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by

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Equity Capital and Restructuring of Cooperatives as Investor-Oriented Firms

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The inability of financially successful cooperatives to recognize appreciation of patron's equity creates a dilemma for cooperative members. The value of an enterprise as an investor-oriented firm may exceed the value of patron's participation in a limited patronage horizon. This difference has been a factor in the decision of several cooperatives to restructure wholly or partially as investor-oriented firms. Reasons for valuation differences are discussed and related to six cases of cooperative restructuring.

Members of several agricultural cooperatives have elected to restructure themselves as investor-oriented corporations, to sell the business, or to restructure segments of their businesses as ordinary corporations with minority public ownership. Other cooperative boards are considering these alternatives.

This paper advances the hypothesis that the nature of patron's equity in cooperatives may predispose high performance cooperatives to restructure as investor-oriented firms and that certain practices by cooperatives may accentuate this tendency. The paper examines equity capital from a patron's viewpoint and the implications for equity capital in cooperative principles. Selected cases of cooperative restructuring are discussed. The major objective of the paper is to raise issues and to call attention to unanswered questions regarding these changes in cooperative status.

It is presumed that cooperative member-patrons participate in a cooperative business primarily to increase the level of their incomes. The value of benefits to member-patrons associated with participation and investment in a cooperative should equal or exceed the value of benefits foregone because of the investment of capital in their cooperative.

Patron investment may be regarded differently depending on one's viewpoint. Some argue that, if the patron's out-of-pocket investment was nom-

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inal or zero, prices were competitive, and the equity was built using only net earnings of the cooperative, the member has no investment. Others may view only allocated equity as patron's capital. Still others consider all equity (allocated credits, patron stock, and unallocated retained earnings) as patron equity that might be employed by patrons in other ways. The latter view is consistent with the assumption that the patron's participation is primarily motivated by economics. It recognizes the option of member-patrons to vote to employ their capital elsewhere through liquidation or sale of the business.

Cooperative Principles and Equity Capital

The three principles—"Cooperatives are . . . controlled by those who use their services," "Net margins are distributed to users in proportion to their use of the cooperative," and "Returns to investment are limited" are generally considered to be "fundamental principles of a truly cooperative business enterprise" (Baarda, p. 4). All have major implications for equity capital in cooperatives. The latter two principles (widely incorporated in state cooperative statutes and found in federal tax law) mean that benefits from participation in cooperatives belong to patrons as users not as shareholders. It is important to note that the principles do not preclude the recognition of the cost of capital in individual patron accounts. That is, limited dividends (a fixed rate based on face value, limited by law) allow for compensation for the use of patrons' allocated capital. If patrons' shares of equity are exactly aligned with patronage shares, allocation of net earnings based on patronage also would reflect equity shares. Barton (p. 27) identifies a set of "proportional" principles that includes "Equity is provided in proportion to patronage." However, in most cooperatives patron equity shares diverge materially from patronage shares. Cobia, Royer, and Ingalsbe (p. 272) reported on an earlier study by Brown and Volkin that found 68 percent of 857 cooperatives redeemed equity in special situations only or had no redemption plan. Proportional investment is very unlikely in these cooperatives.

Many cooperatives pay no dividends on shares of equity capital. Net earnings are allocated to patrons in proportion to business done with the cooperative. Thus the patronage refund includes both compensation for the use of patrons' capital and any earnings of the business itself. No return to equity capital as such means that economically rational patrons will provide only as much capital as is required to use the cooperative and thus participate in its benefit stream.

