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Shared-Services Cooperatives

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Abstract

This report describes the general structure and operations of shared-services cooperatives and discusses some of the benefits accorded to their owners. This report will provide some insights for business people and public servants interested in organizing a shared-services cooperative. It discusses how they are organized and how they operate. This includes corporate structure, governance, and management. It also describes elements that promote the sucess of shared-services cooperatives.

Key ***words:*** cooperatives, service, purchasing

Shared-Services Cooperatlves

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Executive Summary

Rural Americans depend on community services provided by their schools, hospitals, small businesses, churches, local governments, etc. These organizations 'can often help lower their operating costs by obtaining needed services and products through shared-services cooperatives. A shared-services cooperative is a business organization owned and controlled by private businesses or public entities which become members of the cooperative to more economically purchase services and/or products. Members of shared-services cooperatives respond jointly to common problems. [1]

Purpose

This report describes the general structure and operations of shared-services cooperatives and discusses some of the benefits accorded to their owners. This report will provide some insights for business people and public servants interested in organizing a shared-services cooperative. It discusses how they are organized and how they operate. This includes corporate structure, governance, and management. It also describes elements that promote the success of shared-services cooperatives.

Information for this report was gathered from in-depth personal interviews with the managers of 19 shared-services cooperatives. Most of these associations were incorporated as cooperative businesses. The rest were organized as non-profit corporations that operated on a cooperative basis. Those organizations interviewed for this report are not identified, to maintain confidentiality.

Secondary sources of information used in this report were obtained from the Cooperative Services program of USDA's Rural Business-Cooperative Service; National Cooperative Bank; National Cooperative Business Association; and various cooperative development organizations.

Examples of Shared-Services Cooperatives

Examples of shared-services cooperatives include groups of employers who formed alliances to buy health care insurance or to purchase health care services directly from hospitals and physicians. Another example is school districts organizing cooperatives to provide special education programs as well as purchasing products (such as janitorial supplies) for individual school districts. Hardware stores, restaurants, independent pharmacies, rural electric cooperatives, and natural food stores have formed shared-services cooperatives that operate as wholesalers. A shared-services cooperative can serve virtually any business enterprise.

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[1] This report does not represent official policy of the U.S. Department of Agriculture, the Internal Revenue Service, the U.S. Department of Treasury, or any other Government agency. This publication is presented only to provide information to persons interested in cooperatives, including the tax treatment of cooperatives.

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Highlights

Rural communities are in danger of losing the important services provided by hospitals, pharmacies, retail stores, utilities, school districts, restaurants, and other establishments. The loss of services hurts the economic growth and viability of rural communities. Opportunities exist for them to keep or improve existing services. One way is through shared-services cooperatives which provide services competitively and at a high standard of quality to rural communities.

A shared-services cooperative is a group of private businesses or public entities joining together to form a cooperative corporation. It provides one or more services to enhance or increase the competitiveness of their operations. In simplest terms, the shared-services cooperative provides services in response to the specific needs of its member-owners. This makes the cooperative an extension of each member's own operation.

The goal of shared-services cooperatives is to buy or provide products and/or services for their members at a cost less than if individual members were to buy those products or services. The goal is not to generate a return on investment, but to capture savings through lower administrative costs, quantity purchasing discounts, and assured levels of business with vendors and suppliers. By purchasing cooperatively, individual businesses or government entities can increase the efficiency of their buying activities.

Three characteristics distinguish shared-services cooperatives from other business organizations. First, cooperatives are owned by the private businesses or public entities that use it. Second, cooperatives are controlled by those who own and use the business. Third, cooperatives operate to provide benefits to their members as users, not as investors.

Most of these associations are legally organized as a cooperative or as a nonprofit corporation that operates on a cooperative basis. Each has a distinct organizational structure. The chosen structure depends on the needs and structure of its members, and State law. For example, in some States, public entities or nonprofit corporations cannot form a cooperative business but must organize jointly as a nonprofit corporation that operates like a cooperative.

Shared-services cooperatives provide a wide variety of services to members. Some are specific to the business of members, such as providing special education classes for member school districts. Other services are more general, such as providing management information services. A major function for many shared-services cooperatives is buying products for members.

A number of factors contribute to the success of shared-services cooperatives. These include staff; quality management; attention to member needs; and the ability to be flexible, creative, and innovative.

Shared-services cooperatives also face a number of challenges such as "free riders," competition among members, and changing industry practices.

There are other short-term and less formal solutions to the problems facing rural businesses and municipalities which can lead to the formation of a shared-services cooperative. These include simple contractual arrangements and networks.

Shared-Service Cooperatives

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Many rural communities across the United States are in danger of losing the important services provided by hospitals, pharmacies, retail stores, utilities, school districts, restaurants, and other establishments. This loss could be compounded by lost jobs, lower family incomes, out-migration, and eroded local tax bases.

On the other hand, opportunities abound for many rural Americans. Towns and counties that were once economically dependent on outside industries can look inward to home-grown resources for development. Rural communities can empower themselves to keep existing or attract new services to meet their needs. A growing rural economy may offer jobs and help stem the exodus from rural communities, as well as attract new people, new tax revenues, and new services. One measure of a healthy community is the quality and range of services it provides to its residents.

