

WHAT ARE NEW GENERATION COOPERATIVES?

New generation cooperatives are designed to enable producers to profit from the production and marketing of value-added products made from their raw commodities.

Like all cooperatives, a new generation cooperative is a distinct type of organization which is collectively owned and democratically controlled by its members. It satisfies their common economic needs and ambitions while respecting the seven principles of cooperatives.

New generation cooperatives are an option for use in agriculture, forestry, fishing and other industries that are supplied by producers. Formed to enable members to process raw commodities, members should not only receive market prices for their produce upon delivery; they should also gain the opportunity to profit from the processing and marketing of the value-added products produced by their new generation cooperative.

The distinction from the traditional cooperative arises from the evolution of people banding together to obtain goods and services at cost or to provide marketing services for their raw commodity production, to producers banding together to strengthen their economic position by vertically integrating everything from purchasing their production inputs to marketing processed goods into retail markets.

These evolutionary cooperatives have expanded upon the seven basic principles of co-operation as approved by the International Co-operative Alliance, while still meeting the intention of the principles. These principles and their application by new generation cooperatives follow.

Membership is open to anyone who can supply the raw commodity. However, the number of members is limited by the capacity of the cooperative to process the raw commodity and market the processed products and by-products within one of its operating cycles.

Democratic control is still one member one vote; however, *The Cooperatives Act* of Manitoba allows for holders of investment shares to hold separate shareholders' meetings and to elect a representative to the board of directors.

Member economic participation is based upon patronage. Equity requirements and profit sharing are tied directly to patronage. To encourage investment, *The Cooperatives Act* of Manitoba allows investment shareholders to receive more than the traditional token return on capital provided, up to a maximum set out by the Articles of Incorporation.

Autonomy and independence are often the driving force behind these cooperatives. In many cases, developing a new generation cooperative is the only way to get out from under the control of a monopoly or oligopoly.

Education, training and information about cooperatives in general, and the benefits of the new generation model are essential to the success of these cooperatives. It is only by having committed informed members that a new generation cooperative can succeed.

Cooperation among cooperatives is respected by these cooperatives, and alliances with production, service and marketing cooperatives may enhance their profitability.

Concern for community was behind some of the original new generation cooperatives. The leaders saw them as one way to retain their children and grandchildren in the community by stopping the exporting of jobs necessary to retain these children. By building value-added processing plants in their community to process local production, the jobs and opportunities for additional economic spin-offs would give the next generation the choice of careers in their home community. The new generation cooperative model is well suited to assist in community development.

Distinct Features

The continuing evolution of cooperatives to meet the changing economics in agriculture, fishing, forestry and other industries, has resulted in the creation of a new generation of cooperatives that differs from the traditional cooperative in four areas:

1. The focus is on the value-added processing or manufacturing of raw commodities delivered to the cooperative by its members and the marketing of the resulting products.
2. A significant equity investment is required by each member, with the total initial equity contribution being a major portion of the gross project costs.
3. A two-way contract between the member and the cooperative requires each member to deliver, and the cooperative to accept, an agreed-upon amount of the raw commodity for each delivery right (special investment share under Manitoba legislation) owned by the member.
4. Membership is limited to the number of special investment shares (delivery rights) required to be sold by the cooperative to its members in order to meet its processing capacity.

It is primarily the financial structure and membership requirements that distinguish new generation cooperatives from the more traditional cooperatives. Typically, higher equity investments are required by members in order to establish a processing plant. The number of members is also limited to those

who purchase delivery rights, as well as by the processing capacity of the plant. Members feel a greater degree of personal ownership and a stronger commitment to the cooperative because of the unique structure of new generation cooperatives.

Manitoba Legislation

The Cooperatives Act and Regulations of Manitoba now have provisions that provide for the uniqueness in capital structure that new generation cooperatives require. Provisions that restrict returns on share capital, limit the sale of shares to members, and restrict directors to members, have been eliminated.

The return on investment shares is now limited to a maximum as set out in the Articles of Incorporation. Investment shares may be sold to non-members, and boards of directors may now have up to 20 per cent non member content to enable investment shareholders to elect representatives to the board of directors.

There are three types of shares provided for under Manitoba legislation. These are special investment shares, membership shares, and investment shares. Professional assistance from lawyers and accountants should be obtained to set up an appropriate capital structure.

Special Investment Shares

Under *The Cooperatives Act* of Manitoba, special investment shares is the term given to describe the special class of shares that may be issued by a cooperative to its members. Each member who owns shares of this special class is obliged to conduct a specific amount of business with the cooperative (delivery rights). These shares are subject to the Offering Statement process administered by the Superintendent of Cooperatives (Financial Institutions Regulation Branch – FIRB).

These shares do not have a par value. The price, when issued by the cooperative to the member/producer is set by the cooperative based upon its financial requirements. The subsequent trading value is set by the amount a new producer or existing member, wishing to deliver more to the cooperative, is willing to pay to existing special-investment shareholders to acquire additional delivery rights.

