Developing Cooperatives
for the Alaska Seafood Industry

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In the Russian Far East, Andrew established business development centers and managed a joint venture that built meat processing plants for state reindeer herding farms. He also coordinated privatization auctions of large Soviet enterprises for the International Finance Corporation, and managed a program that assisted nongovernment agencies.

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Much of his work in Alaska has focused on the fledgling farming industry. He owns a farm in Delta Junction, Alaska, where he grows barley and canola. He has also worked on commercial fisheries studies. As an economist he is a strong proponent of Alaska's need to enter value added industries instead of shipping raw natural resources elsewhere for processing.

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What Is a Cooperative?

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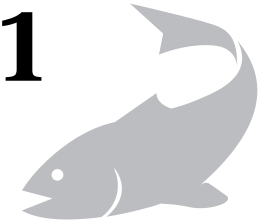

According to the U.S. Department of Agriculture, Alaska has only a small percentage of the nation's cooperatives.[1] Despite this, there is plenty of talk about cooperatives in Alaska and how they can improve the seafood industry's bottom line. Cooperatives have proven to be an effective tool in agriculture for farmers to increase farm income and reduce costs. Cooperatives offer a model for Alaska seafood producers to work cooperatively to open new markets, create locally controlled processing, and pool purchasing power, which can help small seafood producers meet the challenges of today's business environment.

How can a cooperative help a seafood operation?

- Is the ever-escalating price of fuel and other supplies about to sink your fishing business?
- Are low prices limiting your profitability?
- Is getting vessel or health insurance more costly, more difficult, or just impossible?
- Is your processor considering closure?

These are just a few of the many problems Alaska's owner-operated seafood producers face. The owner-operator model is a good way to keep a healthy seafood economy close to the fishing grounds and coastal communities. More and more, markets are responding positively to small food producing operations. But small operations can be overwhelmed in today's global economy.

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[1] Source: United States Department of Agriculture. Rural Development, Business and Cooperative Programs, http://www.rurdev.usda.gov/rbs/coops/table05.xls.

Kurt Byers photo

A salmon gillnetter plies the waters of Prince William Sound. Alaska fishermen, the "farmers of the sea," have many similarities with their terrestrial brethren. As farmers have known for years, fishermen can also find many useful applications for cooperatives in their operation.

A small operator uses a modest amount of supplies and produces small volumes relative to total seafood production. Individuals have limited time, limited resources, and limited expertise to solve problems and create greater product value. For Alaska's small seafood producers, cooperatives may be one way to overcome these hurdles.

Cooperatives can blend marketing, transportation, supply purchase, and processing capacity into a single organization. Through a cooperative, members can increase product quality, bargaining and purchase power, market access, and ultimately profitability.

Description of a cooperative

Cooperatives are user owned, democratically controlled businesses where the member-owners benefit in direct proportion to how much they use the cooperative's services. Through cooperatives,

Cooperative Principles

Cooperatives arose from a nineteenth century movement based on a set of seven "Rochdale" principles. In 1995 the International Cooperative Alliance adopted the latest revision of the guidelines by which cooperatives put their values into practice.

1st Principle: Voluntary and open membership
Cooperatives are voluntary organizations, open to all persons able to use their services and willing to accept the responsibilities of membership, without gender, social, racial, political, or religious discrimination.

2nd Principle: Democratic member control
Cooperatives are democratic organizations controlled by their members, who actively participate in setting their policies and making decisions. Men and women serving as elected representatives are accountable to the membership. In primary cooperatives, members have equal voting rights (one member, one vote) and cooperatives at other levels are also organized in a democratic manner.

3rd Principle: Member economic participation
Members contribute equitably to, and democratically control, the capital of their cooperative. At least part of that capital is usually the common property of the cooperative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership. Members allocate surpluses for any or all of the following purposes: developing their cooperative, possibly by setting up reserves, part of which at least would be indivisible; benefiting members in proportion to their transactions with the cooperative; and supporting other activities approved by the membership.

4th Principle: Autonomy and independence
Cooperatives are autonomous, self-help organizations controlled by their members. If they enter to agreements with other organizations, including governments, or raise capital from external sources, they do so on terms that ensure democratic control by their members and maintain their cooperative autonomy.

5th Principle: Education, training, and information
Cooperatives provide education and training for their members, elected representatives, managers, and employees so they can contribute effectively to the development of their cooperatives. They inform the general public—particularly young people and opinion leaders—about the nature and benefits of cooperation.

6th Principle: Cooperation among cooperatives
Cooperatives serve their members most effectively and strengthen the cooperative movement by working together through local, national, regional, and international structures.

7th Principle: Concern for community
Cooperatives work for the sustainable development of their communities through policies approved by their members.

While cooperative principles are incorporated in government definitions of cooperatives like the USDA definition of cooperatives, the IRS code, or the Alaska Cooperative Corporations Act, they also remain an essential part of the cooperative movement. In fact, cooperatives, national cooperative organizations, and international associations, like the ICA, consider any business that adheres to cooperative principles a cooperative, regardless of how it has been "officially" registered.
—International Cooperative Alliance.

producers can own and control the middlemen who sell their seafood or who sell them the fuel and supplies they need.

For example, a cooperative might be a group of hagfish fishermen who join together to market fresh, kippered, and salted hags. Through their cooperative board, the members hire a management team that handles the details of selling the fish. When it has paid its costs of operation, the cooperative passes all of the surplus earnings back to its member-owners based on how much fish they delivered, otherwise known as patronage refunds. For these fishermen, there will be no "haggling" over price with the processor because they are the processor.

A cooperative is a user owned and democratically controlled business in which benefits received are in direct proportion to use.
—USDA

A cooperative is a legal entity. In Alaska, a cooperative is registered under the Alaska Cooperative Corporations Act (Alaska Statute 10.15). While it is not necessary to register as a cooperative to act cooperatively, registration makes it is easier to take advantage of many programs that give cooperative businesses priority (like federal programs specifically for cooperatives and IRS tax exemptions).

A cooperative will own whatever equipment and assets are necessary to conduct business. It does not own any of its members' personal business property, unless the members agree to transfer property to it. If successful, the cooperative will be staffed by professionals who manage the cooperative while the members focus on running their own fishing businesses.

It is important to remember that a cooperative is a business. Like any other business, a cooperative needs to pay its employees, cover operation costs, and make needed investments for operation and expansion.

Types of cooperatives

There are two types of producer cooperatives—marketing cooperatives and supply or purchasing cooperatives.