Benefits to patrons include any favorable impact on prices to producers that may arise because of the cooperative's existence. The value of participation in a cooperative is represented by the discounted stream of benefits from future use of the cooperative plus the present value of the equity to be returned to the patron (Beierlein and Schrader). If net earnings represent the full benefit of participation and are just equal to the opportunity cost of equity capital, all equity is allocated, and equity is redeemed when patronage ceases, the value to patrons from participation in the cooperative would equal the book value of patrons' equity. That is, the accounting valuation

of equity would accurately reflect the value of the business as a going business. If net earnings exceed the opportunity cost of capital, the value of participation in the cooperative would exceed the book (face) value of patrons' equity. Thus the value to patrons of participation in a very successful cooperative may exceed the book value of their equity interest. Participation in a cooperative whose net earnings fail to cover patrons' opportunity cost of capital is worth less than the face value of equity. The validity of these statements depends on the assumption that prices to patrons are equal to those that would prevail without the cooperative. Reported net earnings could be adjusted to reflect differences between prices to patrons and those expected in the absence of cooperatives.

These observations on value of participation refer to patrons as a group. Individual valuations differ. Rights to benefits from operations above any limited return to equity cease when use ceases. Therefore the value to the individual user relative to equity invested depends to a large extent on his patronage horizon, opportunity cost of capital, and the share of capital invested relative to share of patronage. The value to the individual patron of use of a cooperative relative to equity increases with length of patronage horizon, decreases with increases in opportunity cost of capital, and decreases as the share of equity increases relative to patronage share (Beierlein and Schrader). A beginning farmer with a relatively low investment would value participation in a successful cooperative well above the book value of his equity in the organization. On the other hand, a farmer about to retire, who must wait years to recover his investment, will find the value of his participation well below the book value of his equity. Payment of dividends on equity would diminish the disparity due to differences in patronage horizon but not that arising from differences in opportunity cost of capital.

Equity in Investor-Oriented Firms

Usually the equity (share) holder in an investor-oriented business has control (votes) and rights to earnings proportional to stock ownership. All returns above costs belong to the owners whether or not they are also patrons of that business. The value of stock reflects the present value of the expected flow of dividends from the business and expected future stock price. If the value of a share to the individual shareholder is less than others are willing to pay for it he can sell his interest in the business. Likewise, if the value to an individual is higher than the price at which others are willing to sell their shares he may add to his stockholding. The market may value the stock at, above, or below book value. The value of a successful firm (earnings on book value of equity above the cost of capital for equally risky investments) will exceed the book value of equity. The increased value is reflected in stock price. The rights to earnings held by owners of shares in the ordinary corporation result in the capitalization of all expected future earnings into present stock prices.

Patron vs. Investor Valuation

Cooperative equity holders recover no more than book value of allocated equity when redeemed regardless of the value of the firm as a going busi-

ness. If the earnings stream is below that which could be earned in other equally risky investments, book values of allocated equity may exceed the value of the firm as a going business. If the benefits (earnings) are greater than alternative investments, book value understates the value of the going business. In the latter case, patrons with limited patronage horizons can capture the full value of their share of the business only if the cooperative is dissolved and the business sold. The more successful the cooperative the more attractive this alternative appears to some members. If prices to patrons are the same as without the cooperative, the cooperative's net earnings would be equal to pretax profits of a similar investor-oriented firm. The major difference in value to a patron of participation (other than tax effect) and an IOF stockholders valuation is that IOF stock value is based on the associated rights to earnings for the life of the firm whereas the cooperative equity holder has rights to earnings above limited dividends only as long as he is a patron. The value of participation may be much larger than the patron's equity for a new patron. At the other extreme, a member who is about to retire may value participation at little more than the discounted value of his equity account and well below the going business value of his equity share.

If farmers think of their farm business as a family operation to be passed from generation to generation there would be less difference in the valuation of cooperative participation among farms. In effect, the farm would be the member. If as in some cases, membership goes with the land, the performance of a successful cooperative is capitalized into the value of the land. Thus, the patron does receive a price reflecting the value of the cooperative as a going business when he ceases farming as a part of the price for or rent from the land associated with membership.

The presence of unallocated equity increases the divergence of the value of participation in the cooperative and the value as a going business by patrons with a short patronage horizon. Valuation as a business would include the full value of earnings based on total equity whereas the patron will receive only book value of allocated equity.

