RETIREMENT OF CONTROL AND OWNERSHIP EQUITIES OF INACTIVE COOPERATIVE MEMBERS

by
Nellis A. Briscoe,
James R. Enix and
Per P. Andersen

OKLAHOMA STATE UNIVERSITY
EXTENSION RESEARCH INSTRUCTION
SCIENCE SERVING AGRICULTURE
1891
EXPERIMENT STATION

Bulletin B-659
July, 1968

CONTENTS

Retirement of Control and Ownership Equities of Inactive Cooperative Members

Nellis A. Briscoe, James R. Enix and Per P. Andersen*

A major problem confronting Oklahoma's cooperative associations today is the retirement of ownership equities of inactive members.

Most Oklahoma cooperatives are between 30 and 55 years old. This means that many of the early founders of these associations either have stopped patronizing their association or will stop in the near future due to death, retirement from farming, or for other reasons. Consequently, the problem of how cooperatives are to retire member equities belonging to these departing members is increasing in importance.

This study is an attempt to analyze some of the factors surrounding the problem of retirement of control and equities of inactive members and to make recommendations as to how an association might go about solving the problem.

Cooperative Character

An agricultural cooperative is a voluntary business organization. It is usually incorporated, and it is owned and controlled by member agricultural producers. The cooperative operates for the mutual benefit of its members or stockholders, as producers or patrons, on a cost basis after allowing for the expenses of operation and maintenance and any other authorized deductions for expansion and necessary reserves.[1]

The above definition of an agricultural cooperative sets forth the fundamental characteristics which distinguish a true cooperative corporation from other types of free-enterprise businesses. Several characteristics could be listed. However, the three basic ones are:

1. Service at cost to member-patrons.
2. Democratic control by member-patrons.
3. Limited returns on capital.

These basic characteristics stem from the inherent nature of cooperative business and give it distinctive character; they determine not only the cooperative's functions, but how the functions are performed.

---

* Formerly Professor, Associate Professor and Graduate Assistant respectively, Department of Agricultural Economics.

[1]L. S. Hulbert and Raymond F. Mischler, *Legal Phases of Farmers Cooperatives*, (Farmers Cooperative Service, USDA, Washington, D.C., Government Printing Office, 1958, FCS Bulletin 10), p. 56.

Service at Cost

Cooperatives operate on the basis of service at cost. It is important to keep in mind that the costs involved are not only the daily operating expenses but also the long-range costs connected with maintaining the assets of the corporation and providing for new investments.

Cooperatives provide service at cost by operating at a fair margin and returning savings, or net margins, above costs to patrons in proportion to their use of services.

These savings, usually called patronage dividends, are generally distributed to patrons after the end of the cooperative's fiscal year.

Democratic Control

Democrtic control is a distinguishing principle of agricultural cooperation. It is fundamental that those who are to benefit from the cooperative organization must own and control the business. Otherwise, the benefits they are seeking may not materialize, or they may go to others. In the non-cooperative business corporation, voting rights or control is associated with the amount of stock held. This is logical because the primary objective of this type of corporation is profit on capital invested; therefore, capital is the basis for organization and control. The primary objective of a cooperative corporation, however, is not profit on capital invested but services at cost. For this reason control of a cooperative corporation is associated with the member-patrons rather than with capital stock, either on the basis of "one man-one vote" or on the basis of the amount of business the individual contributes to his association.[2]

Limited Returns on Capital

Capital is as necessary in a cooperative corporation as in any other type of business corporation. It is necessary to finance buildings and equipment and to provide operating funds for the cooperative corporation. It is important to understand, however, that while the incentive to invest in non-cooperative corporations is based on expectations of profits on the capital invested, the reason for investing in a cooperative corporation is to furnish the necessary capital so that the cooperative may be able to serve its members.

The motive of the cooperative corporation is to serve its members at cost by making a profitable return on patronage rather than by making a profitable return on dollars invested. Therefore, payments for capital are usually limited to the "going rate." In other words, capital

[2]The Cooperative Law of Oklahoma specifies that each member is entitled to one vote, and no more, irrespective of the amount of patronage. Thus, voting on the basis of the amount of business is ruled out in the state of Oklahoma.

is employed in a cooperative along with management and labor as a necessary element of conducting a business, and payment for capital is considered a necessary business expenditure rather than a distribution of profits. Since the coopertive corporation as a legal entity is non-profit in purpose, its earnings are in reality savings for its members. Consequently, the cooperative cannot disperse these earnings as a profit to capital.