Shared-services cooperatives are one means to provide these services competitively and at a high standard of quality to rural communities. Discount chain stores located at a significant driving distance can still attract "price-sensitive" customers away from independent local businesses. But, by allowing independent businesses to purchase supplies at prices closer to those paid by the discount chains, shared-service cooperatives can help local businesses remain competitive.

Shared-services cooperatives can also provide services otherwise unavailable to a community. For example, certain medical services might not be provided in an area were it not for the hospital cooperative formed by a group of rural hospitals.[3] Office equipment for the town hall might be too costly were it not for the community services cooperative organized by local municipalities to share the purchasing of equipment. The medical services and the desk are both made available because shared-services cooperatives can purchase products and services for less than the combined costs of individual businesses or municipalities buying for themselves.

Shared-services businesses organized as cooperatives have several structural and operational characteristics that make them different from other business types.

1) A shared-services cooperative is owned by the private businesses or public entities that use it. For example, a pharmacy shared-services cooperative is owned by the independent pharmacies that purchase prescription drugs and / or over-the-counter products through it. An office supply cooperative is owned by the businesses that purchase office products through it.

As owners of the cooperative, members are responsible for the payment of fees and assessments, participation in the governance and operation of the cooperative, and use of its services. Membership support is very important. A shared-services cooperative cannot succeed without the members' continuous patronage.

2) A shared-services cooperative is controlled by the private businesses or public entities that own and use the business. The cooperative is con-

* Authors are listed alphabetically. Senior authorship is shared among the three.

[3] The specific examples used throughout this report are from interviews with 19 shared-service cooperatives.

trolled by its member-owners through a board of directors (elected democratically from among the member-owners) and through participation in membership meetings and committee work. The board sets the overall operating policies for the cooperative, approves the annual budget, oversees its operation, and distributes the benefits derived from use of the cooperative. The board also hires professional management to handle the day-to-day operations of the cooperative. The manager hires needed staff and implements the policies of the board.

3) A shared-services cooperative operates to provide benefits to its members as users, not as investors. While the goal is not to generate a return on investment, operating budgets are developed so expected income exceeds expected operating costs. A shared-services cooperative, like any other business, needs to cover costs and generate an excess to cover expansion and unforeseen emergencies.

Operations of shared-services cooperatives are financed through capital provided by member-owners and debt capital. Ownership capital is defined as the money a cooperative obtains without having a legal obligation to repay it. Initial investments by members are part of that ownership capital. Debt capital is borrowed from financial institutions and the cooperative is legally liable to repay it. Shared-services cooperatives generate income through their fee structure. Part of the earnings generated when income exceeds costs of operation can be retained by the cooperative as ownership capital. The rest is refunded to members based on their use of, not investment in, the cooperative.

The purpose of this report is to present and discuss shared-services cooperatives. These cooperatives are defined as a group of private businesses or public entities that join to form an organization which provides one or more services to enhance or increase the competitiveness of members' operations. The term "cooperative" is defined (for this report) as an organization legally incorporated as a cooperative or non-profit corporation that operates on a cooperative basis (member-owned, member-control, and member-service oriented).[4]

While this report focuses mainly on smaller shared-services cooperatives, it should be noted that several large national cooperatives exist. These cooperatives mostly provide wholesaling services for retail groceries, hardware stores, and "fast-food" restaurants. There are also opportunities for some smaller shared-services cooperatives to expand into national operations. One of the cooperatives interviewed is beginning to move in that direction.

The report describes the distinctive characteristics of shared-services cooperatives. The next section describes the purpose of these cooperatives. Their structure and organization, including the board and staff, are described in section two. Cooperative operations are described in section three. Structured alternatives are reviewed in section four. Sections five and six discuss elements of success and challenges faced by shared-services cooperatives. The final section presents some additional thoughts on shared-services cooperatives.

PURPOSE OF SHARED-SERVICES COOPERATIVES

Private businesses and public entities use shared-services cooperatives to jointly respond to common problems. For example, cooperatives can purchase supplies and services in larger quantities and at lower costs than individual firms or agencies. Members of these cooperatives generally operate similar types of businesses. Common problems related to their businesses bring them together to seek a common solution. Cooperatives address a variety of problems, and in some cases, members face more than one type of problem. Four types of problem situations suggest a cooperative solution.

The first is a shortage of materials or services that motivates individual buyers to consider purchasing jointly. This is particularly true if a product (service) that meets the specifications required by its users is not available. Because buyers' purchasing power is greater through their shared-services cooperative, members gain an advantage in locating a reliable source for a product (service) that

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[4] Although not found among the 19 cooperatives interviewed, cooperatives could include for-profit corporations that operate "cooperatively." Bylaws usually determine if an entity operates as a cooperative".

meets their specific needs. For example, a group of rural utilities formed a cooperative, to purchase wire when there was a shortage.

The second type of problem is the high cost of supplies and services. Through joint purchasing, a shared-services cooperative could enhance the competitiveness of its members by reducing the cost of supplies and services. In other instances, these cooperatives serve as a reliable least-cost supplier for a specified level of quality. For many small, individually owned businesses, this can be a critical factor in remaining competitive. In one example, a group of small retail pharmacy stores formed a cooperative to jointly purchase products to keep them competitive with discount chains. Their cooperative enabled them to offer products to customers at or below the prices of discounters.

