Forming a
New Generation Cooperative
in Manitoba

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Over the past decade, more than 100 new generation cooperatives (NGCs) have been established on the northern plains of the United States. NGCs represent the entrepreneurial efforts of agricultural producers who want to expand into business operations that occur past the farm gate. There is a growing interest among producers across western Canada in NGC formation. The purpose of this site is to provide an overview of some of the key factors involved in forming an NGC in Manitoba. Its intended audience includes agricultural producers, commodity groups, and other parties who are interested in the idea of adding value to their farm commodities. The contents of this site provide only a rough guideline for NGC development. The site is by no means all-inclusive. Instead, it is meant to serve as a tool to help interested parties along the path to starting a successful NGC.

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Background

> "By vertically integrating forward in the distribution chain, farmers can maintain control over their operations, reduce risk, stabilize income, and secure markets." – excerpt from *New Generation Co-operatives: Responding to Changes in Agriculture*

New generation cooperatives represent the most recent wave in the efforts of agriculture producers to pursue and shape their own future. Agriculture has undergone radical change in recent decades. The structure of agriculture is changing primarily because of advances in technology and changes in consumer preferences. One aspect of this transformation is the industrialization of agriculture. Industrialization often means large scale or industrial scale production processes. But it also means the adoption of system wide processes over the entire marketing chain or supply chain to coordinate activities within the food distribution system. Commodity markets, in which commodities are gathered from autonomous producers, mixed, and sold to processors, are increasingly being replaced by full supply chain approaches that are characterized by producer contracts, outsourcing, and vertical integration. This has become especially evident in the poultry and pork sectors. Many experts assert that these approaches are finding their way into the grains and oilseeds sector as well.

Primary production of commodities is rapidly becoming part of an industrialized food system. Traditionally, farmers perceived agricultural production as an independent stage of the food chain. Their involvement with the food chain was often perceived to end at the farm gate. Today, farmers increasingly view themselves as part of an integrated system that moves food from the farm all the way to the final consumer's dinner plate. Farmers understand that decisions at all stages of the food system must be interconnected so that consumer demands are met. The dilemma for the farmer is this: Will the farmer be a contract agent for other parties who control and manage the supply chain or will the farmer play a larger role in the ownership and control of the supply chain?

One of the outcomes of industrialization and other changes taking place has been lower per unit returns to primary agricultural production. In addition, western Canadian farmers have had to deal with public policy changes, most notably the elimination of the Western Grain Transportation Act (WGTA) in 1995. The elimination of the WGTA has led to higher transportation costs for western Canadian farmers to ship their grains and oilseeds to port. It was hoped that this change in legislation would assist in the development of value-added processing activities on the Prairies. As a result, farmers are looking for ways to add value to their grain here on the Prairies rather than ship it as a raw commodity to export markets. In addition, changing World Trade Organization (WTO) rules are beginning to have effects on sectors characterized by supply management. Producers are looking for ways to sell their product directly to processors outside of the supply management system. Changing WTO rules lessen the reliance on government regulation as the buyer and seller of product.

Through new generation cooperatives, producers have the opportunity to share in two income streams: revenue from the sale of the raw agricultural commodity as well as revenue from the processed product. New generation cooperatives therefore allow producers a chance to gain a greater share of the consumers' food dollar and move up the value chain. New generation cooperatives can be particularly adept at capturing niche market opportunities. Niche markets involve low volume products such as bison or exotic oilseeds that don't fit well in high volume marketing strategies followed by larger, established processors. As a result, there may be opportunities in these markets for new generation cooperatives. Although small in volume, niche markets may provide the opportunity to earn high margins.

The changing structure of agriculture has raised many questions concerning control and power in the industry. As contracting and vertical integration become more common, it is likely that producers will have less control over their production and marketing decisions.

Producers must ask themselves how they will fit into the modern food distribution chain. New generation cooperatives are one possible tool to help producers broaden their participation and ownership in today's agriculture system. Forming a new generation cooperative represents a method of maintaining producer independence—by agreeing to cooperate with each other and become owners of their own value-added business, producers can avoid the loss of control to outsiders concerning production and marketing decisions.

The purpose of this sourcebook is to assist farmers and others to evaluate the opportunities and to succeed in those efforts where a new generation cooperative is the best approach.