These basic principles or characteristics of a true cooperative are not arbitrary or accidental. They have been dictated by the major objectives of the cooperative as necessary rules of action for accomplishing the cooperative purpose which, in its final analysis, is gain or profit to the member-patrons, but not to the cooperative corporation *per se*. Adherence to these principles will not in itself guarantee success to any organization. There is no business magic in cooperation itself. It merely enables the members to do business in such a way that the benefits achieved come to them. Failure to follow these basic rules of action tends to impair cooperative character and shift the cooperative toward becoming an organization which is an end in itself instead of a means to an end.

In order to understand the problem of retirement of control and equities of inactive cooperative members it is necessary that the above mentioned basic characteristics are thoroughly understood. They will be referred to from time to time in the following sections of this paper.

Ownership And Capital

Members of cooperatives are joint owners of the cooperative business. Thus, each member should have the same basic cause for financial interest in the cooperative that he has in his own farm. The farmer has to invest in his farm as well as in his cooperative, and the profit made by the farmer does not depend upon the economic performance of his farm alone nor on the economic performance of his cooperative alone, but upon the joint economic result of the two activities.

The capital of a cooperative corporation may be classified as either equity capital or creditor capital. Equity capital is capital supplied by owners as the basic investment in the cooperative. It may be referred to as ownership or risk capital. Since the supplier of this capital is a part owner of the corporation in a real sense, he shares the risk of sustaining a loss of, or realizing a gain on the invested capital through the operation of the cooperative. Creditor capital is the capital made available on other than an ownership basis. Creditor capital is borrowed money, and the obligation of the debt must be honored by the cooperative.

In this study we are primarily interested in the equity capital, but it should be kept in mind that the creditor capital plays a very important role in financing cooperative corporations.

There are two major sources of equity capital:

1. Capital stock and membership fees.
2. Retained earnings.

Capital stock and membership fees form the core of the equity capital in stock and non-stock cooperatives respectively.

To become a member of a stock cooperative, a farmer is required to obtain a specified amount of stock in the cooperative. When associations are organized on a non-stock basis, the members are given certificates of membership upon payment of membership fees. In most instances, the capital obtained through the sale of stock or the payment of membership fees is not sufficient to provide all the equity capital needed in an association. Therefore, part of the patronage dividends (the origination of patronage dividends is explained in the previous section) is often retained in the cooperative as a means of financing. The retained dividends are in reality allocated to the members, but are kept in the cooperative, and each individual member should consider it as an addition to his total member equity in the association.

The terminology for retained equity capital varies among cooperative associations. The most common terminology includes: deferred patronage refunds, certificates of equity, capital certificates, capital credits, certificates of indebtedness, advance funds, revolving funds, withholdings repayable, certificates of interests, capital retains, and book credit. In addition, retained dividends may be distributed or allocated in stock. In any case, however, the retained dividends constitute an investment made by the individual member in his cooperative association, and the problem confronting cooperatives is how to retire these investments to the investors when they no longer can benefit from the services of the association.

The Importance of Retiring Control And Ownership Equities of Inactive Cooperative Members

Implications on Member Relations

When a farmer becomes a member of a cooperative association he usually has an understanding that he is to receive services at cost. He is informed that all revenues above costs in the cooperative are savings to him and the other member in the association. When part of this patronage is retained in the cooperative as a necessary investment to pay for creditor capital or to expand the corporation, he is informed that his member equity in the association has increased by the amount retained.

When a member can no longer benefit from the services of the association, he usually wants to convert his accumulated investment into a more liquid asset. This is where the problems of retirement of ownership equities to inactive cooperative members arise. If funds have not been set aside for that purpose, the cooperative may not be able to retire the members' ownership equities and remain financially sound. If the ownership equities are not retired to a retiring member, he is not receiving service at cost. The retiring member would be merely contributing to the welfare of future members who are taking over his investment "free of charge" unless adequate provisions were made to compensate for the use of this equity.