Responding to changing government policies is a third kind of problem that could be addressed by a cooperative. Education cooperatives were organized in response to legislation requiring schools to provide special education services to all students who need it. Many school districts don't have enough students with special needs to justify forming a class. Special education cooperatives can organize classes by combining members' students. Districts save money by avoiding paying private schools or holding low-enrollment classes. Many education cooperatives also provide training for teachers and specialists to improve the quality of education.

In another example, a recycling cooperative was organized in response to environmental legislation. Recycling was required as landfills were closed or had use restrictions. The cooperative markets recyclables for its township members and offers technical support services on how to operate a successful recycling program.

Information sharing and member education is the fourth problem that cooperative collaboration can address. Schools, businesses, hospitals, municipalities, and utilities each share common concerns. All recognize the advantages of sharing information when operating in separate noncompeting areas. For example, one hospital cooperative began as a forum to share information and discuss mutual problems. Most shared-services cooperatives share information, collect data, and publish a newsletter for their members. Information provided by the cooperative may assist members with their decision-making and increase their overall competitiveness.

STRUCTURE AND ORGANIZATION

The organizational structure of a shared-services cooperative depends on several factors such as the number of members, the nature of their business, and the programs and services the cooperative offers. For example, how the board of directors is chosen for a cooperative with 10 members will be very different from one with 300 members. Similarly, the staffing requirements of a cooperative offering one service may differ significantly from one offering 10 distinct services. The following discusses some of the organizational elements affecting shared-services cooperatives.

Incorporation

Most shared-services cooperatives are legally organized as a cooperative or as a non-profit corporation which operates on a cooperative basis. The structure chosen depends on the needs of the members, the structure of the members, and State laws. For example, some States allow local governments or other public entities to organize only as nonprofit corporations.

Most corporations, including cooperative or nonprofit corporations, are formed under a State law. These statutes grant specific powers (e.g., to market, purchase, manufacture, etc.) and general ones (all powers necessary and proper to conduct business).

Statutes usually describe the association formation process, including number of incorporators required, association name, capital structure, and how long the association may exist. Mandatory and discretionary provisions of the articles of incorporation and bylaws are described in some detail by most statutes. They may also describe qualification for membership and documents of membership (e.g., stock certificates) and define the rights of membership (including members' control of a cooperative).

Incorporation statutes may specify the minimum number of directors required, their qualifications, and method of selection. Procedures for director removal, director compensation, board meetings, and board committees may also be described. Patronage agreements between user and cooperative are frequently defined in the statutes, as are any limitations placed on nonmember business.

Every State has at least one statute that may be used to form a cooperative and one statute to form a nonprofit corporation. These statutes vary widely in topics covered and in specific requirements for each topic. State business corporation law will apply to fill in the gaps in coverage if not in conflict with the cooperative incorporation statute or the non-profit incorporation statute.

Membership

The purpose of a shared-services cooperative is to enhance the welfare of its members. Members design their cooperative to suit their specific needs. As the needs of members change, the services their cooperative offers should also change. But, the cooperative should never change its focus on serving members.

The cooperative's bylaws generally cover membership requirements. In most instances, members are in similar businesses such as utilities, health care, education, retail stores, and municipal governments. Members of most shared-services cooperatives are also located in the same region. However, there are cooperatives with national and international membership. One cooperative has members in the United States and Canada.

The number of members in existing shared-services cooperatives ranges greatly. There is no ideal membership size and membership changes over the life of a cooperative. One cooperative's membership grew from 4 to 3,000. In contrast, another's declined from the initial 21,000 to 560. School cooperatives tend to have the fewest changes in the number of members.

Membership may change when members are dissatisfied with the cooperative, no longer have the need for it, or the cooperative merges or discontinues operations.[5] In one example, a school district switched membership to another purchasing cooperative to gain access to a particular service. Another cooperative lost members when it increased its membership fee. Most cooperatives have adjusted to changes in membership without altering their structures.

Member patronage is essential to the success of a cooperative. To ensure patronage, the cooperative may have a membership agreement that requires members to conduct a specified amount of business with the cooperative over a given time period. However, most shared-services cooperatives do not use membership agreements. Members are generally free to purchase services and products elsewhere. Cooperatives without membership agreements can enhance patronage by providing quality services and products at the lowest possible price.

Associate (nonvoting) memberships can be used to raise revenue, generate awareness and enthusiasm for services the cooperative provides, and increase the pool of experience available for advisory committees. However, few cooperatives have associate membership programs.

Board of Directors

Cooperatives are controlled by their member-owners through a board of directors. The chief responsibilities of the board include safeguarding the cooperative's assets; distributing the benefits of the cooperative; planning the cooperative's future; hiring, directing, and appraising the cooperative's manager; and setting policies.

In cooperatives with a limited number of members (20 or less), all the members may find themselves serving on the board. However, cooperatives often have too many owners for all to be members of the board. Then, members elect a trusted few from among themselves to serve on the board and guide the business affairs of the cooperative.

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[5] Some managers indicated that business failures among their members were lower than industry averages.

Board Composition and Nature Cooperative bylaws define the nature and composition of the board. The bylaws describe director eligibility, method of selection, term of office, and board organization. Boards of these cooperatives generally have 7 to 21 directors who serve a limited or indefinite number of terms.

Director meetings are usually conducted on a monthly or every-other-month basis. An agenda is developed for each meeting and minutes are kept. Some cooperatives compensate their directors for expenses incurred in attending board meetings.

