Why Member Equity is Critical to Successful Cocoa Co-operatives?

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Synopsis

This paper makes the case that cocoa cooperatives must adopt member equity plans based on usage in order to grow and become independent successful co-operatives. The introduction quotes notable co-operative experts on the centrality of member equity. Sections describe: (1) challenges facing cocoa co-ops; (2) reasons that the chocolate, Fair trade and development organizations should understand and support member equity plans; (3) the differences between co-ops and other business forms; (4) member equity plans; (5) equity redemption plans; (6) why agricultural co-ops in developing countries have not adopted such plans; (7) cocoa co-ops as group-based businesses; (8) the donor's role in co-operative development; (9) the financial difference between farmer associations and co-ops; and (10) capitalizing farmer associations and co-ops. The conclusion outlines the historical and current roles of co-ops in social and economic development. There are two attachments: a case study of the adoption of member equity plans by Acopagro and Oro Verde in Peru; and a selected bibliography on member equity for those interested in more insights and information.

Introduction

For over 200 years, successful agricultural co-operatives are premised on the fundamental principle of member equity based on usage. It does not matter whether a co-operative is in a developed country, or a developing country, nor whether farmers are very poor or not, the principle applies in all countries and types of agricultural co-operatives[ii].

While there are seven recognized international principles for co-operatives, what distinguishes co-operative enterprises from investor-owned or other companies is that "Members contribute equitably to, and democratically control, the capital of their co-operative (adopted by International Co-operative Alliance, 1995). These same ICA principles, while stated differently, were adopted in 1966, 1937 and they date back to the co-op pioneers in the 1800s[iii]

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Yet, many if not most Fair Trade and cocoa co-operatives have little or no member equity. The literature of Fair Trade, many development organizations involved in co-operative development, and the chocolate industry that relies on co-operatives almost never mention or discuss the importance of member equity. And yet as detailed below by leading co-operative experts and in the attached bibliography, member equity based on usage is at the very essence of a co-operative.

> Patronage refunds are **a quintessential feature** of agricultural co-operatives. They are the primary means by which co-operatives return earnings to member producers according to use, a concept critical to the definition of a co-operative. In addition, patronage refunds allocated to members, but retained by the organization, are the largest source of equity capital for most co-operatives. (Royer, Patronage Refunds, page 1).

> Using patronage or use of the co-op (rather than capital invested or shares held) as the mechanism for the distribution of financial return is **a defining characteristic** of the co-operative model. (Lund, Co-operative Equity, page 26)

> The principle that a co-operative is owned and controlled by those who use it implies a financing obligation on the part of member patrons… Co-operatives are said to be financed by those who use them in proportion to that use. From an equity standpoint, such financing proportionality places the burden on financing upon those who receive the benefits from the co-operative in proportion to the benefits received." (Baarda, Financing the Co-operative Enterprise, page 1)

> Equity should begin **from the first day of operations** and principally from members."[iv] (Weihe, Pathways, page 14, Success Factors for Co-operatives)

> Co-operatives first and foremost use their members' capital, which makes a co-op less dependent on external financing and decision-making as well as less tolerant on taking excessive risk. Wealth is created sustainability; surpluses are primarily reinvested in the membership and the community where the co-op operates. (Creating Wealth, page 10, Economically Resilient Enterprises)

> Equity capital is the **ownership capital** in a co-operative." (Understanding Co-operatives, USDA)

> Manage patron equity accounts by calculating a strict redemption budget for each "revolving" equity class. Then maintain flexibility and proportionality by using a preferred redemption method, such as a revolving fund or base capital." (Barton, page 14, Journal of Co-operatives, Six Successful Co-operative Finance Practices)

> Many co-operatives and even entire movements may lack the financial base required for growth and sustainability: a condition that appeared especially serious in agricultural co-operatives." Van Pischke, FAO)
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> Members are quick to seek out the benefits of the co-operative business model but often reluctant to accept the corresponding responsibilities of ownership and control. Three functions underlie broad co-operative principles today. **These are benefits, control and ownership.** (Barton, Current Challenges, page 1)
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> **Adequate risk capital** must be provided by retaining and managing equity as an element in the overall business strategy. (Boland, Co-operative Finance, page 1)
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> As owners, co-operative members are responsible for providing the co-operative with adequate capital. Since co-operative profits are distributed on a proportional basis, and this is accepted as an equitable practice, it seems logical to require members to contribute capital in proportion to their patronage as well. Both ownership and control should be vested in active patrons to maintain the co-operative character of the association. (Cropp, Co-operative Principles and practices in the 21st century, page 60)

1. The Challenges Facing Cocoa Co-ops

More than 30 developing countries produce cocoa, providing 14 million people with a livelihood. Cocoa is produced, traded and consumed in vast quantities across the globe. Though the majority of cocoa consumption occurs within the developed world, cocoa is grown in tropical regions of the developing world. In some countries of West Africa and Latin America, cocoa production is the primary income stream. In the Ivory Coast and Ghana, 90% of the farmers rely on cocoa for their primary income. Around the world, 90% of cocoa is grown and harvested on small family farms of 4.8 hectares or less, while just 5% comes from plantations of 40 hectares or more.

Cocoa is a volatile commodity with fluctuating prices and is frequently traded as futures or options – contracts that trade a commodity at a later date for a fixed price today. Since futures and options make income predictable, farmers should benefit from consistent selling prices for their crops over long terms, however futures contracts on the major markets are in units of 10 metric tons or more and the typical subsistence cocoa farm may produce just 1/2 ton per year. As a result, accessing these markets is virtually impossible for small farmers.

Credit is a key issue for farmers with seasonal crops like cocoa; outside of the harvest season, producers need loans to address immediate needs and pre-financing for planting and cultivation of their crop. But, credit needs to be backed up with member equity to assure sufficient internal funds so that the co-operative can meet the demands by their members, and access local bank loans which may be lower than those available internationally.

Producers lack information about quality and industry requirements. Quality requirements and industry knowledge are tools cocoa farmers can use to add value to their crop. Given their

limited education and lack of direct market feedback from end buyers, many small farmers are unable to utilize this knowledge.

Cocoa farmers face a number of other problems, including:

- Low prices that may not even cover costs of production,
- Expensive production inputs and farming costs such as tools, fertilizers and pesticides; and family needs for food, clothes, schools and medical,
- Low production due to the lack of inputs, poor tree genetics and diseases,
- An aging population with many farmers moving to cities, especially their children,
- A lack of economic diversification and education that make it difficult for farmers to engage in more lucrative pursuits,
- Many of the challenges that exist between small farmers and traders can be addressed by organizing small farmers' organizations and pooling resources.

At this juncture, work with cocoa co-operatives is more important than ever. Development assistance focuses increasingly on helping developing countries recover from social, political and economic crises and on preventing "fragile states" from falling into crisis situations. Cocoa co-operatives are present in many of these tropical countries where they face challenges from civil disorder, drug trafficking, climate change, and lack of access to markets due to being located in remote regions.

Cocoa co-operatives can help small farmers and their families fulfill their dreams of freedom, economic viability and crisis recovery. Co-ops offer broad grassroots involvement, local control and ownership, and the potential to nurture the capacities of individuals and groups to drive the development of their own economies. Co-op to co-op partnerships with those in the West and those in developing countries can reverse many of the misconceptions about co-operatives, especially on the importance of member investment and equity.

Major problems confronting cocoa and other agricultural co-operative development today are the legacies, misconceptions and mixed history of co-operatives in developing countries. International and donor institutions have minimized investment in co-operative development assistance. They often turn to associations or other producer organizations. Yet, there are critical differences between groups that advocate for or represent farmers and co-operatives as group-based businesses with member ownership as a central principle.