Today's farming requires large amounts of capital. It is altogether possible that a young farmer faced with a large capital requirement in his farm, as well as evidence that investments and other equities in his cooperative probably never will be returned to him, will decide to market his products and buy his supplies from some type of business organization other than a cooperative association. Failure to provide a method for retiring ownership equities of inactive members may discourage potential members from joining a cooperative.

Let us look at a hypothetical example. Assume that a member has been marketing most of his wheat through a cooperative grain elevator for many years. Due to age, he now decides to retire from farming. Suppose that the cooperative grain elevator has been retaining part of the members' savings over the years and the retained savings allocated to an individual member have accumulated to, say, $5,000. If the member is to receive service at cost, the $5,000 would be available for him when he retired from farming. But the cooperative grain elevator does not have a provision in its by-laws which provides a satisfactory method for the retirement of member equities. Furthermore, the current year's savings are not large enough to supply the $5,000. As a result, the cooperative does not have the $5,000, even though the board of directors may feel that it would be appropriate to make the payment. This problem is largely one of the lack of adequate long range planning. The problem might have been avoided if the cooperative had had a positive policy for retirement of ownership equities.

Therefore, it is important to designate funds for purposes of retirement of ownership equities, and negligence of provisions for retiring member ownership equities may cause serious damage to the whole agricultural cooperative structure.

Implications on Control and Ownership

As stated earlier, democratic control is one of the basic characteristics of a true cooperative association. The control as well as the ownership of the cooperative should be in the hands of the member-patrons. To adhere to this principle it also is essential to retire voting rights of members who, for various reasons, cease to patronize their association. If this is not done, the proportion of members patronizing the cooperative is likely to decrease and cause the bulk of control and ownership to shift from active member-patrons to non-patronizing members. A study made by Manuel[3] illustrates this point. In this study Manuel found that 16.8 percent of all marketing and purchasing cooperatives in Kansas in 1950 showed more than 33 percent of their members as non-patronizing. The average percentage of non-patronizing members for all Kansas cooperatives was 18.6; that is, almost 20 percent of all members were not active patrons. If the cooperative is to continue to serve its purpose of providing services at cost, it is essential that control and ownership be with the active member-patrons. An outstanding authority in the field of cooperation, Dr. Marvin A. Schaars of the University of Wisconsin, states:

> **Absentee ownership of a company's assets and non-patronizing members are not conducive to, nor symbolic of, cooperation. Hence, retention of ownership and control in the current users of the association instead of in those who no longer are active patrons is important in keeping the cooperative character of the business.**[4]

The Cooperative Marketing Association Act of Oklahoma is very specific concerning loss of voting rights. It says: "A member shall lose his membership and voting rights if he ceases to belong to the class of persons eligible for membership."[5]

Reasons Why Members May Become Inactive

There are many reasons why a member may become inactive in his association. The reasons may be groups as follows:

1. Death of the member,
2. The member quit farming,
3. The member moved out of the community,
4. Other reasons.

---

[3]Milton L. Manuel, *Retiring Control and Equities of Inactive Co-op Members*, (Agricultural Experiment Station, Kansas State College, Circular 346, 1957).

[4]Marvin A. Schaars, "Basic Principles of Cooperatives—Their Growth and Development," *American Cooperation* (Washington, D. C., American Institute of Cooperation, 1951), p. 837.

[5]Corporation Laws of the State of Oklahoma, Section 11, Art. 9, Chapter 38, S. L. 1937.

We are primarily concerned with provisions for retirement of ownership equities belonging to members who cease membership due to one of the first three reasons. The cases in group four would have to be considered individually. Most likely, there are cases in this group where retirement of member equities is not appropriate.

If, for financial reasons, an association is unable to retire ownership equities to members at the time they cease membership, the above grouping may be useful to establish a priority for retiring the ownership equities. This will be discussed further in the section dealing with recommendations.

Ownership Equities And Voting Rights of Inactive Members

Oklahoma Legislation Concerning Cooperatives

The Cooperative Marketing Association Act of 1937, also known as the Cooperative Law of Oklahoma, 1937, forms the legal framework within which agricultural cooperative associations in Oklahoma operate.