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Features of new generation cooperatives

What is a New Generation Cooperative?

For the purposes of this guidebook the abbreviation NGC will be used for the term New Generation Cooperative.

An NGC is simply a form of business organization that combines features of a traditional cooperative with those of an investor-owned corporation. An NGC is typically involved in the value-added processing stage of an agricultural product, once the commodity has moved past the farm gate. The focus of an NGC is on value-added processing rather than commodity production. For instance, the NGC structure has been used to transform durum into pasta products, spring wheat into frozen dough, and bison into packaged meat. NGCs are formed to allow producers to retain an interest in their commodities once they have moved past the farm gate, thus allowing them an opportunity to gain part of the marketing share of the consumers' food dollar.

The NGC structure emerged in the United States and was originally based on a California model of cooperatives that required producer agreements as well as up-front equity investments from members. NGC members, who are agricultural producers, sell their commodities to their cooperatively-owned processing business. Any earnings that the NGC generates from value-added activities are then distributed back to the members in proportion to the amount of commodity they delivered to the cooperative.

Major features of the NGC structure include:

- delivery rights that are tied to the level of equity invested
- selected, or defined, membership
- significant level of initial equity investment
- transferability of equity and the opportunity for appreciation or depreciation in the value of delivery rights shares
- expansion of the business is typically funded by new issues of delivery rights shares

Delivery rights

Shares in an NGC can be used to assign membership to producers and to allocate delivery rights. There are generally two types of shares in an NGC: membership shares and special investment shares that convey delivery rights and obligations (sometimes these latter shares are known as delivery rights shares). Producers purchase these special investment shares that obligate them to deliver a certain amount of farm product to the cooperative each year. For instance, one special investment share may give the producer the right and obligation to deliver one tonne of wheat to the cooperative every year. In the case of an NGC that processes livestock, the share may give the producer the right and obligation to deliver one animal to the cooperative every year. Because delivery rights are tied to special investment shares, they ensure that members provide up-front equity capital to the NGC that is proportional to their level of use of the cooperative. Each member's equity position in the cooperative is therefore equal to the member's patronage level with the cooperative. Any patronage refunds that the cooperative generates are distributed to members according to the level of product that they delivered to the NGC.

Essentially, delivery rights shares act as a two-way contract between the producer-members and the cooperative; they obligate the producer-members to deliver product each year to the cooperative, and in turn they obligate the cooperative to accept delivery of the product. Typically there is an underlying producer agreement that accompanies the special investment shares of the cooperative. Each member must sign this producer agreement, which outlines details such as the quality specifications and delivery methods that the member must follow. The agreement also indicates such things as the method of valuing the commodity to be delivered and how the producer will be paid. It will also include details concerning the measures to be taken when a member fails or refuses to deliver the quality and amount of commodity specified under the agreement. Each NGC will structure producer agreements to serve their particular needs.

Members will typically receive two streams of income from the NGC: during the year, they will be paid an amount (determined by the cooperative) for the commodity they deliver to the firm. Then, at the end of the year, they will receive a portion of any value-added processing returns that the cooperative was able to generate throughout the year.

The use of delivery rights assures producers a market for their product, and assures the cooperative a steady source of its primary input. Access to a steady source of inputs may give the NGC a competitive advantage over competitors who lack a captive source of supplies. With producer agreements that indicate delivery arrangements in place, management can coordinate their input supply so that the processing facility is efficiently utilized. Quality stipulations are specified; if the producer cannot fulfill his delivery commitments with his own product, then he must make arrangements to purchase the product from elsewhere to fulfill the delivery requirements. Otherwise, the cooperative will make arrangements to purchase the needed product from another source and charge the member for the difference.

The total quantity of delivery rights equity shares that the cooperative sells to producers depends on the processing capacity of the cooperative's operations. The cooperative only sells enough shares so that it meets its efficient capacity level. For example, if the cooperative plans to operate a facility that has a capacity to process 75,000 tonnes of grain each year, then it will sell 75,000 equity shares that each require the owner of the share to annually deliver one tonne of grain to the cooperative.

In some cases, the NGC will reserve the right to lower the amount of commodity that is to be delivered. For example, consider a special investment share that obligates the member to deliver one tonne of canola to the cooperative. The company may reduce this quantity on a pro rata basis to all members if its marketing needs change during the year.