Many Alaska fishermen are interested in **marketing cooperatives** as a way to market their fish. Marketing cooperatives can be as simple as having a person call up buyers for the cooperative members, or as complicated as creating an organization that can process, store, advertise, and sell its members' fish.

Purchasing cooperatives reduce the costs of goods, supplies, and services by pooling their member's orders to improve their negotiating position. Farmers in traditional agriculture operations, for example, often form fuel supply cooperatives to get better prices. For fishermen, a purchasing cooperative might be a good way to get cheaper fuel, bait, gear, and other necessities.

Comparing Cooperatives with Other Businesses

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There are several considerations when forming a business, including minimizing personal risk and taxes, the ease of creating the business and raising money for its operation, and the type of decision-making process it will use to manage its affairs. This chapter uses these considerations to compare cooperatives, limited liability companies (LLCs), and S corporations.[2]

When to form a cooperative

Different types of business entities include sole proprietorship, partnerships, limited partnerships, C Corporations, S Corporations, and LLCs. Our discussion here relates to small start-up businesses that involve more than one person and do not require millions of dollars of investment.

If you are considering forming a business with a group of people, you will not be setting up a sole proprietorship (a business with one owner). You should be concerned about limiting liability or personal risk, and you will probably not want to set up a partnership. Partnerships do not limit liability and each partner becomes fully responsible for the business's debts and for the actions of all the other partners. With a partnership, the more owners/partners you add, the more risk you take on. You could set up

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[2] An S corporation is a profit-making corporation whose shareholders have applied for and received Subchapter S corporation status from the Internal Revenue Service. S corporation status limits the liability of the corporation's owners/shareholders, while taxing it like a partnership, sole proprietor, or LLC. That is, instead of being taxed as a separate entity (as would be the case with a regular or C corporation), an S corporation is a pass-through tax entity; income taxes are reported and paid by the shareholders, not the S corporation.

An LLC is a business ownership structure that offers its owners the advantage of limited liability (like corporations) and partnership-like taxation, in which profits are passed through to the owners and taxed on their personal income tax returns (source: www.nolo.com).

a limited partnership to protect investors from liability, but the active partners would still be at risk and an LLC or S corporation will achieve the same thing more easily.

For a business involving a group of people, there is no advantage to forming a C corporation that pays its owners/investors through dividends. C corporations are a good way to raise large amounts of capital, but they are complicated to set up, and their owners pay double taxes on profits, first as a corporate income tax and then as an unearned income tax on dividends.

All businesses must have enough volume to cover their costs. Because cooperatives do most of their business with their member-owners, they must have enough members to provide the volume needed to cover the costs. While it is conceivable that a small number of producers could generate enough volume, it is more likely that a cooperative will need to have five or more members.

In the circumstances where cooperatives can work, where you have a group of producers looking to start up a small business and who want to limit their risk, the most likely kinds of businesses you will consider are cooperatives, LLCs, and S corporations.

Similarities among cooperatives, LLCs, and S corporations

Cooperatives, LLCs, and S corporations are very similar in the way they minimize personal risk, they way they are taxed, and the legal requirements to set them up. All of these types of businesses limit their owners' financial risk to the amount they have invested in the business. The entities pass surplus earnings or profits through to their owners. The business does not pay income taxes. Income tax is assessed on distributions to owners, who pay the tax as part of their individual tax returns. (See Chapter 7 for an expanded description of taxation considerations.) And finally, all three organizations require that the owners file articles of incorporation with the state, and adopt bylaws or operating agreements that regulate how the business will be governed. S corporations require filing an additional form with the IRS to certify their tax status.

Differences among cooperatives, LLCs, and S corporations

The unique characteristics of the cooperative model are all attributable to cooperative principles discussed in Chapter 1.

Dependence on member-owners

An LLC or S corporation can function with two or three owners, but because cooperatives are owned by their users, they typically need more members in order to generate enough volume to cover their operating costs. For example, an LLC processing oysters can buy oysters from any farmer, but a cooperative oyster processor must buy the majority of its oysters from the cooperative members. The cooperative members need to deliver enough oysters so that the cooperative has the volume it needs to cover its costs. A cooperative cannot just go out and buy oysters from non-members to cover a shortfall without facing additional tax considerations and following strict bylaw procedures. It must do the majority of

Dave Partee photo

Oyster farmers in Kachemak Bay, Alaska, operate through the Kachemak Shellfish Growers Co-op. Shellfish farmers in other parts of Alaska could benefit from sharing processing costs within a cooperative. Long grow-out periods for the shellfish and high processing and freight costs provide incentives for cooperative relationships.

its business with its members. The cooperative members not only need to produce the volume the cooperative needs, but they also need to be committed enough to their cooperative to provide it with enough product even when other buyers might offer more in the short term.

Cooperatives' dependence on their owners also means that they are more responsive to the producer's needs. A cooperative will not pull up its operation and move to another more profitable fishery unless the majority of its members vote for it to move. In addition to providing the cooperatives' basic services, successful cooperatives in agriculture and seafood offer their members training and information on new techniques and products.

Raising owner capital

The principles of user ownership and democratic control limit a cooperative's ability to raise money. This is especially true of capital-intensive, value-added processing. Cooperative principles require that the benefits/profits of the cooperative be distributed to its owners based on use rather than on investment. So, if a salmon marketing cooperative requires all of its members to invest the same amount, but one member delivers 50% of the fish, that member will get 50% of the surplus earnings even though everyone else invests the same amount. This makes members conservative about how much they will invest. The fact that cooperatives give each member one vote, regardless of how much they have invested, reinforces this tendency. As a result, cooperatives tend to grow slowly and to accumulate capital by retaining part of their members' profits.[3]

Raising outside capital

Attracting outside investment is challenging for cooperatives. Cooperative principles, and federal law, restrict the level of outside ownership to less than 20%, and restrict return on investment to 8%. The ownership restriction means that outside investors will never get a majority of the votes. Because small start-ups like this are risky, one of the big incentives to investors is that they can get

[3] Agricultural cooperatives in the Lower 48 now use a new form of cooperative, new generation cooperatives (NGCs), to create value-added processing. NGCs limit membership and link members' investments and production commitments to their share of the cooperative's processing capacity. See Chapter 8.

a larger return, but 8% is less than what one might earn from investing in blue chip companies on the New York Stock Exchange.

Membership

LLCs and S corporations are free to restrict their ownership and can allocate votes and profit distributions however they see fit. They can link profit distributions to the level of investment, production/deliveries, or a combination of these and other factors. This makes it easier to tailor the business to fit the desire of the investors.