The Act is not specific concerning retirement of member equities. Paragraph (1) of the section entitled, "Articles of Incorporation" reads in part as follows:

> **In addition to the foregoing, the Articles of Incorporation may contain any provisions consistent with law with respect to . . . the issuance, retirement and transfer of its stock, if formed with capital stock, . . .[6]**

Paragraph (2) in the section entitled, "By-Laws" states in part that the following matters, among others, may be covered in the by-laws:

> **. . . the method, time and manner of permitting members to withdraw or to transfer their stock; the manner of assignment and transfer of the interest of members; the mode, manner and effect of the expulsion of a member; the manner of determining the value of a member's interest and provision for its purchase by the association upon the death or withdrawal of a member or upon the expulsion of a member or forfeiture of his membership.[7]**

Note that the statute reads that these are provisions which *may be* included in the articles of incorporation and which *may be* included in the by-laws of an association. There are no statements to the effect that such provisions *shall be* included.

[6]Corporation Laws of the State of Oklahoma, Section 7, Art. 9, Chapter 38, S. L. 1937.
[7]Corporation Laws of the State of Oklahoma, Section 10, Art. 9, Chapter 38, S. L. 1937.

In contrast, however, the section of the Act entitled "Members-Stock" is positive in stating membership and voting rights of members. This section states in part:

> **A member shall lose his membership and voting rights if he ceases to belong to the class of persons eligible for membership under this Section, but he shall remain subject to any liability already incurred by him as a member of the association and shall be entitled to receive from the association within three years after his ceasing to be a member the value of his membership interest in the association subject to the conclusive appraisal by the Board of Directors. . .**[8]

Thus, the Oklahoma law clearly and definitely states the terms and conditions under which a member shall lose his membership and voting rights. Membership termination for these reasons appears, under the existing law, to be automatic. The cooperative really has no voice in the matter. The law also is positive in that the member shall be entitled to receive the value of his membership interest in the association. But the law is not definite in stating what would be included in the membership interest, because this interest is subject to conclusive appraisal by the board of directors. The law simply says that the member *shall* be entitled to receive whatever fruits the board decides that the member should receive.

The state law appears to open the door for cooperatives and invites them to provide for the retirement of member equities. This invitation is apparent in the section pertaining to the Articles of Incorportaion, as well as in the section on by-laws. The state law is permissive in part, as it relates to provisions for the retirement of member equities. The membership of each cooperative should provide for a policy for a satisfactory retirement of member equities.

Oklahoma Legislation Concerning Unclaimed Property

Most local and state governments are looking for additional funds to finance the expanding public expenditures. Some states are finding vast treasures in forgotten and unclaimed bank accounts and safety deposit boxes, unclaimed dividends, utility-company deposits, bonds, traveler's checks, wages, insurance, condemnation awards, income-tax refunds, and Social Security payments. New laws which are closely related to the ancient legal principle of escheat, the appropriation by the state of property which has no owner, are being adopted or are being

---

[8]Corporation Laws of the State of Oklahoma, Section 11, Art. 9, Chapter 38, S. L. 1937.

given serious consideration in many states. Escheat laws are presently in effect in 15 states.

An unclaimed property law for the state of Oklahoma was passed by the 31st session of the Oklahoma legislature. This law, named "Uniform Disposition of Unclaimed Property," specifically mentions unclaimed dividends and certificates of ownership in cooperatives. Section 5 of the law reads as follows:

> **Any stock or other certificate of ownership, or any dividend, profit, distribution, interest, payment or principal, or other sum held or owing by a business association for or to a shareholder, certificate holder, member bondholder, or other security holder or a participating patron of a cooperative, who has not claimed it, or corresponded in writing with a business association concerning it, within fourteen (14) years after the date prescribed for payment or delivery, is presumed abandoned if:**
>
> **(a) It is held or owing by a business association organized under the laws of or created in this state; or**
>
> **(b) It is held or owing by a business association doing business in this state, but not organized under the laws of or created in this state, and the records of the business association indicate that the last known address of the person entitled thereto is in this state.[9]**

Effect of Unclaimed Property Legislation in Other States

In order to estimate the effect of the law on farmer cooperatives, a mail survey was conducted among other states where unclaimed property laws have been in effect for a longer period of time. It was assumed that such a survey would indicate some general implications of an unclaimed property law on farmer cooperatives even though the laws differ from one state to another. The survey was conducted in the spring 1967. Mail questionnaires were sent to 12 states and replies were received from nine.

The following three questions were asked in the survey:

(1) Does the unclaimed property law in your state include equities of inactive members of farmer cooperatives?