The price of each special investment share in an NGC is typically determined by dividing the total amount of equity capital that the cooperative requires to finance the business by the processing capacity of the cooperative's facilities. Continuing with the above example, if the cooperative determines that it requires $12 million in equity capital to establish a 75,000 tonne annual processing operation, then the price per special investment share will be found by dividing $12 million by 75,000 tonnes. Thus, the initial price per special investment share would be $160. Afterwards, market conditions will determine whether or not the special investment share will appreciate or depreciate in value.

The special investment shares that allocate delivery rights are separate from membership shares. In most cases, each individual producer holds only one membership share, but can hold more than one special investment share. Sometimes producers are required to purchase a minimum amount of special investment shares to be considered for membership in the NGC. Voting rights are attached to membership in the cooperative, and therefore each producer only has one vote in the cooperative's affairs, regardless of how many special investment shares he may hold. This is consistent with the democratic principle of one member, one vote that characterizes most cooperatives. The cost of a membership share is typically a nominal amount.

Selected[1] membership

In contrast to many traditional cooperatives that accept new members on a continual basis, membership in NGCs is restricted once the targeted amount of special investment shares are sold. Once the targeted amount of special investment shares are sold, new members will only be allowed if an existing member wishes to sell some of his shares to another producer. This ensures a stable level of supply of product for the NGC; membership may change somewhat because producers wish to sell some of their special investment shares, but this does not change the supply of product being delivered to the cooperative. The sale of shares between producers typically requires approval from the board of directors before they occur. By doing so, the board can ensure that shares are not purchased by ineligible persons.

Significant level of initial equity investment

Because of the presence of delivery rights, the initial equity investment required from producers is higher for a NGC than that found in more traditional cooperatives. American NGCs have generally raised between 30 and 50 percent of their total capital requirements from the sale of delivery rights shares. U.S. lenders typically want to see a 40 to 50 percent member equity position for new cooperatives, depending on their assessment of the risks involved. Financial institutions in Canada will evaluate the NGC's potential based on its strengths and weaknesses. Producers must pay for the right to deliver their commodities to the cooperative; in order to participate in the cooperative's value-added processing, producers must provide up-front capital by purchasing shares that convey delivery rights. The NGC usually sets a minimum required number of delivery rights shares that an individual producer must purchase in order to be eligible for membership. For example, the minimum required investment in one American NGC was set at $4,800 U.S., which represented 800 shares at $6 each. Each share represented the right and obligation to annually deliver one bushel of the commodity to the NGC.

Because the members invest a significant amount of equity and are obligated to deliver product, they tend to remain more committed and involved in a NGC than they might be in a traditional cooperative.

In comparison to a more traditional cooperative, the NGC receives a higher level of equity financing at the start of its operations. The NGC is therefore in a position at the end of the year to return a greater portion of its patronage refunds in cash to its members, rather than retain them in the business as additional equity financing. In other words, since the members invest a significant amount of capital up front, most of the net earnings generated can be returned to members at the end of the year rather than used as retained equity financing for the business. The added value that the NGC has contributed to the members' commodity is therefore returned to the members each year. Because equity is received prior to start-up, the NGC may be able to avoid difficulties that sometimes occur when trying to raise capital. If the NGC decides to expand its operational capacity, then it issues more delivery rights shares, which provide the necessary equity financing for the expansion.

Transferability of delivery rights shares and the opportunity for appreciation or depreciation in the value of delivery rights shares

Members of the cooperative are typically allowed to transfer their special investment shares to other members or other producers who wish to become members, subject to board approval. The price of special investment shares that are sold among producers is negotiated by the producers themselves, according to the perceived market value of the shares. The board of directors does not set prices of shares transferred between producers. The price of the delivery rights will be based on the earning potential they represent, and will therefore fluctuate according to the performance of the cooperative. If the cooperative is performing well and the buyer perceives strong earning potential from owning the delivery rights, then he may offer a price that is higher than that originally paid by the member. The selling member would therefore be able to realize a capital gain from the appreciation of the share value. Thus, in addition to the opportunity to receive patronage refunds from ownership of delivery rights, the member might also benefit from an appreciation in value of these rights if he chooses to sell the special investment shares. In such a situation, the member is able to sell his shares and immediately receive the market value for those shares. Alternatively, if the buyer perceives that the earning potential is weak, then the share might have decreased in value for the member.