While cooperatives are not as flexible as LLCs or S corporations, they have a simple mechanism for expanding membership. Because they tend to grow slowly, are democratically controlled, and link of benefits to use, adding new members does not require changing voting structure or percentages of ownership. Normally, it is enough for new members to pay their dues and sign a membership agreement. If you start out with only 5 or 10 members, but there are many more potential members in the fishery, a cooperative offers an easy way to bring everyone on board.

Government programs and benefits

Cooperative principles not only affect how cooperatives act, but also how they are treated by governments. The social aspects of cooperatives have led both state and federal governments to treat cooperatives differently from other businesses. They have a separate tax regime, are exempted from some antitrust laws, and benefit from a variety of government loan and grant programs aimed solely at assisting cooperatives.

Cooperative network

Cooperatives have access to the wider community of cooperative business. One of the principles is that cooperatives are supposed to help other cooperatives and promote the cooperative model. National organizations of cooperatives have formed banks, insurance companies, and networks to help cooperatives and their members. Many of these organizations advocate for cooperatives with the federal government. Cooperatives can also be effective grassroots organizations to advocate for their members.

Look for yourself!

A quick search on the Web demonstrates how cooperatives help one another and the nationwide network of cooperatives. Here is a list to help you get started. Notice how all of these sites have a list of cooperative principles!

National and regional co-op organizations

National Cooperative Business Association, http://www.ncba.org/.
Cooperative Development Institute, http://www.cdi.coop/.
Cooperative Development Services, http://www.cdsus.coop/.
Northwest Cooperative Development Center, http://www.nwcdc.coop.
USDA Rural Development, http://www.rurdev.usda.gov/rbs/coops/csdir.htm (click on publications).

Cooperative development funds

Cooperative Fund of New England, http://www.cooperativefund.org/.
Cooperative Development Foundation, http://www.cdf.coop.

Food cooperatives

Look at their links and commitment to buy sustainable food.
Willy Street Cooperative, Wisconsin, http://www.willystreet.coop/About/About.html.
Hanover Food Cooperative, New Hampshire, http://www.coop-foodstore.com/.
New Pioneer Food Cooperative, Iowa, http://www.newpi.com/.
A list of food cooperatives, http://www.bbparkslope.com/jim/food.coop.html.

3

Pros and Cons of Choosing the Cooperative Business Option

Like any business model, cooperatives have their pros and cons. Weighing these is a crucial part of forming a cooperative.

First and foremost, remember that a cooperative is a business and, like any business, it should have a compelling reason to exist. This reason might be the need for a group to market or process their catch, or it might be to pool orders to negotiate better prices for supplies or fuel. Regardless of the reason, there is little hope that a cooperative will succeed if its members cannot understand how cooperating will benefit them.

Benefits of a cooperative

Gaining access to high value markets

By pooling catch, several Alaska salmon cooperatives have been able to achieve critical mass to enter higher value markets and increase ex-vessel prices. Often individual fishermen do not catch enough fish themselves to interest buyers. Pooling their catch with other fishermen allows them to guarantee buyers they will have the needed volume of fish. Pooling resources may allow them to have one person (the manager or other designated employee) search for new markets rather than have each fisherman search on their own.

Greater purchasing power

By pooling their resources through a cooperative, members can obtain goods and services they may not otherwise be able to afford. Cooperatives can provide bulk purchasing power for their members and improve their ability to negotiate with suppliers. Farmers have used fuel cooperatives for decades to purchase fuel

Alaska Sea Grant photo

Herring gillnetters pluck fish from their nets. The Alaska herring fishery, particularly the busy sac roe seine fisheries, could benefit from cooperatives in their industry.

in bulk, eliminating middlemen and reducing costs. Cooperatives also allow fishermen to stretch their budgets and buy processing equipment like ice and gel pack machines, box staplers, and vacuum packers and to use this equipment more efficiently. Processing equipment is often more efficient with higher volumes or when there is enough volume to use it for longer periods of time.

Accountability

The cooperative structure gives each of its member-owners an equal vote with a membership that is open to everyone who meets the cooperative's membership criteria. Because of its membership and voting structure, a cooperative is more likely to be held accountable to its members and communities than other businesses.

Community independence

The structure of a cooperative's ownership gives its members a degree of self-determination not found in other business models. Community based ownership also keeps decision making in the hands of the producers.

Stability and risk

The cooperative model can provide great stability and longevity. Cooperatives tend to grow more slowly than other businesses and are more likely to carefully plan each step of their development. Because cooperatives usually have more member-owners than other forms of business, they reduce each member's financial risk, which increases the odds the business will survive when it runs into problems.

Sustainability

Sustainable practices are an elemental concept in Alaska fisheries. Because they are owned by producers, cooperatives have a primary interest in the sustainable development of the resource and enhancement of the communities where they live and work. This is especially important in the fishery sector, where coastal communities are concerned about how the evolution of the fishing industry will affect them. For example, a cooperative could incorporate a mechanism for planning permit transfers as part of its system for transferring cooperative memberships. This could give coastal communities a tool for maintaining their presence in a fishery.

Strengthening communities and community economic development

Producer cooperatives are small, locally owned businesses. Small processors tend to use more labor intensive practices and to spend their money in the local economy. This creates more economic benefit for the entire community. Most successful producer cooperatives offer their members and employees education and training as a way to improve efficiency. The Seafood Producers Cooperative with a processing plant in Sitka, Alaska (see Chapter 4), offers its troll and longline fishermen members courses on how to improve quality so they can get the best price for their fish. This improves the bottom line for the fishermen and cooperatives and gives their communities a better understanding of the economic and social value of their fishery.

Flexibility

Whereas a corporate model's first objective is to make profit for its shareholders, the cooperative model fits any business objective, from obtaining bulk goods at lower prices to processing the catch to creating more jobs to organizing the marketing of goods.

Drawbacks of a cooperative

Need to work cooperatively

Cooperatives are democratically controlled and, to be successful, they need to maintain the commitment and involvement of their members. This means that cooperatives have to spend a lot of time building and maintaining consensus. This process is often alien to most fishermen, who have a reputation for being extremely independent. Building consensus can be a very difficult task. Many fishermen are used to being their own bosses or working as crewmember. Having to discuss options and make decisions jointly can come as a shock. Add to this a lack of communication and conflict resolution skills, skills few people have in any line of work, and the difficulties begin to add up. Communication and conflict resolution skills can be taught and, given time, most people (even Alaskans) can learn to act in a more cooperative manner.