(2) If yes: Under what conditions are equities taken over by the state?

(3) If no: Do you believe that the law may be extended to include equities of inactive members in farmer cooperatives in the near future? Additional comments were invited.

[9]Oklahoma Session Law Service 1967, 31st Legislation First Session (Vernon Law Book Co., Kansas City, Mo.), p. 165.

On the basis of the survey the following general conclusions can be drawn.

1. Most state unclaimed property laws apply to farmer cooperatives. However, only a few cases were reported where a state actually has taken over equities of inactive cooperative members. Some uncertainty was reported from two states as to whether the state unclaimed property laws apply to farmer cooperatives.

2. The answers obtained from the survey indicate that the state unclaimed property laws have caused very few problems for farmer cooperatives. However, some of the respondents indicated that changes in by-laws might be necessary to avoid problems in the future.

3. Some states have provisions that allow cooperatives to transfer equities of inactive members into educational funds or into the income of the cooperative, providing that the inactive members cannot be located.

It seems reasonable to conclude from the survey that state unclaimed property laws have had little effect on farmer cooperatives. However, a small change in the text of the laws or a more strict enforcement of the existing laws could impose financial problems for cooperative associations. It is important, therefore, that each cooperative review and make any necessary changes in its by-laws so that the ownership equities of inactive members may be retired before they are considered abandoned and thereby eventually become property of the state.

Research and Appraisal of Problems Associated with Retirement of Ownership Equities

Review of the literature reveals that very little formal study has been made of the problems associated with the retirement of inactive members' equities in cooperative associations. Research has been conducted and studies have been made which relate to the problem but only two research studies have been found by the authors that deal directly with the subject of the retirement of member equities in cooperative business associations. The studies were made by Manuel[10] and Manasco[11], respectively. Manuel found that more than one-fourth of all cooperative associations in Kansas in 1950 had more than 25 percent inactive members. Only 10 percent of all cooperatives in Kansas in 1950 reported having a policy that retired the control or the financial interests, or both, of inactive members. From his study, Manuel concluded that a large percentage of inactive members made the cooperative less effective.

[10]Milton L. Manuel, *Retiring Control and Equities of Inactive Co-op Members* (Agricultural Experiment Station, Kansas State College, Circular 346, 1957).

[11]Chester Hughes Manasco, *An Analysis of the Distribution of Patron Equity in Selected Cooperatives in Mississippi 1955-1962* (Unpublished M.S. thesis, Department of Agricultural Economics, State College, Mississippi, 1965).

He further suggests that as the cooperative associations become more mature, a major problem confronting them is that of inactive members. Unless remedial action is taken, inactive memberships may accumulate and jeopardize the soundness of a cooperative.

The study of Manasco was based on a sample of ten cooperatives in the state of Mississippi. He found that about one-fourth of the total equity holdings of those cooperatives belonged to inactive members. He further found that the cooperatives under survey generally retained member equities longer in the case of inactive members than was true for active members. Although Manasco's study does not specifically deal with the problems involved when a large proportion of the member equities is owned by inactive members, it is clear from his recommendations that he considers these problems of importance.

Although little research has been made in the field, many students of cooperatives have recognized the importance of making provision and developing procedures for the retirement of inactive members' interests in their cooperative associations. Phillips writes:

> **The turnover of membership in the cooperative association should be specifically provided for in the articles of incorporation of the cooperative. This is usually most satisfactorily accomplished by provisions for repaying the individual's membership stock . . . when he retires, moves out of the community, or for other reasons ceases to be an active patron of the association. Associations have sometimes gotten into difficulty by retaining inactive memberships on the roles of the association.**[12]

Hulbert and Mischler, both of whom are highly respected students of cooperation, recognize the importance of the problem. They state:

> **At the time as association is formed, . . . an association formed with capital stock should include suitable provisions so that all voting stock may be kept in the hands of active patrons. Consideration should also be given to the inclusion of provisions with respect to suspending the voting power of members or stockholders in the event they become inactive. Under the cooperative statutes, associations usually have great latitude with respect to these matters.**[13]

The Bingham Cooperative Marketing Act, which became a model for many cooperative statutes enacted in other states, refers to the neces-

[12]Richard Phillips, *Managing for Greater Returns in Country Elevator and Retail Farm Supply Business* (Des Moines, Iowa: Farmers Grain Dealers Association of Iowa, 1957), p. 248.

