# NOT TOO POOR TO INVEST:

# THE CASE FOR SMALLHOLDER FARMER OWNERSHIP PROGRAMS

# ACKNOWLEDGEMENTS

Adapted from Not Too Poor to Invest: The Case for Member Equity in Smallholder Farmer Cooperatives and Associations, by Ted Weihe, this paper represents the work of many people dedicated to the advancement of smallholder farmers and their cooperatives and associations around the world. Generous funding for both papers was provided by the US Agency for International Development's Cooperative Development Program and Equal Exchange. Equal Exchange (EE) worked with partner cooperatives in the Dominican Republic, Ecuador, and Peru to build the cooperatives' capital through member investment; support cooperative partners' efforts to improve product and increase yields; and access new and deepen relations with existing buyers and markets. EE's engaged and committed project management team, Dary Goodrich (Chocolate Products Manager), Cristina Liberati (Grant Projects Manager), Julia Baumgartner (Cooperative Development Program Consultant) worked closely with cooperative consultants Ted Weihe, Barry Silver, Bob Flick and the Financial Advisory Services team at Root Capital[1] to implement the program. The partner cooperatives in Dominican Republic (Conacado), Ecuador (Fortaleza del Valle, UOPROCAE), and Peru (ACOPAGRO, Norandino, Oro Verde) dedicated much time and energy to doing the hard work of building successful member equity programs. Weihe, Silver and Flick prepared an in depth analysis of the experience with partner cooperatives building member equity.

Dr. Ann Hoyt, a University of Wisconsin–Madison emeritus professor and a member of the Cooperative Hall of Fame, adapted the paper for use in the field. Dr. Hoyt has trained thousands of directors, developed extensive training materials, has a distinguished academic career and developed an extensive multi-media director training program funded by USDA. She currently serves as Board President of Group Health Cooperative of South Central Wisconsin. As a long time cooperative educator and board member, she is highly knowledgeable about cooperative member equity and capitalization issues. As an extension faculty member, her expertise is an ability to translate academic literature into audience appropriate, user-friendly formats.

Catherine Ford, Business Transformation Consultant at CUNA Mutual Group, provided overall management of the document development along with minor document revisions. Ford's deep understanding of cooperative development comes from 15+ years' experience managing international cooperative development projects spanning agriculture, management-board leadership training, health, enabling law and regulation, financial outreach and product development.

Jenny Bernhardt led the design of the document. Since 2005, she's been writing, editing and integrating online and print content to support diverse cooperatives in the United States and around the world.

Cristina Liberati, Dary Goodrich and Julia Baumgartner provided steering on the document development.

1 Root Capital is an agricultural impact investor that grows rural prosperity in poor, environmentally vulnerable places in Africa and Latin America by lending capital, delivering financial training, and strengthening market connections for small and growing agricultural businesses.

# TABLE OF CONTENTS



This paper is not intended to take the place of legal advice. Knowledgeable counsel should be consulted when writing bylaws and developing capitalization programs.

Cacao beans, shown here split open and encased in their pods, were used as a form of currency in the Mayan and Aztec empires. Today, as much as 90% of the world's cacao is produced by small farmers who make less than $2 USD per day for the beans that they sell. When farmers are able to organize into cooperatives and associations, they are able to export to foreign markets. More importantly, they gain ownership and voice in their business, and the potential benefit of becoming investors in capital and savings programs.

# EXECUTIVE SUMMARY


Experience has shown creation and growth of a member-owned capital base is crucial to the long-term sustainability of member owned businesses and can provide an effective savings tool and financial safety net for smallholder farmers. Information presented in the paper grew out of the results of an Equal Exchange[1] (EE) project to introduce member equity programs in smallholder farmer businesses in 3 countries: Dominican Republic, Ecuador and Peru. The paper provides an introduction to effective investment vehicles for smallholder farmers. It is appropriate for use by farmer cooperatives and associations as well as organizations and individuals who provide support to smallholder farmer enterprises, including developers, trainers, lenders, donors, and enterprise boards of directors and staff members.

The paper discusses the role of and necessity for member investment in a strong capital base in group-owned businesses to provide reserves for unexpected business setbacks and to support business growth and development. It identifies potential sources of capital, the difference between equity and debt capital and the importance of member contributions to capital in smallholder enterprises. It goes on to describe differences in the capital structure and member/owner benefits, control and risks in three types of businesses, investor-owned firms, producer associations and cooperatives. Emphasis is placed on the structure of cooperative equity vehicles, allocation of funds and redemption practices.

Based on the background provided, suggestions are given for how to establish a capitalization plan with emphasis on the importance of member education, particularly for farmer members of associations and cooperatives. Suggestions include descriptions of the roles and responsibilities of the stakeholders in the capitalization effort: members, management and staff, board members and delegates, and donors and grantee organizations.

Support for positions taken in the paper is provided by 5 case studies of cooperatives and associations that were part of the Equal Exchange member equity project. Synopses of the case studies are included as well as an example of a smallholder capitalization plan based on per-unit capital retains. An example of saving/capitalization plan, sample regulations, a glossary and an extensive list of references are included in the Annex.


1 Equal Exchange is one of the largest worker cooperatives in the United States, and the world's largest worker-owned coffee roaster. Find out more at http://equalexchange.coop

# INTRODUCTION

Developing a strong capital base is one of the most critical issues facing group-owned smallholder enterprises, cooperatives and associations in developing countries. While there are many reasons that these enterprises have not met their full potential, the focus here is on their capital structure and lack of sufficient owner equity invested in the enterprise. In fact, lack of focus on developing owner equity may be the biggest oversight by farmer members, development professionals, governments and donors anxious to improve rural incomes and livelihoods. Experience has shown creation and growth of a member-owned capital base is crucial to the long-term sustainability of member owned businesses and can provide an effective savings and financial safety net for smallholder farmers. There is a rich literature about member equity in the United States, Europe and other developed countries, yet there is little research on member equity and savings plans in developing country settings with different cooperative or association histories, laws and regulations.

Designed to provide basic information, the paper emphasizes the need to develop smallholder financial ownership in the group businesses, cooperatives and associations that serve them. It is designed to assist them and their supporting organizations (donors, lenders, academia, and the broader umbrella of cooperative development organizations) as they develop and/or implement plans to build member investment. The goal is to help create independent farmer-owned organizations with sufficient farmer invested capital to enable both the farmers and their enterprises to survive and thrive.

The paper is adapted from an earlier document based on an extensive Equal Exchange (EE) project to introduce member equity programs in smallholder farmer businesses in 3 countries: Dominican Republic, Ecuador and Peru. Through the USAID funded Cooperative Development Program, participating smallholder farmer businesses (primarily cacao and coffee cooperatives) created internal savings and investment cultures that resulted in increased capital that could be used to provide reserves, develop infrastructure, grow and reduce dependence on high-interest loans. In partnership with Root Capital's Financial Advisory Services, EE completed baseline diagnostics and tailored individual training programs to meet each cooperative's unique financial and managerial needs. Investments in human capital have been a priority of this program, whether through board and delegate training, or community level workshops that focus on the linkages between healthy personal or family relationships and healthy relationships with the farmer's cooperative.

Understanding the concepts and having the ability to promote and implement member equity plans is also important to organizations and individuals who provide support to co-operatives, including lenders and donors. Donors need to hold Cooperative Development Organizations (CDOs), NGOs and contractors accountable for promoting member investment and implementing member equity plans in enterprises that receive their assistance, whatever the other project goals may be.

When farmers invest in their cooperative, they have an ownership stake that creates a much stronger and tangible bond to the cooperative. With an ownership stake comes an ownership voice, and farmers have the responsibility to engage with the cooperative and help guide the organization as a business. With investments from its members, cooperatives can become more financially sound and have the resources to provide better services to the members. It can create a healthy cycle with positive impacts for farmers, cooperatives and communities.

# WHAT IS CAPITAL?

Consider the challenges that could be faced by small holder agricultural producer associations and cooperatives: inadequate transport or storage facilities, downturns in sales, declines in commodity prices, no reserves to cushion against losses, a lender's withdrawal of credit and/or an end to donor support. Other organizations overcome these challenges, operations run smoothly, bank and donor relations are good, crops are protected in high quality storage facilities and management is able to plan for new goods and services for members. What makes a difference between these two possibilities?

One key to strong group owned enterprises is having a strong capital base. Profitable cooperatives offer products and services their members want in modern attractive settings. They can do that because enough money is invested in the business to enable it to withstand unexpected losses, thrive and grow.[1] Capital is the money that is used to start and operate a business and is an engine for growth and sustainability. Businesses need capital to:

- Start operations and provide funds to operate the business (working capital);
- Purchase, replace, or upgrade buildings and equipment;
- Fund needed infrastructure;
- Meet collateral requirements of commercial banks and reduce lending rates;[2] and
- Expand operations.

The capital of a business typically comes from funds provided by owners (owners equity), funds that are borrowed (debt) and profits (net earnings). Smallholder producer associations often also receive capital from funds that are donated by outside organizations.

OWNERS EQUITY* + RETAINED EARNINGS

+ BORROWED FUNDS + DONATED FUNDS

= **CAPITAL**

* Owners equity is a general term that refers to IOFs and cooperatives. The term member equity is a specific term unique to cooperatives.

Although it is an important part of a business's capital base, debt is fundamentally different from equity. It is a contractual obligation that must be repaid with interest at a specific time or times. Paying a return to owners in dividends on equity shares, on the other hand, is more patient and is dependent upon the profitability and cash flow of the business.

1 Adapted from Frederick, Donald A and Ann Hoyt, Capital Accumulation by Cooperatives: Traditional Methods of Acquiring Equity, Cooperative Business Journal, February, 1994, p.5. Out of print.

2 Access to credit is a continuing challenge in the development field. In previous decades, subsidized loans to cooperatives and associations as well as pass-through loans to members have been major failures. Subsided loans have not resulted in self-sustaining cooperatives or in an acceptable repayment rate from member revolving funds.

Agricultural producer organizations may use capital to:

- Pay wages and operating costs;
- Purchase seeds and fertilizer for members at reduced cost;
- Facilitate bulk procurement of equipment;
- Purchase and market member crops;
- Backstop loans or revolving credit programs; and
- Invest in facilities and infrastructure for operations so that they can reach domestic and international markets.

As producer associations and cooperatives grow, they need to develop the resources to be self-supporting and financially independent. They need sufficient capital to buy members' products, pay for staff, build infrastructure and operate as successful group enterprises. A crucial factor in financial independence is the amount of capital that has been provided by the member-owners of the organization.

Cooperatives are structured to be owned by their members. Members' contribution to the cooperative's capital base is called member equity. It is a fundamental cooperative principle that members contribute their own funds to capitalize the cooperative. The principle, Member Economic Participation, states, "Members contribute equitably to, and democratically control, the capital of their co-operative. At least part of that capital is usually the common property of the co-operative. Members usually receive limited compensation, if any, on capital subscribed as a condition of membership."[3]

Note that there is a critical difference between associations and cooperatives. Associations are non-profit producer organizations that do not have owners. However, members of smallholder producer associations are also expected to contribute funds to the association that function as capital. While non-profits are not structured to accommodate owner equity, they can develop member savings plans. Savings plans are loans to the association and are considered borrowed capital, that is, a liability for the organization rather than an asset.[4] The risks and benefits of member equity and member savings are discussed beginning on p. 8, "Equity Structures and Benefits Vary by Business Types."

## WHY ARE MEMBER CONTRIBUTIONS TO CAPITAL IMPORTANT?

Creation of a strong capital base is a critical component of smallholder organizational design, management and board training, and membership education. Without sufficient capital, the enterprise will be unable to thrive. Success in developing sustainable smallholder organizations depends on direct investment by the members in the enterprise and provides benefits to both the members and the enterprise.

3 International Cooperative Alliance

4 Savings plans may provide working and investment capital to associations but are shown on the balance sheet as accounts payable and are not truly equity, although some financial specialists qualify them as "quasi equity", especially if it is in long-term savings plans with a long rotation period, is part of a written plan and is regulated by rules adopted by the general membership meeting. But as an association acquires assets, these savings may be mortgaged to provide access to some bank financing.

For the enterprise, member contributions to capital promote financial commitment by smallholder members. Ownership of capital is the most effective avenue to creation of loyalty to the enterprise. When they have a financial stake in their organizations farmers are likely have greater loyalty than those who may only occasionally use the cooperative. They are also less likely to rely on or sell to competitors or intermediaries who offer immediate cash (side sellers).[5]

For farmers, with the right approach, member equity plans that specifically allocate funds to individual member equity accounts can build member savings substantially which increases the farmer's net worth. Such plans also provide a way for farmers to save for the future when they retire, have a disability or leave farming. When capital investments (e.g., member equity) are repaid to members, the payments can provide pension-like income to members or be a legacy to be left for a spouse and children. With a clear redemption policy, members can anticipate when they will receive repayment of invested capital funds. Finally, because they are user-owned and operated, farmer enterprises are service-oriented and often provide many services not offered by investor owned businesses or intermediaries.

# EQUITY STRUCTURES AND BENEFITS VARY BY BUSINESS TYPES

Let's assume that *every* business, no matter what its corporate structure, is started by a founder or founders who have an idea for a product or service that people want, is not being provided in the marketplace, or could be provided at a higher quality or lower price. Once the business has been in operation and is successful, it will generate more money that it needs to pay its expenses. This excess is called different things in different organizations, among them profit, net income, net savings, surplus and net earnings.

