving fund capital plan is built around the following assumptions :

#### ***a. Type of cooperative and kind of product handled***

The cooperative involved is a farmers' marketing cooperative engaged in the marketing of rice. The cooperative is organized and registered as a stock corporation.

#### ***b. Period covered and length of accounting period***

The period covered is from 1961 to 1970, inclusive, a span of 10 years.

The farmers' marketing cooperative was of course organized in 1960 but started its operations only the following year, 1961. The accounting period is reckoned by calendar year, that is, from January 1 to December 31.

#### ***c. Required capitalization and composition of initial capital structure***

The required capitalization is P200,000. The members initially contributed P100,000 by purchasing common shares of stock. To be able to raise the necessary capitalization of P200,000, the cooperative borrowed the balance of P100,000 from a cooperative financing institution. The composition, therefore, of the initial capitalization of the cooperative of P200,000 is P100,00 equity capital and P100,000 loan or borrowed capital.

#### ***d. Scheme of plan used***

The cooperative placed all equity capital, except of course, the reserves under the revolving fund capital plan. This corresponds to Scheme 1 of the previous discussion whereby there is a full operation of the revolving fund capital plan in a stock corporation.

#### ***e. Types of revolving equity capital***

Specifically the types of revolving equity capital are: (a) common stocks covered by revolving stock certificates; (b) authorized deductions or retains covered by revolving fund certificates; and (c) undistributed patronage refunds, also covered by revolving fund certificates. All the revolving equity capital are non-interest bearing and have no fixed period of maturity.

#### ***f. Sources of revolving equity capital***

The revolving equity capital came from the following sources: (a) purchases of the common shares of stocks; (b) authorized deductions or collection of retains; and (c) undistributed patronage refunds.

In the case of the collection of retains, a fixed fee of P2.75 is collected for every cavan of palay or rough rice (50 kilos) handled by the cooperative.

The said per unit retains of P2.75 per cavan of palay of 50 kilos is allocated as follows: P2.00 to the revolving equity capital and P0.75 to the reserves.

On the other hand, all patronage refunds due the members were withheld and made part of the revolving equity capital.

g. *Scheme used to accumulate reserves*

Two methods were used to build up reserves, namely: (a) 20 per cent of the net savings was allocated to reserves and (b) a portion of the retains collected, to be exact, P0.75 per cavan of palay or rough rice was used to

boost the reserve funds. The reserves were intended generally to absorb losses in operations and to augment the capital requirements of the cooperative.

h. *Rate of interest on share capital*

A ceiling of 10 per cent was set for interest on share capital. The cooperative can of course declare interest on share capital lower than 10 per cent depending on the results of operations.

i. *Pertinent data on operations*

The pertinent data on operations which make up the basic framework of the revolving fund capital plan are tabulated hereunder in Exhibit VII-3.

**EXHIBIT VII — 3**  
**PERTINENT DATA ON OPERATIONS**

| Year         | Allocation of Net Savings |                |                           |                  | Allocation of Retains |                          |                | Total Revolving Equity Capital |
|--------------|---------------------------|----------------|---------------------------|------------------|-----------------------|--------------------------|----------------|--------------------------------|
|              | Total Net Savings         | Reserves       | Interest on Share Capital | Patronage Refund | Total Retains         | Revolving Equity Capital | Reserves       |                                |
| (1)          | (2)                       | (3)            | (4)                       | (5)              | (6)                   | (7)                      | (8)            | (9)                            |
| 1961         | P 18,375                  | P3,650         | P 5,000                   | P 9,725          | P14,806               | P10,768                  | P4,038         | P20,493                        |
| 1962         | 29,250                    | 5,850          | 7,000                     | 16,400           | 23,568                | 17,140                   | 6,428          | 33,540                         |
| 1963         | 27,625                    | 5,525          | 7,000                     | 15,100           | 22,258                | 16,188                   | 6,070          | 31,288                         |
| 1964         | 35,200                    | 7,040          | 10,000                    | 18,160           | 28,362                | 20,627                   | 7,735          | 38,787                         |
| 1965         | 32,350                    | 6,470          | 10,000                    | 15,880           | 26,065                | 18,957                   | 7,108          | 34,837                         |
| 1966         | 38,450                    | 7,690          | 10,000                    | 20,760           | 30,982                | 22,532                   | 8,450          | 43,292                         |
| 1967         | (23,700)                  | —              | —                         | —                | 28,201                | 20,510                   | 7,691          | 20,510                         |
| 1968         | (11,350)                  | —              | —                         | —                | 22,158                | 16,115                   | 6,043          | 16,115                         |
| 1969         | 18,550                    | 3,710          | 5,000                     | 9,840            | 14,946                | 10,870                   | 4,076          | 20,710                         |
| 1970         | 32,450                    | 6,490          | 10,000                    | 15,960           | 26,147                | 19,016                   | 7,131          | 34,976                         |
| <b>TOTAL</b> |                           | <b>P46,425</b> | <b>P64,000</b>            | <b>P121,825</b>  | <b>P237,493</b>       | <b>P172,723</b>          | <b>P64,770</b> | <b>P294,548</b>                |

**Footnotes on computations —**

1. Allocation of net savings --
  - (a) 20% to reserves
  - (b) maximum of 10% interest on share capital
  - (c) balance for patronage refund
2. Allocation of retains --
 

The fixed retains of P2.75 per cavan of palay or rough rice which represents 5% of the floor price of one cavan of palay of P55.00 was distributed as follows:

  - (a) P2.00 to the revolving equity capital
  - (b) P0.75 to reserves
3. Total revolving equity capital -- (Column 9)
 

The sum of patronage refund (column 5) and revolving equity capital (column 7).



## 2. Mechanics of Operation of the Revolving Fund Capital Plan

The mechanics of operation of the revolving fund capital plan is shown in Exhibit VII-4.

It can be seen in said exhibit that the entire process of formulating and implementing the revolving fund capital plan mainly involves the performance of some basic sequential and closely related steps which can conveniently be broken down in their order of priority as follows:

### Step 1 — Raising of the revolving equity capital fund to the projected capital requirement

It will be noted in the illustration that when the cooperative started its operations in 1961, its minimum required capitalization of P200,000 was made up of two components: (a) equity capital of P100,000 and (b) loan capital of P100,000. In the light of the basic requirement in the revolving fund capital plan that the revolving equity fund must first reach the preset minimum level of capitalization before any fund can be retired or revolved, the primary concern of the cooperative was to increase its equity capital from P100,000 to P200,000. In this illustration, the cooperative was finally able to accomplish this in 1964 when its revolving equity capital fund reached the amount of P224,108.

In the process, as can be gleaned in the illustration, the cooperative was able to repay back all its loan of P100,000 by applying in full the capital contributions of the members of P20,493 in 1961, P33,540 in 1962, P31,288 in 1963, and P14,679 out of the total capital contribution of P38,787 in 1964.

At this juncture, to avoid possible misconception, it should be impressed that the liquidation by the cooperative of its loan of

P100,000, as shown in the illustration, is not a necessary adjunct or feature of the revolving fund capital plan. Actually this payment of the borrowed funds should be properly looked upon and considered as merely incidental to the efforts of the cooperative to increase its revolving equity capital to the prescribed P200,000. In other words, the main or greater concern of the cooperative was to be able to satisfy the requirements insofar as the revolving equity capital is concerned and definitely not merely to be able to repay its loan. To stress the point further, the operation of the revolving fund capital plan is contingent on the creation of a revolving equity capital fund that will satisfy the projected minimum capital requirement of the cooperative and not, by any means, on the repayment of the loans of the cooperative. This matter has to be fully clarified, otherwise, the wrong impression may be created that a cooperative with outstanding loans cannot adopt the revolving fund capital plan. Or that a cooperative which has adopted the revolving fund capital plan is inhibited from securing loans. There is nothing incompatible in the adoption and operation of the revolving fund capital plan and the acquisition of loans.

### Step 2 — Retirement of the initial equity capital

Having successfully pushed its revolving equity capital to P224,108 in 1964, the cooperative, after 5 years of operations, was prepared to start the retirement of funds in 1965. In accordance with the cardinal rule that funds should be retired strictly on a first-in, first-out basis, the cooperative proceeded to retire first the initial equity capital. It will be noted that the cooperative retired its initial equity capital of

P100,000 in two equal installments — P50,000 in 1965 and the balance of P50,000 in 1966. In this regard, the recorded date of purchase of the shares of stock as indicated in the corresponding certificates of stock was used as the reckoning date for the retirement of the stocks.

With the retirement in full of the initial equity capital of P100,000 accomplished, the cooperative then shifted to Step 3.

### Step 3 — Retirement of the subsequent equity capital

Involved in Step 3 were the capital contributions of the members which were generated from the business operations of the cooperative since it commenced operations in 1961. And so following again the cardinal rule of retiring capital on the basis of first-in, first-out, the cooperative retired in 1967 the capital contributions of the members made in 1961 amounting to P20,493. In 1968, however, the capital contributions of the members amounted to only P16,115. Consequently, in order not to disturb the level of capitalization, the cooperative did not retire in full the capital contributions of the members which should be retired amounting to P33,540. Instead it retired only P16,000 of the said amount in 1968 and retired the balance of P17,540 the following year, 1969. Subsequently, however, in 1970, the cooperative was able to retire in full the 1963 capital contributions of the members in the amount of P31,288 out of the capital contributions received that year of P34,976.

This illustration of the mechanics of operation of the revolving fund capital plan, it should be realized, brought to the fore

what had been described earlier as the essential features of the plan itself, to wit: (a) the revolving equity fund is in the nature of capital contributions of the member-users; (b) the two principal sources of capital contributions of the members are the collection of retains and undistributed patronage refunds which are actually offshoots of the patronage by the members of their cooperative; (c) the pre-determined capital of the cooperative must first be fully satisfied before any retirement of funds is made; (d) retirement of the capital contributions should strictly be made on a first-in, first-out basis; and (e) the prescribed level of capital should be maintained at all times.

The point may be emphasized that the capitalization of a cooperative may be maintained at the prescribed level by limiting the amount to be retired to the amount of capital contributions received that year. Through this amount matching process, the incoming and outgoing funds merely offset each other. This practice, it must have been noticed, was demonstrated in the subject illustration.

Finally, one significant feature of this illustration of the revolving fund capital plan which, it is strongly believed, merits particular attention is the accompanying supplemental scheme of accumulation of reserves. By adopting a systematic and effective scheme of reserves formation, it will be noted in the illustration that the cooperative was able to gradually build up its reserves from a mere P7,688 in 1961 to the substantial amount of P111,195 in 1970. This important aspect of cooperative financial management, which is often overlooked if not entirely neglected, was particularly focused in this illustration because of two reasons.