The buyer should verify with the cooperative that the seller in fact owns the shares prior to the sale. The transfer of ownership does not take place until the cooperative has been notified and the transfer is recorded on the books of the cooperative. If he is not already, the buyer needs to become a member of the cooperative in order to own special investment shares. Thus, if he is not a member at the time, the purchase of shares should be made conditional on his becoming a member of the cooperative.

Expansion of the business is typically funded by new issues of delivery rights shares

When a NGC is ready to expand its operations by means such as increasing its current plant capacity or building an additional facility, it generally finances the expansion by issuing new special investment shares. In other words, future expansion is financed in the same way as the original start-up of the NGC. The number of special investment shares issued and their price is determined according to the processing capacity of the expanded facilities. By issuing further delivery rights shares, the NGC is able to rely on new financing rather than retained earnings of the business to finance expansion activities.

[1]Selected membership is sometimes referred to as "closed" membership in the United States.

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An Overview of Available Business Structures

The New Generation Cooperative (NGC) is a relatively new concept on the Canadian prairies. Recently, lawmakers have been struggling with how to fit the NGC form of business into cooperative legislation. An NGC represents a group of agricultural producers who share an interest in owning a business that extends their activities past the farm gate. The objective of an NGC is to move farmers up the value chain. However, there are several other types of business structure that could be used for value-added businesses. The choice of structure to use depends on the particular circumstances of the business. This section will provide a brief description of the various business structures available. The purpose of this chapter is not to provide all of the relevant legal and financial information that is needed to decide on a business structure. Rather, this section provides a brief overview that can help prepare the reader for discussions with lawyers, accountants, and other advisors when making the final decision as to which type of structure to use to organize a business.

There are four common forms of business ownership in Canada:

- sole proprietorship;
- partnership;
- corporation; and
- cooperative.

In order to understand the New Generation Cooperative business structure, it is useful to compare these four forms of business organization. These forms of business structure are outlined below.

Cooperatives

A cooperative is a type of corporation and is governed by similar laws. For the purposes of this booklet, corporations other than cooperatives are referred to as investor-owned corporations. A cooperative is generally described as a business that is organized, owned and democratically controlled by the people who use its products and services, and whose earnings are distributed on the basis of use of the cooperative rather than level of investment. A distinct feature of a cooperative organization is that the role of owner and patron or user are closely connected. A patron or user refers to a person who conducts business with the cooperative. A cooperative is distinct because there is a linkage between the ownership and the users of the business. A member is an individual who owns the cooperative and who is also a user of the cooperative in some way. In contrast, a shareholder of an investor-owned corporation owns the business because he owns shares in the business, but the shareholder might never be a user of the corporation's business. For example, a person might own shares in a meat processing company but might never purchase a meat product from that company or supply raw materials to the company.

Cooperatives, like investor-owned corporations, have elected boards of directors and appointed officers.

Members control the cooperative through the election of directors. The members exert their control through voting power that is attached to their membership. Unlike investor-owned corporations, in which voting power is proportional to the number of shares held, voting power in a cooperative is based on the principle of one member, one vote. Each member has only one vote in the affairs of the cooperative, regardless of the level of equity that he has invested.

Traditionally, a person can qualify for membership in a cooperative by purchasing one or more shares with a fixed (and often nominal) value. On termination of membership, the cooperative will repurchase the share (on a priority) basis at the original purchase price.

Recent legislation in Manitoba created new opportunities for structuring and financing cooperatives. Our newly updated Cooperatives Act allows cooperatives to offer shares that can attract outside investment or increased member investment. These new "investment shares" can be used to reward non-members in a variety of ways for providing risk capital to the cooperative. Non-member investors may be given voting power in limited circumstances, including the right to elect representatives to the cooperative's board of directors. "Special investment shares" can be issued by an NGC, which shares may reflect the market or perceived value of the rights which ownership of the shares creates, rather than a permanently fixed value.