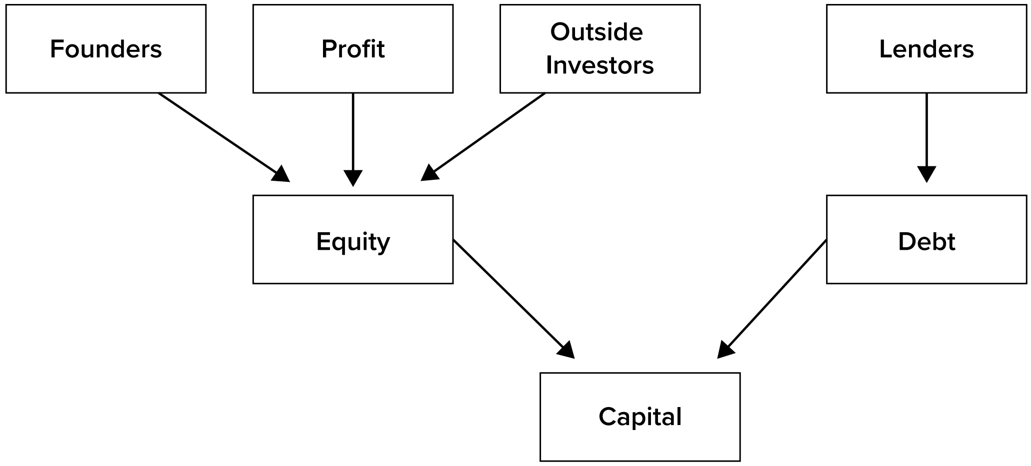
This section and the next describe differences the structure and rewards of investing funds to start up and grow three types of businesses, investor-owned firms (IOF), producer associations and cooperatives. The key differences between the three approaches lie in who owns and controls the business and who receives the benefits of ownership. For example, owner investment in an IOF and member investment in a cooperative represent ownership of the business while investments in a producer association are structured as loans and do not represent ownership of the association.

## INVESTOR-OWNED FIRMS

In a typical for-profit investor owned firm (IOF), funds come from investors who purchase shares because they expect to receive a financial benefit from their investments. Over time, they expect to receive more money than they invested in the shares. When an IOF earns a profit, a percentage of the profit is distributed to shareholders based on the number of shares they own. The more shares an investor owns, the more profit s/he receives. These distributions are called dividends. For example, the Board of Directors of ABC Company has decided

5 FAO, "Internal Financing for Increased Cooperative Performance" in *Mobilizing Capital in Agricultural Cooperatives*, Downloaded June 7, 2017 from ftp://ftp.fao.org/docrep/fao/007/y5469e/y5469e00.pdf

## DIAGRAM 1: SOURCES OF CAPITAL—INVESTOR-OWNED FIRMS




to return $10,000 of last year's profits to the company's two shareholders, Jane and Tom. Since Jane owns 70 of the company's 100 shares outstanding, she will receive 70 percent of the distribution ($7,000) and Tom will receive 30 percent ($3,000). Further, assuming ABC is making a profit each year, has good capital reserves and is growing, investors can also sell their shares to other investors who are willing to pay more for each share than the original investment. Growth in the value of each share is called appreciation.

It is important to note, however, that dividends may not be paid on shares, or if the company does not grow in value, shares will lose their value. In the worst case, if the company goes bankrupt, the shares will have no value. Because of the possibility of loss, money invested in shares of IOFs is "at risk" of loss and is called "at risk capital." If the company goes out of business and assets remain after all liabilities are paid, the remaining assets are distributed to investors, again based on the number of shares they own.

In terms of control of the company, IOF investors receive one vote for every share they purchase. The more shares they own, the more votes they have and the greater their control over the company.

Finally, the IOF investor is not expected to need or use the products or services provided by the company, or live in the community where the company is located. The motive for investing is solely to increase wealth through dividends and appreciation.

There is an important difference in the way net earnings (profit in an IOF) are returned to investors and members of producer-owned organizations. Cooperatives and associations deliver many and varied benefits to members in addition to passing along a portion of surplus or savings. Yet the method they use to allocate and distribute whatever profits occur says much to the member about the fundamental values of their enterprise. The decisions are an important statement of priorities, and an annual opportunity to share those values and priorities with members. The following sections give an overview of member investment and benefits provided by producer associations and more detail about investment, benefits and distribution methods in cooperatives.

## MEMBER INVESTMENT STRATEGIES IN PRODUCER ASSOCIATIONS

This vignette highlights a cocoa farmers' association, a second tier corporation in Ecuador, developed a "quasi-member equity" approach to build long-term member savings to capitalize its business. For each pound of cocoa, 75% of a penny per pound is used as savings by the member and deposited in the association; and 25% supports the five grassroots farmer associations. The funds are held for five years; starting in the sixth year, savers may withdraw 30% of the total of their savings with accrued interest. The interest rate will be based on the Central Bank. From January to June 2015, the plan collected $21,900 ($3,650 per month). Members are also encouraged to contribute voluntary savings within the association. Work continues to better define the conditions and management of the members' savings and needed internal approvals.

## PRODUCER ASSOCIATIONS

Nonprofit producer associations are groups of small holder farmers who provide benefits "to members such as sale of farm supplies, extension services, marketing of member commodities, value added processing, training, and other services that usually do not require significant financial investment.... [They are] usually organized by geographic and/or commodity groups."[6]

As non-profit organizations, producer associations do not have owners. Farmers are considered members and do not have the opportunity to develop ownership equity in the business. In addition producer associations are restricted in the amount of net earnings (profit) they can accumulate. Most tax law recognizes that associations need a financial cushion in case something unexpected happens. For a farmer association, this might be a roof that needs replacing, an unexpected drought that reduces revenue from crop sales, or a loss of donor funding, all of which will require financial resources for the association to survive. Having capital provides cash reserves for hard times.[7] Producer association capital is usually provided by donor organizations and may also be provided by membership fees or dues collected periodically and funds from sales and fees for services (business turnover).

But producer associations cannot distribute net earnings from sales and services to members except indirectly through adjustments in the prices they pay to farmers for their production. There are several ways this can be accomplished. These include:

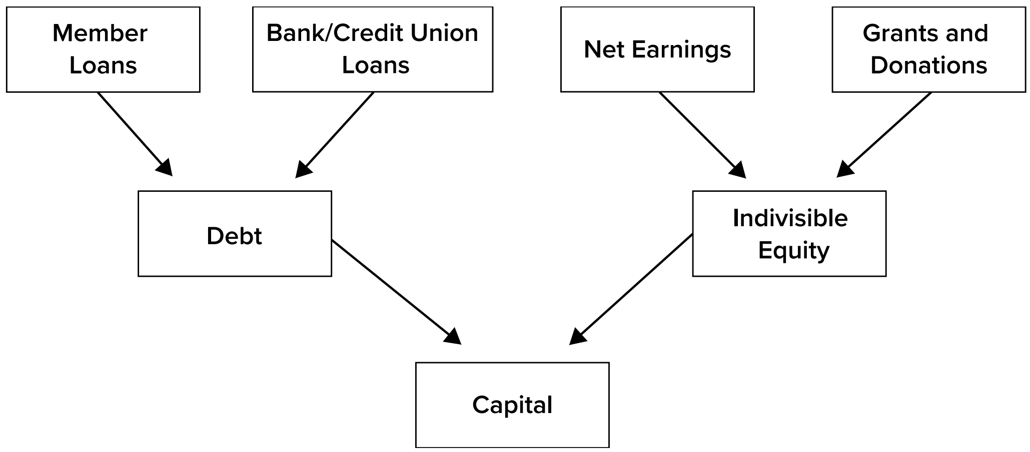
- Setting prices so that association net earnings are minimized at the end of the year.[8] This can be tricky as the association has to monitor net earnings as they get close to the end of the year. The association may make a price adjustment to payments they made to farmers earlier in the year and issue year-end payments to correct for the "under payment." Members can either receive these payments in cash or they can have the association retain the payments in a personal savings or retirement account. While these savings provide long-term capital for the association to grow, they are considered a loan to the cooperative and appear in the financial statements as a liability. Thus, associations can deliver benefits, including an opportunity to save for the long term, but they cannot generate individual member equity, which confers ownership of the enterprise.
- Annually allocating a percentage of Fairtrade, quality and other premiums to member savings accounts based on the individual's percentage of the association's total product deliveries. This is not a distribution but rather a price adjustment before the end of the year.

6 Weihe, T. Saving Fine Chocolate. (page 6)

7 Most countries limit the amount of operating reserves permitted for non-profits. In the United States, the limit is not more than 3 years of current operating expenses. https://www.philanthropy.com/article/Theres-No-Penalty-for-Having/190573

8 A percent of their crop is "monetized" for the association, or, through re-liquidating the purchasing price paid to members for their crop, a patronage refund-like adjustment is paid out before the end of the fiscal year or "capitalized" to member savings accounts forming part of a capitalization plan with a revolving period.

## DIAGRAM 2: SOURCES OF CAPITAL—PRODUCER ASSOCIATIONS




- Establishing a check-off system, in which a percent of payment for the delivery of produce is collected prior to payment and credited to the member's savings account. This system has the advantage of generating capital during the production season rather than waiting to the end of the year and does not require adjustment of payments based on year-end net earnings. Check-off plans may not be the best choice for associations whose members produce small volumes because the cost of recordkeeping for many small transactions outweighs the earnings generated.
- Establishing a system in which farmers can voluntarily save money within the association based on crops delivered.

In each case the association is borrowing funds from its members and the money collected is a liability to the association since the funds are expected to be returned at a set future date with interest.

Control of an association is usually exercised by the members who each have one vote based on their membership in the association as long as they pay the annual membership dues required. Note that all members must pay the same level of dues regardless of their size or business volume with the association.

In the long term, associations, although a useful structure for a startup business, are most appropriate as service or lobbying organizations where all members of a specific class benefit from the association's work to conduct research, provide educational and technical services, promote specific crops, and carry members' views to government, representing them in national and international forums.

Below are four financing mechanisms that could be developed to create "quasi-member equity" in a farmers' association (note that more than one mechanism or all of them could be employed). These are:

1) Annually allocate a percentage of Fair Trade, quality and other premiums to a plan based on deliveries of cocoa, coffee or other crop by farmer members, and a set time to revolve back to the member, such as 5 or 10 years, with interest. In order to do this, the association or corporation must adjust the price it pays members prior to December 31 each year, so as to show the initial advance and then the price adjustment due to the Fair Trade premium for the total sale. Then, this secondary price

adjustment is capitalized into the members' savings account. This is not a distribution but simply a price adjustment before the end of the year.

2) Set a minimal quota on delivery of cocoa beans as capital in the member's name, placed within the savings revolving fund.

3) Establish a system in which farmers can voluntarily save money within the association based on deliveries.

4) Implement a plan in which the proceeds from the sale of plants or other inputs to farmers or the sale of fertilizer from donor-financed programs are placed in the farmer's ledger account. While the farmer's loan balance is diminished, his "savings" grows. The funds are converted by the association to long-term productive assets and working capital and shown as long-term loans (accounts payable).

In each case, the association is borrowing funds from its members. Like a term deposit, the funds may be redeemable only after five or more years and can be considered "quasi equity" or member savings in a long-term revolving fund.

In a non-profit producers association, the producer members are not owners of the association. Their contributions to the capital of the association (their savings) are made in the form of loans and are considered a debt the association owes to its members. As associations have no member share equity, any net margin is capitalized into the association's capital, which is indivisible and can never be paid-out directly to members.

If a producer association decides to dissolve the association and it owns assets that have value (e.g., capital reserves, vehicles, equipment, real estate), those assets must be distributed to another non-profit, after all liabilities have been paid. While the assets may stay in the community, depending on decisions made by the board of directors, they may not be returned to the members of the association. Since liabilities must be paid before remaining assets are distributed, farmers will receive repayment of their loans with interest, providing the funds are available in the association.[9]

## COOPERATIVES

Cooperatives are different from investor owned firms because they are created to provide needed goods and services at reasonable prices *for the people who own them*. Producer associations are often created as a first step in developing a cooperative and are found throughout many developing countries. Cooperatives are similar organizations but with a different capital and legal structure. Unlike associations, cooperatives are able to generate net earnings (profits or surplus) that are divided among the members *in proportion to their use* of the cooperative and, if kept (retained) by the cooperative create ownership (equity) for their members. How this works is the topic of the rest of this section.

The International Cooperative Alliance defines a cooperative as an "autonomous association of persons united voluntarily to meet their common economic, social

9 https://www.councilofnonprofits.org/tools-resources/dissolving-nonprofit-corporation

and cultural needs and aspirations through a jointly owned and democratic controlled enterprise."[10] In other words, a cooperative is a *user-owned* and *user-controlled* business that distributes benefits based on use.

> **The user-owned principle implies that members help finance the cooperative and thereby own the cooperative. Members are responsible for providing the bulk of the cooperative's capital. The equity [capital ] contribution of each member should be in proportion to that member's use (patronage) of the cooperative. This shared financing creates joint ownership.**
>
> *—University of Wisconsin Center for Cooperatives*

Like producer associations, startup cooperatives often depend on donor contributions and contributions from members for initial capital. Those early member contributions, though, are made in the form of low cost membership shares instead of loans. From the beginning, purchase of a membership share gives the member the right to use the cooperative's services and have one vote in the affairs of the cooperative.[11]

As the cooperative grows and is successful, additional funds are generated from sales (business turnover), purchase of member shares by new members, additional donor funds, and on-going financial contributions by the members. Contributions from members are called member equity. Cooperative members provide equity based on their use of the cooperative's services. For example, in a producer cooperative, the more crops that the member sells through the cooperative or the more seeds and fertilizers purchased, the more equity contribution is required. Income may also come from business conducted with non-members or earnings that are not related to patronage (i.e., rental paid by for use of space owned by the cooperative or dividends earned on cooperative investments. Income from on-member sources contributes to the cooperative's equity, but is not added to individual member equity accounts.

Member equity in cooperatives is different from member loans to an association. A loan to an association requires that the association repay that loan at a definite time and a specific amount of added funds (interest). The loan is a debt that must be paid and does not confer ownership rights to the association member. A cooperative is not obligated to repay (redeem) member equity at any fixed point in time and may or may not return additional funds (dividends) to members based on the equity they have invested.