Director selection methods may vary with a cooperative's size, structure, and function. Usually a cooperative's bylaws describe how directors are selected. State statutes may also contain director selection provisions. Larger cooperatives may use a nominating committee of three to five directors to assist with the selection of board candidates. The selection of the nominating committee itself is determined by the bylaws.

Cooperatives have developed various systems to produce equitable representation of their membership. Many cooperatives elect directors "at-large," the entire membership can vote directly to fill each board position, and each director represents the entire membership. Some divide the cooperative's territory into geographic districts that contain nearly equal membership numbers. Directors are then elected by district. Others elect directors from roughly equal territories based on volume of member business.

Delegation and Guidance Structures Directors elect from among themselves corporate officers in the form of a chairman (or president), vice-chair (or vice president), secretary, and treasurer to help conduct meetings and other business in an orderly manner. Some cooperatives will also elect an executive committee to handle many routine director responsibilities. Other board committees may be formed to oversee important aspects of the cooperative (e.g., finance or member relations).

Some cooperatives pick an outside director to provide special expertise to the board (e.g., financial experts or lawyers). In addition to a specific expertise, outside directors may also provide a fresh (and objective) perspective to help assess the general business climate that surrounds the cooperative. Raising grant money is sometimes another responsibility of outside directors.

The board develops and approves policies for the cooperative. They should also review specific operating policies recommended by management. Written policies are important to a board because they reflect the philosophy of the cooperative and serve as guidelines for actions the cooperative must take to meet its goals.

Cooperative boards may establish advisory committees to seek counsel or special insight on specific issues or programs outside their range of expertise. Advisory committees often examine a particular member or customer need, important aspects of cooperative operations, program development, and program delivery. Although advisory committees may not necessarily contain board members, they always report directly to the board.

Management and Staff

Staffs of existing shared-service cooperatives are often characterized by considerable enthusiasm toward their jobs, peers, and managers. This attitude is noteworthy because cooperatives are generally understaffed due to budget constraints. Consequently, staff members are often asked to acquire a variety of skills and perform an array of tasks. Most understand and support the principles of cooperation and view themselves as working for the members, not the cooperative.

Some employees may also be members of the cooperative. Under these circumstances, the employees may be even more committed to the cooperative. However, shared ownership among members and employees may also cause tensions within the cooperative when goals of members and employees conflict. One area of potential conflict is employee salaries and benefits.

There are relatively few levels, from support staff to the chief executive officer, in terms of formally defined positions in the cooperative's organization chart, Each position is defined in terms of its overall contribution to the mission of the cooperative. In contrast to traditional management where decisions move down the "chain-of-command" from top management to general staff, many shared-services cooperatives use a team management concept.

Staff teams are assigned to a project and/or to resolve a particular problem. While each staff member has an assigned responsibility, the team approach adds flexibility and employs the skills of each staff person. This approach also empowers staff members to make decisions regardless of job title. Moreover, once a particular responsibility is satisfied or problem resolved, the team is dissolved and employees are assigned to other duties.

COOPERATIVE OPERATIONS

Shared-services cooperatives provide services and programs to meet member needs. The programs and services offered change when the needs change. In many cooperatives, members help design programs and services. The only limitation is the creativity of the cooperative's staff and its membership. In a real sense, the cooperative acts as an extension of each member's own operation.

Financing and Taxation

To deliver programs and services successfully, cooperatives must have adequate capital to finance assets and operations. Cooperatives can accumulate capital in two basic ways — accumulating net worth (ownership capital) and borrowing (debt capital). Ownership capital is money obtained to purchase assets and to finance operations without having a legal obligation to repay it. Debt capital is money borrowed with a legal liability to repay under specific interest rates, terms, and other conditions.

In general, a shared-services cooperative generates income through its fee structure. Earnings generated when income exceeds costs of operation can either be retained by the cooperative as equity capital or returned to members as a patronage refund. The major distinction between such associations organized as cooperatives and those formed as nonprofit corporations is the way each allocates earnings.

In a cooperative corporation, earnings are allocated to patrons based on the amount of business each conducts with the cooperative during the year. Some of these allocated earnings are usually returned to the members as cash. The remaining allocated earnings are retained by the cooperative as member investments. The board of directors decides what proportion of earnings will be retained as accumulated equity capital.

Most State nonprofit laws expressly forbid the distribution of any earnings to members, trustees, officers, or other private persons. Even upon dissolution, assets of a nonprofit corporation can often only be distributed to other nonprofits. Earnings are usually placed in unallocated reserves. State law may contain further restrictions on the size and use of these reserves.

Acquiring adequate equity capital can be a major challenge for shared-services cooperatives. They frequently depend on fees and debt capital to cover operating expenses and any asset purchases. An important consideration for existing and potential cooperatives is the development of a systematic capitalization plan.

One way cooperative corporations can raise equity capital is to implement a base capital plan. A base capital financing plan requires patrons to maintain a current level of capital in the cooperative based on their degree of use. The plan requires the cooperative to determine its total equity capital needs, then allocate its capital requirements among the member-patrons according to each one's share of cooperative business over a base period of time (3-7 years).

After each operating cycle (or as the board determines appropriate), the cooperative's equity requirements are reviewed. Each patron's equity requirements is then adjusted to reflect changes in the capital needs of the cooperative for the new base period.