Initial shock at complicated start-up

When first confronted with the complexity of starting a cooperative, filing articles of incorporation, adopting bylaws, electing a board, drafting membership agreements, setting up an accounting system, and registering with the IRS, some groups become discouraged. While the process has many steps, there are many organizations that can help. The process itself can help a group focus on how their business will work and avoid problems further down the line.

Securing a market

Securing a market is a challenge for new companies in the fishery sector, whether they are cooperatives or not. The market for Alaska seafood is dominated by large companies. Competing head to head with these companies is extremely difficult, which is why most small seafood marketers target fresh markets that demand high quality, premium products. Producing for these markets can be quite expensive and difficult.

Cost of start-up

Raising start-up capital is a problem for nearly all new businesses. It can be especially difficult for a cooperative, as many banks and even some credit unions are unfamiliar with and hesitant about lending to cooperatives. However, there are other ways to obtain capital. The federal government provides grants and makes loans to groups that want to start a cooperative (most through USDA Rural Development). While these programs should not substitute for a good business plan or for raising money from members, they can make it easier to start a cooperative. New generation cooperatives (NGC) (see Chapter 8) offer a new technique to raise larger sums from members by selling processing shares.

Need for professional management

Many Alaska cooperatives are started with volunteer labor. This fits well with the idea of having a democratically controlled, user-owned business. All too often, cooperative members assume they do not need professional managers, and they try to save money by not paying for management services. But the success of a cooperative, like any other business, depends on its managers. Volunteer managers may "burn out," leaving remaining members to pick up the pieces. Cooperatives that start out with volunteer managers need to plan their transition to a professional management structure if their cooperative is going to survive and grow.

4 Examples of Cooperatives in Fisheries and Agriculture

Farmers began using marketing cooperatives before the start of the twentieth century. By 1922, farmer cooperatives successfully lobbied Congress to pass the Capper-Volstead Act, which exempted them from antitrust laws. By the 1930s, farmer cooperatives were successfully marketing grain, milk, and even cranberries. In 1934, the Fishermen's Collective Marketing Act (FCMA) gave fishermen similar rights, allowing them to jointly harvest, market, and price their products without being in violation of antitrust laws.[4]

Since that time, several fishing cooperatives have formed, shedding light on how these ventures function. Fisheries cooperatives and agricultural cooperatives described here offer important lessons in how cooperatives can help producers.

Alaska seafood cooperatives

Seafood producers

Demand for vitamin A soared during World War II. The market for fish liver oil, a good source of vitamin A, was dominated by an East Coast firm. For several years, Alaska fishermen met in frustration over low prices for the valuable commodity. In 1941, the Deep Sea Fishermen's Union, the Seattle Vessel Owners' Association, and the Lyle Branchflower Company formed the Halibut Liver Oil Producer's Cooperative to try to break the monopoly hold. The partnership did not meet the federal standards of a "cooperative," and in 1944 it was reorganized as the Halibut Producers Cooperative, wholly owned by the fishermen. Each fisherman contributed $10 and a revolving fund was established to provide working capital.

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[4] Source: A. Kitt and S. Edwards. 2003. Cooperatives in U.S. fisheries: Realizing the potential of the fishermen's collective marketing act. Marine Policy 27:357-366.

Deborah Mercy photo

This tender vessel is working for Leader Creek Fisheries, near Naknek in Bristol Bay. Following Leader Creek's business model, where the processor shares half of all net income with the fleet regardless of size, Alaska harvesters can move into the processing sector through cooperative relationships with each other and with processors.

Cans and can'ts for fishing cooperatives

In the 2003 conference series on Rights Based Fisheries Management, economist Andrew Kitts of the NMFS Northeast Fisheries Science Center presented the following "cans" and "can'ts" for U.S. fishery cooperatives based on the Federal Cooperative Marketing Act of 1934.

Can Do

- Agree on terms of sale and minimum prices for products.
- Make similar arrangements with other cooperatives.
- Achieve monopoly power through natural growth or combining with other cooperatives.
- Limit production if market is limited.
- Harvest with fewer vessels and share costs and revenues.

Can't Do

- Make agreements with those outside the cooperative.
- "Unduly" enhance the price by holding back supply.
- Engage in noncompetitive practices (refusing to sell, boycotting, etc.) to force agreements.

With changing times and markets, the Halibut Producers Cooperative became the Seafood Producer's Cooperative (SPC). SPC operates like many typical agricultural cooperatives and is managed as a traditional food company. The president/CEO reports to a board of directors. The board is composed of 12 member-owners elected by the entire membership. Board members are elected to three-year terms. No more than four board seats are up for election each year, to provide consistency. The board's focus is on business performance and strategic direction, as well as owner representation. The cooperative buys from members and pays out patronage refunds. SPC also sells gear, bait, and ice to its members. With 515 members and a member-run board, SPC has established high quality standards and earned a reputation as one of the best salmon producers in Alaska.[5] Look at their Web site, http://www.spcsales.com/index.cfm, to see the type of marketing and training materials they provide.

[5] Source: interview and emails with Tom McLaughlin, president/CEO of Seafood Producer's Cooperative, August 2007.

Alaska harvest cooperatives

Other well-known harvest cooperatives in Alaska include the Pollock Conservation Cooperative (PCC) and the Chignik Seafood Producers Alliance. These harvest cooperatives, formed to allocate and manage the harvest of fish, do not fit the traditional cooperative model.

The Pollock Conservation Cooperative was formed in 1999 following the passage of the American Fisheries Act. Through the Act, catcher/processing vessels were assigned a set amount of the Bering Sea pollock quota and given the ability to form a cooperative to divide the quota among themselves. The PCC successfully increased the product yield and value for these producers.

In 2002, the Chignik Seafood Producer's Alliance received an allocation of the Chignik area salmon harvest by the Board of Fish. While this allocation was eventually overturned by the courts, when in operation the cooperative worked with a Chignik processor to develop a live processed salmon product.

While the PCC and the Chignik cooperative are the best known seafood cooperatives in Alaska, they are not typical cooperatives. Successful, traditional, marketing cooperatives, like the SPC, offer a more realistic example for the Alaska seafood industry.

Agricultural cooperatives

Agricultural cooperatives offer a plethora of examples on how marketing and purchasing cooperatives can function. Here are a few examples.

