Cooperative Model for Producer Cooperatives

Rabobank International Advisory Services
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Objective of a Producer Cooperative
Cooperative Model for a Producer Cooperatives

The primary objective of a cooperative is to maximize the benefits, which members derive from their business transactions with the co-operative.

(International Cooperative Alliance - ICA)
Key principles for a Producer Cooperative
Cooperative Principles for a Producer Cooperatives

Three Economic Principles

To guarantee success and sustainable development of a cooperative, the cooperative Rabobank has particular focused on the following three economic principles:

- Serve at cost
- Proportional principle
- Principle of self – financing
Serve at Cost Principle

Farmers in cooperative business
The cooperative does not create an independent profit but it performs at minimum cost (price) to its members. The cooperative is “a margin organiser” for its members.

However, the cooperative should make a surplus for reservation and expansion.

Non-members and clients / customers are subject to profit maximisation.
Proportionality Principle

Cooperative members: Vote by proportionality

Number of transactions (Lb/K)
Proportionality Principle

PROPORTIONALITY PRINCIPLE

• The cooperative will allocate the returns and costs proportional with the members’ turnover.

• Proportionality will be also stated in members’ rights and duties, including liabilities and voting rights (plural voting);

• Proportionality will also be applied in reservation according to members’ turnover.
Principle of Self-Financing

Farmer

Self-financing

Bank

Contribution Bank

Rabobank
The cooperative cannot, for its main business objective, attract risk bearing capital from external investors, because this would conflict fundamentally with the members’ interests.

Members have to provide themselves the risk bearing capital.

For secondary operations, external participation is possible (joint ventures etc.).

The self-financing principle is realised through liabilities, annual reservations, members’ accounts etc.
Capitalisation requires a consistent reservation policy
The First Policy: Surplus generation (Zero Loss Policy)

- Sales price of coop
- Margin to cover cost of operations
- Pre-paying price to members

Jan  Dec
3 Strategy of Producer Cooperatives
Strategy Modern Cooperatives: based on value creation

Strategy modern cooperatives: based on this primary objective, a producer cooperative must create added value in the supply chain.

Marketing and processing cooperatives need to be demand driven and not supply driven under current market conditions (creating added value for members).

It is important to make a break-down of the margins from end-market to farmer to get a better insight of the added value of a particular actor in the chain.

Added value can be defined as the difference between the price a product/service is sold at and the cost of producing the product/service. It can be stated that in general margins are bigger downstream the value chain compared to upstream the chain.
Strategy modern cooperatives: low costs or product uniqueness

| Cost leadership requires consolidation to create Economies of Scale |
| Product Uniqueness: differentiation strategy requires a contingency approach (adjustment to sub-sector market structures). The market structure and environment are the basic elements of the organization. For instance: the supply side of the market differs essentially from the demand side and the financial markets differ completely from the market for industrial processing. |
Governance Structure
Cooperative Classic Governance Structure

- **Association**
  - Board of directors
  - Members
  - Voluntary

- **Control Board**
  - Elect

- **Enterprise**
  - Manager
  - Staff
  - Remunerated

- **Hire**

- **Serve**
Lessons Learned
Lessons Learned

• Cooperatives need to be operated as a business organization for the members, mixing social and economic objectives, leads to non-transparent behavior and inefficiencies

• Marketing and processing cooperatives are most efficient if they are organized as one tier operational entities instead of a two-tier structure. Reason: resources are more concentrated

• Marketing and especially processing cooperatives require an adequate capitalization mechanism related to the turnover of members
Lessons Learned

• Experience in different parts of the world show that government controlled cooperatives are generally poorly managed, have little discipline in member-cooperative relationship, are mostly poorly capitalized and are not transparent

• The ‘business case’ of a cooperative must be strong enough. In other words the added value of a cooperative should be large enough to create a ‘healthy’ return on investment for the members

• Marketing and processing cooperatives need to be demand driven and not supply driven under current market conditions. Traditionally cooperatives were supply driven, however this was based on non-perfect market with shortages

• Proportionality in voting rights is preferred as this will tie the better and larger producer to the cooperative, which is essential for long term viability
Cases: Cooperative Capacity Building & Key Success Factors
Strengthening the dairy supply chain in Chile

CHALLENGE

- Milk prices below world market prices
- Many farmers closing down their farm activities
- Droughts and unpredictable weather patterns because of climate change
- Social tensions between minority communities and the Chilean population
- One of the drivers of the economy is the copper exports which makes the economy vulnerable for external shocks. Diversification is important
- Consumers want more added value products which requires track and trace systems

OBJECTIVES

Enhancing climate smart agriculture and to integrate minority communities in the supply chain by strengthening businesslike cooperatives

APPROACH

Based on the outcome of the dairy value chain mapping RIAS will design a comprehensive cooperative development plan.