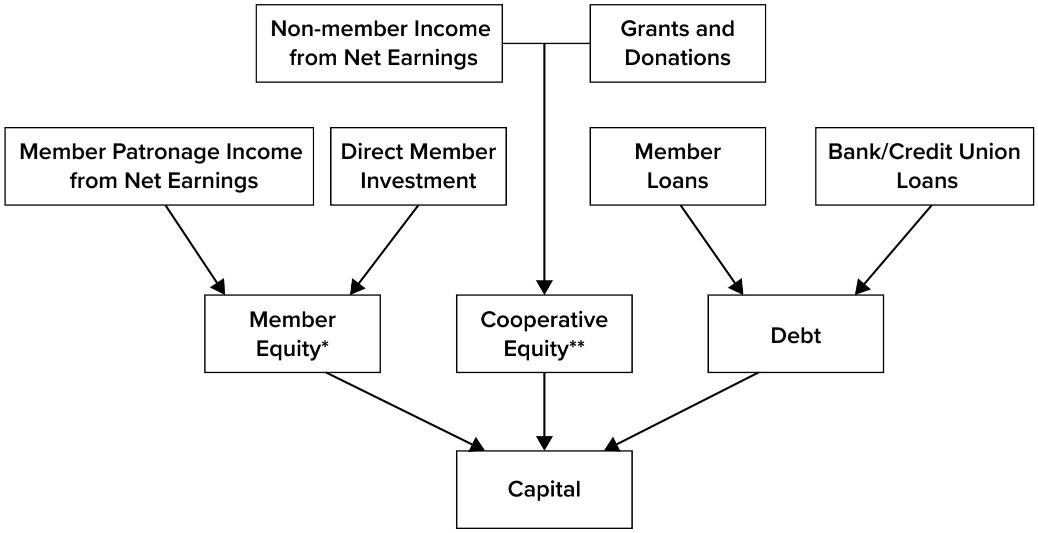
Cooperatives differ from IOFs in the way investors get their money back and how much money is returned. Shares in an IOF can become more valuable (appreciate) over time as the company grows, thus the investor's return is variable and unlimited, based upon the success of the enterprise. In contrast, shares in a cooperative do not appreciate. Cooperative shares may be repaid (redeemed) at the current value or at the value of the original investment, whichever is less. Usually a cooperative redeems its shares from members at the original value unless it has had financial difficulties. If that is the case the repaid member equity is less than was originally invested, hence the invested capital is "at risk capital" as in IOFs.[12]

10 International Cooperative Alliance

11 In cooperatives, all members have one vote regardless of the amount of capital they have contributed. This contrasts to IOFs in which each share purchased provides one vote, so the more shares and investor owns, the more control s/he has over the organization.

12 Regulations regarding redemption of cooperative capital vary widely among countries. For example, in Peru since member contributions cannot

## DIAGRAM 3: SOURCES OF CAPITAL—COOPERATIVES




* Owned by individual members
** Owned by the cooperative as a whole.

Cooperatives also differ fundamentally from other business entities in that they do not promise unlimited—or even particularly high—rates of return in exchange for the risk of ownership. Instead, cooperatives offer their members the advantages of a democratically governed enterprise directed toward meeting the economic and social needs of member farmers. While the benefits of cooperatives are clearly economic, others such as democratic governance, group solidarity and self- help are less easy to calculate, but may be more important.

To compensate for the higher risks they face, most financial analysts agree that ownership shares of a well-capitalized cooperative do deserve a similar rate of return to that of borrowed capital. However, since most cooperatives, especially in developing countries, are undercapitalized, members accept lower rates of investment return because of the other benefits that they receive from the cooperative.

The responsibility to continue contributing equity to the cooperative is an essential element of a cooperative enterprise and is a defining characteristic of the cooperative model. Member equity is the key principle, practice, and responsibility the cooperative and its owners have to each other. Cooperative members provide the crucial flexible and patient equity capital to help achieve financial stability.

Some of the differences among cooperatives, IOFs and nonprofit organizations are summarized in Table 1 on p. 15.

It is important to note that cooperatives have developed many ways for members to make direct investments in their cooperative. As noted by Frederick and Hoyt:

> **There are almost as many varieties of direct member investment programs as there are cooperatives. Programs are distinguished by the ways in which member can make their equity investment, the type of document that is used to record the investment,**

be returned to members unless they pass away or leave the cooperative, so they have come up with strategies to capitalizing only on their interest rates every set number of years.

## TABLE 1: COMPARISON OF COOPERATIVES, CORPORATIONS AND NONPROFIT ORGANIZATIONS

| Attributes | Cooperatives | Corporations (IOFs) | Nonprofit Organizations |
|---|---|---|---|
| **Purpose** | Maximize member service and satisfaction; provide products and services not available or at higher quality/lower cost than competitors. | Maximize shareholder/investor returns. | Serve in the public interest. Redistribute resources to provide educational, charitable and other services. |
| **Ownership** | Member-owned | Investor owned | Generally not “owned” by a person or members |
| **Control** | Democratically controlled: one-member, one vote basis; equal voice regardless of the amount of equity owned. | Shareholder controlled based on number of shares owned. | May be controlled by members or, in non-member organizations, by a board of directors that elects its own successors. People receiving services may or may not be members. |
| **Accountability** | Board of directors is directly accountable to members through nomination and election procedures. | Board election and nomination procedures afford little oversight opportunity to shareholders. Shareholders unlikely to be able to remove board members. | Generally accountable to members of the organization and donors. |
| **Sources of Equity Capital** | Net earnings from operations; equity contributions from members: direct investment, per-unit capital retains, retained patronage refunds; donations (esp. for startups). | Primarily sale of shares through capital markets. | Donations from private or public sectors (e.g. individuals, businesses, organizations, government). |
| **Earnings/ Dividends** | Surplus revenues are reinvested in the cooperative and/or returned to members based on use. Member shares redeemed by the cooperative at cost or less. Shares usually not sold in capital markets, Members share in losses and earnings (risk). | Profits returned to investors based on the amount invested. Shares usually sold in capital markets where their value can increase, decrease or remain stable. Investors share in losses and earnings (risk). | Not designed to create a profit. Any earnings made on operations are reinvested in the non-profit or donated to other non-profits or government agencies. |
| **Community** | Promote and assist community development. | May engage in selected community philanthropic activities. | Serve as a mechanism for collective action based on a common good. |

Source: Von Pischke, JD & Rouse, J. (2004). *New strategies for mobilizing capital in agricultural cooperatives.* page 23. URL: ftp://ftp.fao.org/docrep/fao/007/y5469e/y5469e00.pdf

**benefits the member receives from investing, the amount of investment required to receive benefits and how and when the investment will be returned to the member.**

For our purposes, the most important of these characteristics are the ways members can make their equity investment and how and when the investment is returned to them. The three primary ways producer cooperative members invest in their cooperatives are: cash contributions, per-unit capital retains and retained patronage refunds. Members can use cash at any time to purchase a share or shares in the cooperative. This method is called “direct member investment.”

Per-unit capital retains are used by cooperatives that market products produced by their members. They are deductions from the amount paid to the member for product sold to the cooperative based either on the number of units handled by the cooperative (e.g., number of tons) or on a percentage of the cooperative’s total purchases from all members. Capital retains are credited to the member’s equity account in the cooperative. The amount of capital raised by these retained funds is dependent on the volume of sales generated by members.[13] Like a checkoff system in associations, this system has the advantage of generating capital during the production season rather than waiting to the end of the year and does not require adjustment of payments based on year-end net earnings.

To understand the third method, retained patronage refunds, remember that cooperatives are not created to provide profit for outside investors; instead they are designed to pay farmer members the highest possible price for their product. In order to achieve that goal, they attempt to operate as close to cost as possible. Cooperatives can generate a profit by paying the farmer less than the value of the product plus the cost of marketing the product for the farmer.

PRICE PAID TO FARMER

– COST TO MARKET PRODUCT

= **PROFIT**

To provide the most benefits to farmers, the cooperative wants to operate close to breakeven where there is no profit or loss (price paid – cost = 0). Profit generated in the example above could be considered an under-payment to farmers who sold their products through the cooperative or an overcharge to members who purchase goods and services from the cooperative. Either way, the cooperative idea is to return those under-payments or overcharges to the members based on the amount they used the cooperative. For example, if Farmer A's annual sales of cacao to the cooperative totaled 1% of the cooperative's total annual purchases from members and *the cooperative had no need for capital*, Farmer A would receive 1% of the total surplus to correct for the original under payment. Payments to members when there is a profit at the end of the year are called patronage refunds.

However, there is a caveat here. Like other businesses, cooperatives need to generate sufficient revenue to cover expenses *and* ensure that enough capital is in place to provide for stability and growth. To achieve that goal, they have to generate a profit. In order to emphasize the differences between the uses of profit by IOFs (to generate capital and return dividends to investors based on the amount invested) and cooperatives (to generate capital and provide refunds based on use), cooperatives use other terms for profit such as net earnings or surplus. Many a cooperative has assumed the description of cooperatives as "non-profit" or "not for profit" means the cooperative must operate at breakeven, not generating a surplus. This assumption leads to inadequate capitalization of the cooperative, which ultimately can lead to failure**.**

> **People sometimes blur the distinction between patronage refunds and per-unit capital retains. Patronage refunds are based on the earnings of the cooperative; per-unit retains on the volume or value of business done with the cooperative. Thus, a cooperative can acquire capital, even in a year of limited margins or a loss, through the use of per-unit capital retains.[14]**

13 Source: https://cccd.coop/sites/default/files/USDA-CS-Coops-101t.pdf

14 Ibid.

To insure their cooperative has an adequate capital base, members agree that the cooperative can pay part of their patronage refunds in cash and withhold part in individual member equity accounts. Distributions to members' accounts are called allocations. When a farmer cooperative shows year-end net earnings, the board of directors decides what portion will be distributed to the members in cash and what portion will remain (retained) in the members' equity accounts. Retained allocated equity or retained savings allows member-owners to finance their enterprise in proportion to their use, a very important cooperative principle.

There are many ways cooperatives return allocated equity to members. These are usually a combination of the following options:

- Accumulate and retain equity over time to be repaid when a member leaves the cooperative or stops farming;
- Accumulate equity until a preset amount or "base capital" amount is reached; pay all patronage refunds in cash
- Pay interest/dividends on all equity contributions or only on contributions in excess of the base capital amount;
- Repay contributed equity at set time periods based on number of years since the contribution was made and the amount contributed at that time;
- Allow members to redeem allocated equity funds if the board of directors approves the action.

The choice of capital redemption methods is a critical one and depends on applicable laws and regulations, member needs and expectations, and the cooperative's need for capital in the present and future. Decisions regarding redemption should be made by the board of directors in consultation with members, cooperative advisors, attorneys and accountants.

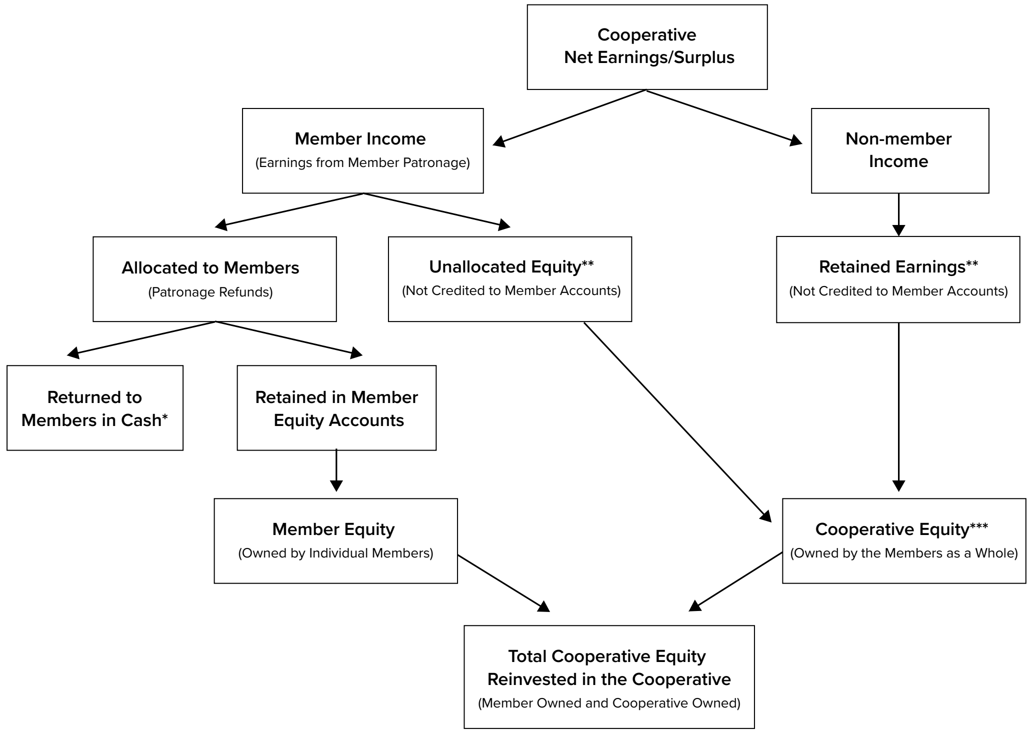
It is important to note that if the cooperative has earnings from business with non-members those earnings are not allocated to the members since they were not a result of members' patronage. Earnings from non-member business usually are added to the capital account as unallocated cooperative equity. Those reserves are still owned by the farmers who own the cooperative, but can only be distributed to them if the cooperative stops doing business or by action of the board of directors to reduce the capital base of the cooperative. In that case, unallocated reserves are distributed after all of the cooperatives liabilities have been paid.

A general summary of how a cooperative's surplus can be distributed is presented in Diagram 4 on p. 18.

Managing cooperative or association equity or savings is the responsibility of the board of directors and management. Equity represents the net worth or risk capital of the enterprise. Business analysts often recommend the equity in a business should be at least 50% of total assets. However, many cooperatives operate on a sound basis and provide significant benefits to members with a lower percentage. The higher the percentage of equity, the stronger the cooperative's financial base for investments in infrastructure, borrowing from commercial lenders, and providing for unexpected changes in markets or losses. Importantly, this capital strength provides evidence to lenders that cooperative and association members are invested in their own organization.

### DIAGRAM 4: DISTRIBUTION OF COOPERATIVE NET EARNINGS

*Adapted from Lund*




* Minimum amounts may be required by law. Seek professional advice.
** Retaining equity in this instance may be taxable. Seek professional advice regarding these actions.
*** Not all cooperatives set aside some portion of patronage income as unallocated equity.

For cooperatives and farmer associations, these funds (returns to owners) stay in the local economy. Dividends, patronage refunds, redeemed equity and price adjustments through re-liquidation of farmer invoices stay in the trading and membership area of the enterprise and contribute to local development and increased net worth of the very farms making-up the heart of the rural countryside, not some distant city or metropolitan area.