2. Reasons to Understand Member Equity

This paper presents the case for why the chocolate industry and especially the Fair Trade movement should better understand the importance of member equity in cocoa co-operatives. The chocolate industry should care because:

- The World Cocoa Foundation supports cocoa co-operatives in many regions in public private partnerships with international chocolate companies. These efforts often focus on farmer schools. A way to make this technical assistance sustainable is to strengthen

the financial underpinnings of cocoa co-operatives so at the end of project activities, they can continue to provide support to cocoa farmers.

- Chocolate buyers want financially strong cocoa co-operative to assure cocoa bean quality and quantities in their marketing agreements.
- With member equity, cocoa co-operatives will be more able to grow and borrow funds to cover the costs of purchasing beans from their members, rather than rely on international transactional financing.
- Since the 1920s, the chocolate industry has relied on dairy co-operatives for their milk chocolate (the sector worldwide with the greatest penetration of co-operatives), and as they move more processing overseas, financially strong dairy co-ops will become more important.
- Historically, co-operatives have been closely affiliated with Land Grant and other universities, and ministries of agriculture as a means to disseminated best farm practices and can help the chocolate industry address cocoa diseases and increased productivity.

Fair Trade organizations should especially support member equity since they specifically certify cocoa co-operatives or co-operative-like cocoa organizations, because:

- Well-designed and financially-strong agricultural co-operatives have lifted more rural people out of poverty than any other interventions.
- Fair trade certification organizations and inspectors need to better understand the financial underpinnings of co-operatives and encourage them to initiate member equity plans, of which Fair Trade premiums could play a useful role.
- Donors and technical experts are heavily engaged in supporting Fair Trade co-operatives, yet few of these practitioners understand the critical role of member equity.
- Fair trade advocates, especially from natural food co-operatives, could provide practical advice on patronage refunds and member equity for their partner, cocoa co-operatives**.**

While many development practitioners do not understand member equity in co-operatives, or believe that it cannot be achieved since the cocoa farmers are “poor,” this paper describes the successful introduction of member equity plans in Oro Verde and Acopagro co-operatives in an attachment.

3. What Is a Co-operative?

In any discussion of the advantages of the co-operative business model, particularly in an international development context, it is important at the outset to clarify what a co-operative *is* and what a co-operative *is not*. Much of the negative legacy burdening co-operative development is a result of labeling a parastatal[v], or even a nonprofit charitable organization, as a co-operative.

A co-operative *is* a *group-based and member-owned business* and can be formed for economic and social development in any sector. The International Co-operative Alliance defines a co-

operative as: "*an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly owned and democratically controlled enterprise*." (ICA principles)

Ownership and control by members, who usually have one vote per person, is a key aspect of co-operatives. Unlike investor corporations, co-operatives raise equity or savings from their members and are designed to provide services to their users as their priority. Co-operatives return surplus revenues to members proportionate to their use of the co-operative. Co-operatives raise resources through the equity of members. There are three key principles:

- *User-owned* -- users finance the co-operative;
- *User-controlled* -- an elected Board of Directors serves as the link between the membership and the manager; and
- *User-benefited* -- members profit when patronage refunds are returned to members based on the amount of business conducted with the co-operative.[vi]

A co-operative is a special purpose corporation. Most corporations are investor-owned institutions. Their purpose is to bring return to investors. Corporations return surplus revenues to investors proportionate to their "investment" or ownership share and typically raise money through capital markets. Under most state laws in the U.S., a co-operative is included under corporation law as a distinct form of corporation (compared to an LLC, partnerships, investor owned company, etc).

A co-operative is not a parastatal. Many organizations in the developing world are called co-operatives, but in reality are government-established parastatals. Membership is often compulsory and civil servants are assigned to management positions. These organizations are instruments of official economic policy and channels for government services, such as farm credit, the supply of agricultural inputs, and marketing. The members of these co-operatives consider them to be state agencies. Government-controlled parastatals are not true co-operatives.

A co-operative is not an association. Associations have many characteristics similar to co-operatives but for an organization to be a true co-operative, it must be a member-owned business, returning surplus revenues to its members. However, many U.S. cooperatives may also call themselves an association, but operate as a co-operative.

A co-operative is not a nonprofit organization. A nonprofit organization serves others outside of the organization, either directly or often through advocacy work on their behalf. Nonprofits usually raise money through public donations, grants and contracts and may earn some money from services.

The chart below compares the attributes of co-operatives, corporations and nonprofit organizations. The three key questions are: (1) who owns the enterprise; (2) who controls the

enterprise; and (3) who benefits from the enterprise. These highlight the differences between forms of enterprise.

Co-operatives, Corporations, and Nonprofit Organizations[vii]			
Attributes	**Co-operatives**	**Corporations**	**Nonprofit Organizations**
Ownership	Member-owned	Investor-owned	Generally not "owned" by a person or members
Control	Democratically controlled; one-member, one vote basis; equal voice regardless of their equity share. Members are involved in the day-to-day business operations and receive services for their input.	Controlled by shareholders according to their investment share. Business decisions and policy are made by a board of directors and corporate officers.	May be controlled by members who elect a board of directors or, in non-membership organizations, the board of directors may elect its own successors. Control is maintained by those not receiving the services.
Board Membership & Compensation	Made up of co-op members elected by the members. Usually, they do not work for the co-op. Cost reimbursed for board meetings. Board members usually serve on an uncompensated, volunteer basis.	Board is comprised of a combination of independent directors, management and other directors with financial or business ties to the organization. CEOs may serve as the board chair. Significant financial compensation is provided for board service.	Board is generally made up of people who do not receive the services, usually chosen for philanthropic or political reasons. Board members usually serve on a volunteer basis.
Board Nomination & Elections	Candidates nominated by membership either directly, or by a nominating committee made up of members. Usually, any member can nominate a director candidate. Board is elected by the members on a one-member, one vote basis.	Candidates nominated by the board of directors and management, often by a nominating committee. Shareholders have limited ability to nominate and elect director candidates.	Either by members or the board of directors.
Accountability	The Board is directly accountable to members through nomination and election procedures.	Board election and nomination procedures afford little oversight opportunity to shareholders. Shareholders are not likely to be able to remove board members.	Generally accountable to members of the organization and those who provide the funding to the organization.

Earnings/ Dividends	Any surplus revenues (profits) earned by the co-op are reinvested in the business and/or returned to members based on how much business they conducted with the co-op that year. Many co-ops are obligated to return a portion of their "surplus revenues" to members each year. Members share losses and earnings.	Profits returned to shareholders based on ownership share. Corporations are generally not obligated to pay out dividends. Timing and amount of dividend payout are determined by the board of directors.	Re-invest any profits they make in their own operations or donate them to other non-profits or to government agencies.
Motivation /Purpose	Maximize customer service and satisfaction.	Maximize shareholder returns.	Primary motivation is to serve in the public interest. Redistribute resources to provide educational, charitable and other services.
Source of funds/ Generation of Money	Raise resources through the equity of members: 1) direct investment, 2) retained margins, 3) per-unit capital retains (capital investments based on the number of physical units handled by the co-op or on a percentage of sales)	Typically raise money through capital markets.	Typically funded by donations from the private or public sector or the government. Tax-exempt.
Community	Promote and assist community development.	May engage in selected community philanthropic activities.	Serve as a mechanism for collective action based on a common good.