[13]L. S. Hulbert and Raymond F. Mischler, *Legal Phases of Farmers Cooperatives* (Farmer Cooperative Service, USDA, Washington, D. C., Government Printing Office, 1958, FCS Bulletin 10), p. 56.

sity of the cooperative association providing in the by-laws a procedure for handling member equities upon the death of a member or upon withdrawal from the association for other reasons.[14] The Act states in part:

> **Each association, under its by-laws, may provide for any or all of the following matters: . . . the conditions upon which and time when membership of any member shall cease; the automatic suspension of the rights of a member when he ceases to be eligible to membership in the association; and the mode, manner and effect of the expulsion of a member; the manner of determining the value of a member's interest and provision for its purchase by the association upon the death or withdrawal of a member or stockholder, or upon the expulsion of a member or forfeiture of his membership, or at the option of the association, the purchase of a price fixed by conclusive appraisal by the board of directors.[15]**

Under the heading "Principles for Financing" Roy states: "Ownership and control should always be vested with active patrons."[16] He touches the problem of retiring control and equities in a section called "Summary of Principles Regarding Equity Capital."[17] He suggests that the right to acquire and to hold voting securities be restricted to patrons of the cooperative. This should be enforced by the existence of a positive provision by which voting securities held by persons who cease to qualify as voting members of the cooperative are canceled and converted into non-voting securities. He further suggests that the board of directors should have authority to pay out, whenever in its judgment the cooperative has cash funds available for the purpose, non-voting securities held by the estates of persons who have died, or held by firms adjudicated bankrupt, or by persons who have moved from or who no longer operate in the trading area served by the cooperative.

Thus the importance of provisions for handling the retirement of members' equities is recognized. Suggestions are made that it *should* be done or that the by-laws provide that the board of directors *may* have the authority to formulate a method or policy for retiring equities, but little is said as to how it *shall* be done. In fact, there are few references to the effect that a procedure *shall* be prescribed.

Several nationally prominent cooperative leaders, who currently are

---

[14]The Bingh m Cooperative Marketing Act was the cooperative law of the state of Kentucky from 1922 to 1966.

[15]L. S. Hulbert and Raymond F. Mischler, *Legal Phases of Farmers Cooperatives* (Farmers Cooperative Service, USDA, Washington, D. C., Government Printing Office, 1958, FCS Bulletin 10), p. 303.

[16]Ewell Paul Roy, *Cooperatives: Today and Tomorrow* (The Interstate Printers and Publishers, Inc., Danville, Illinois, 1964), p. 319.

[17]Ewell Paul Roy, *Cooperatives: Today and Tomorrow* (The Interstate Printers and Publishers, Inc., Danville, Illinois, 1964), p. 345-46.

working with cooperative organizations at local and regional levels, were contacted for information on policies for retiring the equities of inactive members. Quotations from some of their letters follow:[18]

Letter 1:

Few researchers have dealt with this problem. I agree with you that this is a very serious and growing problem. I am sorry I cannot help you more.

Letter 2:

I personally know of no publications dealing definitely with the matters of which you inquire. However, we recognize that this is a problem of continuing and increasing importance—for many reasons.

Letter 3:

There are no pieces of literature, bulletins, pamphlets or other pieces of processed material in this state that deal with the retiring control and equities of cooperative members who are no longer active in their associations.

The problem to which you refer is becoming more real every year and it is my feeling that each organization should have some plan whereby an individual can receive the value of his accumulated equities in a cooperative after he ceases to be identified as an active member in the organization. I feel surely that this is a matter that will require action by each individual organization.

Letter 4:

I have searched office files and . . . have been unable to get anything in the way of bulletins, research data, or pamphlets on the subject of Retiring Control and Equities of Inactive Cooperative Members. I agree with you that we have problems in this area and it would be a real live subject for someone to dig into. Cooperatives have reached the age where there should be a more or less uniform method of handling the problems now coming to the surface.

The Present Situation In Oklahoma

A survey completed in 1965 shows there is a wide range of provisions for the control and retirement of member equities in Oklahoma cooperatives. Some cooperatives have rather complete and positive provisions. Others have no provision for the retirement of member equities.

[18] Personal correspondence.