Advantages of a cooperative

- Cooperatives have many of the same advantages of investor-owned corporations such as limited liability of owners and perpetual existence of the cooperative.
- Whereas investor-owned corporations are typically exposed to double taxation because dividends to shareholders are distributed out of after-tax corporate income, cooperatives are allowed to deduct patronage refunds to members out of before-tax income. Thus, income may only be taxed at the individual member level rather than at both the cooperative and member level. In other words, a cooperative does not pay tax on income that it distributes as patronage dividends.
- Cooperatives are organized on a democratic principle of one member, one vote.
- Control of the business is kept in the hands of those who use the business.
- No one investor, or group of investors, can dominate the decision-making simply because they have made a large investment in the business. This is particularly attractive to members who are smaller than other members of the cooperative.
- However, this may serve as a disadvantage, as it will deter investors who desire control proportional to their investment.

Disadvantages of a cooperative

- Traditionally, equity financing was only available from cooperative members, with most new members only required to contribute nominal capital. However, the flexibility of issuing investment shares to non-members may provide some cooperatives with greater access to capital. Cooperatives issuing shares to the general public will have to obtain clearance from the Securities Commission, which could become a long and costly process. Special investment shares (delivery rights) issued by an NGC may be subject to less scrutiny by the regulators, but the issue of such shares will always require a filing or a disclosure document if an exemption from an offering statement is granted by the Registrar.
- Cooperatives may not provide incentives for members to contribute additional capital.
- Since the benefits from being a member of a cooperative arise through the level of use of the cooperative rather than the level of equity invested, members do not have an incentive to invest in equity capital of the cooperative.
- Some entrepreneurs will not be motivated to invest in the cooperative because they are not satisfied with democratic voting arrangements and dividends that are based purely on patronage.
- Cooperatives need to consider an equity redemption plan.

- In order to finance business growth, cooperatives maintain some patronage earnings in the cooperative rather than distribute them as cash dividends to members. Cooperatives must decide how much patronage-based earnings to retain in the business (by increasing members' equity positions in the cooperative) and how much to immediately pay out in the form of cash patronage payments. Because retained patronage earnings must eventually be returned to members, cooperatives should have a well-designed equity redemption program in place.

The cooperative is a business structure that should be considered, together with corporations, partnerships, and other alternatives in any situation where primary producers are considering pooling their resources to carry on business together.

Individuals considering a cooperative as an option should seek tax and legal advice to ensure that the long-term interests and needs of each of the cooperative's members and investors are properly advanced and protected. In doing so, it must be remembered that each party may have different requirements and expectations of the benefits that the cooperative will provide.

Corporations

A corporation is distinct from a sole proprietorship and partnership in one fundamental way: it is a separate legal entity. It has a legal existence independent from the owners of the business. It can buy, own, and sell property, sue and be sued, and must file its own income tax return.

There are three main groups of people involved in a corporation:

- Shareholders
  - They are the owners of the corporation. Common shareholders are entitled to vote at shareholders' meetings on company-related issues such as electing the board of directors and choosing an auditor. Most shareholders are not involved in managing the affairs of the corporation.
  - Shareholders' liability for debts of the corporation is limited to the price they paid for the shares they own.
  - Shareholders receive a portion of profits based on the type and number of shares they own in the corporation.
  - They are entitled to share the assets if the corporation dissolves, after all debt obligations have been satisfied.
- Board of Directors
  - The board of directors is elected by the shareholders to guide the affairs of the corporation.
  - Directors owe a fiduciary duty to the corporation, and must disclose any personal interest in any business in which the corporation participates.
- Officers
  - Officers are hired by the board of directors. They are responsible for the day-to-day management of the corporation
  - Unlike shareholders, officers can legally bind the corporation to contracts they sign on its behalf.

In contrast to sole proprietorships or partnerships, a corporation is subject to double taxation.

Because it is a separate legal entity, any profits of a corporation are taxed according to corporate income tax rates. Then, if after-tax profits are distributed to shareholders in the form of dividends, the shareholders will be taxed on these dividends. Thus, income from a corporation can be taxed twice: once at the corporate level, and then again when the income is distributed to shareholders in the form of dividends. Shareholder income from dividends does, however, get some form of tax relief in the form of dividend tax credits.