4. What are Patronage Refunds?

Patronage refunds are the key principles, practices, and responsibilities the co-operative and its owners have to each other. The purpose of a co-operative is to provide a service to its member-users at the lowest possible cost, rather than generate a profit for investors. However, service at cost does not mean the co-operative operates that way on a daily basis. There are at least two good reasons: (1) it does not know exactly what its costs are on a daily basis; and (2) as a business in the private enterprise system, the prices it pays for products purchased fluctuate with the market or receives for goods sold.

Once a year, a formal accounting determines the co-operative's income and expenses. Income remaining after deducting all expenses (net margin) is then distributed in proportion to patronage. The income in excess of expenses generated by the members' use of their business is thus refunded to them. This income returned or refunded is called a patronage refund. The patronage refund is the key operating principle that ownership benefits are proportion to use.

The patronage refund is an important source of financing for co-operatives. Boards and members at their annual general meeting usually elect to leave a portion of the refund in the

co-operative to help keep its operations on a sound financial basis. The retained portion of the patronage refund is allocated to the member's equity account and paid out at a later date.

The special nature and purpose of a co-operative places the responsibility to finance the business on its member-users.[viii] Benefits are tied to use. Those benefits do not enhance the value of shares of stock or other equity capital.[ix] Therefore, the incentives that cause persons to invest in stock of other corporations are not present in co-operative stock. Consequently, members of the co-operative must provide most of its equity capital[x], either by direct investment or through retained patronage allocations.

The co-operative has a responsibility, acting collectively for members, to develop a financing and ownership transfer plan that is equitable to members individually and that is in keeping with co-operative principles. As members use the co-operative, they assume the basic responsibility of providing capital according to their use. When patronage terminates, so does the financing responsibility. Unless the co-operative adopts a systematic plan to redeem equities, an increasing amount of capital will be held by inactive members. Such a situation can lead to less participation by members in their co-operative's affairs and conflicting objectives.

Financing the co-operative through reinvestment of patronage refunds is a simple and straightforward way for members to carry out their obligation to finance according to use. Equity redemption serves to keep the co-operative's ownership in the hands of current users. (USDA, *What are Patronage Refunds?,* Cir. 9, 1993).

5. Equity Redemption Plans

Co-op members provide the crucial flexible and patient equity capital to achieve financial stability. Equity shares represent ownership of an enterprise, and ownership by an active and committed group of members strengthens a co-operative in many ways. But what happens when a member leaves a co-op? When they retire, move out of the area served by their co-op, stop farming and marketing product through their producer co-op or otherwise cease to use the core functions of a co-op they are no longer active members and equity should be returned to them.

Since the co-operative is organized and operated to benefit its patron members, most co-ops prefer that only active members be involved as owners -- and therefore decision-makers -- of the business. Thus every co-operative must articulate a system not only for raising money from new members, but also for redeeming or returning equity to departing members. All decisions about capital redemption involve achieving an optimal balance between the solvency needs of the co-operative and the personal interests or desires of members.[xi]

Co-operative practices for the return or redemption of member equity vary dramatically, from immediate redemption upon departure to redemption only after the death of a member. Some of the differences are attributable to tradition or common practices within different co-operative sector or country, while other variations have more to do with member expectations and the different fundamental benefits that the co-op is delivering to its members.

Producer co-operatives depend heavily on retained allocated equity for their financing needs and have historically held onto retained allocated member equity for many years – 10 or more years. For some members this may be no hardship, as they have received numerous other benefits from the co-operative in the intervening years, including lower prices for inputs or better markets for their primary farm business.

Developing an equity redemption plan can ensure that current active members are proportionately financing their co-operative and all members are being treated equitably in terms of equity redemption. The two most common types of plans are: the revolving fund plan, and the base capital plan. A revolving fund plan pays out the oldest retained equity and replacing it with newer retained equity from current member activity on an annual basis. While the simplest to implement, fluctuating or declining business profitability can pose challenges to this approach. The second method is the base capital plan in which the board of the co-op periodically establishes a targeted amount of equity that the co-op needs to fund its ongoing operations. Member equity requirements are set based upon that calculation. Members can fulfill these financial obligations through a variety of means, including allocated equity or per-unit capital retains.

Co-operative boards need to be mindful about balancing the interests of different members in decision-making about the allocation of net profits. Stretching out equity redemption may be good for the balance sheet of the co-op and an efficient way to fund growth, but may be unfair to members close to retirement who won't benefit from the growth they are disproportionately funding. In contrast, adopting a member equity redemption plan that is too aggressive can strain the co-op financially and even threaten its existence. In co-ops with a long history of profitability, newer members reap the benefits of substantial previous equity accumulation while having contributed relatively little themselves, a situation some view as unfair.

On the other hand, there have been cases where a large block of retirement age members have voted to dissolve a co-op that they no longer need in order to monetize their equity investment quickly, leaving younger members without jobs or access to the co-op's ongoing services.

There are no perfect answers to equity allocation and redemption questions, as each situation and country setting, including co-op law and tax policies, is different. The important thing for a co-op's board and management to keep in mind is to manage member expectations and be clear and consistent about communicating the broad range of benefits of co-operative membership. The conversation should not focus solely on profitability and equity redemption to the exclusion of other important ways in which the co-op benefits its members and community. Co-op leaders must also be mindful at all times of balancing the interests of current, past and future members and the sometimes competing needs of co-op solvency and maximum member benefit. They also must be aware of the implications of different equity redemption plan options, making sure that the decisions they make are right for members in the long term as well as the short. (Lund, *Co-operative Equity*, pp 26-33)

A specific problem that may occur in developing countries is that a successful co-operative may accumulate unallocated capital. Capital which is owned collectively, and not allocated to members. This creates an incentive for members to de-fund the co-operative, and advocate an immediate payout to members of unallocated capital. Education of members on the distinction between allocated and unallocated capital is critical, and as members accumulate allocated capital that they own, it increases their support and incentive to use the co-operative.[xii]

6. Agricultural Co-operatives in Developing Countries

Many agricultural co-operatives in developing countries have not adopted, nor understand the very financial basis of a co-operative. Financial challenges included:

- Many co-operative laws did not recognize co-ops as private enterprises, and created laws and regulations that impeded their growth, and over-regulated them. These laws require co-operatives to set aside funds for co-operative education and other purposes.
- Co-ops such as for rice and staples are not very profitable and always will be fragile with very low margins to pay staff and operating expenses.
- Co-operatives were used for land reform efforts, especially in the 1960s, and most failed because the economic conditions did not allow for profitable agricultural activities.
- Co-operatives were formed by donors or outside organizations as a means to address poverty, but not understood the financial underpinnings of a co-operative.
- World Bank-funded co-operative banks provided so-called loans through co-operatives to farmers who did not repay them, and often used the farm loans for personal needs.) Nearly all co-ops for banks have failed usually because of not operating profitably and forced to loan at very low rates (too often the funds came from donors or governments and farmers did not think that they need to pay loans back).
- Mostly they have failed because co-ops have not been organized based on sound principles of member equity (and loyalty) based on usage.[xiii]

In contrast, success factors for well-designed co-operatives based in member equity include:

- Laws and policies, especially tax policies which are favorable to co-operatives and their financial structure (no double taxation of dividends).
- An economy that permits and allows co-operatives to compete fairly with other types of businesses.
- Membership that is open to users (sometimes limited to farmers or those living in a region) and where there is sufficient social capital and trust among farmers.
- High equity/debt ratio.
- Organization around a resource base and services sufficient to sustain the co-operative as a viable business and member-centered services.
- Access to markets.[xiv]

Yet, co-operatives based on sound co-operative and financial principles have been successful in many developing countries. Particularly successful examples are India where even the poorest women dairy farmers, often of the lowest caste, contribute to member equity; and Ethiopia coffee and input co-operatives.[xv]

7. Cocoa Co-operatives as Group-based Businesses

Cocoa co-operatives are group-based businesses formed by like-minded farmers who, by joining together, realize certain economies of scale by lowering production costs, purchasing of inputs such as seedlings and organic fertilizers, and adding value to their cocoa beans through fermentation, drying and sales to international buyers[xvi]. The farmers expect to increase the profitability of their farm through joining the co-operative. But, in most cases, the farmer does not really understand the financial obligations of a co-operative. Unfortunately, most donors, NGO assistance organizations, chocolate companies and Fair Trade advocates don't either.