The cooperator's dilemma is that a cooperative that produces net earnings in excess of the opportunity cost of equity capital may be worth more to investors as an ordinary corporation than it is to many cooperative patrons. The value of participation in the cooperative to all patrons over the cooperative's life would differ from the investors' valuation only because of differences in tax treatment and in opportunity cost of capital. The value of participation for the individual member whose patronage horizon is short will likely be less than an investor in a comparable ordinary corporation as long as equity is redeemed at only face value. Variation in tax rates, variation in opportunity cost of capital, and differences in investment relative to patronage cause the value of participation to individuals to vary. Patron income tax rates lower than corporate rates and single tax treatment afforded cooperative net earnings allocated to patrons enhance the value of participation in a cooperative relative to the value of a comparable business to an investor especially at lower earning rates.

The arguments above apply to a centralized cooperative. Members of a federated cooperative are cooperative corporations with perpetual lives.

Thus there is no difference in patronage horizon to affect their valuation of participation in the federated organization. There would also be less variation in the opportunity cost of capital among member cooperatives than among individual farmer members.

A significant share of local cooperative assets may be in the form of equity in the federated cooperative. To the extent that this is not immediately convertible to cash, it would discourage dissolution of a local to capture equity. The flow of benefits from the federated to the member cooperative would cease upon dissolution of the local and would not add value for a new noncooperative owner.

Six Cases of Cooperative Restructuring

The combination of financial pressure on farmers, a bull market in corporate equities, and lack of means for patrons to capture appreciation in the value of a cooperative as a going business led a number of cooperatives to consider restructuring wholly or in part for various reasons related to equity capital. Six of these cases are very briefly described with a focus on equity capital issues. Four large and apparently successful cooperatives have elected to discontinue operation as cooperatives in the past three years. Three of these operations restructured as or became a part of investor-oriented firms and one was acquired by another cooperative. Two cooperatives have offered shares of subsidiary corporations to the public. The focus of the review of these cases is on the motivation for the decisions made.

Rockingham Poultry Marketing Cooperative, Inc.

Members of Rockingham Poultry Marketing Cooperative, Inc., a grower-owned cooperative, voted to accept the proposal of Wampler-Longacre, Inc., to exchange the assets and liabilities of the cooperative for stock in Wampler-Longacre on September 12, 1987. Operations as a cooperative ceased when the deal was closed on January 1, 1988. The operations of Rockingham were continued as Rockingham Poultry, Inc., a wholly owned subsidiary of the renamed Wampler-Longacre-Rockingham, Inc. (now WLR Foods). The number of shares of Wampler-Longacre stock exchanged for assets and liabilities of the cooperative was determined based on the book value of equity of the two organizations. The agreement, reviewed and found to be fair by outside appraisers, placed 32.96 percent of the shares of Wampler-Longacre-Rockingham in the hands of Rockingham Cooperative equity holders and patrons.

The appraised value of the 1,452,081 shares of Wampler-Longacre exchanged for the Rockingham operation was nearly \$75 million at the time that members voted on restructuring. Book value of Rockingham Cooperative equity was about \$23.5 million at the time of decision. Cooperative equity holders were to receive stock, the appraised value of which equaled the face value of the equity. The remaining stock, representing the excess over book value of patrons' equity, was to be allocated to patrons over the 19-year period from 1968 through 1986 in proportion to the pounds of poultry marketed in the years the gains were determined to have occurred. Internal Revenue Service ruled that the transaction did not result

in taxable gain or loss to Wampler-Longacre shareholders or to Rockingham Cooperative patrons.

Wampler-Longacre was an integrated producer-processor of turkeys including further processing of both turkey and chicken products. Wampler-Longacre initiated discussion of the combination motivated by desire to secure a supply of chicken for further processing. Other reasons advanced for the restructuring were to enable Rockingham to enter further processing without a large investment; to increase product lines and add stability; to increase efficiency of feed ingredient purchasing, production, and distribution; and to eliminate the immediate need for a new feed mill to serve Rockingham's needs. The position of Rockingham management was, in effect, that more capital would be needed to maintain the level of performance of the cooperative (Securities and Exchange Commission 1987).