EXHIBIT VII - 4

MECHANICS OF OPERATION OF THE REVOLVING FUND CAPITAL PLAN OF A FARMERS' MARKETING COOPERATIVE,  
INCLUDING ACCUMULATION OF RESERVES

| Capitalization  | P200,000               | P200,000               | P200,000               | P200,000               | P224,108        | P208,945                          | P202,237                          | P202,254        | P202,369        | P205,539        | P209,227        |
|-----------------|------------------------|------------------------|------------------------|------------------------|-----------------|-----------------------------------|-----------------------------------|-----------------|-----------------|-----------------|-----------------|
| RETAINED        | Loan Capital           | Loan Capital           | Loan Capital           | Loan Capital           | 1964<br>P38,787 | 1965<br>P34,837                   | 1966<br>P43,292                   | 1967<br>P20,510 | 1968<br>P16,115 | 1969<br>P20,710 | 1970<br>P34,976 |
|                 | P100,000               | P79,507                | P45,967                | P14,679                | 1963<br>P31,288 | 1964<br>P38,787                   | 1965<br>P34,837                   | 1966<br>P43,292 | 1967<br>P20,510 | 1968<br>P16,115 | 1969<br>P20,710 |
|                 | Initial Equity Capital | Initial Equity Capital | Initial Equity Capital | Initial Equity Capital | 1962<br>P33,540 | 1963<br>P31,288                   | 1964<br>P38,787                   | 1965<br>P34,837 | 1966<br>P43,292 | 1967<br>P20,510 | 1968<br>P16,115 |
|                 | P100,000               | P100,000               | P100,000               | P100,000               | 1961<br>P20,493 | 1962<br>P33,540                   | 1963<br>P31,288                   | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 | 1967<br>P20,510 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
|                 |                        |                        |                        |                        | 1961<br>P20,493 | 1961<br>P20,493                   | 1962<br>P33,540                   | 1963<br>P31,288 | 1964<br>P38,787 | 1965<br>P34,837 | 1966<br>P43,292 |
| RETIRED         |                        |                        |                        |                        |                 | Initial Equity Capital<br>P50,000 | Initial Equity Capital<br>P50,000 |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   | 1961<br>P20,493 | 1962<br>P16,000 | 1962<br>P17,540 | 1963<br>P31,288 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
|                 |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
| R E S E R V E S |                        |                        |                        |                        |                 |                                   |                                   |                 |                 |                 |                 |
| This Year       |                        | P7,688                 | P12,278                | P11,595                | P14,775         | P13,578                           | P16,140                           | P 7,691         | P 6,043         | P 7,786         | P13,621         |
| Total           |                        |                        | P19,966                | P31,561                | P46,336         | P59,914                           | P76,054                           | P83,754         | P89,788         | P97,574         | P111,195        |

For one, the accumulation of reserves can play a vital role in bolstering the financial capability of a cooperative. And for another, a cooperative which reflects a strong reserves position can definitely command the highest respect and admiration of even the most critical eyes of those in the financial world.

## V. MANAGEMENT USES OF FINANCIAL STATEMENTS

As a matter of practice and policy in cooperatives, as well as in other corporations, the general manager is required to submit periodically to the board of directors certain financial statements or accounting reports. The importance of submitting these financial statements need not be over-emphasized. It would be logical to assume, however, that the submission of the financial statements should be observed not as a matter of compliance with a requirement. But rather, it is a means by which the board of directors, and the entire management in general can secure necessary monetary information that will aid them in discharging their management functions more efficiently and effectively.

Basic, however, to the whole proposition is that the management should understand the financial statements. Otherwise, the financial statements will be utterly meaningless or worthless. In fact it will indeed be a catastrophe for a cooperative if its management, particularly the board of directors and the general manager, does not even have an inkling of the contents of financial statements.

This discussion is intended to impart to management an understanding of financial statements sufficient enough to have a general insight into what is happening in the business of the cooperative and to be able to use the accounting figures to recognize and solve management problems as well as to plan and control the activities.

### A. *Principal Financial Statement*

There are three and only three principal financial statements, namely: (a) the balance sheet, (b) the statement of operation, and (c) the funds flow statement. All these financial statements come by different names but such difference in names is just a matter of terminology rather than of substance.

For a better comprehension of the above-mentioned financial statements together with their relationships, they will be discussed and illustrated separately.

#### 1. Balance Sheet (also called financial statement of condition, position statement or statement of financial position.)

The balance sheet presents the financial condition or status of the business as of a specified period. Structurally, the balance sheet is made up of two sides: (a) the assets side and (b) the liabilities and members' equity side. Because of the dual-aspect concept in accounting, the two sides exactly balance one another. In other words, the assets listed on one side of the balance sheet are equal in total to the sum of (a) the liabilities and (b) the members' equity listed on the other side. It may immediately be pointed out that the fact that the two sides are balance does not mean anything insofar as the financial condition of a cooperative is concerned. As previously stated, they are balance and they have to be balanced at all times precisely because balance sheets are constructed under the dual-aspect concept in accounting. And since under the said dual-aspect concept all transactions can be recorded in a balance sheet, the balance sheet is considered the most basic or fundamental of the financial statement.

A typical balance sheet, presented in a format which is particularly prescribed for cooperatives, is shown in Exhibit VII-5. In order to promote

EXHIBIT

BALANCE SHEET OF THE \_\_\_\_\_

As of \_\_\_\_\_

**ASSETS (WHAT WE OWN)**

**Current Assets** (resources which are expected to be converted into cash or sold or consumed during the normal operating cycle of the business)

Cash (on hand and in bank) \_\_\_\_\_

Accounts Receivable (amounts owed to the cooperative for commodities sold or for cash advances trade) \_\_\_\_\_

Inventory ("the aggregate of those items of tangible personal property which (1) are held for sale in the ordinary course of business; (2) are in the process of production for such sale; or (3) are to be currently consumed in the production of goods or services to be available for sale.") \_\_\_\_\_

**Total Current Assets** \_\_\_\_\_

**Investments** (shares in cooperative corporations or investments in bonds, debentures, securities, etc.) \_\_\_\_\_

**Fixed Assets** (land, buildings, equipment, etc. depreciated to present value) \_\_\_\_\_

**Prepaid Expenses and Deferred Charges** (expenses paid for but still applicable to operations of subsequent periods, i.e., rent and unexpired insurance and bonds) \_\_\_\_\_

**Total Assets (Total of What We Own)** \_\_\_\_\_

\_\_\_\_ COOPERATIVE

—

**LIABILITIES (WHAT WE OWE OTHERS)**

**Current Liabilities** (obligations whose liquidation is done usually within one year and is expected to require the use of current assets)

Accounts Payable (claims for products or services furnished the cooperative) \_\_\_\_\_

Notes Payable (claims evidenced by a note or written acknowledgment of debt due usually within one year) \_\_\_\_\_

Accrued Expenses (unpaid expenses such as taxes, interests, salaries and wages which have accumulated; the converse of prepaid expenses) \_\_\_\_\_

**Total Current Liabilities** \_\_\_\_\_

**Fixed Liabilities** (long-term indebtedness to creditors) \_\_\_\_\_

**Total Liabilities (Total of What We Owe Others)** \_\_\_\_\_

**MEMBERS' EQUITY (WHAT WE OWE OURSELVES)**

Shares of Stock (capital contributions of the members through the purchase of shares of common or preferred stocks) \_\_\_\_\_

Undistributed Savings or Retained Earnings (current savings available for distribution to members, transfer to reserve, etc.) \_\_\_\_\_

Retains (authorized deductions from sales proceeds of products marketed through the cooperative) \_\_\_\_\_

Reserves (amounts set up to meet uncertainties and to furnish capital) \_\_\_\_\_

**Total Members' Equity (Total of What We Owe Ourselves)** \_\_\_\_\_

**Total of Liabilities and Members' Equity** \_\_\_\_\_

and expedite better understanding of basic accounting terms, an attempt has been made in cooperatives to present them in more simple and understandable terms. For example, in cooperatives, it is suggested that (a) the assets be referred to as "what we own;" (b) the liabilities as "what we owe others;" and (c) the members' equity as "what we owe ourselves."

Alternative views may be pursued in examining the relationship between the two sides in the balance sheet. One way is to consider the liabilities and members' equity as claims against the assets. This viewpoint, it is clearly evident, is anchored on the precept of ownership and can be said to underscore the debtor-creditor relationship. The alternative viewpoint is to look upon the liabilities and members' equity as sources of funds, on the one hand, and the assets as the uses of funds, on the other. This latter viewpoint is particularly suggested to students of financial management since two major decisions can be identified and interpreted in a balance sheet. Being sources of funds, the liabilities and members' equity can be considered as *financing* decisions. On the other hand, being uses of funds, the assets can be identified as *investment* decisions. In this way, the soundness of financial management can be better evaluated or assessed in terms of *financing* and *investment* decisions.

2. **Statement of Operation** (also referred to as income statement, operating statement, profit and loss statement, statement of earnings, etc.)

The statement of operations shows the results of operations of the business for an accounting period. Essentially, it presents: (a) all revenue items, (b) all expense items, and (c) the difference between them, that is, either net savings or net loss.

It is pertinent to stress the fact that the results of operations are directly reflected either as an increase

or decrease in the members' equity. Such increases in members' equity are called revenues while decreases are called expenses. The difference between revenues and expenses is called net savings or net loss. The net income, therefore, is directly related to changes in the members' equity and not to changes in the amount of cash, as erroneously thought of. This is the essence of what is referred to in accounting as the accrual concept.

A simple illustration of an statement of operation for which, as in the case of the balance sheet, no specific format is prescribed, is presented in Exhibit VII-6.

The inter-locking relationship between the balance sheet, on the one hand, and the statement of operation, on the other, can be better comprehended in Exhibits VII-7 and VII-8.

It will be noted in Exhibit VII-7 that an statement of operation is prepared for each of the accounting periods. On the other hand, a balance sheet is prepared for each point between accounting periods.

Exhibit VII-8 shows the changes in the members' equity, specifically the retained earnings account, in the balance sheets as of December 31, 1970 and December 31, 1971, effected by the results of the current operations as reflected in the statement of operation for the year 1971. The illustration significantly features the use of the *Retained Earnings Reconciliation Statement* to show clearly the changes in the members' equity from 1970 to 1971.

It will be noted in the *Retained Earnings Reconciliation Statement* that the net savings of P4,573 in 1971 was added to the retained earnings of P6,440 in 1970 to give a total retained earnings of P11,013 in 1971. The arrows in the illustration are intended to facilitate understanding of the construction of the said statement.