In summary, cooperatives offer a unique structure for farmers to organize businesses; they offer more alternatives than IOFs and associations to finance the enterprise, and permit growers to finance the business equitably. With a strong member-owned capital base, cooperatives are more likely to qualify for bank financing if well managed and well financed. In addition they provide markets and increase financial security for smallholder producers. All of these benefits are dependent on having an equitable and effective plan for mobilizing member resources. Suggestions for capitalization planning are the topic of the next section.

# ESTABLISHING A CAPITALIZATION PLAN

As cooperatives receive less contributed capital from donors and social investors over time, it becomes important for boards of directors to develop methods to capitalize their cooperatives through net earnings and member funds. Creating a consistent and equitable capitalization plan is a complex undertaking. It needs special leadership by boards and managers to create, implement and evaluate a plan *and* to educate members on the significant advantages they can achieve by becoming member-owners. Successful member-owner capitalization improves their cooperative's competitiveness, sustainability and ownership.

In order to build confidence in their ability to manage members' contributions, farmer cooperatives and associations should develop clear and consistent communication strategies.

In the previous section we discussed the potential sources of member investment for farmer-owned cooperatives: direct investment by members, per unit capital retains, and patronage refunds. We also discussed ways of returning capital investment to members. This section gives suggestions for putting a capitalization plan in place and maintaining it.

## PREPARATION

Before implementing a capitalization plan the board needs to ensure the cooperative is ready to take on the effort. It must have sound financial management systems since members must trust the organization to properly manage and protect their investments. Additional important factors include:

**Operational success**. Before considering implementation of a capitalization plan, an enterprise must have enough members and product turnover to finance its operations and staff. Otherwise, capitalization is premature, for example in many pre-cooperatives, which are not yet viable as cooperative businesses.

**Commitment**. Mission, vision and goals for the cooperative and the plan need to be consistent with internationally recognized standards (i.e., member ownership and control and finance according to use).

**Legal review**. Cooperative legal statues and tax policies may need review, and possible modifications to the plans may be required to conform to the countries relevant business and cooperative laws. Cooperative statutes or by-laws should include provisions for a member equity plan. For equity, the language may vary but is essentially the same, "member investment," "share capital," "contributions certifications," etc. In the case of a saving plan, the language should include "to promote savings among members," "facilitate the mobilization of savings" or similar words. Member equity plans can be difficult to implement in every case because of restrictive cooperative laws, poor reputation of cooperatives and related tax regulations. They require a financially sophisticated management and enlightened board that must create trust bonds with members since they are safeguarding their money.

**Financial readiness.** Financial skills and systems must be in place to determine the cooperative's equity capital needs and individual member equity requirements, conduct efficient collection processes, keep accurate records of each member's equity contributions, manage cash distributions, and redeem equity allocations in accordance with the capitalization plan.

**Integrated financial planning**. Member equity/savings plans should be part of capital needs of the enterprise including working capital, inventory turnover, rate of return on investments (it can be lower for non-profit organizations than for investor-owned company), and need for infrastructure (a good rule or formula is that the cooperative should put up 20% or 25% of costs with bank lending the remainder).

**Clarity of objectives**. In addition to setting a clear financial target and ensuring that the target will be adequate for the cooperatives needs, objectives for the way plan will be operated are critical. These include: flexibility in the ability to set targets based on changing needs of the cooperative; creating a plan that is equitable and designed to develop member contributions in proportion to their use of cooperative services; ensuring that the plan is practical and it can be reasonably accomplished within the competency and capability of the cooperative and its members; and that members, staff, and directors can easily understand the plans requirements and expectations. (See text box: Capitalization Plan Considerations.)

**Enlightened and supportive board of directors**. Transparency is critical and equity/savings plans need to be understood by directors so they can make critical decisions regarding the plan structure and can communicate the characteristics of the plan and the necessity for sufficient member equity to cooperative members.

**Ability to innovate**. No template exists for equity funds because they must be designed based on local cultures, governmental regulations, member expectations and country settings. Creativity is needed to develop a reasonable and relevant plan for each individual cooperative.

Member equity plans in cooperatives and savings plans in associations will be more successful if combined with members' productivity increases, plus quality improvements in the fresh or value-added product. Asking a poor farmer with low yields of poor quality product to start saving is difficult. However, if members' yields increase substantially through cooperative activities supporting better cultivation practices and total production increases because more land is under cultivation, asking a farmer to put away a few pennies per kilo is likely to be approved more easily. Quality, productivity and equity/saving all go hand in hand.

Creating a plan that requires a contribution from members must apply to the entire membership, but the plan's design may vary based on the delivery of different products where financial needs of the enterprise are different. A check-off system applies equal percentages for each member's deliveries, but if a base capital plan is adopted, different members may save/invest different amounts as their investment/savings will vary based on different targets for different members.

Ideally, the design of the plan for member equity/savings should be based on member usage and patronage (a percentage of goods delivered or patronage refunds at end of the year). However, if a check-off system is not possible or faces opposition, any capitalization plan is better than none. Typically, it transfers

### CAPITALIZATION PLAN CONSIDERATIONS

Before deciding to adopt a base capital plan or any other type of capital programs, cooperatives should address a number of considerations. These include: the financial needs, capabilities and objectives of its cooperative.

- ❑ **What is the appropriate level of equity capital for the organization?**
  - What is the required level of working capital?
  - What are the future needs for expanding the business?
  - How much risk capital is needed to cushion against unexpected losses?
- ❑ **How flexible is the cooperative's equity structure in responding to increased or decreased capital needs?**
  - How quickly can additional capital be obtained to take advantage of acquisition opportunities to meet internal expansion needs?
  - Is there an equitable method of returning excess capital to the owners on a timely basis?
- ❑ **Does the capital program seek to keep ownership in the hands of current users? Can ownership interests of former members be transferred to current members?**
- ❑ **Does the capital program promote a forward-looking, business-like relationship with the membership?**
- ❑ **How equitable is the capital program? Is there a way to keep investment proportional to use?**
- ❑ **Is the capital plan practical and cost effective to administer?**
- ❑ **Is the program easily explained and understood by the membership?**

Source: Adapted from: Rathbone, Robert C. and Donald R. Davidson. November 1995. Base Capital Financing of Cooperatives. United States Department of Agriculture, Rural Business and Cooperative Development Service, Cooperative Information Report 51, p. 5.

unallocated funds to member allocated accounts; uses retained earnings, monthly payments at fixed rates or Fair Trade, organic, quality or other premiums.

The plan should also allow for voluntary contributions (direct investments) that are a means to mobilize capital from members who have more resources or available cash than other members, or who see equity contributions as a good investment for when they leave farming and pass it on to heirs.

## IMPACT OF A CHECK-OFF SYSTEM WITH CAPITALIZATION PLANS

A technician from a Peruvian cacao cooperative speaks to a producer member.

The cooperative adopted a Capitalization plan that included a 1% check-off on deliveries of cocoa and coffee. Since collection agents receive commissions, they had little incentive to retain member savings. They wanted to maximize volumes to earn their commission. The cooperative found it was difficult to track the 1% of deliveries because of the hundreds of small members delivered small amounts of cocoa or coffee. Deducting the 1% was a serious problem. Discrepancies occurred between what members felt that they had contributed and those recorded by the cooperative. Members failed to save receipts so that they could reconcile the differences. Some members refused to deliver their cocoa or coffee to the cooperative so long as the check-off was in place. With the need for volume, keeping the cooperative afloat, and staff reductions, it was difficult to administer the system.

With large numbers of small-scale farmer members, it was very difficult for the cooperative to successfully implement a check off system based on the delivery of member products. The check-off system did not have well defined rules and procedures and was not evenly applied across membership. It faced several obstacles.

At the Annual General Assembly in March 2016, members decided to temporarily end the 1% check off and return to a flat S/. 200.00 Peruvian Nuevo Soles per year, per member, to be capitalized into their member equity accounts. Management indicates that the cooperative is collecting more without the check-off than the 1% method since the majority of growers are small.

For a check-off system to be successful or to be re-introduced, there are several prerequisites:

- The system must be fully supported by the membership and accompanied by a rigorous **member communication and education program** that spells out farmer obligations and responsibilities, the benefits of the program, such as why it is necessary, the logic of capitalizing or contributions according with use, its details and rules. Management, Board of Directors and the Supervisory Committee appointed by the General Assembly need to be educated about the program and be fully supportive.[1]
- It is important to have a **backup system** in case of computer failures or disputes with written paper receipts for every delivery. Farmers should be encouraged to save these receipts and to reconcile their records with the cooperative's statement print-outs periodically.
- In a dispersed cooperative with many buying centers, the agents must have an incentive to **track cooperative member contributions**, especially if they are on a commission basis. A system is needed to be in place to counter negative incentives and equip agents with pre-programmed tablets, cell phones, or other means to assure accurate recording of member contributions based on delivery of products.
- **Technical assistance** for member equity plans should be provided regularly and over time so that issues are addressed in a timely manner. Any assistance should be timed prior to General Assemblies to educate delegates and prepare any documents or presentations for the Assembly.

1 A written plan and clear rules are important to have in place before starting the plan and to adequately train commission agents and other cooperative staff. A robust accounting system must be in place and linked to the main accounting system, in order to track member contributions, interest earned, business with the cooperative, patronage refunds, revolving capital account pay outs, voluntary contributions if a grower decides to leave additional equity with his cooperative and emergency pay outs, if these are allowed. Periodic reports should be printed for each member so s/he can visualize their contributions every three months. Accounting systems, cell and smart phone accounting hardware exist in the micro-enterprise field and could be adapted to tracking small amounts of money including member savings within the cooperative, common to this lending methodology.

## ESTABLISH A CAPITAL STRUCTURE

Before a plan can be implemented, the board of directors needs to decide how the plan will be structured, keeping in mind the relevant laws and regulations in their country. The two most common types of capitalization plans are:

**Revolving Fund.** In a revolving fund plan the cooperative holds retained equity or savings for a set number of years, usually ranging from 1 to 10. At the end of the set time period, the funds are returned to the member. For example, if the time period were 5 years, a member who had received allocated patronage refunds invested in their capital account in 2015 would receive them in 2020. Those equity funds would be replaced with newer retained equity/savings from new members as well as from current member activity on an annual basis. This plan is easily understood and relatively simple to implement. If the revolving period is short (fewer than 5 years) it results in proportional contributions from members and requires no cash outlay from members. In addition, if the capital needed or the cooperative's financial condition is weak, the time period can be extended. Disadvantages arise if the time period is too long, so contributions may not be proportional to use; members expect to receive payment regardless of the cooperative's financial condition and the plan is easily manipulated by extending the time period.

**Base Capital Plan.** With a base capital plan, the board periodically establishes a targeted amount of equity/savings that the enterprise needs to fund its ongoing operations. Member equity/savings requirements are set based upon the percentage of business a specific member does with his/her cooperative or association. For example, if a member does 10 percent of the cooperative's business, s/he would be required to provide 10 percent of the equity needed. Members can fulfill these financial obligations through a variety of means, including allocated equity, per-unit capital retains, mandatory savings accumulated through a check-off program and voluntary contributions.

More specific details regarding implementation of a capitalization plan can be found in sources listed in the References at the end of this document. Among the details that should be explored are payment periods, measurement units, investment levels, modifications to corporate documents, securing member approval and methods for evaluating the plan.[15]

15 See especially Lund, et. al and Cropp, et, al.

## IMPACT OF EDUCATING MEMBERS ABOUT CAPITALIZATION

Members from a Peruvian cooperative meet with technicians to discuss the importance of member equity for their cooperative.

Today, both members and delegates from a cooperative in Peru (see Case Study # 1), have a much deeper understanding of the importance of capital in a cooperative business because of the training efforts undertaken by the cooperative. The cooperative provided two types of member education:

**BOARD/MANAGEMENT TRAINING**

This type of training was delivered to members from members of the board and management at local committee and delegate meetings. The cooperative increased member investment by 334% over a 4 year period, in part due to the effective member education provided. Member investment grew from US $192,000 in 2010 (baseline) to US $834,000 in 2014.

**TECHNICAL PERSONNEL TRAINING**

This type of training was provided by technical personnel *(tecnicos)* and provided education on capitalization in addition to their other tasks. These *tecnicos* are cross trained so the expert in cocoa growing can discuss capitalization

*continued on p. 25*

# MEMBER EDUCATION

> **Cooperatives provide education and training for members, elected representatives, managers and employees so that they can contribute effectively to the development of their cooperative. Members also inform the general public about the nature and benefits of cooperatives.**
>
> *—ICA Co-operative Principle 5*[16]

For producer enterprises, member communication and education programs should be seen as sound investments in the future. Members can make better voting decisions and contribute to enterprise development when they understand the business and financial issues that the enterprise faces. Moreover, the member education program needs to be ongoing and adapted/updated as needed to ensure successful adoption and ongoing implementation of member equity plans.

Financial contributions to the cooperative should be seen as an essential part of its governance and reflects ownership and control by its user members. Members elect the board of directors, who are also members. Directors, as visionaries of the enterprise, develop the long-range business strategies that ensure its economic health and meet the needs of the membership. The manager's role in member equity is to furnish the board with information and recommendations on how equity is linked to business goals, long-range strategies, budgets and financial and operations reports.

*Member education is a key part of the board and manager's responsibilities.*

Education of members on the importance of capitalization must give them an understanding of their financial stake in its success and governance.

As member-owned businesses, cooperatives are most effective when members are well informed and engaged with the business decisions driving the cooperative. The decision to initiate, grow and maintain a capitalization plan naturally would be an important component to the cooperative's member education plan. Incorporating member equity into the cooperative's education program is especially important to make sure members understand any changes in the cooperative's capitalization plan, how members can contribute, how their investment will be redeemed and how the capital will be used within the cooperative.