Members, faced with a choice between the prospect of larger capital requirements and a perceived opportunity to take out nearly three times book value of equity, opted for the latter. When the transaction and stock allocation were complete, patrons of the former cooperative held stock in Wampler-Longacre-Rockingham with full voting rights. The board of directors of the Rockingham subsidiary of Wampler-Longacre-Rockingham includes representatives of Rockingham growers. Control resides with the Wampler-Longacre-Rockingham board where the Rockingham growers hold a minority interest. Growers share in earnings only to the extent they retain allocated shares or acquired additional shares.

American Rice, Inc.

Members of American Rice, Inc., a Texas rice milling and marketing cooperative, elected to restructure the company as a regular corporation in April 1988. American Rice began operation as a rice grading and marketing information service in 1969. It expanded to encompass processing and marketing of rice products in the United States and abroad. Its stated objectives were "to market all its patrons' rice and maximize the returns on the raw products produced and delivered by its patrons" (Securities and Exchange Commission 1988, p. 19). The proposal to restructure was stimulated by a study of ARI and its market position conducted by an outside consultant. Access to capital and decision flexibility were among benefits cited for the change from cooperative status.

American Rice operated on a pooling basis with virtually all net returns paid to or allocated to patrons. Thus there are no measures of profitability exactly comparable to other businesses. Pool returns regularly exceeded nominal competitive returns for rough rice. The cooperative also held real estate in Houston, Texas, the market value of which substantially exceeded book value. Book value of patrons' equity at June 30, 1987, was \$30,409,000.

The President's Letter in ARI's 1987 Annual Report stated (p. 5): "An ongoing complaint we have received from ARI members is their inability to recognize or get their equity out of ARI. The equity interest of an ARI member in ARI is greater than the organization can recognize under the cooperative structure. Under current economic conditions, many members could use this equity interest if it were available."

The cooperative had formed a joint venture, Comet American Marketing, with Comet Rice, Inc. (a subsidiary of ERLY Industries) to sell and market rice in the United States, Canada, and the Caribbean area. Each firm held 50 percent of the joint venture.

The restructuring established a new corporation now using the same name, American Rice, Inc. The new corporation sold 24 percent of issued shares to ERLY Industries for \$20 million, exchanged 24 percent with Comet Rice, Inc., for Comet's share of Comet American Marketing, and exchanged 52 percent with the cooperative for the assets and liabilities of the cooperative. The amounts represented by capital retains were redeemed in cash at book value by the new corporation. The stock issued to the cooperative was distributed to patrons (members and past patrons) in proportion to rice marketed through the cooperative since the inception of rice milling operations.

Shares in the reorganized American Rice were publicly traded at about \$3 per share in September 1988. This implies a value of the cooperative patrons' interest of about \$25 million in addition to the approximately \$25 million of capital retains redeemed. Thus patrons received about twice the book value of allocated equity in cash or relatively liquid assets. The transaction did not trigger any federal income tax liability for the cooperative or those receiving stock in the new organization.

Capitol Milk Producers Cooperative

Members of Capitol Milk Producers Cooperative elected to sell the operations of the cooperative to Southland Corporation in October 1986. The transaction was completed December 30, 1986, when operation of the dairy plants and High's Dairy Stores owned by the cooperative was taken over by the new owners.

Capitol Milk Producers Cooperative was organized in 1941 as a bargaining cooperative. The organization became the major supplier of milk for High's Dairy Products Company, a chain of dairy stores with its own bottling and ice cream plants. In 1962 a plan to transfer ownership of the two dairy plants to Capitol Milk Producers was initiated, and in 1964 the cooperative acquired the chain of dairy stores as well.

The High's operation included 113 limited line dairy stores in 1962. The chain had grown to 352 convenience stores carrying about 3,200 items, a major share of which were not dairy products. By the end of 1986, Capitol had 146 members and book equity was \$23,675,000. Earnings on business other than that involving members' milk were more than double the net margin applicable to member business in recent years.