**EXHIBIT VII - 6**

**STATEMENT OF CONDITION OF THE \_\_\_\_\_ COOPERATIVE**  
**For the period ended \_\_\_\_\_**

**REVENUES** (money received for goods and services sold)

|  |       |       |
|--|-------|-------|
| Sales (covers all types of goods and services) |       | _____ |
| Cost of Sales                                  |       |       |
| Inventory (beginning)                          | _____ |       |
| Plus Goods Purchased During Period             | _____ |       |
| Total Goods Handled                            | _____ |       |
| Less Inventory (ending)                        | _____ |       |
| Net Cost of Sales                              |       | _____ |
| Gross Margin (Sales less Cost of Sales)        |       | _____ |

**EXPENSES** (money spent in operating the business)

|                         |       |       |
|-------------------------|-------|-------|
| Selling Expenses        | _____ |       |
| Administrative Expenses | _____ |       |
| General Expenses        | _____ |       |
| Total Expenses          |       | _____ |

**INCOME** (difference between Revenues and Expenses,  
either Net Savings or Loss)

=====



**EXHIBIT VII - 7**

**SEGMENTATION INTO ANNUAL ACCOUNTING PERIODS  
OF A PORTION OF THE LIFE CYCLE  
OF A BUSINESS**

| <b>ACCOUNTING PERIOD<br/>(Last Year)</b>                               | <b>ACCOUNTING PERIOD<br/>(Next Year)</b>                               | <b>ACCOUNTING PERIOD<br/>(This Year)</b>                       |
|--|--|--|
| <b>Statement of Operation<br/>(For the accounting period.)</b>         | <b>Statement of Operation<br/>(For the accounting period.)</b>         | <b>Statement of Operation<br/>(For the accounting period.)</b> |
| <b>Balance Sheet<br/>(As of the accounting period,<br/>last year.)</b> | <b>Balance Sheet<br/>(As of the accounting period,<br/>this year.)</b> |  |

EXHIBIT VII - 8

CHANGES IN THE RETAINED EARNINGS ACCOUNT BROUGHT ABOUT BY THE RESULTS OF THE CURRENT OPERATIONS

| BALANCE SHEET<br>As of Dec. 31, 1970   |                | STATEMENT OF OPERATION<br>For the Year 1971 |                | BALANCE SHEET<br>As of Dec. 31, 1971   |                |
|--|----------------|---|----------------|--|----------------|
| Assets (What We Own)                   |                | Revenues                                    |                | Assets (What We Own)                   |                |
| Current Assets                         | P52,327        | Sales                                       | P75,621        | Current Assets                         | P55,809        |
| Fixed Assets                           | 25,459         | Cost of Sales                               | <u>61,425</u>  | Fixed Assets                           | 28,723         |
| Other Assets                           | <u>7,892</u>   | Gross Margin                                | <u>P14,196</u> | Other Assets                           | <u>9,856</u>   |
| Total Assets                           | <u>P85,678</u> | Expenses                                    |                | Total Assets                           | <u>P94,388</u> |
| Liabilities (What We Owe Others)       |                | Operating Expenses                          | P 9,623        | Liabilities (What We Owe Others)       |                |
| Current Liabilities                    | P27,871        | Income                                      |                | Current Liabilities                    | P25,960        |
| Other Liabilities                      | <u>21,367</u>  | Net Savings                                 | <u>P4,573</u>  | Other Liabilities                      | <u>22,415</u>  |
| Total Liabilities                      | <u>P49,238</u> |   |                | Total Liabilities                      | <u>P48,375</u> |
| Members Equity (What We Owe Ourselves) |                | Retained Earnings Reconciliation Statement  |                | Members Equity (What We Owe Ourselves) |                |
| Common stock                           | P30,000        | Retained Earnings Dec. 31, 1970             | P 6,440        | Common stock                           | P35,000        |
| Retained Earnings                      | <u>6,440</u>   | Add: Net Savings 1971                       | <u>4,573</u>   | Retained Earnings                      | <u>11,013</u>  |
| Total Members Equity                   | <u>P36,440</u> | Retained Earnings Dec. 31, 1971             | <u>P11,013</u> | Total Members' Equity                  | <u>P46,013</u> |
| Total Liabilities and Members' Equity  | <u>P85,678</u> |   |                | Total Liabilities and Members' Equity  | <u>P94,388</u> |

3. **Funds Flow Statement** (also called statement of sources and uses of funds, statement of sources and application of funds, where got — where gone statement, and funds statement.)

The funds flow statement, the third principal financial statement, is an accounting report that helps explain the changes that have taken place between two balance sheet dates. Its purpose is to show the flow of funds between the various items in the assets and liabilities and members' equity during an accounting period which is bound by two balance sheets, one at the beginning and one at the end. Viewed in proper perspective, the funds flow statement is actually an indicator of trends and tendencies in the financing and investment decisions made by the management of a cooperative.

In its simplest form, the funds flow statement is nothing more than a meaningful and organized presentation of the "increase or decrease" column of the comparative balance sheets. This presentation uses as main guideline the counter-balancing relationship between the increases or decreases in items on the balance sheet expressed as follows:

$$\begin{aligned} &\text{Increases in assets} + \text{Decreases} \\ &\text{in liabilities and members' equity} \\ &= \text{Decreases in assets} + \text{Increases} \\ &\text{in liabilities and members' equity} \end{aligned}$$

This basic relationship between the increases and decreases in the various items in the balance sheet is actually used as the basis for describing or identifying the sources and uses of funds during an accounting period. The decreases in assets plus increases in liabilities and members' equity represent *sources of funds* while the increases in assets plus the decreases in liabilities and members' equity represent the *uses of funds*.

The two-step process involved in the preparation of a simple funds flow statement is presented in Exhibits VII-9 and 10 using as hypothetical example

the 1974 and 1975 financial statements of Agricultural Cooperative Marketing "A." The first step which involves the organized presentation of the comparative balance sheets of the cooperative as of December 31, 1974 and December 31, 1975 is shown in Exhibit VII-9. On the other hand, the second step which specifically pertains to the identification of the sources and application of funds during the 1974 to 1975 accounting period or the funds flow statement itself is presented in Exhibit VII-10.

### ***B. Multiple Ratio Analysis of Financial Statements***

The use of financial statements, particularly the balance sheet and the statement of operation, for analyzing and evaluating the financial condition and operations of a cooperative has long been recognized and demonstrated. Practically all materials on financial management treat the subject quite profusely. It is apparent, however, that the analysis of financial statements still has to gain a degree of acceptance that is commensurate with its immense value judging from the still quite limited number of cooperatives that employ this valuable management technique in all seriousness. A possible reason for this perhaps can be traced to the misconception that financial statements are for the use of accountants only, a fallacious belief that the previous discussion on the understanding of financial statements or accounting reports sought to dispel. It has been impressed earlier that it is possible for all, accountants and non-accountants alike, to adequately understand and have a working knowledge of financial statements. But it is felt that a stronger reason is the lack of proper understanding and appreciation of the immeasurable value of the analysis of financial statements to the management of cooperatives for a more efficient and effective performance or handling of its functions. This discussion on financial management analysis, specifically with the use of financial state-

**EXHIBIT VII - 9**

**AGRICULTURAL MARKETING COOPERATIVE "A"  
COMPARATIVE BALANCE SHEETS**

|  | Dec. 31<br>1974 | Dec. 31<br>1975 | Increase<br>(Decrease) |
|--|-----------------|-----------------|------------------------|
| <b>ASSETS</b>                                |                 |                 |                        |
| <b>Current Assets:</b>                       |                 |                 |                        |
| Cash .....                                   | P 17,180        | P 9,182         | P (7,998)              |
| Accounts Receivable .....                    | 23,765          | 32,419          | 8,654                  |
| Advances .....                               | 8,473           | 5,376           | (3,097)                |
| Inventories .....                            | 57,497          | 62,328          | 4,831                  |
| <b>Total Current Assets .....</b>            | <b>P106,915</b> | <b>P109,305</b> | <b>P 2,390</b>         |
| <b>Fixed Assets:</b>                         |                 |                 |                        |
| Land .....                                   | P 25,450        | P 25,450        | —                      |
| Buildings and Equipment .....                | 175,579         | 182,471         | P 6,892                |
| Less: Depreciation .....                     | (28,360)        | (12,369)        | (15,991)               |
| <b>Total Fixed Assets (Net) ...</b>          | <b>P172,669</b> | <b>P195,552</b> | <b>P 22,883</b>        |
| <b>Total Assets .....</b>                    | <b>P279,584</b> | <b>P304,857</b> | <b>P25,273</b>         |
| <b>LIABILITIES AND MEMBERS' EQUITY</b>       |                 |                 |                        |
| <b>Current Liabilities:</b>                  |                 |                 |                        |
| Accounts Payable .....                       | P 53,973        | P 67,733        | P 13,760               |
| Short-term Loans .....                       | 38,516          | 48,798          | 10,282                 |
| <b>Total Current Liabilities ...</b>         | <b>P 92,489</b> | <b>P116,531</b> | <b>P 24,042</b>        |
| <b>Long-term Liabilities .....</b>           | <b>P 83,163</b> | <b>P 94,334</b> | <b>P 11,171</b>        |
| <b>Total Liabilities .....</b>               | <b>P175,652</b> | <b>P210,865</b> | <b>P 35,213</b>        |
| <b>Members' Equity:</b>                      |                 |                 |                        |
| Capital .....                                | P 72,500        | P 75,500        | P 3,000                |
| Retained Earnings .....                      | 31,432          | 18,492          | (12,940)               |
| <b>Total Members' Equity ..</b>              | <b>P103,932</b> | <b>P 93,992</b> | <b>P (9,940)</b>       |
| <b>Total Liabilities and Members' Equity</b> | <b>P279,584</b> | <b>P304,857</b> | <b>P 25,273</b>        |

EXHIBIT VII - 10

AGRICULTURAL MARKETING COOPERATIVE "A"  
 FUNDS FLOW STATEMENT FOR THE YEAR ENDING DECEMBER 31, 1975

| <u>USES OF FUNDS</u>  | <u>SOURCES OF FUNDS</u>   |
|---|---|
| (Increases in Assets<br>+<br>Decreases in Liabilities<br>and Members' Equity) | (Decreases in Assets<br>+<br>Increases in Liabilities<br>and Members' Equity) |
| <b>Increases in Assets:</b>   | <b>Decreases in Assets:</b>   |
| Accounts Receivable . . . P 8,654   | Cash _ _ _ _ _ P 7,998  |
| Inventories _ _ _ _ _ 4,831   | Advances _ _ _ _ _ 3,097  |
| Fixed Assets (net) _ _ _ <u>22,883</u>  |   |
| P36,368   | <u>P11,095</u>  |
| <b>Decreases in Liabilities<br/>and Members' Equity:</b>                      | <b>Increases in Liabilities<br/>and Members' Equity:</b>                      |
| Retained Earnings _ _ _ _ 12,940  | Accounts Payable _ _ _ _ P13,760  |
|   | Short-term Loans _ _ _ _ 10,282   |
|   | Long-term Liabilities _ _ _ 11,171  |
|   | Capital _ _ _ _ <u>3,000</u>  |
| <u>P49,308</u>  | <u>P38,213</u>  |
|   | <u>P49,308</u>  |

ments, is precisely intended to add to the understanding of financial statements.

An extremely valuable guide in analyzing and evaluating the financial condition and operations at the disposal of cooperatives is the so-called "multiple ratio" analysis — a method of analysis wherein interrelated ratios are computed from the financial statements and the significance of each of the ratios evaluated. This method of analysis is relatively simple that the management of cooperatives can make full use of it.

At this juncture, it is particularly stressed that the analysis of the financial statements should as much as possible be based on audited financial statements precisely to ensure the reliability of the figures that will be used in the analysis. It cannot be over-emphasized that an analysis of the financial statements with the use of doubtful figures will serve no useful purpose and will merely be a futile exercise.

#### 1. Steps Involved in Using the Figures in the Financial Statements for Analytical Purposes

It will be realized that in order that the full meaning of the figures in the financial statements may be clearly perceived for analytical purposes, two steps have to be pursued. As first step, the said figures should be expressed in relative terms, in the form of ratios in this specific case. And as second step, the ratios should then be compared with some standard or norm.

##### a. *Selection of the Ratios*

In connection with the first step, that is, reduction of the figures in the financial statements into ratios, it will be particularly noted that a ratio is nothing more than one number expressed in terms of the other. It is derived by dividing the base figure into the other. Under the situation, it is actually possible to come out with many ratios from the different figures in the financial statements. In fact, there is always the danger of one being tempted to do so, a clear exercise in futility since there are dif-

ferent uses for the ratios. A logical procedure is to select the ratios in advance and use only the ratios which are deemed applicable and relevant to a given problem.