These shares do not have redemption rights. The owner does not have the right to redeem them at the cooperative. The owner may sell them to another member/producer; however, the purchaser must be a member or be applying for membership that is subject to the approval of the cooperative.

Upon wind-up of the cooperative, these shares rank last, behind all other claims on the assets of the cooperative. The remaining property, after payment of all debts and liabilities, including unpaid dividends, and redemption of all other

classes of shares, is distributed pro rata among the holders of these special investment shares, based upon the number of special investment shares held.

The original selling price of these special investment shares at the start of the project is set by the total equity to be raised by this class of shares, the total quantity of raw commodity that the proposed plant can process in an operating cycle, and the number of shares that are to be issued.

For example, if a seed processing plant needs \$5 million in equity from the sale of these shares, and the plant can process 200,000 tons of seed, then each ton of seed must raise \$ 25 (\$5 million ÷ 200,000 tons) to meet the equity requirement. If each share requires the delivery of 10 tons of seed, then each share would cost \$250 (10 tons x \$25). The minimum number of shares to meet membership requirements could be set at 10, which makes the minimum investment required for membership \$ 2,500 (\$250 x 10 shares). This would limit membership to a maximum of 2,000 (\$5 million divided by \$2,500).

New generation cooperatives require a substantial equity commitment from members. Equity targets are often set at approximately 60 per cent or more of project costs, including the costs of feasibility and viability studies, business plans, plant construction, and operations, until the plant is functioning. Annual profits are allocated through patronage returns to producers, which should be payable in cash within one operating cycle. The high initial equity requirement is designed to ensure that there is already sufficient working capital in place to fund the ongoing operation of the plant and the marketing side of the business. This makes the investment in special investments shares more attractive, as the profits do not have to be retained to build equity and may be returned to the producers/members in cash.

Membership Shares

The Cooperatives Act of Manitoba provides for a class of shares known as membership shares. These membership shares are purchased to qualify for membership. The membership shares are par value shares and the Act and Regulations limit dividends on membership shares in keeping with the cooperative principle of limited return on membership shares. The requirements as to the minimum number of membership shares to be held by each member, and the rate of return, are set out in the Articles of Incorporation. The bylaws provide guidance on the criteria for membership shares to be eligible for redemption and as to the order in which membership shares may be redeemed.

Each membership shareholder is entitled to one vote at a meeting of members. Membership shareholders are the owners of the cooperative and control the business and affairs of the cooperative through an elected Board of Directors.

Investment Shares

Previously, the raising of equity through share offerings was difficult for several reasons. The reasons relate to requirements that cooperative shares have a par value, leaving no possibility for capital gains, and the legislated limit on the rate of return, which leaves no possibility of the investor sharing in the prosperity of the cooperative.

The Cooperatives Act of Manitoba, revised on July 1, 1999, provides for the sale of investment shares which, if the Articles of Incorporation allow, may be sold to non-members. These investment shares can be used to enable any individual, as well as development corporations, municipal governments and other corporations resident in the community, to support the project by supplying additional equity funding.

The preferences, rights, conditions, restrictions, limitations, prohibitions, redemption terms and methods of holding meetings of shareholders, quorums, rights of voting, and ability to elect a representative to the Board of Directors, must all be set out in the Articles of Incorporation.

The terms of the investment shares are set by the cooperative to serve its financial objectives in harmony with the need to offer sufficient incentives to make the investment shares an attractive investment.

These shares are subject to the offering statement process and could be sold to members and to non-members under an exemption order issued by Manitoba Securities Commission, exempting qualified offerings from *The Securities Act*.

DEVELOPING A NEW GENERATION COOPERATIVE

Identify the opportunity

Every new business venture begins with an idea. It could be a new product or service, or a variation on an existing one. Often, the process to start a new generation cooperative begins with a group realizing they face a common challenge. The perceived opportunity or mutual need requires the strength provided by acting together to improve the chances of success.

Determine the project need

Once the need for a new generation cooperative is determined, a meeting with potential members and community leaders starts the process. The community leaders can present the idea and its benefits to potential members, usually the producers of the raw commodity. It is necessary to obtain feedback from all interested parties to determine interest.

Following the meeting, a survey of the people in attendance, plus others identified as potential members or investors will help quantify interest. The survey should be designed to provide information to measure the concept, evaluate the volume of business that may exist, and determine if people are willing to contribute financially to the project.

Do a feasibility study

If the interest to proceed is sufficient, a steering committee comprised of a combination of community leaders and producers can oversee the preparation of a feasibility study. An industry expert independent of the cooperative should do the study. The study should have local input regarding availability of resources within the immediate trading area. These resources include the number of existing and potential producers, the amount presently produced as well as the potential production, size and the available skills within the local labour force, and availability of transportation services to supply the raw product and to ship the processed products and by products.

The results of the feasibility study will demonstrate the project's potential for success. However, the study only determines that the project is feasible, it is not a guarantee of success. It will provide information needed to make a sound decision on whether to proceed with the venture, and how best to go about it.