### DEVELOP A MEMBER EDUCATION PROGRAM

For a member education program to be successful, it must be communicated

16 ICA Principle 5 adaptation from Cooperation Texas http://cooperationtexas.coop

and implemented by a strong management team with adequate financial and management systems in place. The organization needs:

- Board and management leadership able to communicate the benefit to the member of having a capitalization plan
- A well-articulated business plan in which capitalization is an integral part
- Sound financial systems that communicate information to members in simple terms: cash flow, budgets, balance sheets and basic ratios
- Software and computer systems with internal controls and the capacity to track, record and periodically report on member's equity.

## COMMUNICATIONS PLANNING

To create a successful member education initiative around member equity and capitalization, the board and manager need to work together to build a member communications plan and integrate language and information about member equity into their current messaging and platforms. Elements to include in the plan would be drawn from the following:

- Member demographics such as age, gender, language preference, literacy levels, education levels, address/location, access to telecommunications, travel distance to the cooperative
- Member use of cooperative provided products and services;
- Ability of very small farmers to participate in capital accumulation;
- Current educational tools (printed materials, meetings/trainings, Annual General Assembly, etc.)
- Ways to provide multiple communication events/efforts (in person meetings, phone, text, email, etc.)
- Opportunities to engage with members during other in-person events and trainings (directly with agronomists)
- Resources or ways to update individual members about the value of their individual capital accounts

Materials need to be developed that are appropriate for the cooperative's membership and shared through the communications plan. The goal of the member education program should be to educate the member about how a capitalization plan benefits the personal financial goals of the member as well as the cooperative. Educational materials about member equity, how it functions, the importance of members' personal and financial commitment and transparency about how the cooperative is using member invested capital would be a part of this. If there is an opportunity, the cooperative could include recognition for members who contribute their full capital shares and equity contributions, and who are loyal users of the cooperative or association.

*continued from p. 24*

as well as related social issues. The certifications team promotes capitalization, collects loans, and speaks to the member if his /her loan is overdue or there are unpaid dues. As a result, members feel closer to the cooperative with fewer delinquencies in their loan portfolio, reduced delinquent dues/quotas and greater loyalty through increased delivery of their cocoa beans. Member contributions (paid over installments) grew from 40% to 90%.

Prior to instituting the capitalization plan, there was limited contact between management and members about equity and financial contributions as member-owners. Today, in part due to the extensive training, managers and boards are more connected to membership. Members appear to understand the importance of their contributions and the basic function of capital in a business. As a result, members are closer to the cooperative; have reduced delinquency in their loan portfolios and provide larger cocoa deliveries for cooperative value added processing, practically eliminating the side selling that had been an earlier problem.


A member of the board of directors of a Peruvian co-op explains the new member equity certificates.

# ROLES AND RESPONSIBILITIES

Development of a successful member equity plan requires specific actions by all the participants in a farmer group business effort. Each group's role is described in this section.

## MEMBERS

Financial contributions to the cooperative's capital base are a fundamental principle of user ownership and reflects the extent to which members are committed to their cooperative. The responsibility to capitalize the cooperative requires members to:

- Develop sufficient financial literacy to be able to understand financial reports on the condition of their cooperative/association including liquidity and solvency, the terms of the member equity program and the balance between member returns and cooperative reserves.
- Become educated on the purpose of member equity, their individual responsibility to support member equity requirements and redemption policies and support them.
- Actively participate in annual meetings when member equity or savings plans are being proposed to and voted on by the membership.
- Monitor the status of their own member equity accounts.
- Stay informed through member communications from the board of directors, management and staff.
- Elect directors who are trustworthy leaders of the organization and will fulfill their responsibilities regarding member equity honestly and free from conflicts of interest.

## MANAGEMENT AND STAFF

While the ultimate purpose of management regarding member equity ("to have a well-capitalized, competitive business in which each member's investment in the cooperative is maintained in proportion to use") is identical to that of the board, management is concerned with how to implement board policies through daily performance of the business. This responsibility requires management to:

- Responsibly manage the cooperative to increase net earnings sufficient to contribute to member equity.
- Accurately monitor, report, and forecast the cooperative's financial results and equity capital requirements and how member equity is related to business goals and long-range strategies.
- Operate the cooperative's equity programs to guarantee sufficient equity capital is acquired and retained in the business.
- Ensure member equity capital is only used for allowable purposes as defined in the capitalization plan.
- Ensure communication and education is regularly provided to members regarding the importance of member equity to the cooperative, and the

current status of the cooperative's equity accounts including sources and uses and member account balances.

- Establish and implement procedures to collect, allocate, implement and report individual equity contributions.

## BOARD MEMBERS AND DELEGATES

In terms of equity management roles, the ultimate purpose of the board of directors and management become the same: "to have a well-capitalized, competitive business in which each member's investment in the cooperative is maintained in proportion to use."[17]

As trustees for the members' equity/savings, directors have a fiduciary responsibility to safeguard the members' and the cooperative's assets. This responsibility requires directors to:

- understand cooperative finance. This includes the ability to review and evaluate financial reports, assess financial performance, determine capital needs of the enterprise, and determine distribution of net savings.
- set reasonable expectations for financial performance, provide resources to achieve that performance, monitor performance and hold management accountable for meeting expectations.
- establish an effective and equitable member equity program that provides for equity capital accumulation and distribution/redemption that protects the cooperative's liquidity and solvency.
- effectively communicate financial performance and member equity information to the membership that emphasizes the important role of member equity capital in the capital structure of the organization.
- define and communicate about the allowable uses of member equity capital (e.g. for buying crops from members, financing operating costs, infrastructure investments, etc.)
- ensure the safety of members' funds by establishing a supervisory or audit committee to verify management of the equity finds in accordance with board policy and hire a professional outside auditor to confirm their findings.
- periodically review the entire member equity plan and make necessary amendments needed as the financial needs and performance of the business change over time.
- develop an effective board-management relationship that clearly ascribes roles and responsibilities regarding member equity development to each.

## DONORS AND GRANTEE ORGANIZATIONS

Cooperative Development Organizations (CDOs), lenders and contractors that provide loans and development assistance can leverage their resources to

17 http://www.uwcc.wisc.edu/info/mgequity.html#WhatDoesManaging

mobilize member equity. Their expertise is particularly important in providing expertise in the structure of successful member equity programs and board, management and member training in financial literacy.

Small farmer group business success depends on sufficient community infrastructure to enable farmers to move their products to domestic and export markets. Infrastructure includes credit facilities; roads; collection, processing, packaging and transportation centers; and member education programs. Donors often invest such infrastructure support. In providing this support, donors can create incentives to encourage grantees to promote and implement member equity plans that incorporate member ownership into the capital structure of the group business.

These funds provide evidence of member financial commitment to the enterprise. Donors can also encourage grantees to develop board, management and member education programs that emphasize financial literacy and the critical role of equitable contributions based on use.

# CASE STUDIES

There are few examples of successful member equity plans in most developing countries. In response, we have developed several case studies to illustrate the concepts in this paper by showing how some cooperatives and associations have created and supported member equity and savings plans. They provide promising examples that were carried out by effective managers; enlightened boards of directors and supportive members.

A specific challenge is that these enterprises were initially formed as associations, and in the case of the three cooperatives in Peru, they converted to cooperatives. Thus, the enterprises historically relied on member subscriptions/dues, rather than traditional cooperative member equity that is based on usage and a percentage of crops that are monetized into member accounts. Each of the enterprises has received significant donor funding, which often undercut the self-help and financial nature of cooperatives or associations. However, there is now broad awareness of the underlying concepts of member equity based on usage.

The case studies illuminate some of the challenges and issues in adopting and operating capitalization plans. Our intent is not to be prescriptive, but to offer these examples of equity and savings plans that have been promoted, discussed, implemented and owned by small-holder agricultural cooperatives and associations.

It is important to point out that Equal Exchange's USAID Cooperative Development Program included capitalization, quality and productivity initiatives as key components in cooperative and association success.

The Program provided support to cooperatives and associations through:

1) innovative quality improvements that increased quality premiums and made the cooperatives more competitive, and

2) improved productivity to help farmers with better seedlings plants as well as farmer training and education so that their farms are more profitable and they have the ability to make contributions to their cooperatives.

The project design was re-enforcing as each component complimented the others. While the project kept it focus on these components, the participating cooperatives were free to design their own programs and set their own priorities.

In each case, the cooperative benefited from outstanding and highly experienced technical advisers who shared expertise in capitalization and member equity plans; provided on-going assistance and guidance, worked closely with boards and managers; and participated in several Annual General Membership meetings to educate members on the concepts and importance of equity contributions. Equal Exchange supported the cooperatives with member education efforts designed to build member trust, understanding and positive attitudes about their cooperatives; the need for financial contributions by members and the advantages of investing in their cooperatives.

But, credit for these plans is a testament to the managers and boards that provided the leadership for their adoption and implementation.

A collection and post-harvest processing center at a Peruvian cacao cooperative. This cooperative uses a check-off system, where members pay 1% on the sales of their cacao production to the cooperative. Funds collected through the check-off system can be borrowed for purchasing beans from the members during the harvest season, so that cooperative may reduce the need to take out high-interest loans from banks.

## CASE STUDY # 1 (PERU): EDUCATED MEMBERS GROW MEMBER EQUITY[18]

The 1,925 farmer-member cooperative buys members' raw cocoa beans, ferments and dries them, and exports quality organic and Fair Trade cocoa beans around the world, working hard to ensure their product meets Fair Trade standards. The cooperative promotes improved cocoa cultivation, ensuring market stability and increased income levels and product quality for farmers. The following timeline highlights the evolution of this cooperative's member equity plan:

**Establish capitalization plan.** In 2010 the only way to increase member investment in the cooperative was to collect non- refundable monthly flat-rate contributions from each member. These contributions are directed to support operating expenses. At that time, the cooperative had accumulated significant unallocated capital funds through successful operations. An impetus to create the plan was due to some cooperative leaders and members that wanted to de-fund the cooperative through distributing those unallocated funds to members. By shifting the unallocated capital funds to allocated individual member equity accounts, the cooperative was able to keep the capital funds in the cooperative, quickly establish the capitalization plan, and gain wide support from the members.

**Individual investment.** The new capitalization plan proposed an initial individual investment quota for all members of 480 soles ($145 US), which could be paid in a lump sum or through installments. Once members reached their quota, they would receive interest on their member equity so the sooner they reached their quota, the sooner they would start receiving interest, thus encouraging payment of the total sum .

**Extensive member education.** In 2012, the General Assembly Meeting adopted the plan and, in 2013, expanded the member equity plans based on the recommendations of their managers and boards of directors. Extensive field training to their local committees, delegates and agriculture technicians so they could educate the members on the provisions of the plans.

**Continuous plan adaptation and evaluation.** As of 2016, there continue to be significant changes in the plan. The current plan reflects the cooperative's evolution

18 The cooperative described in Case Study #1 represents how cooperatives are defined and operated in the Peruvian legal context

in finding a system that works best for them. While educating and persuading members to make changes in the plan continues to be a challenge, at their 2016 General Assembly the members voted to change from an equal quota system (480 soles for all members) to a more equitable system, in which member equity requirements are based on usage of the cooperative. Now, the cooperative uses a check-off system (per unit capital retains) where members pay 1% on the sales of their production to the cooperative, rather than a flat rate. Once this amount reaches 1050 soles ($318 US), members receive a certificate and earn 7% interest. Because Peruvian cooperative law does not allow members to have access to their member equity payments until they leave the cooperative, the board designed a plan for cash payments of interest earned every 5 years. Thus, creating a system to incentivize investment in the cooperative with periodic cash payments while also creating long-term member savings of the actual equity invested plus allocated equity from surpluses.

Over five years, the cooperative has increased their member equity accounts over 300%, from $191,923 to $832,333. As a result of implementing effective member education programs during this time, 90% of members are now current on their contributions compared to 40% in 2011. Members now understand the importance of their contributions and the basic function of capital in a business. The capital generated through member equity payments is generally used to offer services to members in the form of small loans to continue investing in their farms and increasing productivity. The cooperative has trained its technical and field staff to promote capitalization and provide constant communication and education to members. Thus, members are closer to the cooperative; have reduced delinquency in their loan portfolios and provide larger cocoa deliveries for cooperative value added processing, practically eliminating the side selling that had been an earlier problem. In addition, member equity now makes up about 30% of the cooperative's overall capital, demonstrating great gains, but the cooperative should continue to increase this to meet its overall capital needs.

Farmer member from a Peruvian cooperative depulps coffee on their farm, contributing to the quality of the exported product. Members can invest in equipment like this to grow their farm businesses as another form of capitalization.

## CASE STUDY # 2 (PERU):
## MOBILE TECHNOLOGY AND COMMITTED LEADERSHIP FOSTERS CAPITALIZATION GROWTH

The second case presents a secondary level cooperative, with a deep commitment to organizing organic and Fair Trade farmers with a focus on member equity, especially given its complexity in terms of the varied crops produced by its members (coffee, cocoa, and granulated brown sugar). The cooperative has over 4,565 farmer members active in the three sectors.

This cooperative was originally organized as an association, before implementing a member equity plan in 2013, the organization restructured to operationally become a cooperative. The formal plan was adopted at an annual meeting of the members in 2015. The new plan provided a drastic increase in capital for the cooperative, generated by member equity payments. Beginning with $100,000 US in 2015, member equity accounts have grown nearly 400% to $500,000 US in 2016. This dramatic growth in a short period of time is the result of the following factors:

- The management and elected board understand capitalization and its methodologies.
- Key staff have a good general knowledge of capitalization and what it means for both the cooperative and individual members.
- The capitalization plan depends on both dues and net margins rather than more typical cooperative per unit retains.
- Information transparency has been strengthened with the implementation of mobile technology systems used to collect, record and manage member equity payments.

Investment returns are based on patronage refunds. Using projected net margins for the current year, the total patronage refund (*reintegro*) is estimated. Based on this projected patronage refund, the board decides the amount to be allocated to and retained in Individual member equity accounts and the amount to be refunded to members in cash.

Equity investments revolve back to the members five years after the investment was made. Normally revolving funds after five years is considered too frequent for accumulating capital. In this case, since individual members in this cooperative are around 60 years old, the board adopted revolving period enables farmers to start redeeming some of their equity when they reach 65.