##### b. *Bases of Comparison for the Ratios*

With regard to the second step, the five possible bases of comparison for the ratios are :

- (1) A comparison against targeted or budgeted performance in the cooperative.
- (2) A ratio-to-ratio historical comparison of the current ratios with past ratios, also in the same cooperative.
- (3) A comparison with corresponding ratios of other cooperatives engaged in comparable activities and operating under more or less the same conditions.
- (4) A comparison with published average ratios for groups of cooperatives in the same industry and of similar size.
- (5) A comparison against standards set by the analyst himself from experience.

Of the above-listed basis of comparison, the first two are certainly the most convenient to use since the data are drawn from the same cooperative. Such attendant difficulties in making comparisons that may arise from possible differences in situations and accounting practices between cooperatives are reduced to the minimum. Understandably, however, a comparison of ratios in the same cooperative can at best only reflect whether the performance of the cooperative in the current period is in a general way better or worse than the past. Such a comparison therefore has a tendency to be more subjective rather than objective in the absence of a really valid standard. At any rate, it should be emphasized that either the budgeted comparison or the historical comparison, as the two bases of comparisons are sometimes known, or

both, are particularly prescribed for use of neophytes.

The third listed basis of comparison, that is comparison with corresponding ratios of other cooperatives is susceptible to the creeping in of manifold differences usually resulting from the use of data coming from two cooperatives which are possibly operating under different situations and using different accounting practices. In this case, it is necessary for the analyst to make sufficient allowance for these possible differences.

The use of published industry-to-industry average ratios, it will be realized, has to take into account also the usual differences or difficulties involved in using data coming from other sources in addition to the problem of possible lack of information on the specific figures that were lumped together in deriving the average ratios. Nonetheless, the industry-wide average ratios, with all its limitations, are helpful guides in indicating the general situation in an industry. In the United States, for example, certain specific standards had been developed for food and oil cooperatives.

Finally, the standards developed by the analyst himself appear to be his most reliable bases of comparison of those listed. The analyst, on the basis of his experience, is fully equipped to provide the necessary allowances in comparing ratios and to determine reasonable ratios under specific situations.

Particular attention is invited to the fact that this acumen of analysts is developed only through long experience. Neophytes certainly cannot match the skill of experienced analysts in this regard. However, they can be better than those who simply, if not blindly, rely on rigid formula or rules of thumb with the use of more common sense regardless of the bases of comparison for the ratios.

## 2. Financial Ratios and Their Significance

The more commonly used financial ratios and their significance are discussed in accordance with the specific financial statements from which they are drawn out, to wit: (a) balance sheet, (b) statement of operation, and (c) combination of balance sheet and statement of operation.

### a. *Balance Sheet Ratios*

#### (1) *Current Assets to Current Liabilities*

This ratio which is popularly called "current" ratio or "working capital" ratio is computed by dividing the total current assets by the total current liabilities.

The significance of the "current" ratio lies largely in its value for measuring the ability of the cooperative to meet current debts or obligations. This ratio is chiefly used particularly by financing institutions to gauge the "short-term" credit standing of a cooperative. It is generally assumed that if the current assets of a cooperative is twice as much as its current liabilities, there is a reasonably safe assurance of payment of current indebtedness, even in the event of forced liquidation. Hence, a current ratio of 2:1, which can be interpreted to mean that for every P1.00 of current liabilities, a cooperative has P2.00 of current assets to answer for it, is usually accepted as the standard measure for judging the relative debt-paying ability of a cooperative.

It is pertinent to point out at this juncture that the working capital of a cooperative can be determined simply by deducting or subtracting the current liabilities from the current assets. In other words, the working capital is the difference between the current assets and the current liabilities.

Referring back to the "current" ratio, it is not enough to determine

*how much* current assets a cooperative has. It is equally important to know *what kind* of current assets it has. In other words, it is very relevant to ascertain the composition of the current assets—an examination not only of the quantity but also the quality of the current assets. It is therefore necessary to pursue this matter in the light of other ratios which are related to the “current” ratio.

#### (2) Accounts and Notes Receivable to Current Assets

This ratio indicates the extent to which a cooperative has indulged in credit trading. Through this ratio, therefore, the management of a cooperative can guard closely the trends of its receivable accounts.

Extensive studies have shown conclusively that cooperatives with more than 40 per cent of their current assets tied up in receivables make less savings. More specifically, if more than 40 per cent of its current assets are in receivables, which actually means that for every P1.00 of current assets, P0.40 is in the form of receivables, the supposed “ready” money is not really ready and available for immediate use and the cooperative is not only losing possible savings owing to a depletion of its working capital but also running the risk of not being able to meet its current indebtedness on time.

#### (3) Cash and Receivables to Current Liabilities

Commonly known as “acid-test” ratio, this ratio expresses the relationship between the “quick” or relatively liquid assets, such as cash and receivables, and the current liabilities or obligations which should be met in a relatively short time. The “acid-test” ratio is actually a more severe test of the liquidity of the current assets than the “current” ratio.

A cooperative with an “acid-test” ratio of 1.5:1 or P1.50 of cash and

receivables for every P1.00 of current liabilities may be considered as being in a good current financial condition although in most cases a ratio of 1:1 is considered as reflective of a fair financial condition of a cooperative.

#### (4) Fixed Assets to Fixed Liabilities

This ratio answers the crucial question, “Have the members put enough of their money into the business?” and “Where do they want their capital to go?”

As to be expected, the members like to see their money used to acquire buildings and equipment and inventories of goods. If, therefore, there is an absence of sufficient capital to cover those necessities, it may be because the cooperative’s capital has been diverted to some other uses as for example to accounts receivable.

It is widely accepted that to have a ratio of 1.5:1 or P1.50 of fixed assets for every P1.00 of fixed liabilities is quite ideal.

#### (5) Members’ Equity to Total Assets

This ratio expresses the relationship between the permanent capital furnished by the members and the total of the different asset accounts to which the members’ equity capital was used. The members’ equity, it will be recalled, represent that portion of the capital of the cooperative which is furnished or supplied by the members themselves.

A ratio of 0.5:1 or P0.50 of members’ equity for every P1.00 of total assets may be reasonable for a cooperative which has just started its operations. However, it is of course desirable, for the ratio to become higher each year as the members put in more equity capital in their cooperative. Every cooperative should aspire to attain a maximum ratio of 1:1 in this regard which means that the cooperative is being financed completely by the members.



b. *Statement of Operation Ratios*

(1) *Cost of Sales to Average Inventory*

This ratio shows the relationship of the cost of sales for a given period to the goods carried in stock for sale. It indicates the turnover of inventories, showing the number of times within a period the inventories are converted into sales. It, therefore, reflects the purchasing policy of a cooperative.

One of the most dangerous things that may happen to a cooperative is to get its money "tied up" or "frozen" in slow moving inventories or in goods that do not sell in its supply operations. Good management requires maintaining a well-chosen stock of goods that is fast selling and never becomes shopworn and does not have to be sold at a loss.

A relatively high ratio of, say, 12 times reflects a reasonably rapid turnover of inventories of once a month.

(2) *Gross Margin to Sales*

The significance of this ratio of gross margin (sales minus cost of sales or cost of goods sold) to sales is that it is a direct measure of the spread between buying and selling prices as determined by competitive conditions and is not affected by actual operating expenses. A general tendency among newly organized cooperatives is to attempt to pay higher prices for farm produce, on the one hand, and to sell farm supplies and merchandise at prices lower than the prevailing competitive levels. The net result, in either case, is to reduce the ratio of gross margin to sales, a practice which is definitely disadvantageous to the cooperative.

Most of the older and more successful cooperative have learned the unsoundness of this practice. They no longer attempt to operate strictly at cost but are taking reasonable gross margins and subsequently pass on their earnings or savings to their mem-

ber-patrons in the form of patronage refunds.

A ratio of gross margin to sales of 0.20:1 which means a gross margin of P0.20 for every P1.00 of sales is regarded as a reasonable level.

(3) *Net Savings to Sales*

This ratio is frequently considered the most reliable indicator of success in operations, a high ratio being desirable. Viewed by an average member of a cooperative, however, the net savings is often regarded as the amount of cash left after all expenses had been paid. Since this is not necessarily true, the proper significance of this ratio needs to be compared and evaluated with the use of other related ratios such as the ratio of receivables to sales.

(4) *Operating Expenses to Sales*

This ratio shows the relationship of cost of doing business to volume of business. Competitive conditions cause the establishment of relatively standard prices and sales services which competitive business must meet. This is definitely one of the most reliable indicators of how efficient the cooperative is being managed. A relatively low figure is to be desired in this ratio.

(5) *Salaries and Wages to Sales*

Inasmuch as salaries and wages invariably represent from one-half to two-thirds of the total operating expenses, the ratio of salaries and wages to sales is an indicator of the overall labor efficiency. A low ratio value is to be desired in this regard.

c. *Composite Balance Sheet and Statement of Operation Ratios*

(1) *Accounts and Notes Receivable to Average Daily Sales*

Actually, this ratio is intended to reflect the average credit sales in relation to the accounts and notes re-

ceivable. However, since credit sales are not usually segregated from the cash sales in the statement of operation, it is most often necessary to use simply the sales figure. The validity of this ratio can therefore be gauged best if compared with a similar ratio of another cooperative having more or less the same proportion of credit sales to total sales.

The resulting ratio which reflects the average collection period is indicative of the adherence to the credit policy of a cooperative — the rule of thumb being that the collection period should not exceed 1-1/3 times the regular payment period. Hence, if the regular payment period of a cooperative is 30 days, the collection period should not exceed 40 days.

#### (2) Accounts and Notes Receivable to Sales

This ratio is roughly indicative of the extent to which the cooperative indulged in credit sales. The evaluation of this ratio suffers from a major constraint in the sense that the information on accounts receivable in the balance sheet of a cooperative is on a cumulative basis. Thus the periods covering the items of sales and the accounts and notes receivable are not identical.

Nonetheless, this ratio, as previously stated, gives a rough information on the practice of credit sales, particularly significant shifts or changes in credit policies and is in essence another way of expressing the relationship conveyed by the average collection period.

### 3. Illustration of the Multiple Ratio Analysis of Financial Statements

This is an attempt to illustrate the use of financial ratios as a method of analyzing the financial condition and operations of a cooperative. For the purpose, the financial statements of Agricultural Marketing Cooperative "A" will be used as hypothetical example.

For understandable reasons, only a general and brief analysis of the financial condition and operations is presented and, for the most part, the historical comparison (wherein ratios for the current period are compared with those for the past period) was used as basis of comparison of the ratios.

The management of cooperatives can no doubt draw out from this illustration a practical worksheet for the ratio analysis of their financial statements subject of course to whatever modifications or revisions that may be required by varying local conditions.

#### a. *Balance Sheet Analysis and Discussion of its Results*

##### (1) Comparative balance sheets for 1974 and 1975

The comparative balance sheets of the Agricultural Marketing Cooperative "A" for 1974 and 1975 are presented in Exhibit VII-11.

##### (2) Balance sheet analysis

The balance sheet analysis is shown in Exhibit VII-12.

##### (3) Discussion of results of analysis

The results of the balance sheet analysis provide clues on two possible problems or weaknesses in the financial condition of Agricultural Marketing Cooperative "A" namely: (a) apparent lack of liquidity sufficient enough to enable it to meet its current obligations and (b) seemingly inadequate members' capital contribution.