First and foremost a co-operative is a business and as any co-operative business should have equity investments by its members to capitalize it, leverage quasi-permanent capital to leverage borrowing, and facilitate the acquisition of fixed assets and services. A co-operative is legally considered a "not-for-profit" business in the sense that it works to maximize long-term financial returns to its members, while limiting net margins of the business itself. Unlike investor-owned corporations, a co-operative does not need to make "profits" on behalf of the investors; rather surplus is used to expand services to member owners and to grow the co-operative enterprise.

As a business, a cocoa co-operative must be competitive in the market place and therefore requires adequate working capital, sufficient reserves, assets, and management that hold the entire aggregation together and makes it work. The not-for-profit nature of a co-operative is manifested through the tradition of returning un-needed cash and capital in the form of patronage refunds, dividends on contributed equity capital (often by law to 6% - 8% maximum[xvii]) and equity pay-outs when funds are revolved back to farmers or when they retire.

Many cocoa co-operatives also carry out community activities such as educational opportunities for members' children, social projects, installation of drinking water wells, and other community services, a practice which is especially encouraged through Fair Trade certification, Fair Trade plans, FLO inspectors and decisions by the membership who has specific community needs[xviii].

To be considered a co-operative involves operating like a co-operative even though legally the business may not be a co-operative. In many cases and depending on laws in developing countries, farmer associations operate as a co-operative or quasi co-operative. However, a farmer association is not the proper organization structure got s group-based business. It is important to the chocolate industry to have properly capitalized co-operatives as reliable business partners. Similarly, Fair Trade groups want to see the co-operative grow as a successful business so that cocoa farmers receive additional benefits, and more income.

In nearly every developed country, including Europe, the U.S., Japan, South Korea, India, co-operatives were a major force in alleviating poverty among small farmers, and today represent a significant component of their agricultural sectors. However, this history is almost unknown, not taught in business schools and nor understood by NGOs and donors carrying out co-operative assistance programs overseas.

The effectiveness and efficiency of co-operatives or farmer organizations should be measured by financial analyses parameters similar to other types of businesses but modified to reflect their financial structure as member-owned, compared to investor-ownership. Co-operative ratios may include ratios that reflect solvency, liquidity and profitability including:

- Return on member equity,
- Return on total invested capital,
- Return on total assets,
- Member equity as a percentage of fixed assets, gross and net margins,
- Inventory turnover,
- Working capital,
- The current ratio of debt to equity, and leverage.

In a co-operative, the members must provide adequate long-term financial resources to maintain the competitiveness of the business while permitting the co-operative to borrow necessary liquidity/working capital. Members are expected to benefit as well as accept financial risks as member-owners.[xix]

Co-operatives traditionally operate in accord with one member one vote, equity in proportion to use, not-for-profit, open membership that encourages more farmers to join, apolitical, and no privilege to capital. Sometimes in the more advanced countries, agricultural co-operatives have proportional voting based on usage, and allow outside investors but with limited voting rights or restricted shares.

Since by definition co-operatives are “not for profit” so they should try to avoid undue risk. This is usually reflected in how the added value marketing activities are undertaken. The co-operative processes the product thereby adding value to it and then sells the product on behalf of the farmer, deducting costs of the added value, and the agreed upon per unit capital contribution. The remaining proceeds are then paid out to the farmer (this payment is referred to as patronage refund and commonly is paid 80% additional shares or equity certificates and 20% cash).[xx]

In many cocoa co-operatives, this usually works slightly differently as farmers have immediate cash needs at the time of harvesting - harvest labor/costs and repayment of crop loans. Therefore the co-operative board, based on a management proposal, sets the first partial liquidation at the time product is delivered for handling and processing by the co-operative. This is usually between 60% - 80% of the expected sales price. Later, after actual sale and payment, co-operative management can allocate costs (direct and indirect) and capital

contributions (long-term equity and working capital) per unit of measure and after deducting these, the remaining funds are “reimbursed” or “refunded” to each member.

But this practice of “marketing co-operatively” is rarely practiced in the developing countries as many members live very close to the margin, just barely above the poverty line, and need every cent as quickly as possible. Intermediaries offer cash at the time of delivery so the temptation of cocoa farmers is great to bolt the co-operative in favor of quick returns rather than long-term investment that can foster prosperity, and build the co-operative so that it can bring more farmers out of poverty.

8. Donors’ Role in Co-operative Development

In developing countries, donations play a significant role in subsidizing cocoa co-operatives. Donor funds substitute for a lack of member equity and are a disincentive for farmers to invest in their co-operatives. In fact, these funds not only create a disincentive for farmers to invest in their cooperative, it undercuts the underlying cooperative tenet of mutual help.

Donors also fund infrastructure so that the co-operative is able to process cocoa beans and sell them as well as provide technical services to their members. In most Fair Trade cocoa co-operatives, donations have almost exclusively replaced member investment/equity. Farmer/members are relieved of this obligation on the premise that they are poor small farmers. Yet, some the most successful co-operatives, such as in India are owned by very poor women; and most co-operatives in developed countries where formed by poor or at least cash-starved small family farmers In most cases, the farmers in cocoa co-operatives do not even provide modest membership dues. Some co-operative managers fear that insisting on farmer contributions, or repaying loans from the co-operative, will drive them away from the co-operatives.

This is not a financially healthy situation for a cocoa co-operative and puts the businesses in danger of collapse should donors’ in which they often lose interest, especially as the co-operative grows to a sizable business. **The key development challenge for cocoa co-operatives is how to persuade members to invest in their organization after years of being free riders.** Business sustainability requires financial reserves when disaster or market conditions change, and equity capital is necessary for the co-operative to borrow from banks, either to expand their purchases from members, provide operating capital and build infrastructure[xxi].

There is an inherent danger in low levels of member investment and large amounts of "co-operative capital," as a result of donations in which capital is not generated by allocating margins to members, and legally mandated corporate reserves. Co-operative laws sometimes require a substantial portion of net earnings before distribution to members as indivisible co-operative reserves – in the most part because lawmakers do not understand the essence of the co-operative form of business. The danger is that without significant member investment, the business owns itself and members own little.

With low investment by members, there is little interest and loyalty in the co-operative as they have nothing to lose. This lack of interest and involvement can be dangerous in the sense that it can become a great temptation for the manager to abscond with funds that do not have names and addresses associated with them. In some cases, farmer members think that this "unallocated" capital in the co-operative should be redistributed to them, rather than serve the purposes of the co-operative business.

Another issue is legally mandated co-operative reserves (common in producer co-operatives in Latin America), sometimes as much as 25% for co-operative reserves and 10% for the "Education Fund" from their annual margins. These mandated reserves represent a substantial portion of net margin and, in a sense, may be considered as a future tax should the co-operative decide to disband or enter bankruptcy. Since, after paying off all debts and returning member paid-in equity, any remaining balance may revert to the government or another non-profit.