Fee Structure Shared-services cooperatives use a variety of techniques to generate income to cover operating costs and acquire assets-initiation, flat annual, and usage fees; product markups (margins); rebates; and member assessments. The goal of a cooperative's fee structure is to generate income in a manner that is fair to all members. Thus, as the number and complexity of programs and services offered by the cooperative increase, so does the complexity of the fee structure.

Fees are usually set annually by the organization's board of directors. The board estimates the cooperative's budget for the coming year and determines what income is needed to cover operating costs, working capital, and prudent reserves. Members are then charged fees based on the level of income necessary to meet program and service obligations.

Initiation fees are used by shared-services cooperatives to recover some of their operating expenses, but, more importantly, to ensure that potential members will use and be committed to the cooperative. Initiation fees may consist of a one-time membership fee, an application fee, or the price of a share of cooperative (common) stock. Some health care and educational cooperatives charge members on a population basis. For example, one cooperative charges new members a flat amount for one share of stock plus a set fee for each employee in their firm.

Annual fees are the most common income source for shared-services cooperatives. There are two main types—a *flat fee* charged equally to all members and a usage fee charged based on a member's past usage of the cooperative's programs and services. The flat fee is charged when the cooperative offers one or two relatively simple programs. The usage fee can be based on the use of an individual program or service or on the use of all of them. Some cooperatives use a combination of both. Some education cooperatives use this type of fee structure, charging a flat fee plus tuition based on the number of students.

Fees-fir-Service is a common income source because members pay only for the services used. For example, if a member receives technical services from the cooperative, its fee is based on the resources used by the cooperative. Those who do not use this service are not charged for it. Nonmembers who use the cooperative's service are normally charged a higher fee than members.

Product markups are used by cooperatives that act as wholesalers. These cooperatives buy products from manufacturers or distributors and resell them to members. Cooperatives often have a minimum markup policy. When setting the price for members, the cooperative will add to the cost of the product a minimum fee to cover its operating costs, working capital, and a contribution to ownership capital.

Rebates from manufacturers and distributors, usually based on the volumes purchased, is another income source for cooperatives that buy and resell products. Rebates can also be included in the price of products negotiated with various vendors. For example, a cooperative can negotiate a price of 61 cents per gallon for No. 2 fuel oil with 1 cent rebated to the cooperative for administrative costs. The cooperative must be careful to fully inform its members about this rebate procedure.

Member assessments are usually used in special cases when the cooperative needs additional capital. The most common usage of special assessments is to initiate a new program. Members who plan to use the program are assessed a fee to pay startup costs. This fee is usually the same for all participating members. Other members who later decide to use the program must also pay the assessment fee. Member assessments can also be used in cases of financial emergencies when cooperatives need additional operating cash.

Taxation The income tax treatment of shared-services cooperatives and their members depends on whether they are organized as cooperative or nonprofit corporations.

The rules for taxing cooperative corporations are found in Subchapter T of the U.S. Internal Revenue Code (I.R. Code). Subchapter T defines how cooperatives calculate their taxable income, the time period within which patronage refunds must be paid, patron taxation, and other rules unique to cooperatives.

The general principle of cooperative income taxation is that of single tax liability, usually assumed by the patrons. Single tax treatment is achieved by allowing a cooperative to deduct from its taxable income distributions of earnings from business with or for patrons, that are made to patrons on a patronage basis. These distributions, called patronage refunds, are deductible whether paid in cash or an equity allocation.

However, this single tax principle applies only to business income that is "cooperative" in nature. Earnings from sources other than patronage (e.g., income from activities not directly related to the cooperative's business) and income from cooperative activities not distributed in the manner specified by the I. R. Code are generally not eligible for single tax treatment.

Generally, a surplus placed in reserves by nonprofit corporations are totally tax exempt. No tax liability accrues at the member level because, unlike the cooperative member-patron, members of nonprofits never have access to any of the funds retained by the organization. Like cooperatives, nonprofits lose their favorable tax status with regard to income generated by activities unrelated to their principal purpose.

Shared Services

Services provided by shared-services cooperatives are developed and designed as needed by the board, committees, and members themselves. Most cooperatives begin by offering one service. Additional and more complex programs may then be added as the cooperative matures.

For example, a cooperative may start by purchasing an item members need but that is in short supply. However, as members voice a need for more items, the cooperative responds by purchasing a full line for its members. At the same time, the cooperative may begin to offer accounting services to its members.

Shared-services cooperatives can offer industry-specific or general services. For example, a marketing program for recyclables would be specific to solid waste management cooperatives. Advocacy, on the other hand, is a service that may be provided to any industry.

Specific Shared Services Special education classes are a shared service provided by education cooperatives. Most education cooperatives employ teachers, rent or own classrooms, and often provide transportation for students attending their classes. They may also employ specialists such as physical therapists and speech therapists, if needed.

Another example of industry-specific services is the hiring or contracting of health care professionals by hospital cooperatives. Member hospitals may have limited resources to recruit and pay professionals, especially when that service is needed only part time. The cooperative could hire a full-time doctor whose services could be shared among member hospitals. Each member then pays the cooperative for a specified period of service.

General Shared Services Cooperatives may offer services of a general nature to assist members with their management and operations. Management information is an example of a service that assists members by providing recordkeeping, billing, personnel and payroll management, insurance processing, inventory, and other types of data processing. Many small enterprises must contract outside for these services. Having the services provided by their cooperative can offer savings for the member.

Equipment maintenance is a similar type of shared service that benefits members in many industries. In each case, members save by sharing the costs of a general service contract with other members of the cooperative.