Advantages of a corporation

- A corporation provides limited liability for the owners (shareholders); shareholders are only liable to the extent of their investment in the shares of the corporation.
- As a separate legal entity, the corporation is responsible for its own debts and obligations.
- A corporate structure provides flexibility in the organization of the business, and in the relationship between the owners.
- A corporation has a perpetual existence, so it does not end upon the death of one of the shareholders.
- This perpetual existence allows for simpler estate planning, without the necessity of re-negotiation of partnership agreements each time a change is made.
- Control and ownership of a corporation are easily transferable by selling shares.
- Corporations may facilitate access to capital because additional shares in the corporation can be sold to raise funds.
- A corporation may be the preferable structure when there is a large number of owners, as it provides for a formal decision-making hierarchy.
- A shareholder can contract with or sue the corporation, whereas a partner can do neither with respect to the partnership and must contract with or sue the partners individually.
- A corporation can provide flexibility of financing.
- The corporation can create different classes of shares, with varying rights and characteristics.
- This flexibility provides more options to investors, as they can obtain a type of investment that most properly fits with their own investment objectives.
- Some government assistance is only available to corporations.
- Corporations may offer possible tax advantages compared to other forms of organization. For example, small businesses that have incorporated may be eligible for the small business deduction.

Disadvantages of a corporation

- The costs of creating and maintaining the corporation can be very high. For instance, the required legal and accounting work may be significant.
- Laws governing corporations are more complex. If a corporation's shares are publicly traded, then the corporation must also follow stringent financial reporting and securities commission requirements.
- Shareholders cannot use corporate losses to offset their personal income.

Sole Proprietorships

A sole proprietorship is the simplest and most common form of business structure, and it is the oldest form of legal ownership in Canada. It is owned by one person who retains all of the legal rights and bears all of the responsibilities associated with the business. The owner enjoys all of the profits flowing from the business and is responsible for all of its debts. The business is not considered as a separate entity from the owner. In other words, the firm is part of the owner. The income of the business is reported as personal income on the owner's personal income tax return, and is taxed at the same rate as the owner's other personal income, if any.

Advantages of a sole proprietorship

- A sole proprietorship is the simplest and least expensive type of organization to create or dissolve.
- Sole proprietorships are not governed by any specific legislation. Each province, however, has some specific regulations.
- The owner retains absolute control over business decisions and is the sole owner of any profits from the business.
- The profits of the business are not taxed as a separate entity, only as part of the owner's personal income.
- Unlike an employee, a sole proprietor can deduct business expenses from personal income.
- The owner may derive personal satisfaction from being one's own boss.

Disadvantages of a sole proprietorship

- The owner faces unlimited liability. Unlike some other business structures, a sole proprietorship is not a separate entity from the owner. Unlimited liability occurs because there is no legal distinction between the owner and the business.
- With regard to liability and taxation, the owner and the business are one in the same.
- Therefore, the owner can be held personally liable for all business debts, or for negligent acts of employees in the course of business.
- Creditors can seize the personal assets of the owner for non-payment of business debts. Unlimited liability implies that the owner is liable for claims against the business, even those that go beyond the value of his or her ownership in the firm.
- The ability to obtain financing may be impaired because the amount of money the owner is able to invest in the business is limited to what available resources he or she has and what he or she is able to borrow.
- In contrast to some other business structures, in which funds can be raised through the sale of equity in the business, the only option available to sole proprietorships is debt financing.
- The ability to obtain this debt financing will depend greatly on the value of the owner's personal assets that can be used for collateral.
- The owner is solely responsible for all aspects of the business, from day-to-day operation to securing financing. If the business grows, the managerial responsibilities may become too large for one person to handle.
- Upon death of the owner, the business is legally terminated.
- The assets may be transferred to a new owner who establishes a new sole proprietorship, but the new owner acquires the business free and clear of all debts, obligations, and other liabilities of the original owner.
- As a consequence, the resulting taxes payable by the owner's estate may be so substantial that some assets must be sold to meet these obligations.

Partnerships

A partnership is established when two or more people agree to pool their financial, managerial, and technical resources in order to operate a business for profit. Partnerships are most commonly found in professions such as law and accounting. The definition of a partnership, as enumerated in the provincial Partnership Act, is the relation which subsists between persons:

- carrying on a business in common,
- with a view to profit from the business.

Each partner owes every other partner a duty to act in the best interests of the partnership. Like a sole proprietorship, a partnership is not taxed as a business that is separate from its owners. The income from the partnership is included as part of the partners' personal incomes and taxed accordingly.