*Like the first case study, members earn 5% interest on member equity payments and the cooperative pays out interest on member equity payments every 5 years. The capital generated in this case study makes up 30% of the cooperative's overall capital and similarly the primary use of this capital is to be used as credit to purchase product from members during the harvest. Members of this cooperative have shown a decrease in default on loans and 100% of members are on time with their payments.*

## CASE STUDY # 3 (PERU): HOW CAPITALIZATION PREVENTS BANKRUPTCY

This case study provides a cautionary note about the importance of member equity and demonstrates the difficulty of adopting check off systems (per unit retains) based on the delivery of member products, especially with large numbers of small farmer members. Originally primarily a coffee cooperative, Fair Trade and organic cacao became the bulk of this cooperative's sales as coffee production decreased and opportunities for cacao production have increased.

The cooperative faced potential bankruptcy when the local bank called in their loans and withdrew working capital. A major cause of the bank's withdrawal of credit and working capital was the lack of capital, especially member equity, compared to outstanding loans based on their property and assets. As a result, they downsized and moved their headquarters to their processing center of coffee and cocoa, and sold one of their buildings. The cooperative was able to find alternative financing through a social institutional investor.

It was clear that the cooperative needed to develop greater member investment /equity in their cooperative. Initially, the cooperative adopted a plan that included a 1% check-off on deliveries of cocoa and coffee.

However, although the percentage check-off system is more equitable and created significant member equity funds, it created a number of problems for the cooperative.

Since collection agents receive commissions, they had little incentive to encourage member savings. They wanted to maximize volumes to earn their commission. Greater volumes did maximize commissions, but they also increased the members' required contributions. In addition, the cooperative found it was difficult to track 1% of deliveries because hundreds of small members delivered small amounts of cocoa beans or coffee cherries. Deducting the 1% was an accounting nightmare. Discrepancies occurred between what members felt that they had contributed and those recorded by the cooperative, exacerbated by a monitoring system that was dysfunctional. Members also failed to save receipts so that they could reconcile the differences.

Being dissatisfied with the check-off system, at the Annual General Assembly in March 2016 members decided to temporarily end it and return to a flat S/.200.00 per year, per member to be credited to their member equity accounts.

It became apparent that for a check-off system to be successful or to be re-introduced, there are several prerequisites:

- The system must be fully supported by the membership and accompanied by a rigorous member communication and education program that spells out farmer obligations and responsibilities, the benefits of the program, such as why it is necessary, the logic of capitalizing or contributions according with use, its details and rules.
- Management, Board of Directors and a Vigilance Committee appointed by the General Assembly need to be educated about the program and be fully supportive.
- A written plan and clear rules are important to have in place before starting the plan and to adequately train commission agents and other cooperative staff.
- A robust accounting system must be in place and linked to the main accounting system, in order to track member contributions, interest earned, business with the cooperative, patronage refunds, revolving capital account pay outs, voluntary contributions if a grower decides to leave additional equity with his cooperative and emergency pay outs, if these are allowed.
- Periodic reports should be printed for each member so s/he can visualize their contributions every three months.

Over five years as they faced a financial crisis, the cooperative was able to increase significantly member investment by 87% to $222,000. Their staff did an excellent job addressing the cooperative's financial challenges. Members are now capitalizing the cooperative through quotas and some voluntary contributions, and 100% of members are now up to date on their member equity payments. Today, member equity as a percentage of total capital has grown from 10.7% in 2010 to 33.4% in 2016, showing a very positive trend. Additionally, during General Assemblies, members have voted to put yearly dividends towards member equity payments to be capitalized.

This large farmer organization has an associated savings and loan cooperative where members and their families can save and take out loans tailored to making improvements on their farms.

## CASE STUDY # 4 (DOMINICAN REPUBLIC): KEY STRATEGIES TO GENERATE MEMBER EQUITY

This cooperative is made up of over 9,000 small producers that produce high quality cocoa. For over 30 years, it has pioneered in Fairtrade, organic cocoa production. The cooperative was formed as a non-governmental organization (NGO) farmers association but operated as a member-owned and controlled cooperative. The case study demonstrates a model in which a for-profit, limited-type company can operate as a cooperative which may be particularly useful where cooperative laws and regulations are restrictive. It separates donor funding through the NGO from cooperative business operations.

In 2010, the cooperative underwent a dramatic restructuring. The 1995 Dominican Republic Law 122-05 prohibited NGOs from distributing profits. As a result, the cooperative was unable to commercialize organic cocoa and distribute returns among members. The cooperative had no way to retain profits or provide patronage refunds to members based on the delivery of cocoa beans. The restructuring has allowed the cooperative to operate as a group-based business rather than a farmers' association.

The cooperative now comprises three interrelated organizations, with offices located in each of the seven regional centers: an NGO that provides technical assistance to members; a credit union that provides savings and loan services to members; and a company that operates the collection, processing and sale of cocoa including production of cocoa powder and cocoa butter from its production plant.

The governance of the cooperative is based on cooperative principles in which the 172 small producer associations elect representatives to the seven bloques. In turn, the bloques elect board members to the overall cooperative group. Each of the three interrelated entities has its own General Assembly that selects the Executive Director and establishes policies for that entity. To be a member of the cooperative, a producer must buy a 500 pesos (US$ 11.00) share and must own four shares in order to vote.

Prior to creation of the credit union, the cooperative had high rates of member loan defaults, resulting in serious liquidity problems that complicated payments to members when they sold their organic cocoa to the cooperative. Creation of the credit union reduced the rate of members' defaults on loans by 39%.

This cooperative uses three strategies to generate member equity: direct payments from members, programmed savings and allocated capital to member accounts. Through these strategies, the cooperative has managed to increase their member equity accounts 365% from $400,000 to $1.7 million USD.

Overall, the creation of the credit union resulted in lower defaults on member loans, and provides a means to pay members for deliveries of cocoa beans, thus, generating savings that can be the basis for loans to members. It demonstrates that credit unions are a better financial structure than NGOs to operate loan programs.

## CASE STUDY # 5 (ECUADOR): MEMBER SAVINGS PROVIDES CAPITAL TO GROW BUSINESS

The final case study represents a farmers' association, a second-tier corporation in Ecuador. It shows how a farmers' association can develop a member savings plan to capitalize its business. With no member paid-in capital, the association lacked member loyalty since they had no financial stake in the group-based business. The association groups small-scale cacao producers into 5 grassroots organizations and collects, processes and sells high quality cacao in international markets. In November 2014,the association adopted a "savings capitalization plan." For each pound of cocoa, 75% of a penny per pound of cacao delivered is retained by the cooperative and deposited in the member's savings account in the credit union. The other 25% of the penny per pound supports the five grassroots farmer associations.

Savings funds are held for five years. Starting in the sixth year, savers may withdraw 30% of the total of their savings with accrued interest, based off the Central Bank's standard rate on savings accounts. Members are also encouraged to contribute voluntary savings within the association.

In a smallholder farmer's association, the association's equity is held in a general indivisible fund, accumulated through earnings and donations but without shared equity by members. In terms of equity contributions, at most, members pay minimal dues in amounts too small to cover normal operating expenses. Members do not have share accounts, due to the legal structure of an association, even though it is called a "corporation" in this case. At least four potential financing mechanisms are available to create "quasi-member equity" in a farmers' association:

▶ Allocate annually a percentage of Fairtrade, quality and other premiums to a plan based on deliveries of cocoa by farmer members, and a set time to revolve back to the member, such as 5 or 10 years, with interest. In order to do this, the association or corporation must adjust the price it pays members prior to December 31 each year, so as to show the initial advance and then the price adjustment due to the Fair Trade premium for the total sale. Then, this secondary price adjustment is capitalized into the members' savings account. This is not a distribution but simply a price adjustment before the end of the year.

- Set a minimal quota on delivery of cocoa beans as capital in the member's name, placed within the savings revolving fund.
- Establish a system in which cocoa farmers can voluntarily save money within the association based on cocoa deliveries.
- Implement a plan in which the proceeds from the sale of plants or other inputs to farmers or the sale of fertilizer from donor-financed programs are placed in the farmer's ledger account. While the farmer's loan balance is diminished, his "savings" grows. The funds are converted by the association to long-term productive assets and working capital and shown as long-term loans (accounts payable).

In each case, the association is borrowing funds from its members. Like a term deposit, the funds may be redeemable only after five or more years and can be considered "quasi capital" or member savings in a long-term revolving fund.

To date, the association has managed to generate $57,620 in capital through member savings contributions. Different from the previous case studies that highlight the experience of cooperatives, this association saw a lower increase in capital generated (15%) and this capital represents only 7% of the association's total capital. Although generation of member capital has been slower in the association that the cooperatives, this case study highlights here an alternative model that provides alternatives to capitalize their business.


# CONCLUSIONS

There is little research on member equity and savings plans in different country settings with different cooperative or association histories, laws, and regulations. That said, member equity and savings plans for smallholder farmer enterprise can be successfully introduced as evidenced by the case studies in this document. Boards and managers quickly understand them; and broad membership support is readily grasped, especially when productivity and quality improvements go hand in hand with equity and savings mobilization.

This paper grew out of a desire to address one of the most critical issues facing the survival of group owned smallholder enterprises, cooperatives and associations in developing countries: financial structure and lack of sufficient owner equity invested in the enterprise. In fact, lack of focus on developing owner equity may be the biggest oversight by farmer members, government and donors anxious to improve rural incomes and livelihoods.

Smallholder member equity and savings are contributions to capital made by farmers to group business, associations and cooperatives through a variety of means including direct investment, per-unit capital retains and retained patronage refunds. There are significant financial advantages to members who invest in their associations and/or cooperatives. These include being able to make contributions in small increments that are dependent on delivery of product and the amount invested grows over time either from interest paid on savings, or additions to it from retained earnings of the cooperative. There is substantial evidence that member capital investment plans can, over time, build member savings and substantially increase members' net worth. These funds, when redeemed can provide for pension-like income or in the case of death, provide a legacy for family members.

The advantages are just as significant for the association or cooperative. Like other businesses cooperatives need to generate sufficient revenue to cover expenses *and* ensure that enough capital is in place to provide for stability and growth. Strong member/owner equity or equity-like savings strengthens the enterprise's balance sheet, enhances its ability to borrow at reasonable rates, provide additional services to members and withstand unexpected emergencies, decreases in member production, and market shocks. It has also been shown that member investment/savings increases member loyalty to the business and decreases the temptation to sell product to side sellers. Evidence from the case studies shows substantial increases in the value and number of member investments after a member equity investment vehicle was introduced.

Before deciding to build capital through member equity, consideration needs to be focused on the organizations' financial needs, capabilities and objectives. Creating a consistent and equitable capitalization plan is a complex undertaking. It needs special leadership by boards and managers to create, implement and evaluate a plan *and* to educate members on the significant advantages they can achieve by becoming member-owners investors. It takes time to introduce and build a capitalization plan. The small-scale farmer organizations highlighted in the case studies worked with Equal Exchange and its partners over four years with focused technical assistance and coaching.  Longer time frames may be needed for the introduction and growth of member equity plans without this support.

In order to build a capitalization plan, the cooperative or association must be ready to take on the effort. That means it must have sound financial management systems to enable integrated financial planning so that members must trust the organization to properly manage and protect their investments. Capitalization requires enough members and product turnover to finance its operations and staff. And the board of directors needs to be supportive and equipped to make critical decisions regarding the plan structure along with management staff ready to launch a solid and comprehensive communication plan to educate members for buy-in and adoption. Key questions to ask include;

- What is the appropriate level of equity capital for the organization?
- How flexible is the cooperative's equity structure in responding to increased or decreased capital needs?
- Does the capital program seek to keep ownership in the hands of current users? Can ownership interests of former members be transferred to current members?
- Does the capital program promote a forward-looking, business-like relationship with the membership?
- How equitable is the capital program? Is there a way to keep investment proportional to use?
- Is the capital plan practical and cost effective to administer?
- Is the program easily explained and understood by the membership?
- Where to start and what are first steps?

In addition, it is important to recognize that small farmers often have low amounts of cash available and their incomes don't always allow for contributing to savings or investing. Creating programs that are realistic in relation to their incomes, accessible, and well communicated is crucial. Investing in a company of any kind involves a change of perspective, which is 'cambio de chip' as they say in Spanish. That is, it's not an easy change. They are taking a risk with their limited resources. They could lose their investment, their entire savings, if the cooperative does not succeed. That should not be taken lightly.

Equal Exchange is committed to supporting the development and strengthening of small-scale farmer organizations around the world. As part of this commitment, EE in partnership with Root Capital has developed a teaching module for how to implement a capitalization plan. For more information about this, please visit Equal Exchange.

# GLOSSARY

**Allocation:** the process cooperatives use to determine each member's share of the cooperative's net earnings in a particular year. The allocation is based on the member's proportion of the total member patronage for that year. In some cases, allocation is base d on a percentage of the patronage in a particular product line or service rather than the total patronage for the entire cooperative.

**Allocated capital:** the portion of a cooperative's net earnings that is contributed to members' capital accounts. Also refers to the portion of net earnings contributed to an individual member's account. May also be called allocated equity.

**Allocated equity:** see allocated capital

**Assets:** cash or anything of value owned by a company that can be converted to cash. In addition to cash, may include accounts receivable, inventory, land, buildings, and equipment.

**Association:** see producer association

**At-risk capital:** money invested in a business venture that is not guaranteed to be returned. The risk is the possibility that the investor may lose all or part of the amount invested if the business has financial difficulties or fails.

**Base capital:** a targeted amount of required equity that is periodically and systematically adjusted to meet the current capital needs of the cooperative. The plan is designed to readjust each patron's required equity contribution based on his/her share of the cooperative's total patronage over a period of time, usually between three and ten years.

**Base capital plan:** the plan that is put in place by cooperatives to ensure that financing of the cooperative is provided by members in proportion to their use of the cooperative.

**Breakeven:** the point at which the income of a business is equal to the cost of operating the business. In this case, there is no profit or loss.

**By-laws:** a set of rules made by a company or by the members of a cooperative or producers association to define roles responsibilities of participants and rules and procedures for operating the organization.

**Capital:** financial assets of a company and the value of tangible assets used to operate the business. Capital comes from invested funds, earnings from business operations, and, in the case of cooperatives and farmer associations, it may come from donations and government grants.