Casualty and surety is another general service offered by many cooperatives. Insurance coverage varies with member. Some examples are workmen's compensation, health, liability, and life insurance. By pooling resources and risk, cooperatives can access more attractive insurance rates. The savings can then be passed on to members in the form of lower premiums. In one example, a cooperative saved members 25 percent in annual insurance expenses.

Some cooperatives also provide technical assistance to members. It may be in the form of feasibility studies for new services, strategic planning assistance, and management training. The exact type of technical assistance offered to members will depend upon the type of industry and member needs.

Advocacy and education are also services offered by cooperatives. Advocacy includes lobbying efforts. In one cooperative, the president's chief duty is to promote cooperatives as a way of solving industry-specific problems. A cooperative can be more effective than individual members in lobbying activities. The cooperative speaks with a louder voice than each member separately.

Consumer education is similar to advocacy in that the ability to communicate is greater when the members speak with one voice. Members save by having the cooperative conduct this activity rather than each member acting alone. All members benefit if the demand for their product increases.

Members also use their cooperative as a vehicle to exchange information. They often gain a competitive edge over nonmembers because of their ability to share solutions. Information exchange can be formal or informal. Formal information sharing includes publications such as newsletters. Information is shared informally via member networks and conferences.

Cooperatives can also provide professional development and training opportunities. Professional training is offered to teachers, managers, facilities maintenance personnel, health professionals, and others. This service benefits all members, but is designed to meet specific staff or professional needs. In some cases, the cost of training is included in the membership fee.

Purchasing Activities

The primary function of shared-services cooperatives is to buy products and / or services for members at less cost than individual members could obtain for themselves. The idea is to capture the savings associated with lower administrative costs, quantity purchasing discounts, and assured levels of business with vendors and suppliers. By purchasing cooperatively, individual businesses or governmental entities can increase the efficiency of their buying activities.

In purchasing, the cooperative's goal may not necessarily be to obtain the lowest price possible. A vendor's reputation for reliability is another important consideration. The lowest price will not benefit the cooperative's members if the vendor misses deliveries, is often out of stock, or goes out of business. Reliable past performance is, therefore, an important factor when choosing a vendor.

Cooperatives must also develop and maintain good relations with vendors. Prompt payment, quick and fair resolution of problems, and a consistent, honest approach in dealing with vendors help build strong relationships. This leads to better and more responsive service from vendors.

There are three basic purchasing techniques: competitive bids, contract negotiation, and buy / resell. Each procedure can have elements of the other procedures. For example, a cooperative that buys products for resale to its members may have negotiated contracts with various vendors concerning the purchase price and / or the quality of the products.

The technique adopted by a cooperative buying for its members depends on several factors. The most important factor is industry convention. Successful cooperatives tend to purchase products and / or services using the same methods as other businesses in that industry. If the normal way of conducting business is to request bids from numerous vendors, shared-services cooperatives will generally follow that practice.

Other factors influencing the choice of buying techniques include the size of the purchasing organization, number of members, frequency of purchases, and the types of products or services being purchased.

Competitive ***Bids*** Competitive bidding at its simplest works as follows. The cooperative collects a list of items and quantities that members wish to purchase. This list is sent to various vendors who market those items. After the vendors submit bids, the cooperative selects a particular vendor or vendors based on price, product (or service) quality, and other considerations. Members are notified of the selected vendor and the prices of items to be purchased. Members then deal directly with the vendor when ordering, taking deliveries, and billing. The cooperative's remaining responsibility is to handle any problems that cannot be resolved between the member and the vendor.

Cooperatives can identify potential vendors in various ways. The easiest method is to continue with vendors previously used by the cooperative's members before they joined the organization. A second method is to use resources such as trade journals, trade associations, and contacts with other businesses in the industry. The cooperative also may invite bids by advertising in newspapers, trade journals, and state procurement publications.

Cooperatives with public entities as members may be required to follow State buying regulations. For example, Massachusetts law has specific requirements when requesting bids from vendors. For purchases under $1,000, the cooperative can buy from anyone; for purchases from $1,000 to $10,000, the cooperative must obtain three quotes; for purchases of more than $10,000, the cooperative must advertise for bids.

Once vendors have been identified or have contacted the cooperative, they should be sent a bid package inviting them to participate. The bid package should include:

1. An explanation of the cooperative's process for awarding a contract.

2. Explicit instructions on what materials the vendor must submit to the cooperative.

3. A list of the products the cooperative wants, including quality specifications.

4. Terms of the contract such as the time period covered and procedures for ordering, delivering, and paying.

There are many variations to operating a competitive bidding system. These variations are additional services the cooperative could provide its members. For example, a cooperative can provide a list of available items to members rather than having them develop their own lists. The cooperative's list would include a description of the item, quality specifications, packaged quantities, estimated prices, and other relevant information. Members would only indicate the quantity of items they wish to purchase.

Another variation concerns selecting a vendor. An advisory committee composed of individuals from member organizations could review bids. For example, a committee of custodians would review the bids for janitorial products. In some cases, the cooperative may require bidding vendors to submit product samples which can be tested by those who will use the product. The committee then recommends its selection (or selections) to the board for approval.