In providing financial advice to co-operatives, it is important to know that in developing countries the co-operative laws may contain mandated co-operative reserves and capitalization for an Education Fund, as well as extensive government interference from co-operative departments. This government interference and poorly crafted laws may restrict co-operatives in terms of joint ventures; require annual board of director turnovers; excessive reporting; required attendance at general membership meetings by government co-operative staff, etc.

Many co-operative boards (and donors) seek managers who are great proposal writers rather than experienced managers to help ensure a continual flow of donor capital. Rather than growing the co-operative through quality, member equity and based on fundamental co-operative principals, managers find it easier to cultivate the donors. The co-operative becomes manager or donor driven with little input or involvement of members. Well-intended foreign buyers, unaware (or unconcerned as they want a steady flow of products) of co-operative marketing principles, provide financing or donations without regard to strengthening the long-term sustainability of the group business. Small farmers, pleading poverty, are let off the hook in capitalizing their own businesses through insisting on full payment at delivery, rather than setting aside some of their products as long-term capital and equity.

Many Fair Trade and project implementers, and their advisors do not understand the key characteristics of co-operatives and often undermine them with excessive donations, seconded staff and other types of support that undermine member-ownership and equity. Many co-operative experts oppose most donor investments[xxii], or at least, they would design projects so that the donations re-enforce co-operative principles, and require financial matching or member equity contributions as an integral part of the assistance. Unlike co-operatives in developing countries, successful Western-style co-operatives were formed with little outside financial capital[xxiii] and only technical assistance from ministries of agriculture or rural development

The issue is, therefore, how to strike a balance between donor, international buyers, and member funds so that the co-operative is not donor/management-driven, but owned and controlled by and for farmers so the business does not stray from its intended purpose - the strengthening of the farm businesses that form the co-operative rather than strengthening the company at the expense of farmers/members.[xxiv] Donors also provide large amounts of funds for quick results despite the fact that it takes time to create and develop co-ops beyond usual donor timelines. Often, with modest investments in co-op education and training are more effective, and sustainable.

9. Financial Difference between Farmer Associations and Co-ops

Often in Latin America, implementing agencies and other groups refer to farmer cooperatives when, in fact, they are farmer associations.

The difference between associations and co-operatives is the capital structure which is especially important for Fair Trade, organic and other cocoa co-operatives in Latin America[xxv]. Whereas a co-operative has individual member investment usually denominated as share or equity capital (certificados de aportación in most Latin countries), an association (or non-profit corporation) has no member investment other than perhaps a membership fee to join and modest periodic dues.[xxvi]

The net worth of an association is contained in a general indivisible fund plus corporate reserves of different types in accordance with local practices/law. Associations are non-profit and cannot distribute net margins to members. In most Latin American countries, Civil Codes restrict non-profit associations or corporations from distributing or even allocating net margins. And in some countries, restrictions are even applied to associations with respect to the types of services they are permitted to offer. For example, associations may be restricted in conducting businesses, and if allowed, must return all operating surpluses to the members at the end of the year in order to maintain their non-profit status.[xxvii]

There are generally two main types of associations - the trade association and the business association.

A trade association usually represents the interests of members, lobbies government, seeks to create or maintain a favorable regulatory environment for the membership, is usually organized along commodity lines but also can be organized in accord with geographic distributions, and may provide services such as training, insurance services, sale of tires and batteries, extension services, etc. These types of services usually do not require major infrastructure or processing assets. Thus, by their nature do not necessarily require equity investment.
The trade associations are non-profit, abide by one member one vote and are usually financed by dues and fees for services. Their capital structure does not contain member equity and is usually represented by a general fund, which is not owned by any one individual but by everybody in common. Most of these associations do not qualify for bank loans since their have little real net worth and their assets are generally insufficient to provide guarantees. Many of these groups in the developing countries receive donations from government and international

donors to finance specific activities of interest to the donor and the association. And many of these so-called “trade associations” actually undertake regular commercial services as would be expected of a service co-operative or for-profit business.

The business associations are those associated groups that provide business services to members such as sale of farm supplies, extension services, marketing of member commodities (without significant value added processing), training, and other services that usually do not require significant assets. They are usually organized by geographic and/or along commodity groups, are financed by business turnover, capitalized net margins, fees for services, and from dues as well. These also generally abide by the one member one vote principle, and are nonprofit.

As with the trade associations, the business association cannot distribute earnings to members and must either capitalize them in the name of the organization or set prices/costs in such a manner that profits are minimized at the end of the year. These associations - sometimes legally organized as non-profit corporations (such as in Ecuador) - are usually considered businesses and do not lobby government nor specifically represent member interests in a political sense. Some of these business associations or corporations are federated to regional or national levels and these higher level organizations may be more involved in lobbying. The capital structure of these groups may be proportionally larger to represent a net worth that can facilitate borrowing from banks or other financial institutions although in most developing countries banks require fixed assets to guarantee a loan up to as much as 150% of the value of the loan.

Like the trade association, many of these business associations also receive donations from international donors for specific activities of interest to the donor and the association. Sometimes the association becomes donor-driven and undertakes activities in line with donor wishes rather than in accord with member interests.

In the developing countries of Latin America there are many associations and co-operatives. But in some countries co-operatives seem to predominate (Peru and Costa Rica, for example) while in others associations or non-profit corporations seem to be the favored organization structure (Ecuador, Nicaragua for example). In Ecuador, farmers and the public state openly that co-operatives don't work yet they turn to associations to undertake business activities that they are ill equipped for. Instead of obtaining member investment, skilled managers seek out international donors for donation after donation, build sizable unallocated net worth and take risks these types of businesses should not. At the end of the day farmers invest little or nothing and are in reality "free riders" on donor coat tails. Buyers of product offered for sale traditionally have focused on quantity, quality and continuity of supply and have paid little attention to how the business is organized as they are more interested in acquiring needed raw materials and don't have time or the interest to worry about the strength or legal status of the supplier.

Nevertheless, through the Fair Trade mechanism, buyers are required to ensure supplier organizations follow standards established by the Fair Trade certifying organizations.

10. Capitalizing Cocoa associations and Co-operatives

There also is recognized the need - in some cases at least - for farmer investment and in several cases such as in Ecuador, Dominican Republic, Ghana and Peru[xxviii], members have created a separate savings and loan co-op affiliated with the producer co-operative or farmer association. But, these organizational structures should be separate since they are hard to manage as a single entity and may end up cross subsidizing the less profitable operations. However, side-by-side, the credit union can help members with saving and borrowing for short-term cultivation needs and harvesting costs. In a sense these affiliated savings associated with the producer co-op may be considered "quasi capital" as they can replace some of the working capital that the co-op requires to "buy" the cocoa crop. However, this type of "capitalization" should be defined better to ensure it is indeed can be considered as "equity" by the producer organization, their accountants, banks and/or savings and credit co-operatives.

Co-operative development experts are wrestling with capitalization in farmer associations, or co-operatives with little or no member equity. The patrimony of these types of organizations is a general indivisible fund, accumulated through earnings, and donations but without one cent invested by members. At most, members may pay dues but these funds are used for normal operating expenses of the associations and not considered paid-in capital.[xxix]

An alternative is to convert the farmer association into a co-operative, or educate the management and members of co-operative without member equity in its importance. For example, the association can be maintained for business serves and donor support and a parallel co-operative for business operations in which members would be required to make investments. In some countries and situations, forming a co-operative is difficult. So, another approach is to leverage donor funding with a requirement for member investments.