Land O' Lakes

The Land O' Lakes cooperative corporate logo is probably familiar to most people in the United States. It was initially organized in 1921 to process milk. Its corporate mission is to be "A market- and customer-driven cooperative committed to optimizing the value of [its] members' dairy, crop, and livestock production" (http://www.landolakesinc.com/). Land O' Lakes producers provide

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[6] In a federated cooperative structure, several cooperatives are members of a regional or federated cooperative. Within this structure, member control is indirect. The regionals usually provide centralized buying and distribution services for the locals (source: C.D. Merrett and N. Walzer, eds. 2003. Cooperatives and local development: Theory and applications for the 21st century. M.E. Sharpe).

top-quality milk, eggs, meat, and crops and buy feed, animal milk replacers, seed and crop nutrients, and crop protection products. It does this through a network of farmer-owned local agricultural cooperatives, using a federated cooperative structure.[6]

Land O' Lakes adopted a federated cooperative structure early on in its history. Members hold ownership in Land O' Lakes either as direct stockholders or as stockholders of one or more of the local cooperatives that hold Land O' Lakes stock. The member-owners of Land O' Lakes elect directors to represent them on the corporate board. The board determines policies and business objectives, controls financial policy, and hires the chief executive officer to conduct day-to-day business affairs. More than 3,000 milk producers and 1,100 member cooperatives are shareholders.

Land O' Lakes processes the milk from more than 3,000 dairy producers from Pennsylvania to California and markets dairy products throughout the United States and in 50 countries. It has grown to be the largest feed company in North America and the largest distributor of agronomy products in the United States.

It is unlikely that any fisheries cooperatives in Alaska will reach the scale of Land O' Lakes. But the federated structure may offer Alaska fisheries cooperatives a model for cooperation between local fisheries cooperative firms.

Central Minnesota Ethanol Cooperative

The Central Minnesota Ethanol Cooperative (CMEC; http://www.centralmnethanol.com/) illustrates how a successful processing (value adding) cooperative based on new generation concepts can succeed (see Chapter 8). CMEC was formed in 1994 and began production in 1999. CMEC has processed corn (more than 26 million bushels) from more than 930 members, producing over 68 million gallons of 200 proof ethanol between 1999 and 2002. A plant of this size costs millions and would have been impossible to build as quickly with a traditional cooperative structure.

New generation cooperatives are one way that fishery cooperatives could raise the capital necessary to build value-added processing. They make it easier to raise capital from members, and there are loan programs to purchase stock. They also offer fishery cooperatives a way to attract members who have different catch histories. Since ownership and control are based on an ability to deliver product and investment, this may offer incentive for large producers (highliners) to join, in addition to average or low volume producers.

Minot Cooperative Oil Company

The Minot Cooperative Oil Company, http://www.cenexofminot.com/, was incorporated as a reaction to perceived price gouging by existing suppliers. On June 28, 1928, the incorporators met, adopted bylaws, and elected a board of directors. All prospective members were sold two shares of stock at $25.00 each. In July 1928, the North Dakota Farmers Union put their stamp of approval on the new cooperative. The first stockholder meeting was held November 10, 1928, with 92 members present.

Currently, the Minot Cooperative Oil Company has gas stations, convenience stores, fuel distribution, and other hardware related businesses in and near Minot, North Dakota. It is another example of a federated cooperative and an important founding member of CENEX, a fuel, farm supply, and hardware cooperative.

The Minot Cooperative Oil Company's mission is "To serve the ever changing needs of our patron/owners with timely delivery of quality products and services at competitive prices, while efficiently utilizing cooperative resources to provide a local net savings that will service the financial needs of our cooperative." Their broad purpose is "To enhance the economic well being of our member/owners."

Any fisherman in Alaska can identify with the circumstances that spurred creation of the Minot cooperative, as fuel, bait, and other supplies are costing more and more. It may be in the interest of some fishing groups to form a cooperative like the Minot Cooperative Oil Company to lower the cost of expensive supplies.

Successful cooperatives expand

One fact that can be seen in the examples of cooperatives given here is that successful cooperatives, just like other businesses, tend to expand. They expand based on cooperative principles, by focusing on how they can benefit their member-owners and by working with other cooperatives.

Starting a Seafood Cooperative

5

There are a number of basic steps to take and items to have in place before forming a successful seafood cooperative.

Compelling reason

Why would someone form a cooperative in lieu of a regular corporation? Whether the problem is low fish prices or high costs of supplies, there must be a compelling reason to form a cooperative. However, need alone is not enough to achieve a successful cooperative. Fish prices and supply costs fluctuate significantly from year to year, and before a group invests time and energy into a new venture, they must critically analyze their willingness to make a long-term investment of time and money.

The compelling reason(s) must be well articulated and able to stand the test of time. To develop adequate support, it is important to clearly articulate why a cooperative is necessary and what will be gained from having one.

Develop the core support

The first step in building support is to meet with prospective members. Initial meetings among potential members do not need to be large. Gather your core supporters to discuss why you want to form a cooperative and then refine and expand the concept. From there, identify an expanded group of potential cooperative members and begin to gather information.

If you are thinking about a marketing cooperative, find out how many pounds of fish each member could produce. What are they getting paid? What would they expect a cooperative to do for them?

If you are thinking about a purchasing cooperative, determine roughly what kinds of supplies the members buy. What volumes

Kurt Byers photo

Alaska Airlines promotes wild Alaska seafood. With high freight costs, transportation is one area where Alaska seafood operators could work together to lower costs by forming a cooperative.

do they buy, and could the cooperative provide those supplies at a price to make it worthwhile?

At this stage, the information gathered can be approximate, but it will help refine your ideas for the cooperative and will help with the next stage—drafting a business plan. Once it appears you have the critical mass to push the issue through, seek assistance from professionals who can help facilitate meetings and outline the process. The Alaska Cooperative Development Program, at the University of Alaska Anchorage Center for Economic Development, can help you in forming a cooperative. Visit them on the Web at http://ced.uaa.alaska.edu/acdp/index.html. The U.S. Department of Agriculture, Rural Development, awards grants to organizations to assist in the formation of cooperatives.

Prepare a business plan

Regardless of the type of business venture, business plans are critical. Understanding costs and production requirements is just as important for cooperatives as other businesses. In preparing a business plan, take general information and refine it. Given cooperatives' unique status as businesses that buy from their owners and the inherent problems in not gathering enough volume to break even, all members must understand the required output before investing in the organization.

File articles of incorporation and bylaws

To organize a cooperative in Alaska, you will need to file articles of incorporation with the Alaska Department of Commerce, Division of Corporations, Business and Professional Licensing. A form version of the articles is available at their Web site (http://www.commerce.state.ak.us/bsc/cforms.htm). You will also need to adopt a set of bylaws. Samples are available at the Alaska Cooperative Development Program Web site (http://ced.uaa.alaska.edu/acdp/index.html).