Negotiated Contracts Negotiated contracts may be used independently or in conjunction with the bidding process. For example, a cooperative may negotiate with a vendor for only part of its set of services to be provided at a lower cost. In other cases, a cooperative may negotiate contracts without using the bidding process. Health care cooperatives negotiate contracts with a variety of health care providers. Each hospital, clinic, and individual provider would have a separate contract.

A contract formalizes commitments by both parties on how to conduct their relationship. The contract specifies the products and services to be provided; the terms and conditions such as price, quality, and delivery schedules; recourse for non-performance; and the method for voiding the contract. In the process of negotiating a contract, it is important for the cooperative to be totally honest with the other party. Aside from being the best way to conduct business, it helps to avoid future confusion. Formal written contracts between the cooperative and the organization providing the product or service legally protect the cooperative and its members from problems associated with failure to perform.

Buy/Resell (Wholesaling) Another purchasing technique is wholesaling or buying product from manufacturers and distributors and then reselling to members. Members benefit from group purchases by capturing volume discounts and rebates offered by vendors. Members also benefit through coordinated product deliveries. Wholesaling cooperatives are common among food and hardware stores and other independent consumer retail operations.

Wholesale cooperatives frequently operate on a larger scale than other types of purchasing cooperatives. Their larger staffs include buyers who make the purchases, sales representatives who service members' needs, and logistics persons who coordinate deliveries. These cooperatives also use a more sophisticated data processing system for tracking members' purchases and inventory management. Warehouse facilities, either owned or rented, are needed to store products.

STRUCTURAL ALTERNATIVES

Shared-services cooperatives may consider several structural alternatives to improve their own operations and to increase the level of services to their members. These include nonprofit social welfare units (501(c)3 organizations), subsidiaries, joint ventures, and licensees. Normally, these are associated with established cooperatives that offer a wide variety of services to their members. However, businesses that are considering the formation of a new shared-services cooperative may wish to include one of these structural alternatives.

501 (c)3 Organizations

Organizations incorporated as nonprofit corporations and operating exclusively for the promotion of social welfare may qualify under I.R. code 501(c)3 as tax-exempt associations. Nonprofit shared-services organizations that operate cooperatively may qualify for this exemption and cooperatives may form subsidiaries that qualify. This exemption makes it easier for these organizations to receive grants from public and private sources.

Subsidiaries

A subsidiary is a business organization that is owned and controlled by another firm.[6] Cooperatives can use subsidiaries to conduct nonmember business. By diverting all nonmember business through a subsidiary, a cooperative can have a more efficient accounting of its activities. The subsidiary pays all corporate income taxes and any remaining profits go to the cooperative.

A subsidiary can also be organized as a 501(c)3 organization. The subsidiary can then solicit grants from various foundations and Government agencies to fund specific activities. There are cases where a cooperative was initially organized as a nonprofit corporation with a 501(c)3 designation and later reorganized as a cooperative with a 501(c)3 subsidiary.

Joint Ventures

Joint ventures are separate legal entities owned and controlled by a small number of participants to carry on a specific and limited economic endeavor. Participants agree to share expenses, earnings, losses, risks, and control of the venture. These ventures facilitate collaborative business activities more efficiently than if tried separately. Furthermore, venture activities require less capital investment than if each participant had invested separately.

A joint venture should be implemented with a binding written agreement that sets forth specific information on these issues: legal structure, venture purposes, finance, distribution of earnings, control of the joint venture, employees, raw materials acquisition, marketing responsibility, nonparticipant business, rights to compete, structural reorganization, and agreement amendments. Joint ventures can also be separate legal organizations organized as a partnership or corporation.

Joint ventures are appropriate for many activities including value-added manufacturing, research and development, and distribution. For example, wholesale cooperatives have formed a joint venture to own and operate retail stores. This provides an additional market for the cooperatives' products.

Licensees

Licensees are organizations authorized to market a product or service owned by another organization. Sole distributorships of a product are one example. As a sole distributor, the cooperative has the exclusive right to market a product in a specified geographic area. In this case, the cooperative must sell to nonmembers as well as members. Shared-services cooperatives may also hold licenses to sell and/or carry property and casualty insurance and other risk management instruments for their members.

[6] A subsidiary is often called "wholly owned" if the controlling firm owns all of the voting interest in the subsidiary and "majority owned" if the controlling firm has more than 50 percent but less than all of the voting interest.

ELEMENTS OF SUCCESS

Many factors contribute to the successful operation of a shared-services cooperative. Not all need to be present for a cooperative to be successful, but the more elements present, the better the chances for success.

Membership

Member loyalty or commitment is a major contributing factor to the success of shared-services cooperatives. Members must be supportive and maintain a high level of patronage of cooperative programs and services. In turn, cooperatives should involve their members directly in program design and oversight.

Board

Successful cooperatives have boards of directors that possess expertise and commitment, and that pay close attention to the overall direction of the cooperative. Boards also provide a "sense of history" or an awareness of member circumstances and the business environment before the cooperative existed.

Staff

Successful cooperatives, like most businesses, require a talented and dedicated staff to run daily operations. Staff that have a full understanding of the cooperative method of business are an additional asset.

Management

Quality management is a crucial factor in the success of any cooperative. Shared-services cooperatives, like any business, are managed to benefit their owners. However, a cooperative conducts business primarily with patrons who are also its owners. As a result, cooperative decisionmaking is quite different from other businesses. Shared-services cooperatives, for example, focus on obtaining quality products that their members need, rather than searching for products that maximize the cooperative's profits. Members of a shared-services cooperative invest to acquire services and not for monetary returns on their investment. Managers of successful cooperatives pursue this goal in their decisions.