A farmers' association has no member paid-in capital, which results in a lack of member loyalty since there is no financial stake in the group-based business. Their patrimony is a general indivisible fund, accumulated through earnings and donations but without investment by members. At most, members pay minimal dues used for social activities, as the amounts are too small to be used for normal operating expenses. Members do not have share accounts, as the legal structure of an association even though it may be called a "corporation."

A model that may wide application to farmer associations and similar organizations without member paid-in capital is to use donor funds to create "quasi-capital" or savings in the association. For example, a donor provides funds for a nursery to produce 100,000 high quality cocoa seedlings to distribute among its members[xxx]. There may be a strong demand and urgent need for these plants, but some farmers have little income this past harvest due to the floods and poor weather.

In the sweep of history, co-operatives have been major forces in rural and farmer poverty reduction (rural farm credit, Austria Germany/Black Forest Region, Raiffensen, 1860s), Netherlands (rural farm credit, Rabobank, 1890s), Quebec (rural credit, Desjardin, 1900), Finland (Pellervo Society, farm co-ops resistant to Russification, 1899), U.S. (1920s, formation of most producer co-ops after farm depression), Italy (Legaco-op farm co-ops after WWII), Japan (rice co-ops, MacArthur reforms after WWII), South Korea (dairy and credit unions after Korean war, 1950s), India (input and farm co-ops, critical to Green Revolution, 1960s), Bolivia/Santa Cruz (utility co-ops, 1960s), Nicaragua (Equal Exchange supports Fair Trade coffee co-operatives as resistance to U.S. war in Central America, 1980s), Philippines (rural electric co-ops, 1970s), Bangladesh (rural electric co-ops, 1980s), Poland (farm co-operatives, 1920s and Rural Solidarity-inspired resurgence, late 1990s), Ethiopia (fair trade coffee co-ops, 1999), East Timor (Café Timor, FT coffee co-ops, 2000), and Rwanda (coffee and credit co-ops after genocide, 2001).

Rather than the association giving the plants to farmers, an alternative is use the plants to fund a member equity approach. The association may sell the plants on credit to their members at 50 cents each; in effect, the farmer is borrowing from the association for the cost of plants.

As the member pays back the loan with the delivery of beans, the funds would appear on the member's ledger reducing his debt to the association. At the same time, these loan payments are credited to the member's "ledger account" and while his loan balance is diminished, his "savings" grows. The funds are kept by the association as long-term assets and working capital. Thus, the association is borrowing funds from its members. Like a term deposit, the funds may be redeemable only after five or more years, and can be considered "quasi capital" or member equity in a long-term revolving fund.

Another innovative way to strengthen a farmers' association is to build member capital through the use of a portion of their Fair Trade (FLO), organic and/or quality premiums for their capitalization goals. These premiums should benefit farmers who use the cooperative, provide quality cocoa beans for processing, and enable the farmers to invest in improving their farms.

Conclusions

Since the early 1800s, co-operatives have made pivotal contributions to the development of economies at strategically important times. In the English-speaking world, the Rochdale Society of Weavers, inspired by ideas of Robert Owen and William King, is considered the first co-operative.[xxxi] For more than 160 years, the Rochdale principles have included open and voluntary membership, democratic management, modest expectations concerning return on capital and dividends paid to members. Inevitably, these pioneers experienced familiar growing pains including friction when members had to sell back their shares because of financial difficulties, suppliers who were wary of the small-scale initiative (a co-operative retail store), competition from established businesses that opposed the co-operative as

a competitor, as well as on occasion when ill-conceived investments were not profitable.

Well-conceived and financially-sound co-operatives endure. With the highest per capita number of co-operative members (2.5 million), Finland formed successful co-operatives that survived through the Russian revolution, two World Wars and economic downturns, and today are the largest employers in the country.[xxxii] These co-operative networks were economic operations and grew rapidly as part of social movements that deal with rural poverty and economic depression as part of the industrial revolution. The growth of Western co-operatives also reflected visionary leadership and competent management.

As countries move beyond the stage of emergency relief, co-operatives can help build the framework for solidarity and just civil societies. In post-crisis situations where the entrepreneurial spirit of rural people is allowed to flourish for the first time in years, co-operatives cultivate good business practices, emphasize markets; financial systems controlled by members and communities; and broader participation in economic activities.

Co-operatives help people design programs from the ground up, centered on group businesses that can be profitable. Members define their own needs and have a personal stake in the group business. Over time, co-operatives build economic co-operation in fractured societies, with participation open to all including women, ethnic minorities and those practicing different religions. Co-operatives mainstream poor and discriminated groups into conventional economies.

Thus, the co-operative idea is still dynamic -- the fundamentals of aggregating people for marketing power; and placing control in the hands of users, are very powerful ideas if co-operative practitioners are dynamic as well. Today we stand at another strategically important time in history as the world struggles to find the most effective ways to alleviate rural poverty and suffering in developing countries across the globe. The Fair Trade movement provides an unparalleled stage to promote small farmer co-operatives with currently over 131 cocoa co-operatives or similar organizations certified as Fair Trade. Rapidly expanding markets for chocolates in China, India and other middle-income countries is also boosting the need for greater cocoa production by small farmers, and properly formed cooperatives can provide more sustainable cocoa for these growing markets.

The challenge is first to recognize this phenomenon, analyze and understand it more thoroughly, find more effective ways to help fledging co-operative networks reach scale, and reorient development professionals' thinking to recognize the universality of co-operatives, and its core principles especially member equity, as one means to achieve poverty alleviation and economic opportunity in the developing world.

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[i] Equal Exchange's mission is to build long-term trade partnerships that are economically just and environmentally sound, to foster mutually beneficial relationships between farmers and consumers and to demonstrate, through

our success, the contribution of worker co-operatives and Fair Trade to a more equitable, democratic and sustainable world.

Equal Exchange has created Big Change for over 25 years. It all started with an idea: what if food could be traded in a way that is honest and fair, a way that empowers both farmers and consumers? Our founders - Rink Dickinson, Jonathan Rosenthal and Michael Rozyne - asked this question as they envisioned a trade model that values farmers and consumers. So they took a big risk and plunged full-force into changing a broken food system. In 1986, they started with fairly traded coffee from Nicaragua and didn't look back.

At Equal Exchange they believe that they should expect no less from themselves and each other than they demand of our farmer partners. For that reason they have organized themselves as a democratic worker co-operative, now one of the largest in the country. A worker co-operative is an alternative for-profit structure based upon standard democratic principles. It is not designed to maximize profits, nor returns to investors, but rather to bring to the workplace many of the rights and responsibilities that we hold as citizens in our communities (Equal Exchange website).

Equal Exchange only sources its cocoa from Fair Trade and organic small farmer co-operatives in the Dominican Republic, Ecuador, Panama and Peru. Equal Exchange markets it chocolate products through 175 U.S. natural food co-ops, 10,000 congregations in 12 faiths, Whole Foods and other outlets.

[ii] In nearly every developed countries, co-operatives were organized among very poor and often subsistence farmers where the Black Forest in Germany in the 1860s, or American farmers in the 1880s and 1920s. See listing of co-operative development under conclusions.

[iii] . For example, the Rochdale Co-operative Pioneers in 1844 stated that “Equity is provided by members”, “Equity ownership share of individual members is limited”, “Net income is distributed to members as patronage refunds on a cost basis”, and “Dividends on equity capital are limited.”