Once the cooperative is registered with the state and the bylaws are in place, obtain a business license and employer ID number. The business license application is online at http://www.commerce.state.ak.us/bsc/cforms.htm, and employer ID applications are available at http://www.irs.gov/businesses/small/article/0,,id=98350,00.html.

Determine board of directors

With the passage of bylaws, the cooperative needs to elect a board of directors. For continuity, the board may include the individuals who initially started the organization. Board members must be prepared to work hard. Be sure to stagger the director's terms of duty to maintain institutional knowledge.

Draft a membership agreement

A membership agreement can be as simple as a one page form that sets out how membership refunds will be paid by a purchasing cooperative, or they can be complicated contracts that spell out the terms under which members will deliver their seafood to the cooperative. Guidelines for drafting a membership agreement are available at the Alaska Cooperative Development Program Web site (http://ced.uaa.alaska.edu/acdp/index.html).

Hire a management team

As stated previously, it is important to have enough volume and activity to justify hiring individuals to run the day-to-day affairs of the businesses. The actual members are busy running their own businesses and should not be saddled with running the cooperative. A good management team is critical for a successful cooperative.

Managing a Cooperative

6

Profit and democracy

Cooperatives are unique combinations of profit motive and democratic control. Like any other business, cooperatives exist to benefit their member-owners. Like any other business, cooperatives should have clear goals and strategies to achieve them. And, like any other business, cooperatives should understand their operating costs and be able to cover them.

Cooperatives also function on the principle of member ownership and make decisions based on one vote per member. Cooperatives depend on their owners both for business and for leadership. This means that they have to spend time building consensus and communicating with their members. Successful cooperatives pay attention both to business fundamentals and to their members' needs.

Know your business!

All successful businesses know their industry. With knowledge of their products, markets, and costs comes a long-term strategy for building the business. It is not uncommon in the Alaska seafood industry for the harvesting sector to look to their processors as the "market," instead of the end consumer. Knowing who the end consumers are, what they want, and what it costs to deliver seafood has always been the processor's job. Forming a marketing cooperative does not mean that these business imperatives disappear. It means the cooperative will be answering these questions.

The pitfalls facing seafood marketing cooperatives are similar to those that trap many start-up businesses. The first pitfall is inadequate operating capital. The business starts, but then runs out of money midstream. The best way to avoid this problem is to understand the business's cash flow. You need to know how much

Breakeven point
One way to calculate the breakeven point is to take the total fixed costs and divide that by the difference between the revenue per unit and variable cost per unit. The resulting answer tells how many units must sell before costs will be covered.

Formula:

$$\frac{\text{Fixed Operating Costs}}{(\text{Price per Unit} - \text{Variable Cost per Unit})}$$

Example:

$$\frac{\$112{,}400}{(\$2.50 - \$1.75)} = \frac{\$112{,}400}{\$0.75} = 149{,}867 \text{ units}$$

money it will cost to operate and how long it will take for the cooperative's income to catch up to its costs—the breakeven point.

The second pitfall is not calculating the cost of member work. Often a cooperative will have one or two active members who take on a lot of the work. They make calls, arrange sales, pack and ship the product, and bill the customers. More often than not, they do not charge the cooperative for all of their work. While having one or two members contribute their time gets more money to the other cooperative members, in time the active members burn out, and the cooperative starts to fail. It is important to calculate all of the cooperative's costs, including the value of the work volunteered by members. Then the cooperative can make a conscious decision about the value of that work. Remember, a cooperative is like any other business; if it can't pay for itself, it should not be in business.

Build consensus

Cooperatives are businesses that depend on the patronage of their member-owners. This means cooperatives have to pay as much attention to their members as they do to their markets. Oftentimes, the reason that many new cooperatives have a few members doing all the work is that they have not spent the time necessary to build a consensus. As democratic institutions, cooperatives must communicate and build consensus to get things done. Most members join a cooperative because they want to earn more, so

Debbie Maas photo

Fishermen launch a salmon set net in Olga Bay, Kodiak Island. In Alaska's remote locations, cooperative activities among fisheries participants can be a good way to reduce costs and improve fish marketability..

they pay more attention when the discussion focuses on how the cooperative will make money. Having a clear business plan that estimates revenues and costs and demonstrates an understanding of how surplus income will be distributed is the best way to spur a discussion and come to a consensus. It is just as important for the cooperative management to develop a system to regularly communicate with members, as it is to develop a business plan.

Running the organization

Like corporations, cooperatives are run by a board of directors. Directors are members elected by the members at large. Directors will establish goals and strategies, oversee the cooperative's management, establish quality standards on the product, and approve major investments and expansions.

Managing

The advantage of setting up a separate organization to handle marketing or purchasing is that it allows the cooperative members to hire a manager who can devote more time to these jobs. This lets fishermen focus on fishing while the manager hired by the cooperative performs the tasks that used to be done by middlemen (the processor, the gear supplier, or the fuel delivery service). Make sure you hire someone who will do the job well. This means paying well and communicating with the manager. Your business plan should look into what the going rates are for this type of work. Do not expect to get good service if you do not pay the market rate.

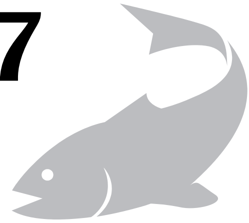
Conclusion

So, how do you manage a cooperative? First, you have to take care of business fundamentals. Draft a business plan that estimates the cooperative's income and expenses and discuss it with your members. Then, develop a system that allows management to communicate with members. Using the business plan and estimates, help the members agree to a distribution plan that gives the cooperative enough retained earnings to cover contingencies and to grow. This should include a discussion of how bookkeeping and especially how retained earnings will be credited and paid. Hire a good management team and expect to pay them the prevailing market wages for their work.

The Maryland and Virginia Milk Producers Cooperative have a useful Web site at https://www.mdvamilk.com/index.php. Look especially at their "Members Only" section, where they describe prices and how membership equity (retained earnings) is calculated.

Making Sense of Cooperative Taxation

7



Cooperatives, corporations, and partnerships pay the majority of their taxes, property, employment, withholding, fish, and excise taxes under the same tax regime. Differences occur in how profits or surplus earnings are taxed. In general, businesses pay taxes in one of two ways: under the corporate model where profits are taxed twice or under the partnership model where profits are taxed once. The profits, or surplus earnings, of a cooperative are taxed once, like partnerships or LLCs, but cooperatives pay taxes under a separate section of the IRS code, Subchapter T. In most small cooperatives, patronage refunds are taxed as part of the individual member's income and are accounted for in their personal tax return (Schedule C for commercial fishermen, Schedule F for shellfish farmers).