Flexibility, Creativity, and Innovation

Shared-services cooperatives must be flexible and creative in service to their members. These cooperatives are often required to redesign or abandon programs and to add or eliminate services in response to members' changing needs.

Service to Members

Beyond these factors, the success of a cooperative may be attributed to the quality of service it provides members. Successful cooperatives stress the importance of focusing on member needs, then satisfying them through the services they provide.

CHALLENGES

Shared-services cooperatives face both internal and external challenges. Internal challenges are structural and operational. External challenges are usually specific to an industry.

Internal

"Free riders" can be a major internal challenge to cooperatives if all members do not participate in a program. For example, the purchasing program of one cooperative required members to pay a fee to participate. However, vendors often would sell to participating and nonparticipating members at the same price. These nonparticipants were "free riders" who took advantage of other members' investments.

Financial problems are another internal challenge many cooperatives face. Some cooperatives lack the capital to develop and implement new programs when needed. Furthermore, when a cooperative depends upon grants as a source of income, financial stress may result when the funding ends and no other source is available.

Cooperation among members is a vital element in a successful cooperative. However, competition among members is somewhat common. Overall, competition among members could be perceived as a greater problem than it is, given that members are typically in the same area of business.

The need to cooperate and share services in a cooperative business structure can minimize competition.

The need to innovate is a final example of an internal (operational) challenge. For example, an insurance provider recognized the need to provide innovative policies and services to dissuade members from going back to previous suppliers.

External

External challenges originate from factors outside the control of the members and the cooperative which serves them, such as industry competition where a cooperative competes with other suppliers. If a private supplier can provide a similar product or service at a better price or quality, members will often purchase outside of the cooperative to acquire the service. This erodes the viability of the cooperative.

Changes in industry practices and technology are other external challenges. These changes challenge cooperatives to continue providing the best possible product or service at the lowest cost to keep members competitive in their industry For example, hospital cooperatives and their members constantly work to adopt changing medical practices and technologies.

SOME ADDITIONAL THOUGHTS

Shared-services cooperatives are one way to increase the quality of life for rural Americans, but are not necessarily a solution to all of rural America's problems. The formation of a shared-services cooperative requires a major commitment of time, energy, and capital. Potential cooperative members need to devote significant effort to move from a concept to an operating cooperative.

Some initial capital investment is also required to organize potential members, conduct feasibility studies, hire an attorney experienced with cooperatives, etc. In some rural communities, potential member commitment may exist, but sufficient capital may not. Also, further assistance will be required if a cooperative is to be formed.

Other short-term and less formal solutions exist for problems facing businesses and municipalities. Some of these could lead to the formation of a cooperative. The simplest alternative is to join an existing shared-services cooperative. This presumes that the type of cooperative needed conducts business in the area and is willing to accept new members.

A second alternative is a contractual arrangement among several businesses or municipalities to purchase products or services. Such an arrangement will work well for one-time purchases, or the purchase of a major item to be shared among buyers. Through contractual arrangements, businesses can learn about the benefits of cooperation. It is also a way for a group to become more comfortable in a combined operation.

A third alternative is an informal network of businesses facing similar problems. Networks are not incorporated organizations, but rather ad hoc gatherings of like businesses or municipalities which discuss mutual problems and possible solutions. These discussions can result in joint activities such as purchasing one or two products.

One drawback to contractual arrangements and networks is instability. These alternatives do not require a considerable commitment from participants. Once the contract expires, the parties can go their separate ways. A network is even more unstable in that a participant can withdraw at any time.

At the same time, the second two alternatives can lead to the formation of a shared-services cooperative. By learning to work together and becoming more comfortable with each other, participants may wish to formalize the relationship. This is especially true if they believe there is a need for additional and / or continued services. Under these circumstances, the idea of a stable organization may encourage participants to commit to a cooperative.

A shared-services cooperative can provide a group of private businesses or public entities one or more services that enhance or increase the competitiveness of their operations. The role of these cooperatives is to provide services in response to the specific needs of member-owners. They can offer a wide array of services including purchasing of products or support services such as accounting, management information, staff education, insurance, and legal assistance.

Services are developed and designed based on the needs of members by the board, committees, and often, by the members themselves. Most cooperatives begin by offering a single service. New and more complex services may be added as members' needs change and as the cooperative matures. With a committed membership, a conscientious board, and a dedicated management and staff who are flexible, creative, innovative, and member oriented, a shared-services cooperative can benefit all its members. The only limitation is the creativity of the cooperative's staff and members.

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Rural Business-Cooperative Service (RBS) provides research, management, and educational assistance to cooperatives to strengthen the economic position of farmers and other rural residents. It works directly with cooperative leaders and Federal and State agencies to improve organization, leadership, and operation of cooperatives and to give guidance to further development.

The cooperative segment of RBS (1) helps farmers and other rural residents develop cooperatives to obtain supplies and services at lower cost and to get better prices for products they sell; (2) advises rural residents on developing existing resources through cooperative action to enhance rural living; (3) helps cooperatives improve services and operating efficiency; (4) informs members, directors, employees, and the public on how cooperatives work and benefit their members and their communities; and (5) encourages international cooperative programs. RBS also publishes research and educational materials and issues ***Rural Cooperatives*** magazine.