[iv] Usually, start-up co-operatives should have 40% equity or member contributions.

[v] A state-owned organization, often used to describe cooperatives and other government controlled businesses in Africa.

[vi] The key difference between co-operative and other forms of enterprise is that a co-operative is an extension of the members’ businesses. There is a clear, unambiguous difference between owners of an investor-owned business and the business in case of a cooperative that identity is not distinct. Thus, assessing the performance of the co-operative as a distinct entity is a mistake. It is essential to look at the performance of the co-operative and its members to make an accurate assessment.

[vii] Weihe, et all, Pathways, pp 4-5.

[viii] Member equity is not the sole source of capital. In fact, many co-operatives borrow against assets similar to other forms of businesses.

[ix] New generation co-ops are an exception and due allow the value of equity to reflect the market.

[x] In the U.S. some co-operatives have classes of equity with some open to the public, but with sharply circumscribed participation in governance.

[xi] There are inherent issues in co-ops on the productive life of assets and problems of free rider, horizon and portfolio. There are also issues of control – principal, agent, influence and collective decision-making that are inherent in the cooperative structure.

[xii] This was an issue that occurred with Acopagro in Peru. See attached case study.

[xiii] Other reasons for co-op failures include:

- As a legacy of colonialism, co-operatives were formed in colonies, often by white settlers, to export goods to the mother country, and not formed as autonomous and independent group-based enterprises.
- Newly independent countries decided to use co-operatives as instruments of the State and controlled them through marketing boards.
- Many co-operatives failed because of political interference, malfeasance and lack of true member control.
- Top-down government co-operatives based on Marx-Lenin beliefs were often models adopted by some developing countries.

- Donors provided grant funds to co-operatives so why should farmers invest in their co-operatives since they obtained co-operative services virtually free. Often, implementers have view co-operatives as social organizations and not group businesses. They have undercut the business purposes through requiring them or encouraging them to carry out social activities.
- Many state dominated co-operatives failed, especially in Africa, so the entire sector got a bad reputation. Human capital including management skills are often weak where co-ops are situated.
- Co-op boards of directors have often interfered in day-to-day management operations.
- Oligarchic interests have crushed co-ops as a threat to their economic dominance.

[xiv] Other success factors include:

- Boards of directors elected by and from members only (no government representatives).
- Professional management.
- Accountability of all employees to the co-operative (no seconded personal).
- Management training and membership education.
- Willingness to use modern technology.

[xv] Weihe et all, Pathways, pp 10-11 on India, pp 31-32 for Ethiopia. India's Dairy Co-operatives and the National Dairy Development Board provide another example of the potential scale of the impact of co-operatives in bringing grassroots farmers out of poverty and connecting them with markets. The National Dairy Development Board (NDDB) was established in 1965 to help grassroots Indian milk producers reach markets and assist them with inputs and services. Its creation was rooted in India's recognition that its progress lies largely in the development of rural India. "Operation Flood," a program extending over 26 years, was funded by World Bank loans and made dairying a vehicle to a better future for millions of grassroots milk producers.The NDDB helps Indian milk producers reach markets and provides inputs and services, technical expertise and financial assistance. Innovative transport is another achievement of the NDDB. By using special rail and road tankers, milk can be moved over 2,000 kilometers to reach markets.

Since its inception, the NDDB has planned and spearheaded India's dairy programs by placing dairy development in the hands of milk producers and the professionals they employ to manage their co-operatives. In addition, the board promotes other commodity-based co-operatives, allied industries and veterinary biological on a nation-wide basis.

Today, India's 100,000 dairy co-operatives procure an average of 16.5 million liters of milk from 12 million farmer members every day. The milk is processed and marketed by 170 milk producers' co-operative unions which, in turn, own 15 state co-operative milk marketing federations. Dairy co-operatives account for the major share of processed liquid milk marketed in the country. In 1968, India's milk production was 21.2 million MT, and the per capita availability of milk was 112 grams per day. In 2003-04, those same figures were 88.1 million MT and 231 grams per day, illustrating the impressive impact of Indian dairy co-operatives.

Ethiopia provides an additional example of co-operatives moving from government control to member ownership. Co-operatives became successful when they reoriented and restructured themselves as private businesses that were able to increase member productivity and access national and international markets.

In 1997 Ethiopian co-operatives began the transition from a socialist orientation under the repressive Derg regime, to a free market, business-driven approach which has spurred economic development. U.S technical assistance has helped carry out plans to privatize business and industry by assisting agricultural co-operatives in becoming farmer-owned and -controlled, profitable and governed in a democratic fashion.

The reform government placed a high priority on food security and self-sufficiency and began to promote co-operatives as part of its rural and agricultural development strategy. Government proclamations revised outdated

provisions and supported farmer-owned and controlled co-operatives. Farmer members began democratically electing their leaders without government intervention. Co-operatives were no longer state instruments.

The recent growth and profitability of co-operatives in Ethiopia has removed their negative stigma. Market-oriented, multi-purpose primary agricultural co-operatives have restructured, with independent boards of directors and managers; and registered under new co-operative legislation. Concurrently, co-operative unions now serve as business support units for primary co-operatives, which provide greater economies of scale, bargaining power, and influence for primary co-operatives.

Governance has improved and books of accounts are regularly audited. To change and revitalize co-operatives, several interventions (in addition to improving the enabling legal environment) were critical:

- Professional managers were hired to manage the unions; board members and managers were trained, and auditors—who were previously considered “fault finders”— were trained to conduct regular audits;
- Co-operatives began to operate as businesses and to be based on profits and incentives such as patronage dividends (annual business plans are now required);
- The co-operatives achieved creditworthiness through a credit guarantee by the Commercial Bank of Ethiopia (CBE) which now provides inventory credit; and
- Savings and credit services were institutionalized for savings mobilization and members could borrow working capital for grain and other purchases - a major breakthrough in rural finance.

In Ethiopia, overall, co-operatives have become increasingly important to individual members, the community, the business sector and the national economy. More than 85 percent of the total inputs in rural areas are now distributed through co-operatives; and they are responsible for over 75 percent of coffee exports, the country’s major foreign exchange earner. Coffee unions are exporting high quality, organic and Fair Trade coffee to the United States, Europe and Japan, with premium prices.

[xvi] In a few cases, they also process the cocoa beans into cocoa liquor, butter and powder.

[xvii] When inflation is high, it is not much of a return to members.

[xviii] While community service is one of the seven ICA principles, many co-ops separate their business activities from their community ones, through the creation of a separate foundation, or out-sources to an NGO. Many co-operative development experts believe a co-operative to stick to their group-business, not take on additional activities more suited to an NGO, or local government. When co-ops do both, it creates management challenges and confusion about the purposes of a co-operative. It also adds additional management responsibilities that can distract from the co-operative business.

[xix] See Blueprint for a Co-operative Decade, January 2013 by Cliff Mills & Will Davies, Centre for Mutual Employee-owned Businesses, University of Oxford, pp. 33-37 for discussion of financing options.

[xx] These proportions can range considerably depending on the commodity, the nature of the cooperative (input supply and marketing vs integrated production, etc.).

[xxi] A fair return to members may be as high as or higher than interest on savings while the cost of capital may be lower than from financing agencies or banks.

[xxii] Typically, when I design co-op projects, I will include model farms, or model systems which the co-operative itself will expand or replicated from its business or Fair Trade income. If seconded employees are needed, they should be provided on a declining salary basis each project year.