In early 1986 management saw the need for greater capital for plant improvement, store renovation, and addition of stores to maintain High's position in the fast growing convenience store segment of retailing. A proposal to study the option of selling the business was approved by the board in April and in July the operation was offered for sale. A bid by Southland Corporation to buy the full equity of Capitol for in excess of three times book value was accepted by the membership. The sale was completed before the end of 1986 to take advantage of low capital gains tax rates and certain other tax treatments not available after the end of 1986.

All equity capital credits were redeemed at face value. The excess over face value of equity credits was distributed to members as of a date representing first serious consideration of sale in proportion to patronage during 10 years including 1986.

American Cotton Growers

Members of the American Cotton Growers (ACG) voted to sell their textile mill in April of 1987 in response to an offer from an investor-oriented corporation. The subsequent agreement with the prospective buyer included a provision giving a cooperative first opportunity to buy the mill. The denim mill was acquired by Plains Cotton Cooperative Association (PCCA), thus continuing the cooperative status of the mill while allowing ACG members to capture appreciation of their equity in ACG.

American Cotton Growers was organized in 1975 by a group of Texas cotton producers who wished to market their cotton on a pooling basis rather than on the buy-sell basis used by PCCA at that time. At the same time a new spinning method was developed that allowed the production of good quality denim from Texas short staple cotton. A contract was negotiated with the Levi Strauss Company to buy all the denim produced by the mill that met the buyer's specifications. The cooperative received a Farmers Home Administration guarantee to back a construction loan under the 1972 Rural Development Act. The city of Littlefield, Texas, provided land and there were tax concessions. Thus ACG was able to begin operation of a textile mill with no initial investment of cash by members with financing provided by the Texas Bank for Cooperatives. Management was provided by PCCA under contract to ACG. Equity capital was accumulated using per unit capital retains.

After several early lean years, during which there was the need to replace looms to meet changed buyer specifications, the operation proved to be a financial success. Patrons' allocated equity had reached nearly \$46 million by the end of fiscal 1986. A number of original members had dropped out during the difficult years. The remaining group was not eager to share the gains with new or returning members once the mill began to pay off. Returns to ACG pool, which included returns to the denim mill (and to capital invested), were substantially larger than were available from the cash market through PCCA.

An offer of \$100 million for the assets that would result in an immediate payment of 2.24 times book value of allocated equity to members produced the vote to sell. A last minute increase from the outside bidder produced a potential payout at 2.55 times book value. With loan guarantees provided by three other cooperatives, PCCA was able to borrow the capital needed for the purchase from the Texas Bank for Cooperatives.

Gold Kist/Golden Poultry

Gold Kist Inc. is a diversified agricultural membership cooperative headquartered in Atlanta, Georgia. It operates as both a marketing and purchasing cooperative in southeastern United States. Gold Kist ranks among the nation's largest processors and marketers of broiler chicken. Golden

Poultry Company, Inc. is a subsidiary of Agri International, Inc., which is a wholly owned subsidiary of Gold Kist.

Private stock offerings to officers, directors, and employees in 1985 and 1986 had reduced Gold Kist interest in Golden Poultry to 84 percent. An additional 1.1 million shares of newly issued stock were sold in a public offering in October 1986. This reduced the Gold Kist share to 73 percent. Gold Kist retains effective control of the affairs and policies of Golden Poultry. Management services are provided by Gold Kist under a service agreement with Golden Poultry.

Proceeds from the sale of new stock were intended to be used to finance "expansion of production capacity through acquisitions, internal expansion and improvements" (Golden Poultry Co., Inc., p. 5). Golden Poultry has invested in processing plant improvements, built a new feed mill, constructed broiler growout facilities, and started work on a new processing complex.