The marked unfavorable trends in the "current" ratio (from 1.15:1 in 1974 to 0.94:1 in 1975) and in the "acid-test" ratio (from 0.44:1 in 1974 to 0.36:1 in 1975), tend to indicate that the cooperative may encounter great difficulty in settling its current debts. The current ratio in 1975 of 0.94:1 can be interpreted to mean that the cooperative has only P0.94 of current assets to answer for every P1.00 of current liabilities. This is of course quite

EXHIBIT VII - 11

**AGRICULTURAL MARKETING COOPERATIVE "A"**  
**COMPARATIVE BALANCE SHEETS**

|  | Dec. 31, 1974   | Dec. 31, 1975   |
|--|-----------------|-----------------|
| <b>A S S E T S</b>                                 |                 |                 |
| <b>Current Assets:</b>                             |                 |                 |
| Cash .....   | P 17,180        | P 9,182         |
| Accounts Receivable .....                          | 23,765          | 32,419          |
| Advances .....                                     | 8,473           | 5,376           |
| Inventories .....                                  | 57,497          | 62,328          |
| <b>Total Current Assets</b> .....                  | <b>P106,915</b> | <b>P109,305</b> |
| <b>Fixed Assets:</b>                               |                 |                 |
| Land .....   | P 25,450        | P 25,450        |
| Buildings and Equipment .....                      | 175,579         | 182,471         |
| Less: Depreciation .....                           | (28,360)        | (12,369)        |
| <b>Total Fixed Assets (Net)</b> .....              | <b>P172,669</b> | <b>P195,552</b> |
| <b>Total Assets</b> .....                          | <b>P279,584</b> | <b>P304,857</b> |
| <b>LIABILITIES AND MEMBERS' EQUITY</b>             |                 |                 |
| <b>Current Liabilities:</b>                        |                 |                 |
| Accounts Payable .....                             | P 53,973        | P 67,733        |
| Short-term Loans .....                             | 38,516          | 48,798          |
| <b>Total Current Liabilities</b> .....             | <b>P 92,489</b> | <b>P116,531</b> |
| <b>Long-term Liabilities</b>                       |                 |                 |
| <b>Total Liabilities</b> .....                     | <b>P175,652</b> | <b>P210,865</b> |
| <b>Members' Equity:</b>                            |                 |                 |
| Capital .....                                      | P 72,500        | P 75,500        |
| Retained Earnings .....                            | 31,432          | 18,492          |
| <b>Total Members' Equity</b> .....                 | <b>P103,932</b> | <b>P 93,992</b> |
| <b>Total Liabilities and Members' Equity</b> ..... | <b>P279,584</b> | <b>P304,857</b> |

EXHIBIT VII - 12

AGRICULTURAL MARKETING COOPERATIVE "A"  
BALANCE SHEET ANALYSIS

| Description of Ratios   | Computation of Ratios                 |                                       |
|---|---------------------------------------|---------------------------------------|
|   | For<br>Dec. 31, 1974                  | For<br>Dec. 31, 1975                  |
| 1. Current Assets to Current Liabilities<br>("Current" ratio)         | $\frac{P106,915}{P 92,489} = 1.15:1$  | $\frac{P109,305}{P116,531} = 0.94:1$  |
| 2. Accounts and Notes Receivable<br>to Current Assets                 | $\frac{P 23,765}{P106,915} = 0.22:1$  | $\frac{P 32,419}{P109,305} = 0.30:1$  |
| 3. Cash and Receivables to Current<br>Liabilities ("Acid-test" ratio) | $\frac{P 40,945}{P 92,489} = 0.44:1$  | $\frac{P 41,601}{P116,531} = 0.36:1$  |
| 4. Fixed Assets to Fixed Liabilities                                  | $\frac{P172,669}{P 83,163} = 2.08:1$  | $\frac{P195,552}{P 94,334} = 2.07:1$  |
| 5. Members' Equity to<br>Total Assets                                 | $\frac{P103,932}{P 279,584} = 0.37:1$ | $\frac{P 93,992}{P 304,857} = 0.31:1$ |

low when it is considered that the recognized reasonable current ratio is 2:1. Furthermore, the related "acid-test" ratio in 1975 of 0.36:1 or P0.36 of liquid resources for every P1.00 of current indebtedness seems to place even in more serious doubt the ability of the cooperative to repay its current obligations.

On the other hand, the ratio of members' equity to total assets in 1975 of 0.31:1 or a members' equity of P0.31 for every P1.00 of total assets when measured against the recommended ratio of at least 0.50:1 appears to suggest the existence of the rather unhealthy situation wherein the bulk of the cooperative's financing which should appropriately be supplied by the members themselves comes instead from external or outside sources.

In sum, the results of the ratio analysis provide the management of the cooperative with leads to some problem areas. In pursuing further these leads and in formulating alternative remedial measures to improve the financial condition of the cooperative, it will perhaps be advisable for the management of the cooperative to seriously look into the possibility of restructuring the financial posture of the cooperative principally through the conversion of the accounts payable and short-term loans into long-term loans. In addition, of course, it may be appropriate for the cooperative to make an all-out appeal for more capital contributions from the membership.

**b. *Statement of Operation Analysis and Discussion of its Results***

**(1) Comparative statements of operation for 1974 and 1975**

The comparative statements of operation of Agricultural Marketing Cooperative "A" for 1974 and 1975 are shown in Exhibit VII-13.

**(2) Statement of operation analysis**

Exhibit VII-14 shows the analysis of the statement of operation.

**(3) Discussion of results of analysis**

The results of the ratio analysis tend to pinpoint probable causes of the sharp reduction of the net savings from P31,432 in 1974 to P18,492 in 1975, a drop of P12,940 or 41.17 per cent. Based on the ratio analysis, among the possible inter-related contributory factors to this unfavorable development may be mentioned: (a) the slowing down of the annual turnover of inventory of from 24.62 times in 1974 to 17.03 times in 1975, a decrease of 7.59 times or 30.83 per cent; (b) the reduction in the percentage of gross margin to sales of from 11 in 1974 to 8 in 1975, a decrease of 3 per cent or P0.03 for every P1.00 of sales; and (c) the decrease in the volume of sales of from P1,145,600 in 1974 to P916,862 in 1975, a difference of P228,738 or almost 20 per cent.

On the other hand, the cooperative, perhaps in an effort to cope with what could be a pressing cost-price squeeze problem, seems to have opted to adopt a strategy of severe cutting down of expenses as reflected by (a) a decrease in the percentage of operating expenses to sales of from 8.26 in 1974 to 5.98 in 1975, a reduction of 2.28 per cent or more than P0.02 for every P1.00 of sales and (b) a reduction in the percentage of salaries and wages to sales of from 3.40 in 1974 to 3.21 in 1975, a difference of 0.19 per cent.

In the main, it would seem that the ratio analysis has provided the management of the cooperative with initial indicators that it can consider and work on in probing extensively into the operating deficiencies of the cooperative in search of appropriate remedial measures therefor.

**c. *Composite Analysis of the Balance Sheet and Statement of Operation and Discussion of its Results***

**(1) Composite analysis of the balance sheet and the statement of operation**

The composite analysis of the balance sheet and the statement of operation is presented in Exhibit VII-15.

EXHIBIT VII - 13

AGRICULTURAL MARKETING COOPERATIVE "A"  
COMPARATIVE STATEMENT OF OPERATION

|   | Dec. 31, 1974   | Dec. 31, 1975   |
|---|-----------------|-----------------|
| <b>REVENUES</b>   |                 |                 |
| Sales .....   | P1,145,600      | P 916,862       |
| Less: Cost of Sales                                       |                 |                 |
| Beginning Inventory .....                                 | 25,342          | 36,723          |
| Plus goods purchased during<br>period .....               | 1,051,739       | 869,118         |
| Total goods handled .....                                 | 1,077,081       | 905,841         |
| Less: Ending Inventory .....                              | 57,497          | 62,328          |
| Net Cost of Sales .....                                   | 1,019,584       | 843,513         |
| Gross Margin .....  | P 126,016       | P 73,349        |
| <b>EXPENSES (Selling, Administrative and<br/>General)</b> |                 |                 |
| Salaries and wages .....                                  | P 38,943        | P 29,472        |
| Travelling expenses .....                                 | 3,423           | 2,311           |
| Freight and hauling expenses .....                        | 1,845           | 1,773           |
| Store supplies .....                                      | 562             | 465             |
| Interest on loan .....                                    | 17,035          | 12,043          |
| Depreciation .....  | 28,360          | 7,069           |
| Taxes and licenses .....                                  | 479             | 507             |
| Miscellaneous expenses .....                              | 3,937           | 1,217           |
| Total Expenses .....                                      | P 94,584        | P 54,857        |
| <b>NET SAVINGS (LOSS).....</b>                            | <b>P 31,432</b> | <b>P 18,492</b> |

EXHIBIT VII - 14

AGRICULTURAL MARKETING COOPERATIVE "A"  
STATEMENT OF OPERATION ANALYSIS

| Description of Ratios                 | Computation of Ratios                            |  |
|---------------------------------------|--|--|
|                                       | For<br>Dec. 31, 1974                             | For<br>Dec. 31, 1975                           |
| 1. Cost of Sales to Average Inventory | $\frac{P1,019,584}{P41,419.50} = 24.62$<br>times | $\frac{P843,513}{P49,525.50} = 17.03$<br>times |
| 2. Gross Margin to Sales              | $\frac{P126,016}{P1,145,600} = 11.00\%$          | $\frac{P73,349}{P916,862} = 8.00\%$            |
| 3. Net Savings To Sales               | $\frac{P31,432}{P1,145,600} = 2.74\%$            | $\frac{P18,492}{P916,862} = 2.02\%$            |
| 4. Operating Expenses to Sales        | $\frac{P94,584}{P1,145,600} = 8.26\%$            | $\frac{P54,857}{P916,862} = 5.98\%$            |
| 5. Salaries and Wages to Sales        | $\frac{P38,943}{P1,145,600} = 3.40\%$            | $\frac{P29,472}{P916,862} = 3.21\%$            |

EXHIBIT VII - 15

AGRICULTURAL MARKETING COOPERATIVE "A"  
 COMPOSITE ANALYSIS OF THE BALANCE SHEET AND THE  
 STATEMENT OF OPERATION

| Description of Ratios   | Computation of Ratios                   |  |
|---|---|--|
|   | For<br>Dec. 31, 1974                    | For<br>Dec. 31, 1975                     |
| 1. Accounts and Notes Receivable to Average Daily Sales (Average Collection Period) | $\frac{P23,765}{P3,138.63} = 7.57$ days | $\frac{P32,419}{P2,511.95} = 12.90$ days |
| 2. Accounts and Notes Receivable to Sales   | $\frac{P23,765}{P1,145,600} = 2.07\%$   | $\frac{P32,419}{P916,862} = 3.54\%$      |

(2) Discussion of results of analysis

The results of the analysis seem to indicate a marked upward trend in the average collection period of from 7.57 days in 1974 to 12.90 days in 1975, an increase of more than 5 days, as well as in the percentage of accounts and notes receivable to sales of from 2.07 in 1974 to 3.54 in 1975, an increase of 1.47 per cent or almost

P0.015 for every sale of P1.00.

Under the situation, although the 1975 figures are still way below the accepted standards, it behooves on the management of the cooperative to take a really serious look at its credit operations for possible defects or unduly loosening up in the implementation of an otherwise sound credit policy.