When the feasibility study has been completed, reviewed and amended by the steering committee, and indications are that the project is feasible and viable, the steering committee can then present it to the potential members of and investors in the cooperative. At this point the potential membership is in a position to consider how to proceed.

Ingredients for success

Although there are many ways to develop a new generation cooperative, there are certain steps and processes adopted by many successful developers of cooperatives.

If the decision is made to proceed with the venture, the key areas to address are the **organizational structure** and the **business plan**.

For the most part, cooperatives require assistance from experienced outside resources, such as lawyers, accountants, community leaders and industry experts. They have the knowledge and experience to develop reasonable and appropriate organizational structures and sound business and financial plans.

Incorporation of a new generation cooperative

When enough potential members, to achieve the volumes of business outlined in the feasibility study, are prepared to provide start-up equity, it is time to proceed with the incorporation of the new generation cooperative. The decision to proceed should be made by those people who have either invested funds towards the project, or are prepared to sign commitment letters to assure that the next stage will have enough financial support to cover costs incurred in the incorporation process, the development of a business plan and an equity campaign.

In Manitoba, incorporation requirements include the following minimum standards:

- three individuals or two corporations willing to act as incorporators
- three individuals willing to act as first directors
- approval of the proposed name and name reservation at the Companies Office
- completion of Articles of Incorporation

The approved Name Reservation from the Companies Office, Articles of Incorporation, and if required, the Offering Statement, must be submitted to the Registrar of Cooperatives together with the required fees.

An Offering Statement is required when:

- a) The amount of the membership requirement exceeds \$1,000 in membership shares and/or loans
- b) special investment shares (delivery rights) are being issued
- c) investment shares are being issued to members only.

The Offering Statement must be filed with FIRB. A request for exemption from filing an Offering Statement can be made to FIRB. An exemption may be granted; however, the use of a disclosure document may be required in lieu thereof. A disclosure document is a less formal document that discloses the risks and conditions associated with the purchase of shares in the new generation cooperative. It is also used as the marketing and information package given to potential shareholders.

In Manitoba, the incorporation process may be expedited by restricting the share capital option to simply issuing membership shares and/or loans for less than a total of \$ 1,000 per member and collecting a membership fee. This leaves the details for the investment shares and special investment shares until after the business plan is completed and approved by the members. At this point, the required securities filings and the filing of Articles of Amendment can be done to reflect the decisions made on the capital structure.

The funds received from the membership shares and fees are used to cover the costs of applying for funding for assistance in developing the new generation cooperative, preparation of the business plan, research and development costs, the costs associated with attracting producers into membership, and maintaining contact with the membership as the project proceeds.

After incorporation

Once the incorporation process is complete, the incorporators are usually the first directors and the only members until new members are approved by the board. At the first meeting of members and potential members, held as soon as possible after incorporation, voting members elect directors, approve bylaws, and set out financial requirements of membership. The bylaws must be submitted to the Registrar of Cooperatives within 30 days of this meeting.

Potential members should be encouraged to join before the meeting in order to have the right to vote at the meeting. This is also the time to sell membership shares and collect membership fees to provide the new generation cooperative with some working capital until the business plan is brought to the membership for approval.

The business plan

A business plan is a document providing a complete description of the operations of the proposed new generation cooperative. The plan must include financial projections for capital costs, inventories, receivables, banking arrangements for lines of credit, working capital loans to cover receivables and inventories, mortgages on the capital assets, the amount of share capital required, sales volumes, production costs, operating expenses, break-even volumes, marketing opportunities, commitments and all other pertinent information about the venture, including details about the competency of the proposed management team. It must also address all issues relevant to the project.

The share capital requirements must set targets for each category - the membership shares, the special investment shares or delivery rights, and investment shares where this option is being considered.

Once the board of directors approves the business plan, and a decision is made to proceed based on the probability that the project will be a success as outlined by the business plan, a members meeting is necessary. The business plan would be presented to the membership by the board of directors with the support of the consultants responsible for its preparation. The members require the information in the business plan to enable them to decide if they are willing to risk investing equity in the project.

The support of the membership is essential. Once the membership approves the business plan, the Articles of Incorporation can be amended to include the proposed share structure and the Offering Statement and/or Prospectus can be filed with the appropriate authorities (or requests can be made for exemptions to the filing requirements). The board is then in a position to make presentations to the individuals or organizations for financing. It is important that the presentations explain:

- why investments in the new generation cooperative should be made;
- the seriousness of the proponents of the project; and
- The ability of the board and management to launch and develop the project successfully.

Prepare for business launch

Once the business plan has been approved, leaders should be identified (for consistency) to run the membership and equity drive. When members have committed to deliver the volumes of raw product, and have purchased the special investment shares required by the business plan, the new generation cooperative is ready to launch the project.

A members meeting should be held to confirm that the equity and delivery targets have been achieved and to obtain approval of the membership to continue the project. This will involve hiring management, acquiring or building facilities, hiring and training staff and commencing of business operations. In the event that there is any significant deviation from the business plan, the members should be consulted before further commitments are made.