Some of the questions asked in the survey are stated below.

Managers were asked (in personal interviews):

(1) Age of the association.

(2) The percent of active members of the total stockholder members.

(3) The percent of total business that is member business.

(4) Details of the plan being used in retiring member equities.

(5) Why it was adopted.

(6) How the plan was financed.

(7) Its effect upon the cooperative.

(8) Its relation to the cooperative's finances.

(9) Special problems in carrying out the plan.

Without going into details, answers to these questions were generally as follows:

(1) Most Oklahoma cooperatives were organized during the period 1910-1940. In other words, most of them are between 30 and 55 years old. This also tells us that many of the early founders of these associations have now departed from our midst and death is rapidly reducing the ranks of those now living. These two factors, death and retirement from farming, focus attention on how cooperatives are to retire member equities.

(2) Most of the business done by cooperatives is with their active member stockholders. However, methods for and time of determining who are active and inactive members is not a definite policy with most associations. Some managers did not know the number of active members in the association. Neither could the number of inactive members be determined. Some could not recall that such a determination was ever made by their association. Others reviewed their active membership once each year, or more often.

(3) Most cooperatives have some type of a policy for retiring member equities, but a few do not have a policy. Most managers did not know why the policy followed by their association was adopted, probably because the present manager was not the manager at the time the policy was adopted.

(4) Some associations have a predetermined policy provision in the by-laws whereby *positive* action *shall* be taken when a member stockholder stops patronizing the association because of death or because he disposes of his farming interest. Others do not have a provision for taking positive action; instead, this matter is left to the discretion of the board of directors who *may* take action.

(5) None of the cooperatives surveyed had a *positive* policy for retiring member equities for members who cease patronizing the association for reasons other than death or retiring from farming.

(6) No special provisions are generally made for retiring member equities. In years when savings are substantial, some associations set aside a fund to be used to retire member equities. Most associations, however, retire member equities out of current operating capital.

The problem of financing the retirement of member equities was of considerable concern to most managers interviewed. Some members have equities between five and ten thousand dollars in their association. Death or retirement of several members with such large ownership equities could place a heavy financial load on the association.

Observed also was the steady increase in the value of the assets of cooperatives. This fact, coupled with the decline in the number of farms in Oklahoma emphasizes a question which eventually will confront most cooperative members. Sooner or later, farm operators with large capital outlays in their farming operation will ask the question of how much they should invest in their cooperative, or if they should use this capital in other phases of farming operations. This is a serious question.

(7) Cooperatives that have a positive policy for retiring member equities believe that such a policy adds strength, confidence, and cooperative character to their organization. A known, predetermined provision relieves the board and manager from the necessity of handling the retirement of member equities on a "catch as catch can" basis. In addition, members are more willing to provide financial support to their organization.

(8) Most cooperatives are not satisfied with their policy for retiring member equities. Although they may have a positive policy in this regard, and although they may be in a sound financial position to back the policy, they still feel their program is inadequate.

Most associations which have a policy feel that it should be more definite and positive. In most instances, management would favor a more positive policy for financing the retirement of member equities.

Recommendations

A policy to retire financial interests of inactive members is recommended for all cooperative associations.

As previously stated, the Oklahoma law clearly and definitely states the terms and conditions under which a member shall lose his membership and voting rights. Retirement of control therefore appears to be automatic under the existing law, assuming that every association complies with the state law. The Oklahoma law does not, however, definitely state the rules for retirement of financial interests. It is therefore up to the individual association, through provisions in its by-laws, to establish a policy to retire financial interests if such a policy is wanted by its members.

Cooperative associations which are interested in a positive policy to retire ownership equities of inactive members may wish to consider the following recommendations.

1. Establishment of a cash retirement reserve fund. Annual allocations could be made to this fund from the annual earnings. The amount allocated could be determined on the basis of estimated future requirements of funds for retirement purposes as well as on the basis of the current financial position of the association. The money set aside in the fund should be used exclusively for the retirement of equities of inactive members. The establishment of, and the allocation to the retirement reserve fund should comply with Internal Revenue regulations and the Oklahoma law.

This recommendation is to be considered as a possible long-range solution. It is likely that the amount of funds needed for retirement purposes will exceed the amount available from the retirement reserve fund simply because the association is not in a position to make the necessary allocations. This will be particularly true during the beginning of such a policy. The following recommendation is focused on this problem.