## EPILOGUE

*Agricultural cooperation is an undertaking that is extremely enormous, highly complex, and potently challenging. The success of its management will be greatly enhanced given the formidable combination of (1) understanding of cooperation; (2) management know-how; (3) commitment to the task; and (4) hard work.*

In retrospect, there are at least three very valid perceptions of the overall task of setting up a viable agricultural cooperative system that immediately comes to the fore. For one, it is extremely enormous. The activities span such a broad field of endeavor that manifold service opportunities abound both within and outside the movement itself. The task is indeed not only for a few but rather for all. For another, the undertaking is highly complex. It demands no less than the most effective matrix of management working knowledge, skill and experience with a liberal dose of common sense and backed up with a firm commitment to the movement. And finally, the task is potently challenging. It is a crucial test of individual and group determination and tenacity to utilize their limited capabilities to the maximum in the total effort to help themselves.

Every country has its own unique experience in tapping agricultural cooperation as an effective vehicle for change. And, as expected, the experience of each country is checkered with successes and failures, mostly of the latter. Cooperators should, however, always find solace and inspiration in the thought that agricultural cooperation is definitely workable, that it can be done. It has long ceased as a mere concept or idea ever since the Rochdale Society of Equitable Pioneers of England succeeded in making an actual demonstration of the efficacy of cooperation as an instrument of service to its members in the middle of the 19th century. This unprecedented feat of the Rochdale Pioneers, it is too well known, has since then been duplicated with equal success in many other countries.

As developing countries continue with their unabated strivings to provide a stable footing for agricultural cooperation in their respective areas, it will perhaps do well for them to always keep in mind the fact that cooperators may fail but cooperation will not. The burden of proof is with the cooperators themselves. They will have to prove themselves through the only way they can and should — through hard work.



# **APPENDIXES**



## APPENDIX A

### “LAWS AND OBJECTS”

Rochdale Society of Equitable Pioneers  
Rochdale, England

1. The objects and plans of this Society are to form arrangements for the pecuniary benefit, and the improvement of the social and domestic condition of its members, by raising a sufficient amount of capital in shares of one pound each, to bring into operation the following plans and arrangements:

- The establishment of a store for the sale of provision and clothing, etc.
- The building, purchasing or erecting a number of houses, in which those members desiring to assist each other in improving their domestic and social condition may reside.
- To commence the manufacture of such articles as the society may determine upon, for the employment of such members as may be without employment, or who may be suffering in consequence of repeated reductions in their wages.
- As a further benefit and security to the members of this society, the society shall purchase or rent an estate or estates of land, which shall be cultivated by the member who may be out of employment, or whose labour may be badly remunerated.
- That as soon as practicable, this society shall proceed to arrange the powers of production, distribution, education, and government, or in other words to establish a self-supporting home-colony of united in-

terests, or assist other societies in establishing such colonies.

- That for the promotion of sobriety a Temperance Hotel be opened in one of the society's houses, as soon as convenient.

[ Addition to the first law

That for the establishment of the store department a capital of one thousand pounds be raised in shares of one pound each, by not more than two hundred and fifty members . . . ]

2. That the government of this society shall be vested in a President, Treasurer, and Secretary, three trustees and five directors, the President, Secretary, Treasurer, and Trustees to be elected at the general meeting to be held in January, the directors to be elected at the July general meeting, any of them being eligible for re-election, but if through death, resignation, or otherwise, a vacancy should occur among the trustees or other officers of this society, a special general meeting of the members shall be called, at which meeting another or others shall be elected to fill such vacancy or vacancies.

3. That two auditors be appointed, each to remain in office six months, and retire alternately. They shall audit the accounts of the society, see that they are correctly kept and balanced quarterly, and report the same to each quarterly meeting or be fined.

4. That the officers and board of directors shall meet every Thursday even-

ing, at eight o'clock, in Committee Room, Weavers' Arns, Yorkshire-street, Rochdale, for the transaction of the society's business; the officers names shall be called over at a quarter past eight o'clock, and any officer not present shall be fined, — the secretary shall keep a record of all absentees.

[A new law to be placed or read between the 4th and 5th laws]

That general meetings of the members be holden on the first and third Monday evenings in each month, the business to commence at eight o'clock, the four general quarterly meetings to be included. The business of these meetings to consist in the explanation of the principles, objects, and laws of the society, to discuss the affairs, and suggest any improvements for the consideration of the officers and board of directors.

At these meetings, shall be proposed and seconded by two members, all persons for membership. A person proposed and seconded at one general meetings, may be admitted a member at next, if approved by a majority then present.

Members present at all general, quarterly, and annual meetings to have, each, one vote, and no more, in the decision of all questions, and should the number be equal for any motion, the president, or chairman acting in his place, shall have the casting vote, a majority to govern in all cases, except on a motion for the dissolution of the society, for which a special law is enacted.

5. That general meetings of the members shall be holden on the first Monday in the months of January, April, July and October, at eight o'clock P.M., at which meetings the officers of this society shall make their quarterly financial report, in which report shall be specified the amount of funds, and value of the stock possessed by the society.

6. That an annual general meeting be holden on the "first Market Tuesday," on which occasion a dinner shall be provided at a charge of one shilling each person, and one week's notice.

7. The president shall act as chairman at all meetings of this society, and should be not present at any of the society's meet-

ings, the officers or members present shall elect one from amongst themselves to act as chairman on that occasion. The president or chairman acting in his absence, shall sign the minutes of the proceedings at each of the society's meetings.

8. The secretary shall attend all meetings of this society, record the names of officers present or absent, take minutes of the proceedings at each meeting, keep all accounts, documents, papers, book etc. in such form, maner, or place as the society may appoint, and summon all general meetings.

9. The treasurer shall be responsible for such sums of money as shall from time to time be placed in his hands by any of the society's officers, on account of the society, and for the investment and application of the same under the authority of the officers of this Society.

10. The property of this society shall be vested in the trustees, and the said trustees shall hold such property for the benefit of this society, and in the names of the trustees for the time being shall be made and taken all grants, conveyances, and assurances of property in favour of this society, and all instruments and assurance for the security of this society; they shall transact all business connected with the paying of money into, or withdrawing from the bank, but on no pretence whatever shall they transact such business unless all three are present.

11. They shall jointly and severally be responsible for all funds, deeds, effects, or assignments placed in their hands for the use and benefit of this society; and should they at any time either unitedly or individually misapply any property placed in their hands, upon due proof thereof, the president and directors shall give such trustee or trustees so misapplying the property, fourteen days notice to give up possession of all funds, deeds, effects, or assignments in his or their possession belonging to the society, and should he or they refuse to do so, then the officers shall compel him to give up the property, and transfer the same pursuant to the 10th Geo. IV., c. 56, sec. 14. The trustees are to attend all weekly meetings, or be fined.

11 (Sic). That all securities, investments, and purchases which shall be taken or made by, or in the names of, the trustees of this society, and all monies thereby invested or accruing therefrom, shall be under the control of the officers and directors, and every order made in writing by the officers and directors touching the management of or dealing with, the said securities, investments, or purchases, shall be obligatory on and observed by the trustees of this society, and be a justification to them and their indemnification in acting in obedience to the same order, and all such trustees shall when required by a majority of the officers and directors, sign, seal and execute such declaration of trust, of the estates, securities, moneys, and effects vested in them in behalf of this society, as the majority of the officers and directors shall require.

12. That any person who may be appointed to any office in anywise touching or concerning the receipt, management, or expenditure of money collected for the purpose of the society, shall, if required to do so, before entering upon the duties of such office give such security as may be thought sufficient, by a majority of the members present at a general meeting. 10 geo, IV c. 56 sec. 11.

13. Any person desirous of becoming a member of this society shall be proposed and seconded by two members at a meeting of the officers and directors, and if approved of by a majority of those present, shall be eligible for election at the next weekly meeting, each candidate shall pay the sum of one shilling as entrance money, on being admitted to membership, shares may be paid for by instalments of three pence per week, on each share.

Any member neglecting to pay such instalments for three months shall, except in case of sickness or want of employment be fined in the sum of six pence.

Any member neglecting to pay such instalments for the space of six months, shall be expelled, his or her shares sold, and the remainder after paying all necessary expenses, returned to such expelled member. No member to have more than fifty shares.

14. That should the officer and members of this society find the conduct of any of its members to be injurious to the interests of the society, the president is hereby called upon to remonstrate with such member, and should any member after such remonstrance still pursue the same offensive line of conduct, such member shall receive one month's notice of exclusion from this society, at the expiration of which time the offending member shall be expelled without further notice.

15. That should any member wish to withdraw from this society such member shall give one month's notice of such intention to the officers, at the expiration of which time the member shall be at liberty to withdraw from the society, such liberty continues in force until the next meeting of the board but no longer.

16. That in all cases of exclusion or withdrawal from this society, previous to receiving the balance remaining (after paying all necessary expenses) for shares sold, the excluded or withdrawing party shall sign his or her name in a book kept by the society for that purpose, after which he or she shall have no further claim upon this society, nor shall this society have any further claim upon him or her.

17. Any member withdrawing from this society desirous of retaining possession of his or her share or shares until they can be disposed of advantageously, will be allowed to retain possession of such shares or shares for the space of twelve months but no longer, but such member withdrawing shall not enjoy any of the privileges of a member, nor receive interest on such share or shares.

18. That this society shall not be responsible for the debts of any of its members except to the amount of the share or shares held by a member, should any member of this society become bankrupt or distressed for debt, and application be made to the officers of this society by the creditor or creditors of such distressed member may have invested in the funds of this society, the officers are hereby bound to examine the accounts of such member, and make declaration of such accounts, and should the creditor or creditors claim the amount of such member's investment, then



the share or shares shall be sold, and the amount, after paying all necessary expenses, be paid to the proper party for receiving it, after signing his or her name in the book as in the case of expelled members.

19. That in case of dispute between this society and any of its members, or members or persons claiming on account of a member finding himself aggrieved, or having any complaint against any member or officer, may apply to the officers and directors for redress, but should the party not receive satisfaction, appeal may be made to a general meeting of the members of the society, whose decision shall be final and binding, except reference be made to arbitration.

20. That at the first meeting of the society after the enrolment of the laws, five arbitrators shall be named and elected, none of whom shall be either directly or indirectly interested in the funds of this society, in case of dispute the names of arbitration shall be written on pieces of paper, and placed in a box or glass, and the three whose names are first drawn out by the complaining party, or by some one appointed by such party, shall be arbitrators, to decide the matter or difference whose decision shall be final.

21. That no person shall be allowed to purchase anything on behalf of this society, except those who are regularly appointed by the officers or members, and the officers of this society shall not in any case, nor on any pretense purchase any articles except for ready money, neither shall they be allowed to sell any article or articles except for ready money. Any officer acting contrary to this law, shall be fined in the sum of ten shillings, and be disqualified from performing the duties of such office.

22. That at each quarterly general meeting the officers in their financial statement shall publish the amount of profits realized by the society during the preceding quarter, which shall be divided thus; — interest at the rate of 3.5 per cent, per annum shall be paid upon all shares paid up previous to the quarter's commencement; the remaining profits shall be paid to each member in proportion to the amount of money expended at the store.

#### [Amendment of the 22nd law

That the rate of interest be five pounds per cent per annum, instead of three and a half.]

23. That on the death of any member of this society the heirs, executors or administrators of such deceased member shall succeed to the share or shares of such deceased member, on subscribing to the objects and rules of this society, but should the said heirs, executors or administrators not subscribe to the objects and rules the officers shall cause the share or shares to be sold, and dealt with as in the case of expelled members.

24. This society shall not be dissolved so long as the intents and purposes thereof or any of them, remain to be carried into effect, without obtaining the votes of five sixths of the ten existing members of this society. Pursuant to 10. th, Geo. IV. th, c. 56. sec. 26.