**Capital accumulation:** the process by which an organization increases the funds it needs to provide goods and services and/or create wealth for the organization's owners.

**Capital rotation:** the plan for returning invested capital based on the period of time when the capital was paid in and when it is returned to the member.

**Capitalization:** the fundraising process carried out by businesses through individual and reimbursable contributions of the members and the cooperative reserve.

**Capitalization plan:** the tool the cooperative uses to raise capital by projecting how much it will capitalize and how that capital will be invested.

**Cash reserves:** money, or assets easily convertible to cash, set aside by an individual or company to cover emergencies or short term needs. For example, a company may have enough cash reserves to provide for 90 days of operating costs.

**Check-off system:** a method by which a farmers association or cooperative retains a certain portion of the price paid to farmers for their products and credits it to their loans or capital accounts. Check-off systems are used in producers associations and cooperatives to build equity or savings and increase member economic participation in the organization.

**Control rights:** the right to vote on organizational matters based on the amount of shares owned (many shares equals many votes) in an IOF or having a membership in an association or a cooperative (one member, one vote).

**Cooperative:** "an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise." Source: ICA

**Cooperative capital:** the total value of funds and assets owned by the cooperative, including allocated and unallocated funds, borrowed funds and funds from grants and donations. The term capital assumes two meanings: first, funds generated by member deposits, patronage refunds and/or capital retains (member equity) and capital generated by non-member business (cooperative equity).

**Cooperative equity:** capital held by the cooperative in the form of reserves and special funds over which the members have no individual rights.

**Cooperative statute:** a state, province or national law that defines the requirements for forming and operating a cooperative corporation. Cooperative statutes vary from state to state and country to country. See co-oplaw.org for more information.

**Corporate capital:** the amount of shareholders' equity plus retained earnings in a corporation.

**Corporate reserves:** an amount of money a corporation keeps in a special account for future needs and cannot be returned to investors as dividends, or in the case of cooperatives, as patronage refunds.

**Decapitalize:** to spend down capital funds, especially equity funds, to invest in long-term assets or return equity to member-owners. See revolving capital.

**Dissolution:** ending of a corporation, cooperative or nonprofit either by a vote of the shareholders/members (a voluntary dissolution) or by a court order resulting from a failure to pay taxes (involuntary dissolution).

**Dividend:** a payment made by a corporation or cooperative to its shareholders, usually a portion of profit or net earnings. For cooperatives, see patronage dividend.

**Equity:** the amount of capital contributed by corporate owners or the difference between a company's total assets and its total liabilities. In a cooperative there is a distinction between member equity (contributed by and allocated to members) and cooperative equity (unallocated equity). In the case of dissolution, all cooperative equity belongs to the members.

**Equity redemption:** in a corporation, the purchase of corporate shares by the company from the shareholders. In a cooperative, the cooperative has an obligation to redeem (e.g., buy back) allocated equity at some future date in order to maintain ownership of the cooperative in the hands of current users. See revolving equity and base capital.

**Equitable contributions:** Equitable means a fair share, not necessarily an equal share. In cooperatives, an equitable contribution is a contribution based on the proportion a member used the cooperative services. For example, a farmer who marketed 5% of the cooperative's total coffee marketed would be expected to provide 5% of the cooperative's member equity; a member who marketed 20% would be expected to contribute 20%.

**Fair Trade:** Fair Trade is a way of doing business that ultimately aims to keep small farmers an active part of the world marketplace, and aims to empower consumers to make purchases that support their values. Fair Trade is a set of business practices voluntarily adopted by the producers and buyers of agricultural commodities and hand-made crafts that are designed to advance many economic, social and environmental goals, including raising and stabilizing the incomes of small-scale farmers, farm workers, and artisans, connecting consumers and producers, and increasing the organizational and commercial capacities of producer groups. Source: Equal Exchange

**Fair Trade premium:** an additional sum of money paid on top of the Fairtrade minimum price that farmers and workers invest in social, environmental and economic developmental projects to improve their businesses and their communities.

**Fiduciary responsibility or fiduciary duty:** the ethical responsibility to stakeholders in a corporation, nonprofit or cooperative to manage the organization's funds, property and valuables with loyalty and care. Loyalty means avoiding conflicts of interest and always acting in the stakeholders' best interest. Care means acting rationally, providing clarity and being objective.

**Interest rate:** a) the amount of money paid on money that is loaned to an individual or organization or b) the amount of money paid for borrowing money from a lender. In both cases, the amount is usually calculated as a percentage of the loan amount.

**Intermediary:** a person or organization who acts as a link between parties to a business deal, for example a side seller who sells farmers' crops to organizations that will market the crops.

**Investor owned firm:** a company owned by shareholders who may or may not use the goods and services of the business and whose primary objective is to receive financial returns on the money invested.

**IOF:** See investor owned firm.

**Member equity:** initial and ongoing money to run the cooperative contributed by cooperative members through direct investment, per-unit capital retains or allocated patronage refunds.

**Member equity plan:** a plan established by the board of directors and the members of a cooperative to describe how and when members will contribute equity to their cooperative and when their contribution will be redeemed.

**Member investment:** See member equity.

**Member savings:** the initial and ongoing money loaned by nonprofit members to run a producer association.

**Member savings plan:** a plan established by the board of directors of a nonprofit farmers association to describe the terms of loans members make to the cooperative including the interest rate that will be paid to farmers and the methods the association will use to repay the loans.

**Member share:** a) a portion or portions of a cooperative that is owned by a member; b) a written certificate that documents ownership in a cooperative. Certificates include information such as the number of shares owned, the date, an identification number, usually a corporate seal, and signatures. Shares represent legal evidence of ownership of a company or business.

**Monetization:** "a United States policy that allows private voluntary organizations and cooperatives to sell designated amounts of agricultural commodities in developing countries. Commodities may be purchased in local currencies or dollars. The currency generated by these sales can then be used to finance internal transportation, storage, or distribution of commodities; to implement development projects; or to invest and with the interest earned used to finance distribution costs or projects." Source: http://ncseonline.org/nle/crsreports/05jun/97-905.pdf

**Net earnings:** a cooperative, nonprofit or corporation's income minus cost of goods sold, expenses and taxes for a given accounting period. Also called net income, net savings, net profit or profit.

**Net income:** See net earnings.

**Net margin:** a company's net profit (gross profit – expenses) divided by its net sales (gross sales – expenses), usually expressed as a percentage. The higher the percentage, the more profitable is the company.

**Net profit:** See net earnings.

**Net savings:** commonly used in nonprofits to indicate net earnings.

**Net worth:** total assets of a company minus its total liabilities.

**Non-member patronage:** the volume of product sold to or purchased from customers who are not members of a cooperative or income generated from other non-member related sources (e.g., rental of a portion of a storage facility to a non-member).

**Patronage:** the conduct of business with a cooperative, either selling agricultural products or purchasing goods or services.

**Patronage refund:** a refund issued to members who sell agricultural products or purchase goods or services from a cooperative based upon the amount of business each member conducts with the cooperative as a proportion of the cooperative's net earnings in a given year.

**Per-unit capital retain:** an amount of money deducted from sales proceeds usually in agricultural marketing cooperatives and credited to a member's equity investment account. The amount is based on the member's patronage in proportion to the total quantity of products marketed by the cooperative.

**Pre-cooperative:** an informal or nonprofit association of farmers who pool their products or their purchases in a cooperative manner prior to becoming a full-fledged formal-sector cooperative operating under the relevant cooperative statutes. In some developing and transitional countries, cooperatives are not democratic entities, and a stigma may be attached to the name "cooperative. In these cases a pre-cooperative or producer association may be a more appropriate organizing vehicle.

**Producer association:** nonprofit producer association of smallholder farmers that provides benefits such as sale of farm supplies, extension services, marketing of member commodities, value added processing, training, and other services that usually do not require significant financial investment.

**Profit:** See net earnings.

**Redemption:** See equity redemption.

**Redemption plan or schedule:** See member equity plan.

**Reserves:** amounts of net earnings retained (not distributed to owners ) by a business to provide for unexpected expenses or reinvest in the business.

**Retained earnings or margins:** See reserves.

**Retained patronage:** a portion of the patronage refunds left in a cooperative by its members to build equity in the cooperative and allocated to the member's equity account to be paid out at a later date.

**Revolving equity:** member equity that is held for a fixed number of years, then returned to the members based contributions in a previous year. See revolving fund.

**Revolving fund:** in cooperatives an account used to collect and disburse member equity funds based on a continuous cycle. For example, in a 5 year cycle, funds collected in year 1 will be returned to members in year 5, funds collected in year 2 will be returned in year 6, etc.

**Revolving fund plan:** the most common design for systematically managing revolving funds. See member equity plan.

**Risk capital:** funds invested in a business that can be lost if the business is unsuccessful.

**Share:** See member share.

**Side seller:** See intermediary.

**Social capital:** An economic idea that refers to the connections between individuals and entities based on shared norms, values and understandings that can facilitate cooperation within or among groups and be economically valuable.

**Unallocated reserves:** the portion of a cooperative's net earnings that is not contributed to individual members' capital accounts; may also be unallocated capital or unallocated equity. See reserves.

**Voluntary contributions:** funds added to individual equity or savings accounts at the discretion of the cooperative or association member.

**Working capital:** the capital of a business that is used in its day-to-day trading operations, calculated as the current assets (those that can be converted to cash within one year) minus the current liabilities (those that must be paid within one year).

# REFERENCES


Baarda, J. (2003). Circle of Responsibilities for Cooperative Boards: Management Tips (Cooperative Information Report, Rep. No. 61). Washington, DC: USDA/ Rural Business-Cooperative Service. Retrieved March 31, 2017, from http:// www.uwcc.wisc.edu/pdf/CIR61.pdf

Baarda, J. (2007). *Financing the Cooperative Enterprise* (LLM Course). Fayetteville, AR: University of Arkansas. Retrieved March 31, 2017 from http:// www.geo.coop/sites/default/files/finance.pdf

Barton, D., Boland, M., Chaddad, F. & Eversull, E. (2011). *Current Challenges in Financing Agricultural Cooperatives.* Retrieved March 31, 2017 from http://www.choicesmagazine.org/choices-magazine/theme-articles/critical-issues-for-agricultural-cooperatives/current-challenges-in-financing-agricultural-cooperatives

Boland, M. (2012). Cooperative Finance and Equity Management, CHS Center for Cooperative Growth (CMS Insight Meetings) Retrieved May 31, 2017, from http://purl.umn.edu/143556

Boland, M., & Barton, D. (2013). *Overview of Research on Cooperative Finance.* Journal of Cooperatives*, 27*, 1-14. Retrieved March 31, 2017, from http://accc.k-state.edu/ncera210/jocpdfs/v27/boland.pdf

Canadian Co-operative Association, Developpement International Desjardins, & SOCODEVI. (2012). *Creating Wealth, Reducing Poverty and Building a Better World*, 2012. Retrieved June 5, 2017, from http://www.did.qc.ca/media/documents/en/cooperatives-canadiennes/DID-SOCO-ACC-Broch_ang.pdf

Castillo, E., Medina, WD., Albano, AL., Peria A. & Manila, AC. (2006). *Cooperativism in Agriculture: The Case of Top Four Cooperative in Region IV, Philippines*. Retrieved May 31, 2017, from http://www.academia.edu/1459880/Cooperativism_in_Agriculture_The_Case_of_Top_Four_Cooperatives_in_Region_IV_Philippines

Chesnick, D. (2000). *Financial Management and Ratio Analysis for Cooperative Enterprises,* Research Report 175, USDA Rural Business Service-Cooperative Service. Retrieved May 31, 2017, from https://www.rd.usda.gov/files/rr175.pdf

Cobia, D. (1989). Cooperatives in Agriculture, New Jersey: Prentice-Hall.

Corman, J. & Fulton, M. (1989). *Patronage Allocation, Growth and Member Well-being in Co-operatives.* Canadian Journal of Agricultural Economics, vol. 38. Downloadable link retrieved May 31, 2017, from http://dx.doi.org/10.1111/j.1744-7976.1990.tb03448.x

Cropp, R. (1998). *Equity Redemption Practices: A Study of Wisconsin Cooperatives*, University of Wisconsin center for cooperatives, Retrieved May 16, 2017, from http://www.uwcc.wisc.edu/info/equity_2.html

Cropp, R. & Zeuli, K. (2003). Cooperative Principles and Practices in the 21st century, (Chapter 7: *Cooperative Financial Management*), University of Wisconsin Extension. Retrieved June 5, 2017, from http://learningstore.uwex.edu/assets/pdfs/A1457.pdf

Cumbie, P., Bauers T. & Read, S. (2010). *The Member Equity Toolbox: Structuring Capital to Meet Present and Future Needs: A Guide for Retail Food Co-ops.* Retrieved June 5, 2017, from http://www.uwcc.wisc.edu/pdf/Member%20Equity%20Toolbox.pdf

Frederick, D. (1997). *Co-ops 101: An Introduction to Cooperatives.* Retrieved May 16, 2017, from https://cccd.coop/sites/default/files/USDA-CS-Coops-101t.pdf

Frederick, D. & Ingalsbe, G. (1993). *What are Patronage Refunds?* Cooperative Information Report 9, USDA, Agricultural Cooperative Service. Retrieved May 30, 2017, from https://www.rd.usda.gov/files/cir9.pdf

Groeneveld, H. (2012). *Cooperative and Rural Financial Development: Great Opportunities and Surmountable Difficulties,* (See Ch. 2 Economic theory of cooperatives), Rabobank Foundation. Retrieved June 5, 2017, from https://economics.rabobank.com/PageFiles/1125/Cooperativeandruralfinance-20121101.pdf

Healy, M. *Patronage Dividend: Presenting GM Recommendations*. Retrieved May 17, 2017, from http://library.cdsconsulting.coop/patronage-dividend-presenting-gm-recommendations/

International Labour Office. (1998). Cooperative Management and Administration. International Labour Office, Geneva. URL to purchase retrieved May 16, 2017, from https://books.google.com/books/about/Co_operative_management_and_administrati.html?id=ZX-7AAAAIAAJ

Lund, M. (2013). Cooperative Equity and Ownership: An Introduction, University of Wisconsin Center for Cooperatives. Retrieved June 5, 2017, from http://www.uwcc.wisc.edu/pdf/Cooperative%20Equity%20and%20Ownership.pdf

Mellor, J. (2009). Measuring Cooperative Success: New Challenges and Opportunities in Low-and Middle-Income Countries, U.S. Overseas Cooperative Development Council. Retrieved June 5, 2017, from http://www.ocdc.coop/pdf/metrics.pdf

National Council of Non-Profits. *Dissolving a Nonprofit Corporation*. Retrieved May 16, 2017, from https://www.councilofnonprofits.org/tools-resources/dissolving-nonprofit-corporation

Rasmussen, A.E. (1975). *Revolving Equity Capital,* (Chapter 12: Financial Management of Cooperative Enterprises, Cooperative College of Canada, Saskatoon.