2. Establishment of a priority rank for retiring member equities. This priority rank should be applied in cases where retirement of financial interests of all inactive members upon demand involves too heavy a burden on the finances of the association. In terms of the above long-run solution, such a priority rank should be applied when the funds required for retirement purposes exceeds the amount present in the retirement reserve fund. In the priority rank, preference should be given to cases where circumstances are beyond the immediate control of the member. The following priority rank is recommended.

a) Retirement of equities due to death of a member.
b) Retirement of equities to members who either move out of the community ,or quit farming but stay in the community.
c) Retirement of equities to members who could, but do not, patronize their cooperative.

3. By-laws should be amended to authorize the retirement of member equities. Amendment of by-laws is a legal matter, and should be done only with the counsel of a person who is familar with cooperative law. Cooperative associations may wish to consider the recommendations made under items one (1) and two (2) for forming a by-law provision for retirement of member equities. The provision should define how to determine the amount of money to be allocated to the retirement reserve fund, this amount depending upon the current and estimated future needs of funds for retirement purposes.

Summary

The three basic characteristics of a true cooperative association are service at cost, democratic control, and a limited return on capital. These three characteristics have been maintained not for their own sake but because they have proven to be of vital importance for a cooperative to accomplish its final purpose, gain or profit to the member-patrons. Retirement of control and ownership equities of inactive members is an important factor in maintaining these basic characteristics in an association. If control by a member is not retired when a member ceases to patronize the cooperative, the principle of democratic control is altered; and if ownership equities are not retired when a member ceases to patronize, the principle of service at cost is altered.

Ignoring retirement of ownership equities when a member ceases to patronize his cooperative may seriously damage the whole cooperative structure. Potential members may be discouraged from joining a cooperative if they think that their financial interests in the association will not be retired, at least not within their lifetime. On the other hand, retirement of equities on demand may cause a serious financial hardship on an association. This is particularly true if no action has been taken in the past to provide for funds for future retirement purposes.

The Oklahoma law specifically provides for retirement of control but not for retirement of equities. It is therefore left to the individual cooperative associations to establish a by-law provision for retirement of ownership equities of inactive members. A survey of Oklahoma cooperatives showed that a number of associations do not have such a by-law provision.

It is recommended that all cooperative associations establish a positive policy to retire ownership equities of inactive members. In addition, it is recommended that each association establish a cash retirement reserve fund. Annual allocations from earnings should be made to this fund. The amount allocated should be determined by the position of the individual association and by the estimated future need for funds for retirement purposes. It is further recommended that each association establish a priority rank for retiring ownership equities. This priority rank should be applied in cases where the financial position of an association does not permit retiring ownership equities of inactive members on demand.

Bibliography

Corporation Laws of the State of Oklahoma. Office of the Secretary of State, 1938.

Hulbert, L. S. and Raymond F. Mischler. *Legal Phases of Farmers Cooperatives* (Farmers Cooperative Service, USDA, Washington, D. C., Government Printing Office, 1958, FCS Bulletin 10).

Manasco, Chester Hughes. *An Analysis of the Distribution of Patron Equity in Selected Cooperatives in Mississippi 1955-1962,* (Unpublished M. S. thesis, Department of Agricultural Economics, State College, Mississippi, 1965).

Manuel, Milton L. *Retiring Control and Equities of Inactive Co-op Members* (Agricultural Experiment Station, Kansas State College, Circular 346, 1957).

Oklahoma Session Law Service 1967, 31st Legislature First Session (Vernon Law Book Co., Kansas City, Mo.)

Phillips, Richard. *Managing for Greater Returns in Country Elevator and Retail Farm Supply Business* (Des Moines, Iowa: Farmers Grain Dealers Association of Iowa, 1957).

Roy, Ewell Paul. *Cooperatives: Today and Tomorrow* (The Interstate Printers and Publishers, Inc., Danville, Illinois, 1964).

Schaars, Marvin A. "Basic Principles of Cooperatives—Their Growth and Development," *American Cooperation* (Washington, D. C.: American Institute of Cooperation, 1951) p. 835-852.

U. S. Department of Agriculture. *Farmer Cooperatives in the United States,* (Farmers Cooperative Service, FCS Bulletin 1).