How cooperative accounting is different—surplus earnings vs. profit

Before discussing the specifics of Subchapter T, it is important to remember why cooperatives talk about surplus earnings and not profits. Where most businesses operate on the principle of transferring money from their patrons to their owners/investors, cooperatives are owned by their patrons. Cooperatives exist in the place of middlemen so that their members can get lower prices on the goods and services they need or so they can be in a better bargaining position when they sell their seafood. In the course of performing these functions, the cooperative keeps only enough to pay its costs. It can also retain some of its earnings as a contingency or investment fund. Therefore, a cooperative normally has less cash on hand than a comparable business.

All the cooperative's surplus earnings, the income left over after paying the cooperative's operating expenses, are distributed to its members based on how much they have used the cooperative. Even the surplus that the cooperative retains as a contingency or investment fund is credited to members in proportion to their patronage. If a cooperative member provides 10% of the cooperative's products and the cooperative has surplus earnings of $100,000, the member is entitled to $10,000. If the cooperative board decides it needs to have $20,000 to expand its operation, it would pay the member $8,000 and give the member a credit of $2,000. This credit is called "retained earnings" or "retains." There are a number of ways to calculate and pay back retained earnings. Many producer cooperatives pay retained earnings out to long-term members on a rotating basis over a 20 year period or when the member leaves the cooperative. A cooperative's system for paying out retained earnings is usually spelled out in its bylaws. At some point the member will have to pay income tax on retained earnings; Subchapter T determines when they must pay tax on it.

IRS Subchapter T

The chief benefit of Subchapter T is that income is only taxed once, when the member receives it. Subchapter T generally frees cooperatives from paying income tax on their surplus earnings if they are refunded to the cooperative members.[7] In this, the tax treatment of cooperatives is similar to treatment of partnerships or LLCs that choose to be taxed like partnerships. In contrast, a normal for-profit corporation would pay taxes on its net income, and the investors in that company would pay an additional tax when they received their share of the company's profits as dividends.

Subchapter T also lets the cooperative and its members decide when they want to pay the taxes on the retained earnings—either when they are retained or when they are paid out to the cooperative member. Since they do not normally pay federal income tax, cooperatives are also free from paying Alaska state corporate income tax, which is a percentage of the federal tax bill. Cooperatives still pay property taxes, fish taxes, and excise taxes just like any other enterprise.

The advantage of Subchapter T is that it is tailored to cooperatives. It allows cooperatives to pass part of their surplus earnings

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[7] Cooperatives do have to pay taxes on income they generate from business with non-members.

Comparing taxes for cooperatives with other types of businesses

Tax	Sole proprietor	Cooperative	LLC[a]	Partnership	Corporation
Property tax	Yes	Yes	Yes	Yes	Yes
Local fish taxes	Yes	Yes	Yes	Yes	Yes
Employment taxes (withholding, FICA, FUCA, Medicare)	Yes, if owner has employees	Yes	Yes	Yes	Yes
Self employment tax	Yes, paid by owner	No	No	No	No
Unearned income tax	No	No	No	No	Paid by investors on dividends
Personal income tax	Yes	Yes, paid by members on patronage refunds and retained earnings	Yes, paid by members for profit distributions	Yes, paid by partners on income distributions	No
Federal corporate income tax	No	No	No	No	Yes
State corporate income tax	No	No	No	No	Yes

[a]This assumes the LLC is paying taxes under the "check the box" partnership option. An LLC can select to be taxed either like a corporation or like a partnership.

on to their members and retain a portion of those earnings as a contingency or investment fund. The cooperative and its members have a fair amount of flexibility in determining how and when the retained earnings will be paid and when the taxes will be paid on them. A member could, for example, ask the cooperative to defer paying until he or she has retired and is in a lower income tax bracket.

Who can file using Subchapter T?

In order to file taxes under Subchapter T, an entity must receive a "521 exemption" from the IRS. To do this, the business must meet the federal definition of a cooperative which requires that the business operate on an at-cost basis (see IRS Cooperative Information Report 23, Tax Treatment of Cooperatives, p. 2) and limit the

Deborah Mercy photo

Drift fisherman and direct marketer Richard King has fished in Cook Inlet for 30 years. Alaska fishermen can benefit from cooperative business models.

dividends its members receive on their investment to 8% per year (IRS Cooperative Information Report 1, Cooperative Principles and Legal Foundations, Capper-Volstead Act, section 521 IRS code). This definition codifies several of the basic cooperative principles: that the business is owned by its member-users and the members benefit in proportion to their transactions with the cooperative. A cooperative applies for a 521 exemption by submitting Form 1028, Application for Recognition of Exemption, to the IRS.

Help with accounting and taxes

Because there are so few cooperatives in Alaska, it can often be difficult to find an accountant who is comfortable setting up the bookkeeping and filing taxes for cooperatives. There are, however, a number of resources that can obtained by contacting the Alaska Cooperative Development Center. One of the advantages of organizing your business as a cooperative is the nationwide network that exists to promote the cooperative model and provide assistance to new cooperatives.

8

New Generation Cooperatives

Many Alaska fishermen are interested in using cooperatives to help market their fish. Cooperatives often involve some form of value-added processing, whether as simple as gutting and freezing or as complicated as producing oven-ready products for the retail market. Value-added processing normally requires a large investment. You have to buy and install processing equipment, hire and train a crew and managers, and market the final product.

Raising money to pay for all this can be difficult using a traditional cooperative. New generation cooperatives (NGCs) are an adaptation of the cooperative model aimed at making it easier for cooperatives to raise money from members. NGCs link access to processing capacity to level of investment. The more members invest and deliver, the more they benefit. Linking investment to the right to deliver enables NGCs to raise large amounts of capital.

The problem of raising capital

In Chapter 2, Differences between Cooperatives and Other Businesses, we discussed the problem traditional cooperatives face raising capital from their members. In a traditional cooperative, all members pay the same membership fee, but they benefit based on how much they use the cooperative. So, if a salmon marketing cooperative requires all of its members to invest the same amount, but one member delivers 50% of the fish, that member will get 50% of the surplus earnings even though everyone else has invested just as much. This makes members conservative about how much they will invest.

The new generation solution

NGCs overcome this problem by linking delivery rights to investment. The assumption they follow is that processing capacity is limited, and producers/members will pay to guarantee a share of this capacity.