RIAS will work on the ‘governance’ part and ‘business’ part in parallel.
A strong vertical integration, ‘one member, at least one vote’ and a solid financial base can boost cooperative development in Chile

<table>
<thead>
<tr>
<th>Farmers</th>
<th>Cooperative Legislation</th>
<th>Business Principles</th>
<th>Governance</th>
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<tbody>
<tr>
<td>Creating strong cooperatives requires involvement of all classes of farmers. Vertical integration could be a strong response to the constantly changing consumer demands and market developments in the dairy and beef chains.</td>
<td>Create room under the cooperative law to allow cooperatives to align their own organization with the specific issues in various supply chains in various regions. This can be easily done by making a set of compulsory provisions and a set of optional provisions in the law. The ‘one member- one vote’ rule creates weak and under-capitalized cooperatives. RIAS recommends to change this rule into ‘one member, at least one vote’ to allow cooperatives to deviate from this rule.</td>
<td>Cooperative enterprises can only be successful if they are based on business-like principles. Cooperatives are doomed to fail if they are based on social-political organizations. A cooperative needs a solid financial base to become sustainable and less vulnerable to all kinds of risks to which it is exposed.</td>
<td>Managing a producer cooperative requires professional management to carry out the day-o-day business. Separation of roles &amp; responsibilities is important to avoid interference from Board members in the daily activities.</td>
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Cooperative Capacity Building Thailand

Transforming from a Social-Political approach towards a business-like approach

**Cooperatives**
- The social-political approach derives from consumer cooperative structures
- The current cooperative system is not suitable anymore for producer-based cooperatives
- Based on the economic development in Thailand and international trends, the agricultural sector is more and more exposed to market forces
- Organization of cooperatives according to administrative zones and not according market needs (supply chains)
- AMCs (Agricultural Marketing Cooperatives) cannot compete with the international quality standards
- AMCs focus on providing inputs to farmers. Although this creates added value to farmers, the impact is limited.
- Facilitating processing and/or marketing activities would create much more added value
- Cooperatives should allocate the returns proportional with the members' returns

**Government**
- High Government interference
- The cooperative act is very descriptive and not very flexible
- It describes how a cooperative should be organized, how it should arrange its capitalization, how the voting should take place, etc.

**Financial Institutions**
- BAAC, the Bank for Agriculture and Agricultural Cooperatives has an impressive track-record regarding reaching-out to farmers through its joint-liability program
- One of the strategies to uplift quality of life of farmers is strengthening cooperatives, so that they create additional added value
- BAAC’s client base exists mainly of smallholder farmers. Because many farmers are aged BAAC has to attract other client segments.
### Key Success Factors Cooperative Development in The Netherlands

**A flexible cooperative law, plural voting, homogeneous membership, pragmatic governance structure, clear strategic direction**

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<th>Key Success Factors</th>
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<tbody>
<tr>
<td>Top 100 cooperatives have a turnover of &gt; 108 billion EUR and employed 156,000 persons, owned by nearly 24 million members (including double counts)</td>
<td>Capital Intensive (30-35% equity)</td>
<td>No ideological dimension</td>
<td>Adjustments governance structure based on market trends and legislation applicable in a particular sector</td>
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<td>Main sectors financial services, agriculture and purchase</td>
<td>2/3 general accounts</td>
<td>A flexible law with compulsory and voluntarily provisions</td>
<td>Board members may be composed completely of non-members</td>
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<td>Friesland Campina (Dairy), Super Unie (Sugar), Flora Holland (Flower Auction), For Farmers and Agrifirm (feed) are leading cooperatives in the Netherlands</td>
<td>1/3 member accounts</td>
<td>Differentiation in voting rights connected to the volume of members’ transactions or the amount of money invested</td>
<td>A Supervisory Board is not mandatory</td>
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<td></td>
<td>Profit retention</td>
<td>Flexibility in financial arrangements through articles of associations</td>
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<td>Liability abolished</td>
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<td>Member participation and consensus building</td>
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Key Success Factors for Cooperative Development

• Stick to economic and business principles
• Adequate governance structure
• Consistent business discipline (zero-loss & capitalization policies)
• Do not mix up governance and management
• Communication with members
• Clear business legislation