Gold Kist management reasons that the addition of the Golden Poultry operation benefits Gold Kist members by making patronage business more profitable as well as providing earnings on the nonpatronage business. The added volume provides additional marketing flexibility and channel control. Costs of management, advertising, research, etc. increase less than proportionally with volume. Thus unit net returns to Gold Kist grower-members are increased before considerations of dividends that may be paid by Golden Poultry.

The impact of Golden Poultry on Gold Kist equity capital position is complex. The subsidiary increases Gold Kist capital requirements over that which would be required to process and market member poultry whereas the sale of a part of Golden Poultry equity reduces the Gold Kist capital required to achieve the member benefits in marketing and unit cost reductions associated with the subsidiary operation. The sale of stock representing 13.53 percent of the stock outstanding generated \$11,620,000 or 29.78 percent of Golden Poultry equity at the end of fiscal 1987. That is, the public shares were sold at nearly twice book value. The stock sale resulted in a gain of \$5,857,000 for Gold Kist in fiscal 1987.

Land O'Lakes/Country Lake Foods

Land O'Lakes, Inc. is a diversified Minnesota cooperative providing marketing and purchasing services for farmers in the upper Midwest. Country Lake Foods, Inc. was incorporated as a wholly owned subsidiary of Land O'Lakes in September 1987. Country Lake was formed from a combination of Norris Creameries, Inc., Lakeside Dairy Company, and the fresh packaged milk and ice cream business assets of the Dakota Division of Land O'Lakes. Country Lake was formed to focus development of Land O'Lakes' fresh packaged milk and ice cream businesses and to facilitate the acquisition of family-owned dairy companies for stock rather than cash. All parts were already owned by Land O'Lakes.

The Country Lake prospectus reasons as follows:

The establishment of the company is the result of a strategic review by LOL of its several dairy products businesses. LOL formed the

Company for two principal reasons. First, due to the relatively short shelf life of fluid milk and the special handling and intensive retail merchandising required by fluid milk and ice cream, the Company's products are distributed through its own regional sales force, not through the national distribution system used by LOL for its longer shelf life dairy products such as butter, spreads and hard cheese. The Company's products are also produced at different facilities than LOL's longer shelf life dairy products. Second, the dairy products businesses in which the Company competes are undergoing consolidation due to increased competition, the requirements for modernization of facilities, the need for capital and the benefits derived from economies of scale. As a public stock corporation with the ability to raise capital in the public markets and offer securities in acquisitions, the Company will have more flexibility to grow during this period of industry consolidation. (p. 5)

The Company's strategy for growth "will be to build on its existing business through selected acquisitions of established dairy businesses, generally in geographically contiguous areas" (Country Lake Foods, p. 5).

Stock was sold at more than two times book value that includes cash from the stock sale. Public ownership of a share of Country Lake reduces the member capital needed for a similar sized and leveraged business.

Observations

These cases confirm the difference in valuation of a business as a cooperative patron and as an investor in an investor-oriented firm. The evidence is that members voted to sell when offered a price reflecting market value of the going business. American Cotton Growers appears anomalous, having been acquired by another cooperative. Patrons of the original cooperative were being required to maintain a higher equity than the acquiring cooperative whose members did not increase their equity to make the purchase. The value to patrons of the more highly leveraged business may well have exceeded the value to patrons as originally capitalized. The acquiring cooperative may have taken a longer view of benefits than individual members of the original cooperative.

Valuation models suggest that older patrons would place a smaller value on participation than those with a longer expected patronage horizon. None of the persons interviewed in the course of this study indicated that there was evidence of this in grower attitude at the time of a vote to restructure. In one case, growers in an area newly served by the cooperative favored continuation as a cooperative while those in its original area (with a greater share of equity) favored restructuring as an investor-owned firm.

A common feature of the cases reviewed (excepting American Growers) is that top management concluded that growth is essential for the organizations to remain viable. That is, to remain static is to lose market position and eventually to shrink. Dependence on internally generated capital was viewed as limiting the rate of growth.