25. That in giving effect to the foregoing laws the following meanings shall be assigned to expressions unless either the subject or content otherwise require. The word laws, shall include laws, rules, orders, regulations, etc.; treasurer or trustee to include treasurers or trustees, the word person to include females as well as males, the word book to include books, bond to include bonds, name to include names, account to include accounts, members to include members, clerk of the peace to include town clerk, Pursuant to 10th Geo. IV. c. 56. sec. 38.

#### MANAGEMENT OF THE STORE

25. (Sic.) That the store be opened to the public on the evenings of Monday and Saturday: on Mondays from seven till nine; on Saturdays from six till eleven.

26. That all purchases be paid for on delivery.

27. That a cashier and salesman be appointed to conduct the business of the store, each to serve six months alternately, and be eligible for re-election.

28. The salesman shall weigh, measure, and sell such articles and commodities as are to be disposed of at the store, but shall not receive payment for any articles or goods sold.

29. The cashier shall receive payment for all goods purchases at the store; he shall give a receipt to each purchases for the amount received, and keep a cheque of such receipt in a book provided for that purpose; he shall pay over to the secretary at each weekly meeting the money drawn at the store.

30. That purchasers be furnished with printed forms containing the names of such articles as are on sale at the store, these forms to be filled up by the purchaser and handed to the salesman when goods are required; the salesman shall hand in all such orders to the secretary at the weekly meetings of the board, as a cheque on the cashier.

31. That the amount of money expended by each member during each quarter be determined by the cheque receipts produced by each member.

32. That the cashier or salesman be fined one shilling for non-attendance at the proper time, unless 48 hours notice be given to the president and secretary of inability to perform the duties of his or her office.

33. That the president and secretary be empowered to appoint a member to perform the duty of any officer not attending to his duty, but that the board have power to alter such appointment should it be thought expedient to do so.

34. That the store be opened at the proper time by the president.

Miles Ashworth, President  
John Holt, Treasurer  
Charles Howarth  
James Standring  
James Daly, Secretary

#### FINES

That the following FINES be inflicted for non-attendance or non-performance of duty:—

- Auditors, 2s, 6d each, for each offense.
- Salesman or cashier, 1s, for each offense
- President being late, 3d; non-attendance, 6d.
- Secretary being late; 3d; non-attendance, 6d.
- Trustee or Director, 3d; non-attendance, 6d.
- For a violation of Law 21st. 10s.

I hereby certify that the foregoing Rules are in conformity to Law, and with the provisions of the Act 10th, George IV, c. 56, as amended by the 4th and 5th William IV, c. 40.

John Tidd Pratt,  
The Barrister at Law appointed  
to certify Rules of Savings'  
Banks.

London, 24th October, 1844.

Copy sent to the Clerk of the Peace for the County of Lancaster.

J. Tidd Pratt



## APPENDIX B

### ILLUSTRATION OF THE ALLOCATION AND DISTRIBUTION OF PATRONAGE REFUND AND INTEREST ON SHARE CAPITAL

It is quite a sad commentary on the part of the management of cooperatives, particularly the members of the board of directors, that a substantial number of them grossly lack the necessary working knowledge on such vital aspects of operations as the allocation and distribution of patronage refund and interest on share capital. Precisely to correct this uncalled for situation, efforts were exerted to present the basic guidelines governing the dispensation of said benefits to the farmer-members. Hopefully, this illustration will pave the way for a clearer insight into the practical application of the principles on the distribution of savings and interest on share capital and promote a better understanding and appreciation of the said principles.

#### A. Assumptions

The following assumptions were made in this illustration —

1. Type of cooperative — Agricultural Marketing Cooperative “B”
2. Total volume of business for the year . . . . . ₱500,000
3. Net savings for the year ₱ 15,000
4. Value of fully-paid shares of stock (1,000 shares @ ₱10.00) . ₱ 10,000
5. Rate of interest on share capital ----- 10 per cent

#### B. Allocation of Net Savings

1. Net savings to be allocated — ₱15,000

2. Basis of allocation — specific provision in the cooperative’s by laws
3. Mechanics of allocation

| <i>Allocation</i>                                       | <i>Amount</i>         | <i>Balance</i> |
|---|-----------------------|----------------|
| a. 10% to Cooperative Education and Training Fund ----- | ₱ 1,500               | ₱13,500        |
| b. 10% to General Reserve Fund -----                    | 1,350                 | 12,150         |
| c. 10% to Interest on Share Capital -----               | 1,000                 | 11,150         |
| d. Balance for Patronage Refund -----                   | <u>11,150</u>         |                |
| <b>Total -----</b>                                      | <b><u>₱15,000</u></b> |                |

#### C. Formula for Computing Interest on Share Capital

1. Amount to be distributed . . . ₱1,000
2. Formula

|   |         |  |
|---|---------|--|
| Value of fully-paid shares of stock of a member | X 10% = | Interest on share capital due the member |
|---|---------|--|

**D. Formula for Computing Patronage Refund**

1. Amount to be distributed \_\_\_P11,150

2. Formula (using the constant factor method)

$$\frac{\text{Amount Allocated for Patronage Refund}}{\text{Total Volume of Business}} \times \text{Volume of Business Contributed by a Member} = \text{Patronage Refund Due the Member}$$

$$\frac{P\ 11,150}{P500,000} = 0.0223 \text{ (constant factor)}$$

**E. Distribution of Patronage Refund and Interest on Share Capital**

In actual practice, two separate lists or schedules are usually prepared, one

each for patronage refund and interest on share capital. In this illustration, however, a different presentation of the distribution of the two benefits has been designed in order to accentuate their contrasting features.

**AGRICULTURAL MARKETING COOPERATIVE "B"**

Table Showing Distribution of Patronage Refund and Interest on Share Capital

| Farmer-Member | No. of Shares | Value          | Interest on Share Capital | Volume of Business Contributed | Amount of Patronage Refund | Rank                      |                  |
|---------------|---------------|----------------|---------------------------|--------------------------------|----------------------------|---------------------------|------------------|
|               |               |                |                           |                                |                            | Interest on Share Capital | Patronage Refund |
| J. Torres     | 4             | P 40.00        | P 4.00                    | P20,000                        | P446.00                    | 3                         | 1                |
| E. Magno      | 1             | 10.00          | 1.00                      | 10,000                         | 223.00                     | 5                         | 2                |
| T. Jacinto    | 10            | 100.00         | 10.00                     | 3,000                          | 66.90                      | 1                         | 4                |
| M. Santos     | 3             | 30.00          | 3.00                      | 7,500                          | 167.25                     | 4                         | 3                |
| D. Paz        | 5             | 50.00          | 5.00                      | 1,500                          | 33.45                      | 2                         | 5                |
| <b>Total</b>  | <b>1,000</b>  | <b>P10,000</b> | <b>P1,000</b>             | <b>P500,000</b>                | <b>P11,150.00</b>          | <b>—</b>                  | <b>—</b>         |

It will be noted in the table that for obvious reasons, the list of farmer-recipients has been limited to only five of the total membership. In other words, what is shown in the table is only a partial list of the farmer-members involved. The figures under the total column, however, correspond to the entire membership of the cooperative.

In computing the amounts due the farmer-members, the amount of interest on share capital each member is entitled to receive is computed by multiplying the value of the shares of stock owned by each member by 10 per cent, the rate of interest declared for the purpose. On the other hand, the amount of patronage refund each member will receive is determined by multiplying the volume of business transacted by each member by the constant factor of 0.0223.

Particular attention is invited to the column under the heading "Rank" which shows a disparity in the ranking

of the amounts received by the members under the two items of interest on share capital and the patronage refund. In the said column, it will be noted that insofar as the amount received in the form of interest on share capital is concerned the ranking of the amount received by the members depends on the value of shares of stock owned by each, with the member owning the largest value of shares of stock receiving the biggest interest on share capital. However, with respect to patronage refund the members are ranked in accordance with the volume of business transacted by each, with the member contributing the largest volume of business receiving the biggest patronage refund. The point is reiterated that the pronounced difference in the ranking of the members can be attributed to the fact that the interest on the share capital is based on the value of the shares of stock while the patronage refund is based on the volume of business transacted by the members.



## APPENDIX C

### STRATEGIES FOR COOPERATIVE GROWTH AND EXPANSION

Growth and expansion have been attributes of cooperatives since the inception of the movement. So ingrained is expansion in cooperatives that it has been included as one of the principles of cooperation, to wit:

“All co-operative organizations, in order to best serve the interests of their members and their communities, should actively co-operate in every practical way with other co-operatives at local, national and international levels.”

The need for cooperatives to expand becomes more imperative in this era of highly competitive business which is being increasingly dominated by large enterprises. Co-operatives must perforce grow and expand to strengthen their bargaining power and attain greater economies of scale and thereby place them in an effective competitive position.

What is important is for cooperative management to understand fully the problems and implications of the different growth processes and not the processes themselves. While the members will have to make the final decision on all expansion proposals, the manager and the board of directors are expected to conduct a thorough study of the whole situation and make appropriate recommendation to the members.

Basically, growth and expansion can be effected in three ways which are inter-related. One way is by integration, both horizontal and vertical. Another way is by diversification. And still another way is by consolidation and merger.

#### A. Horizontal and Vertical Integration

In brief, horizontal integration involves the grouping together of associations or units with similar business activities. This is usually accomplished in cooperation through the formation by several similar associations of a federation. On the other hand, vertical integration has reference to the extension by an association of business activities to another stage of operation. In cooperatives, this involves the addition of services in the subsequent or successive stages in the process as in the movement or flow of the products from the farm to the table.

The following short illustration will help in differentiating between the two types of integration.

Association A, B and C are all primary or local marketing cooperatives whose services are limited only to the storage and sales of palay and rice in their respective localities. When associations A, B and C form a larger overhead organization called a federation for the purpose of expanding their area of service, specifically from the local or town level to the provincial level, this process of expansion is called horizontal integration, since no new services are contemplated. It is actually a case of an expansion of area of services but maintaining the same type of services — that is, storage and sale of palay or rice. In this particular case, neither of the associations loses its independent identity.

However, when associations A, B and C extend their services with respect to the other stages of marketing such as milling, transporting, packaging in smaller units,



just to cite a few examples, then the process is called vertical integration.

From the foregoing, it will be realized that integration involves expansion with particular reference to services and not organization matters.

In general, the advantages of horizontal integration are those economies and opportunities normally associated with large-scale operations, such as: (a) accessibility to the use of more capital; (b) increase opportunity to employ better management materials; (c) additional emphasis on research; (d) control of quality; (e) standardization of products; (f) scheduling of production; (g) elimination of competitive wastes; (h) improved business practices; and (i) utilization of by-products.

Vertical integration, on the other hand, has, among others, the following advantages: (a) prevents duplication and competition of functions; (b) reduces cost through better and more economical utilization of the production factors and resources; (c) effective coordination; (d) more efficient and orderly flow of commodities from the producers to the consumers; and (e) better utilization of by-products.

In considering vertical integration in particular, the problems revolve around two crucial questions:

1. How far should the cooperatives follow and control their products to the customers?
2. How far should cooperatives go to the primary sources of supply?

These are indeed very ticklish and baffling but nonetheless very relevant questions encountered as an association grows. It is important to realize that the various decisions which perforce have to be made are mostly economic in nature. Thus, the problems have to be duly considered in the light of economic feasibilities.