[xxiii]While the earliest coops, such as Land O’Lakes were not funded through government loans, there are noteworthy exceptions are U.S. rural electric and telecommunication cooperatives with heavily subsided loans from REA, and production and marketing co-ops also received government guaranteed funds from the farm credit system.

[xxiv] Root Capital and other socially-based financing organizations provides loans to co-coops for short-term trade credit and pre-harvest loans with terms of up to one year that are generally oriented around a harvest or production cycle. These loans are used by borrowers to cover costs of purchasing raw product from their farmer suppliers. It is important to design these credit programs in ways that re-enforce farmer investments and member

equity including requirements that the co-op adopt member equity plans as part of the financial analysis required prior to making and agreements for such loans.
Long-term fixed-asset loans with terms of up to five years for investment in equipment and infrastructure.
[xxv] Some scholars such as Larry Harrison of Tufts University (who was also a USAID mission director in Latin America) believe that the top-down, hierarchal nature of Spanish culture inhibits co-operative development and trust bonds critical to their formation. See his publications which are Culture Matters, or the Central Liberal Truth.
[xxvi] Robert Flick, a co-operative expert with over 35 years' experience, has substantially contributed to this section, especially as it relates to Latin America.
[xxvii] This was required by CONACADO in the Dominican Republic when it was an NGO, and prior to its reorganization into an agro-business where it can retain profits, an NGO for farmer supporting services funded by donors and/or premiums and credit union so cocoa members can save and borrow.
[xxviii] Many U.S. producer co-operatives also formed credit unions for their members such as Heartland Credit Union within the Land O'Lakes co-operative system.
[xxix] In many cases, members are delinquent in paying their subscription dues which are usually very small and do not provide sufficient capital for business operations.
[xxx] The Equal Exchange/TCHO cooperative development project is attempting this approach with Fortaleza del Valle, a farmer association, in Ecuador.
[xxxi] The Rochdale pioneers were the first successful consumer co-operative as distinct from rural agricultural and credit co-operatives. Consumer co-operatives are much more prevalent in Europe than the U.S. REI recreational stores are an example of a successful U.S. consumer co-operative.

[xxxii] See history of the Pellervo co-operative movement.

Case Study

Oro Verde and ACOPAGRO Launch Member Equity Plans

In 2012, the General Assembly Meetings at Oro Verde and ACOPAGRO adopted and in 2013, they expanded their member equity plans based on the recommendations of their managers and boards of directors, and extensive field training to their local committees and delegates.

In March, 2012, Oro Verde and ACOPAGRO – both Fair Trade cooperatives located in the San Martin District, not far from Tarapoto, Peru - adopted and initiated member equity plans, likely the first for a developing country in Latin America. At its annual membership meeting, Oro Verde agreed to increase member equity in share accounts ("bono de producción") in accordance with deliveries of coffee and cocoa from US $38,200 to $122,500, a 220% increase. ACOPAGRO members agreed to increase member investment from US $278,000 to US $866,292, a 212% increase.

The major distinction between a cooperative and an investor-owned company is how they raise capital. Without investors, cooperatives raise money from their member-owners usually through retaining a portion of each member's sales as member equity in a revolving fund. Member equity is based on usage and it fuels the cooperative's growth, leverages funds from banks, expands member services and, most significantly, increases member loyalty because now they have a financial stake in their coop. Member equity is also significant for small farmer cooperatives to become financially independent, and not dependent on donors.

Under the USAID Cooperative Development Program, Equal Exchange, a highly successful and pioneering Fair Trade workers cooperative in West Bridgewater, Massachusetts, and TCHO, an innovative chocolate company on Pier 17 in San Francisco, are assisting these two supply chain cocoa cooperatives in Peru. They have installed innovative Flavor Labs and trained in sensory analysis so that farmers can taste their chocolate, usually for the first time, and understand critical post-harvest and processing improvements for higher quality cocoa. The project is also helping the coops with increased productivity through soil analysis, agronomy services and revolving funds for organic fertilizers so that they can increase sales of their Fair Trade, organic cocoa and coffee.

But, the biggest challenge is to assist the coops in adopting member equity plans so that they can grow to meet the rapidly rising consumer demand, mostly by young people, who prefer the dark, higher-quality varieties of chocolate produced by U.S. specialty fine chocolate companies.

Over three years, Equal Exchange engaged two international experts: Barry Silver, a former Peace Corps volunteer in Peru and senior vice president of the National Cooperative Bank; and Robert Flick, an international development expert in cooperatives who currently operates a family avocado farm in Ecuador. They carried out several technical assistance assignments to Oro Verde and ACOPAGRO. Robert Flick introduced the importance of member equity at their 2011 annual membership meetings in 2011 and the advisors followed up on these recommendations prior to and at the 2012 and 2013 annual meetings.

At the request of ACOPAGRO, the Equal Exchange project supported a membership education program. José Luis Bardales, a grassroots community trainer and university professor selected by the cooperative, spent a full day at each of the 38 district committees that elect delegates to the annual meeting. He explained that a cooperative is a society of persons and that family is the most important link in such people-based organizations. If the family structures are dysfunctional so are the community, coop farmer committees and related structures. By helping families organize their lives on a more healthy and functional level, the community strengthens the building blocks of the cooperative and harmonizes internal tensions. Barry Silver and his long-time friend from his Peace Corps days, Eustaquio Flores who is a professor, auditor and leader in Peruvian savings and loan cooperatives - added to these grassroots presentations the importance of member capital and ownership, rounding out the dialogue on how members can and should support their coop.

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Case Study

Oro Verde and ACOPAGRO Launch Member Equity Plans

In 2012, the General Assembly Meetings at Oro Verde and ACOPAGRO adopted and in 2013, they expanded their member equity plans based on the recommendations of their managers and boards of directors, and extensive field training to their local committees and delegates.

In March, 2012, Oro Verde and ACOPAGRO – both Fair Trade cooperatives located in the San Martin District, not far from Tarapoto, Peru - adopted and initiated member equity plans, likely the first for a developing country in Latin America. At its annual membership meeting, Oro Verde agreed to increase member equity in share accounts ("bono de producción") in accordance with deliveries of coffee and cocoa from US $38,200 to $122,500, a 220% increase. ACOPAGRO members agreed to increase member investment from US $278,000 to US $866,292, a 212% increase.

The major distinction between a cooperative and an investor-owned company is how they raise capital. Without investors, cooperatives raise money from their member-owners usually through retaining a portion of each member's sales as member equity in a revolving fund. Member equity is based on usage and it fuels the cooperative's growth, leverages funds from banks, expands member services and, most significantly, increases member loyalty because now they have a financial stake in their coop. Member equity is also significant for small farmer cooperatives to become financially independent, and not dependent on donors.

Under the USAID Cooperative Development Program, Equal Exchange, a highly successful and pioneering Fair Trade workers cooperative in West Bridgewater, Massachusetts, and TCHO, an innovative chocolate company on Pier 17 in San Francisco, are assisting these two supply chain cocoa cooperatives in Peru. They have installed innovative Flavor Labs and trained in sensory analysis so that farmers can taste their chocolate, usually for the first time, and understand critical post-harvest and processing improvements for higher quality cocoa. The project is also helping the coops with increased productivity through soil analysis, agronomy services and revolving funds for organic fertilizers so that they can increase sales of their Fair Trade, organic cocoa and coffee.

But, the biggest challenge is to assist the coops in adopting member equity plans so that they can grow to meet the rapidly rising consumer demand, mostly by young people, who prefer the dark, higher-quality varieties of chocolate produced by U.S. specialty fine chocolate companies.

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