Rathbone, R. (1997) *Managing Your Cooperative's Equity,* Cooperative Information Report 56, USDA, Rural Business-Cooperative Service. Retrieved June 5, 2017, from http://www.uwcc.wisc.edu/pdf/cir56.pdf OR http://www.uwcc.wisc.edu/info/mgequity.html#WhatDoesManaging

Reynolds, A. (2008). *Benefiting from the Board: A Case Study*, Staff Paper 8, University of Wisconsin Center for Cooperatives. Retrieved June 5, 2017, from http://www.uwcc.wisc.edu/pdf/Staff%20Papers/Staff%20Paper%208.pdf

Royer, J. & Smith, D, (2007). *Patronage Refunds, Producer Expectations and Optimal Pricing by Agricultural Cooperatives.* Journal of Cooperative, University of Nebraska-Lincoln. Retrieved June 5, 2017, from http://ageconsearch.umn.edu/record/46577/files/RoyerSmith18June2007.pdf

S, S. (2015). *Difference Between Nonprofit and Not for Profit Organization.* Retrieved June 5, 2017, from http://keydifferences.com/difference-between-non-profit-and-not-for-profit-organization.html#ixzz4frHBDNJc

Von Pischke, J.D. (1996). *Capital Formation in Agricultural Cooperatives in Developing Countries: Research Issues, Findings and Policy Implications for Cooperative and Donors*, SD dimensions, Sustainable Development Department, FAO, Rome. Retrieved June 5, 2017, from Annex III of http://www.copac.coop/publications/1995-capital-formation.pdf

Von Pischke, J.D. (2004). New Strategies for Mobilizing Capital in Agricultural Cooperatives. FAO, Rome. Retrieved May 30, 2017, from http://www.fao.org/docrep/007/y5469e/y5469e00.htm

Weihe, T. (2013). *Why Member Equity is Critical to Successful Cocoa Co-operatives?* Retrieved June 5, 2017, from, http://www.worldcocoafoundation.org/wp-content/uploads/files_mf/1383069012MemberEquity_revisionsoct10_Combined_1_.pdf

Weihe, T. (2014). Chocolate & Cooperative Equity: Reforming small farmer cooperatives so they can prosper. Retrieved May 30, 2017, from http://www.lulu.com/shop/ted-weihe/chocolate-cooperative-equity-reforming-small-farmer-co-ops-so-they-can-prosper/ebook/product-21563677.html

Weihe, T. (2015). Saving Fine Chocolate: Equity, Productivity and Quality in Cocoa Cooperatives. Retrieved May 30, 2017, from http://www.lulu.com/shop/ted-weihe/saving-fine-chocolate/ebook/product-22462742.html

Williams, L. (1987). *The Farmer's Cooperative Yardstick: Cooperative Refunds: Patronage and Revolving. College of Agriculture Extension Publication No. AEC-54*. University of Kentucky, Department of Economics. Retrieved May 30, 2017, from https://www.uky.edu/Ag/AgEcon/pubs/aec54.pdf

# ANNEXES

# ANNEX 1:
# EXAMPLE OF SAVINGS/CAPITALIZATION PLAN REGULATIONS

## INTRODUCTION

This regulation is exclusively prepared for the contribution of USD $0.75/QQ, a product of the delivery of cacao by members of the Association, and any voluntary contribution according to approval at the extraordinary Assembly. New ways to capitalize the association, would require amending these regulations.

## OBLIGATION OF DECLARING A PERSON AS BENEFICIARY MEMBER

- Each participating member in the Capitalization Plan must designate one or more beneficiaries of its assets in the Organization in the event of his death, absence, divorce or incapacity.
- Approved uses of the contributions of the Members:
- The contributions of the members may be used only for:
- Purchase of cocoa to the organization Members
- Specific investments that generate additional resources for the Association (e.g., installation of a nursery to produce and sell cocoa plants to members, when there are sufficient resources, start a loan program to members for work/investment on his farm, produce and sell organic fertilizers and other inputs required by the members, etc.)
- Applications not approved with the contributions of members.
- Members' savings may not be used or committed for the payment of any current expenditure: such as payment of electricity, water, telephone, salaries, transportation of cocoa or other current expenditures. These current expenses should be paid with other resources at the disposal of the Corporation.
- Responsibility of the Audit Committee will ensure that the funds be used for the purposes set forth in this instrument; as well as decisions on the use of resources, properly analyzing the profitability of proposed activities.

## INTEREST RATE PAID AND THE SETTING OF RATES BY THE ASSEMBLY

The contribution of the member is returned acknowledging an interest, the interest rate shall be fixed annually and may not be lower than the interest rate set by the Central Bank.

## STATEMENTS AND REPORTS OF THE CONTRIBUTIONS

The accounting department has the obligation to prepare a statement of account for each member in January and July of each year. The summary should show the economic accounting of each member has had during the period. The following items should be included:

- Cacao in baba delivered during the period:
- The mandatory savings
- Voluntary savings
- Accrued interest
- Ending balance of the semester
- State of the credit, if there is a loan

These statements must be printed and delivered to each member within 30 days after the end of January and July of each year.

## WITHDRAWAL OR EXPULSION OF A MEMBER

The following paragraphs govern the redemption of assets of members when different events occur:

Member resigns voluntarily. When a member decides not to belong anymore to the Association and puts his or her resignation in writing, the Organization will reimburse the account of the person who resigns, less the balance of any loans.

The organization may not redeem the contributions/capitalization until the applicant has cancelled the entirety of any outstanding loan. Once the loan is canceled in its entirety, the Organization will liquidate the savings of the member as follows:

Voluntary savings including interest earned up to the date of the resignation will be returned within 90 days of having canceled securities outstanding in his Association and the Corporation.

Required savings plus accrued interest will be redeemed according to the period of rotation specified by the Assembly.

The mandatory savings will only bare half of interests, a penalty for early withdrawal.

Member sells his or her farm. If a member sells the farm and stops being a producer of cocoa and requests the redemption of their savings, the Organization will reconcile the account of the person, including the balance of an active loan by the member. The organization cannot redeem the savings/capitalization until the applicant has canceled any outstanding loan in its entirety. Once the loan is canceled, the Organization will liquidated savings with interest earned in the following way:

The required savings plus accrued interest will be redeemed according to the period of rotation specified by the Assembly until the end of redeeming the totality of accumulated savings and interest.

Voluntary saving including interest earned up to the date of the resignation will be returned within 90 days after having updated with any unpaid loan, and if the savings balance including the mandatory savings does not exceed $500, this will be paid to equal their voluntary savings. If the balance exceeds $500, this will be paid within the subsequent 360 days in monthly payments.

Ceases to be farmer and delivers the property to one or more children. If the member ceases to be a farmer but his heir or family member who receives the property as inheritance continues to cultivate fine aroma cacao and is a member of an association, the Organization will reconcile the account of the person who resigns, including the balance of a loan of the member.

The Association may not return the savings/capitalization until the applicant has canceled any outstanding loans. Once canceled the pending value in its entirety, the Organization will liquidate savings plus interest accrued in the following way:

Voluntary saving plus interest earned up to the date of the resignation will be returned within 30 days of having updated with any outstanding value.

Required savings plus accrued interest will be redeemed according to the period of rotation specified by the Assembly until the end of redeeming the totality of accumulated savings and interest.

Expulsion a member. When a member is expelled from the Organization for any reason, the organization will return their saving within 90 days of their expulsion. Their savings will not generate interest after the date of expulsion.

Member refuses to save / capitalize. The member who does not want to participate in the saving/capitalization plan cannot continue as a member of the Association and, if not, must put his or her resignation in writing within 90 days after initiating the saving/capitalization Plan, the base association may eject him or her immediately for failure to follow the decisions taken by the General Assembly of the Association.

Death of a Member If a member dies after accumulating saving according to Plan, the assets, mandatory and voluntary, within the Organization will be paid to the official beneficiary determined by the Member within 30 days from the date that the Association is notified of the death. If the deceased Member has a loan or debt with the Corporation, their savings will cover the debt and the balance will be paid to the beneficiary.

Member is prosecuted and forced to pay compensation or fine. If a member who is participating in the Plan, and is processed with a judicial order, the member may not pay the fine or compensation from their savings/capitalization. However, if the member has voluntary savings/capitalization, these funds can be used as collateral for a loan of the organization or to pay a civil judgment, etc.

Member is sued by his ex-spouse. If a member participating in the plan loses a civil lawsuit and is forced to pay an alimony to support their children as a litigation liability, the member may not use their savings/capitalization to cancel its obligations with their children that may be in the custody of his ex-spouse. However, if the member has voluntary savings/capitalization, these could be used as collateral for a loan from the Organization, etc.

The member has a loan to the base association or Association and does not pay. If a member participating in the Plan has a loan from the Organization and falls in arrears, the member cannot use their savings/capitalization to pay off the loan since the plan is not designed to be an alternative to taking out a loan and then not paying it. The member who took out a loan must meet their credit obligations with other funds. However, if the member has voluntary savings/capitalization, these funds could be used as collateral for a loan from the organization.

Member took out a loan in the Organization and wants to use their savings to guarantee the loan. A member may not use their compulsory savings/capitalization as collateral for a loan. However, if the member has voluntary savings/capitalization, these could be used as collateral for a loan in the organization or to pay a civil judgment, etc.

Other possible eventualities. In case of other eventualities, which are not regulated, the Assembly of Delegates together with the Surveillance Commission may resolve the claim of the member. Any decisions taken in this instance will be final and may not be appealed. Any request for a member, an ex-wife, wife, son, or an heir, buyer, judge, lawyer, etc., should be in writing with notarized signatures.

# ANNEX 2: ILLUSTRATION OF A CAPITALIZATION PLAN

The farmer association is dedicated to the collection, processing and marketing and industrialization of cacao and agricultural products that it receives from its members or acquired from third parties.

Its members are organized into four base associations, which have not previously contributed money to capitalize on the association.

Due to the need to grow more cacao, stimulate economic growth and provide more and better services to its members, including saving, the association has to mobilize capital from its members. As an association which may not issue shares or certificates of contribution, the only way to mobilize contributions from members for the use of the association is to start a system of contributions or programmed savings based on deliveries of cacao and the voluntary savings with a period of rotation initially of five (5) years, which may be changed by the Board of Directors according to the needs of the association.

The results expected from this program are as follows:

- Contributing to capitalization of members can partly replace donations and loans to external institutions. These resources can be used as a counterpart to encourage and stimulate new grants and projects.
- Fostering a culture of welfare by members in their organization and the habit of saving among the farmers, members of the base associations.
- Increasing loyalty of the members to the association, which should result in more deliveries and availability of cacao for the association. Members who contribute to the Corporation will feel more ownership and will want to participate more frequently in the affairs of the secondary association.
- Reducing the cost of working capital for association since it would borrow less money from foreign banks or their buyers.
- The program was adopted at the 25th extraordinary meeting in March 2015, gathered at the headquarters of the legal quorum of 21 members of the Association, which approved the following Capitalization Plan, or also known as the Scheduled Savings Plan.

## THE PLAN

1) **Establish a required contribution** of USD $0.75/QQ of the weight of cacao the member delivers to the association. This can be modified by the Assembly.

2) **Volunteer:** Contribution in dollars, which are delivered to the association for the exclusive purpose to boost operations and fulfill its statutory objectives. Each contributor may request the return and delivery of the amount stated by this Program at the end of the agreed period.

   Other alternatives to capitalization to be considered in the future:

   Assign a percentage (minimum 20%) annually awards of Fairtrade, and any other premiums received based on deliveries of cocoa producers.

Implement a contribution/capitalization special plan, for example through the sale of services: sale of cocoa plants, selling organic products to apply to farms, training and others.

3) **Rotation Period of the savings:**

   The association decided to start the Capitalization Plan with a rotation period of five (5) years. The organization can change the rotation period through adoption by an absolute majority in the Assembly of Delegates convened for this purpose.

4) **Delegation of authority and responsibilities:**

   The Surveillance Committee will be responsible for ensuring all members that the resources are being used according to the established standards. The Audit Committee, with the help of an external auditor, if necessary, will review the implementation of the Plan every six months, as required. They should do several tests to ensure that the money deducted or contributed by members is duly registered with the appropriate accounts and that the association is using the product of the contribution to the agreed needs. The Audit Committee must issue written and verbal reports to the Assembly, at any time, when so required.

5) **Reports for members:**

   Transparency and a proper flow of information are important to achieve the objectives of the proposed savings plan. The accounting department will issue "Statements" showing each contribution/capitalization account to members in January and July of each year at General Assembly meetings.

6) **Operation of the Plan:**

   Once approved by the relevant authorities, the Capitalization Plan will start with the transformation or adaptation of the Organization's accounting and computer system, creating for each member a separate account for registration of their required contributions to its capital account and their voluntary contributions.

When the members sell their cacao at the fermentation center, those responsible for the accounts will record the respective payments to the saving plan according to the proportion of baba delivered, and this transaction must be clearly reflected in his receipt of payment.

In the case of the voluntary contributions, the person in charge of receiving or retaining the contributions must deliver a receipt for this contribution of the member and ensure that each contribution is duly registered in the accounting system of the Corporation.

EQUAL EXCHANGE

50 United Drive
West Bridgewater, MA 02379

Phone: 774-776-7400
Fax: 508-587-0088
www.equalexchange.coop