From our previous example, our salmon marketing cooperative wants to build a small processing plant to fillet, portion, and freeze fish. For $500,000 they can build and staff a plant with a capacity to process 100,000 pounds a day. They can set up an NGC and offer 200 shares to their members at $2,500 a share, with each share giving its holder the right to deliver up to 500 pounds per day. The number of shares members buy is based on the number of fish they think they will deliver. Someone who expects to catch 5,000 pounds per day will buy 10 shares, and someone else who normally catches 1,000 pounds per day will buy 2 shares.

When the cooperative sells all 200 shares, it will have enough money to start up its plant. The delivery rights are distributed according to how much fish the members think they will catch.

Delivery rights are also an obligation. Value-added plants need to have enough product going through them to pay the bills. The cooperative signs a contract with each member that outlines the member's right to deliver product and obligates them to deliver a given quality. When a member cannot meet an obligation, he or she can buy fish from another member, sell unused delivery rights to someone who has fish, or pay a penalty.

The ability to transfer the right to deliver to the cooperative makes it easier for members to cash out their interest. In a traditional cooperative, a member's equity is held as retained earnings and is paid out according to a plan adopted by the board of directors. Often this is done on a twenty-year cycle, but it always depends on the cooperative's ability to pay. In an NGC, a member can sell his or her shares to another fisherman who wants access to the cooperative's processing and marketing capacity. If the cooperative is doing its job and creating surplus value for its members, there will be a market for its shares.

Differences between NGCs and traditional cooperatives

In agriculture settings, NGCs are widely used by bison ranchers and sugar beet and corn farmers. Because members put money into the cooperative up front and can trade shares, NGCs operate differently from traditional cooperatives. NGCs are stricter about deliveries and pass more of their surplus earnings back to their members in cash rather than crediting them as "retained earnings." The following table outlines some of these differences.

Differences between new generation cooperatives and traditional cooperatives.[8]

	Traditional cooperatives	New generation cooperatives
Delivery rights	Unlimited	Limited to those purchased
Delivery obligation	May be required	Required
Quality accepted	Will range	Narrow
Initial investment	Very low	Very high
Liquidity of equity	Low	High
Exchange value	Fixed at par	Variable at market
Redemption obligation	Ability to pay	None
Eligibility requirement for members	Low	High
Voting power	Usually one vote	Variable number

Setting up an NGC

Organizing a new generation cooperative takes more thought than setting up a traditional cooperative. Members need to know how much money to raise, necessary plant capacity, and delivery expectations. When filing articles of incorporation with the state, the cooperative needs to record the number of shares it will offer and set a par value. The par value should be high enough to raise the capital necessary to get the processing plant up and running.

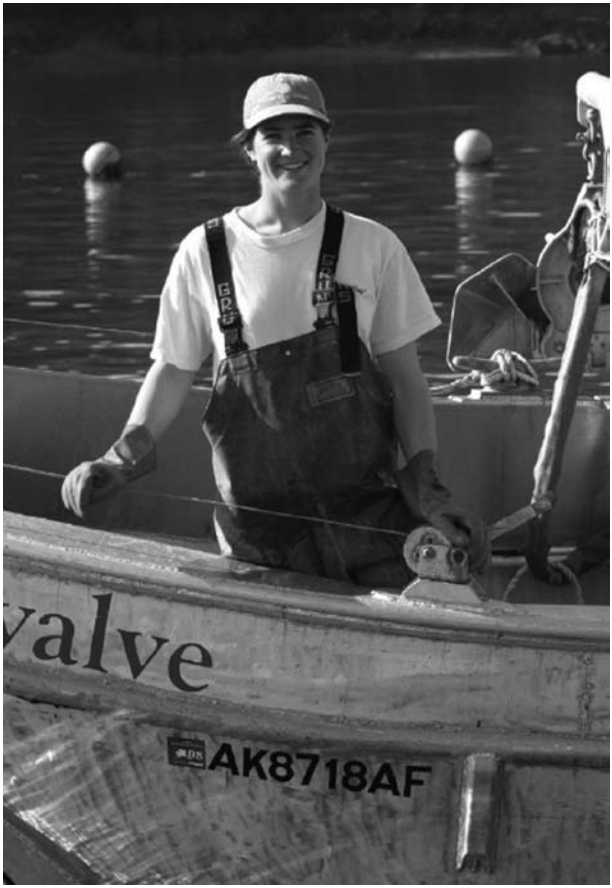
In its bylaws, an NGC should clarify how delivery rights will be allocated and how they can be transferred.

Traditional cooperatives adhere strictly to the principle of one vote per member. New generation cooperatives can depart from this principle and allow for the number of votes to vary depending on the number of shares a member owns. Regardless of the voting system, it must be set out in the bylaws.

The cooperative will also develop membership contracts that outline how the cooperative will set its price, the delivery terms, and penalties for failure to deliver the minimum quantity. This contract can also include provisions to guarantee quality and grade if these are important factors in the cooperative's business strategy.

NGCs open a number of possibilities for cooperatives to enter value-added processing. In the Midwest, this model has been used

[8] Source: D. Coltrain, D. Barton, and M. Boland, Differences between new generation cooperatives and traditional cooperatives. Kansas State University, http://www.icdc.coop/pdfs/Differences_between_Trad_and_NGC.pdf.



Dave Partee photo

Establishing a cooperative with satisfying results takes a shared vision, hard work, and time. Members of the Kachemak Shellfish Growers Co-op have benefited from their business cooperative since 1995.

to raise money for very large and expensive processing plants for sugar beets, pasta, and ethanol (see discussion of the Central Minnesota Ethanol Cooperative in Chapter 5).

In food production, NGCs allow producers to move away from producing a raw commodity and closer to producing a retail food product. While this requires greater investment, it also offers higher returns and takes advantage of a consumer trend that highlights the link between producer and consumer.

FishBiz Publications

http://seagrant.uaf.edu/bookstore/bus.html

Business Resource Guide for Alaska Fishermen
Contact information useful to Alaska seafood businesses. 56 pp.

Fishermen's Direct Marketing Manual, 4th edn.
How fishermen can direct-market their seafood catch. 96 pp.

Financial Statements and Business Calculations for Commercial Fishermen, & Alaska Fish Business Plan
Spreadsheets customized for your fishing business. Data CD.

How to Make a Directed Transfer of Your Fishing Business
Booklet on transferring a fishing business to family or others. 48 pp.

Tips for Direct Marketers: The Onboard DEC Inspection
Show the inspector that your small-boat processor is squeaky clean. 6 pp.

Developing Cooperatives for the Alaska Seafood Industry
Pool your resources and improve business. 45 pp.

The Fish Entrepreneur newsletter
Covers issues important to Alaska's small seafood processors.