Arguments for investor-oriented subsidiaries include the contention that added volume is needed to maintain effective marketing (higher value for

patron products) and that average costs will decrease as volume increases. If realized product prices increase and cost increases are less than proportional to increases in size, the argument for continued growth is very strong. The case for size is more easily stated than demonstrated. There are seven public investor-oriented firms (including Golden Poultry) that are heavily involved in broiler production and processing. These firms show no consistent relationship between size and rate of profit before interest and taxes earned on total assets. The smaller firms include both the highest and lowest profit rates with the largest firms in the middle. Stock values in September 1988 relative to book value of equity per share ranged from 1.13 to 4.10 for these seven companies.

Cooperatives are generally presented as capital short. Yet both Golden Poultry and Country Lake Foods appear to have a higher equity to total assets ratio than many comparable public companies. ERLY Industries, which now controls American Rice, is highly leveraged. Southland, the buyer of High's, has been acquired in a leveraged buyout. The new owner of the American Cotton Growers' denim mill is a much more highly leveraged cooperative than the original.

In each case the initiative for restructuring originated from management or an outside expression of interest. Once members were made aware of the possibility to recover substantially more than book value of their equity in cash or marketable securities, they voted to take the liquid asset. In each of these cases the amounts accumulated in member equity accounts were relatively large. Although the value of equity was decisive in member votes to restructure, it was not the reason for action put forward by management.

Once a proposition from outside to pay well in excess of book value of equity has been made to management, the prudent management and board have an obligation to present the alternative to members. One might argue that the alternative to sell or reorganize should be examined continuously by the diligent management team.

On to the Future

There is little question that other cooperatives will be faced with decisions to sell all or part or to restructure their enterprises. The principles as reflected in practice and various laws result in a chronic shortage of capital and the lack of a means to reflect equity appreciation to owners. Thus there is a need to recognize the problem and to be prepared to provide information useful to members when alternatives are presented.

Research is needed to identify and evaluate alternative means to recognize increasing or decreasing value of a cooperative as a going business to patrons/equity holders that are consistent with operation on a cooperative basis. It may be too late to explore alternatives fully when a cooperative is faced with a bid. Regular revaluation of patrons' equities or releveraging should be evaluated. A market for patrons' equity (nonvoting) begs for further study. Innovation in the treatment of cooperative equity may require some changes in laws to be feasible.

Intelligent decisions by management and membership depend on an accurate assessment of benefits that accompany patronage. This is difficult

to accomplish especially when the cooperative operates on a pool basis and there is no market that reflects competitive value of raw products. There is a tendency for management to overstate benefits and not to recognize the cost of equity capital when comparing cooperative net prices to patrons to other alternatives. If these assessments are to be useful, they must be accurate and understandable by the members. Estimates of the value to members of participation must recognize the time value of money. A record of accurate benefit assessments would provide the basis for an appraisal by members of financial benefits from participation in the cooperative.

The cases examined indicate that these cooperatives may have been overcautious in the use of leverage. Member capital is generally more expensive than borrowed capital. That is, members pay higher rates on loans than are paid by their cooperatives. Perhaps members could accept greater liability to allow greater leverage at favorable rates of interest. The fact that buyers of case cooperative assets have a lower equity ratio than the original cooperative suggests that some growth was possible without additional equity.

Cooperative principles and practices place capital constraints on growth. There are other disadvantages to operation as a cooperative including, perhaps, more cumbersome decision making. Thus, if the cooperative form does not best serve members, restructuring as an investor-oriented firm may be an advantage for both the farmers and new investors. If there are sufficient reasons to have a cooperative, it must operate to minimize the incentive for members to vote otherwise. Investment proportional to patronage reduces the burden on those with a short patronage horizon. Borrowing based on real value of the going business rather than book values can be used to reduce the need for member capital in financially successful cooperatives. Payment of dividends to reflect capital costs to members can be used if investments cannot be proportional. Allowing the capital-short member to borrow capital is another means to make the burden more equitable. The best defense may be keeping the patron apprised of the benefit of participation in the cooperative as a cooperative.

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