## B. Diversification

Growth and expansion may also be achieved by cooperatives through diversification. This involves the broadening of the range of services specifically by adding new lines of service. For example, a purchasing association dealing exclusively on such farm inputs as fertilizers, seeds and farm

chemicals may diversify its services by engaging in such other lines as farm machinery and equipment. In this case, diversification was effected through the addition of new product lines. Proceeding to another example, cooperatives originally starting as purchasing associations may find it desirable to perform marketing services also. Conversely, a marketing cooperative may decide to offer purchasing services. Diversification, in this second example, was undertaken by handling new services.

Diversification is closely related to horizontal integration. In fact the two processes are complimentary and one strengthens the other. In a way but not necessarily, diversification may also be viewed as conversion of a specialized cooperative into a multipurpose type.

Decisions to move toward diversification are motivated by two principal reasons. The primary reason is to increase the satisfaction of the members. Members find it a convenient and practical arrangement to have their requirements serviced by just one cooperative if possible. The other main reason is to effect economy in operations in terms of reduced overhead unit costs. The enlargement of services is usually accompanied by a minimum increase in overhead costs, if any, since practically the same set of personnel and facilities are employed in performing the additional services.

## C. Consolidation and Merger

The general trend at present is for corporations throughout the world to get bigger and bigger. And cooperatives naturally have to keep in step with this development for their survival. In the cooperative picture in all countries in the world, this trend is reflected in and accounts for the gradual reduction in the total number of cooperatives. As the number gives way to size, the strategy is to have less but bigger cooperatives. The solidifying of the positions of practically all corporations, including cooperatives, is done either through consolidation or merger.

By way of brief explanations of the two distinct legal processes and the basic difference between them, consolidation is the

combining of two or more associations wherein a new association is formed. It normally involves the dissolution of the combining associations and the filing of new corporate papers for the new single association that is being formed. On the other hand, merger is the union of two or more associations wherein one of the merging associations absorbs the other association and therefore no new association is formed. The corporate existence of the more stable association is usually maintained.

Consolidations and mergers may be resorted to in all levels of the cooperatives system but they are usually effected in the larger organizations, say, on a regional or national level where overlapping of activities usually occur resulting in competitive wastes. It is wisely and rightly contended that the cooperative system should be the bulwark of cooperation and should not harbor competition.

Consolidations and mergers may be illustrated by taking associations A, B and C as examples. In consolidation, associations A, B and C are all dissolved as corporations and an entirely new corporation, say association D, is formed. This means that a new set of corporate papers has to be prepared and filed for the incorporation of association D.

On the other hand, in merger, one of the associations, either association A, B and C absorbs the two others and retains its corporate identity. To be more specific, assuming that the decision is to retain the stronger association A, then associations B and C are both absorbed by association A. The corporate existence of association A is not disturbed and no new association is actually formed.

In sum, all decisions regarding expansion of a cooperative corporation, regardless of the strategy to be adopted, that is, whether integration, diversification or consolidation and merger, are responsibilities of the members. The manager and the board of directors should, however, initiate and develop all necessary moves to help bring about the growth of the cooperative.

There are no hard and fast rules of thumb that can serve as guides in the conduct of the growth activities. In the final analysis, the vital determining criterion is the *economic feasibility* of the undertaking. For the purpose, the different techniques and tools for determining the economic feasibility of a project should be freely availed of.

Based however on past experiences, some statements can be advanced on the use of the various growth strategies:

1. Horizontal integration usually proceeds from and is the basis of vertical integration. It has therefore been utilized more extensively by cooperatives than vertical integration.
2. Horizontal integration is usually achieved through federation.
3. Diversification and horizontal integration usually go hand in hand and the former strengthens the latter.
4. Too much vertical integration usually demands more complex management and requires more capital support.
5. Consolidations and mergers are essentially legal matters and should be instituted with the assistance of competent corporation lawyers.



## APPENDIX D

### WORKSHEETS FOR DETERMINING THE BREAK-EVEN POINTS OF VARIOUS COOPERATIVE PROJECTS

An invaluable practical tool that can be used effectively by the management of cooperatives for planning and forecasting purposes as well as for judging the results of operations is the break-even point analysis. It can actually be viewed from two standpoints. Firstly, it can be used to determine the level of operations where total revenues equal total expenses. And secondly, it can be used in a broader sense to determine the probable savings at any level of operations.

In its simplest terms, break-even point may be defined as the specific level of operation or point where the total revenues

equal total expenses. Based on the foregoing definition, at break-even point, a business is neither gaining nor losing.

Some worksheets which can be used for determining the break-even points of the more common departmental operations of agricultural cooperatives are presented. It will be noted that in general two basic steps are involved in the process: (a) segregation of expenses into fixed and variable expenses and (b) computation of break-even point. In the case of administrative expenses, they should be allocated to the different departmental operations.

#### A. STORE OPERATIONS

##### 1. Segregation of Expenses

###### a. *Fixed expenses*

|   |   |       |
|---|---|-------|
| Fixed salaries and wages <sup>†</sup> . . . . . | P | _____ |
| Depreciation . . . . .                          |   | _____ |
| Expired insurance . . . . .                     |   | _____ |
| Interest on loan . . . . .                      |   | _____ |
| Amortization on store facilities . . . . .      |   | _____ |
| Rent . . . . .                                  |   | _____ |
| Administrative expenses . . . . .               |   | _____ |
| Total Fixed Expenses . . . . .                  | P | ===== |

b. *Variable Expenses*

|                                    |   |       |
|------------------------------------|---|-------|
| Repairs .....                      | P | _____ |
| Commission expenses .....          |   | _____ |
| Advertisement .....                |   | _____ |
| Store supplies .....               |   | _____ |
| Traveling expenses .....           |   | _____ |
| Freight and hauling expenses ..... |   | _____ |
| Miscellaneous expenses .....       |   | _____ |
| Total Variable Expenses .....      | P | ===== |

2. **Computation of Break-even Sales**

*Formula*

$$X = F + \left( \frac{V + CS}{S} \right) X$$

*Where*

- X = Break-even sales
- F = Fixed expenses
- V = Variable expenses
- CS = Cost of sales
- S = Sales

**B. WAREHOUSING OPERATIONS**

**1. Segregation of Expenses**

**a. Fixed expenses**

|   |                     |
|---|---------------------|
| Fixed salaries and wages . . . . .                  | ₱ _____             |
| Depreciation . . . . .                              | _____               |
| Interest on loan . . . . .                          | _____               |
| Amortization on loan . . . . .                      | _____               |
| Expired insurance on building . . . . .             | _____               |
| Expired bond premium of ware-<br>houseman . . . . . | _____               |
| Taxes and licenses . . . . .                        | _____               |
| Administrative expenses . . . . .                   | _____               |
| Total Fixed Expenses . . . . .                      | ₱ <u>          </u> |

**b. Variable expenses**

|  |                     |
|--|---------------------|
| Piece-work wages . . . . .             | ₱ _____             |
| Warehousing supplies . . . . .         | _____               |
| Repairs . . . . .                      | _____               |
| Freight and hauling expenses . . . . . | _____               |
| Traveling expenses . . . . .           | _____               |
| Insurance of stocks . . . . .          | _____               |
| Miscellaneous expenses . . . . .       | _____               |
| Total Variable Expenses . . . . .      | ₱ <u>          </u> |

## 2. Computation of Break-even Volume

*Formula*

$$\left( \frac{\text{GR}}{\text{P}} + \frac{\text{CSA}}{\text{P}} \right) \text{X} = \text{F} + \left( \frac{\text{V}}{\text{P}} \right) \text{X}$$

*Where*

X = Break-even volume

F = Fixed expenses

V = Variable expenses

GR = Gross revenue

P = Total value of palay stored

CSA = Cost of shrinkage allowance

C. MILLING OPERATIONS

1. Segregation of Expenses

a. *Fixed expenses*

|                                    |   |       |
|------------------------------------|---|-------|
| Fixed salaries and wages . . . . . | P | _____ |
| Depreciation . . . . .             |   | _____ |
| Interest on loan . . . . .         |   | _____ |
| Amortization of loan . . . . .     |   | _____ |
| Expired insurance . . . . .        |   | _____ |
| Rent . . . . .                     |   | _____ |
| Taxes . . . . .                    |   | _____ |
| Administrative expenses . . . . .  |   | _____ |
| Total Fixed Expenses . . . . .     | P | ===== |

b. *Variable expenses*

|                                   |   |       |
|-----------------------------------|---|-------|
| Piece-work wages . . . . .        | P | _____ |
| Rice-corn mill supplies . . . . . |   | _____ |
| Fuel and lubricants . . . . .     |   | _____ |
| Repairs and maintenance . . . . . |   | _____ |
| Miscellaneous expenses . . . . .  |   | _____ |
| Total Variable Expenses . . . . . | P | ===== |



## 2. Computation of Break-even Volume

*Formula*

$$\left( \frac{\text{MF}}{\text{F}} + \frac{\text{SBP}}{\text{P}} \right) \text{X} = \text{F} + \left( \frac{\text{V}}{\text{P}} \right) \text{X}$$

*Where*

**X** = Break-even volume

**F** = Fixed expenses

**V** = Variable expenses

**P** = Total value of palay milled

**MF** = Milling fee

**SBP** = Sales of by-products

**D. TRUCKING, TRACTOR AND THRESHER OPERATIONS**

**1. Segregation of Expenses**

**a *Fixed expenses***

|                                       |                |
|---------------------------------------|----------------|
| Salaries and wages . . . . .          | ₱ _____        |
| Depreciation . . . . .                | _____          |
| Expired insurance . . . . .           | _____          |
| Interest on loan . . . . .            | _____          |
| Amortization of loan . . . . .        | _____          |
| Taxes and licenses . . . . .          | _____          |
| Administrative expenses . . . . .     | _____          |
| <b>Total Fixed Expenses . . . . .</b> | <b>₱ _____</b> |

**b. *Variable expenses***

|  |                |
|--|----------------|
| Fuel and lubricant . . . . .             | ₱ _____        |
| Repair and maintenance . . . . .         | _____          |
| Subsistence allowance . . . . .          | _____          |
| Miscellaneous expenses . . . . .         | _____          |
| <b>Total Variable Expenses . . . . .</b> | <b>₱ _____</b> |

## 2. Computation of Break-even Revenue

*Formula*

$$X = F + \left( \frac{V}{R} \right) X$$

*Where*

X = Break-even revenue

F = Fixed expenses

V = Variable expenses

R = Revenue

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## ABOUT THE BOOK

Mendoza's book is comprehensive, readable and will be of use particularly to students of Agricultural Co-operation. It is a study written by an Asian, born and brought up in the social and cultural milieu of the East and who has had long experience of managing agricultural co-operatives. He has carried out the task with commendable clarity. I can recommend the book to students of Agricultural Co-operation and to those interested in problems and principles of Co-operation.

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The author of this book has had more than 25 years of active involvement in various capacities in agricultural cooperation particularly in the field of cooperative management. He initiated the identification of the Philippine cooperative movement with the International Co-operative Alliance which gave the movement a distinct international stature. He served as Philippine representative to the advisory council of the ICA Regional Office and Education Centre for South-East Asia in New Delhi, India and of the Institute for the Development of Agricultural Cooperatives in Asia in Tokyo, Japan. He was one of the pioneers of the innovative "compact" method of farming, a projected prototype of cooperative farming. He holds a B.S. in agriculture from the University of the Philippines at Los Baños.