Creation of a Partnership

Partnerships may be created either by agreement between the parties, or by the conduct of the parties. However, where a partnership is the desired form of business structure, it is recommended that the partners draw up a written Partnership Agreement. This can help greatly in the settlement of any disputes that may arise in connection with the business of the partnership.

Advantages of a partnership

- Because two or more people will be in business together, they can combine their finances in order to invest more than either could have done individually.
- A partnership will most likely be able to borrow more than a sole proprietorship because creditors will have the collateral of two or more people instead of only one to secure their lending.
- Partners can pool their talents so that each person can focus on his or her area of expertise in the business.

Disadvantages of a partnership

- Like a sole proprietorship, partners in a partnership are also exposed to unlimited liability incurred by the business.
    - However, unlike a sole proprietorship, each partner can legally bind every other partner.
    - Each partner is jointly and severally liable for all partnership debts, so a partner can be held personally liable for any debts, obligations or wrongful acts of another partner.
- The partnership ends every time a partner leaves, unless provided for in a partnership agreement. In addition, a partner cannot simply withdraw his or her investment from the business. He or she must find someone (or another current partner) who is willing to buy into the partnership in order to replace the exiting partner, and this candidate must be acceptable to the remaining partners.
- Management decisions may be more complex and more difficult to make, particularly when disagreements among partners occur.

    - A properly drawn partnership agreement may provide for a mechanism to resolve any decision-making problems.
- Start-up costs can be as high as, or even higher than, the cost of incorporating, once a properly drawn partnership agreement is taken into account.

Limited Partnerships

Limited Partnerships are a special form of partnership, often used where investors want the tax treatment that comes from a partnership relationship, without incurring personal liability for all of the partnership debts. When a limited partnership is formed, one of the partners (usually a corporation with no assets, formed and controlled by the promoter of the investment for this sole purpose) is designated as the "general partner" and all other investors are usually designated as "limited partners". The partnership agreement then makes the general partner responsible for managing the business of the partnership. The limited partners are simply “silent” investors with no say in the business activities of the partnership.

Any income earned by the limited partnership are directed to and taxed in the hands of the partners, and any losses incurred by the limited partnership are allotted amongst the partners and may become a deduction from the taxable income of such partners.   A limited partner is restricted in their ability to deduct losses and in aggregate cannot deduct losses which exceed the amount they have invested. This restriction can be less than the amount invested if the partner bought their interest from a former partner and not the partnership. (The ability of a limited partner to deduct losses is restricted and professional tax advice should be received with respect to such restrictions).

In the event the limited partnership is unable to meet its obligations, only the general partner will be liable for the debts of the partnership. The liability of a limited partner would be limited to the amount of capital the limited partner invested in the partnership. However, if the limited partner participates in the management of the partnership, that partner would lose his or her "limited liability" and may become liable for the debts of the partnership, the same as the general partner.

Limited partnerships are used, for the most part, as a method for structuring tax driven investment ventures. If the investment is tax driven, the limited partnership may have to register with Revenue Canada as a tax shelter.

Which type of business structure to use?

Deciding which type of business structure to use can be difficult. Some questions to ask when choosing among various business structures include:

- How easy and costly is the form of business structure to organize?
- How much capital will the business need?
- How much capital will come from owners and how much debt financing will be needed?
- What are the tax implications of each business structure?
- How much personal involvement should the owners have in controlling and managing the business?
- How much risk and liability for the business should the owners assume?

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Factors Involved in Successfully Starting a New Generation Cooperative

Regardless of its unique features, a new generation cooperative is a business that must compete in the same marketing environment with other businesses. Although there is no automatic formula for ensuring that an NGC will be successful, some important observations have been gathered from previous experiences:

- **Economic justification**

The primary reason for starting up an NGC must be a compelling economic need rather than a rural development objective. If an NGC is started mainly to create jobs and tax dollars in a local economy, it likely won't last very long. Although these sorts of things can be positive spin-offs from a successful cooperative, they cannot be the driving force behind the NGC's formation. This can be a particularly sensitive area when the NGC's organizers are choosing a location for the cooperative's facility. The fundamental reason for starting a business is because there is an economic need to be fulfilled in the marketplace. The key questions to ask are: Is there a customer market for the finished product? Can the NGC meet customer needs and earn a profit?

- **Leadership**

Leadership for the NGC needs to come from within the producer group rather than from outsiders such as government consultants. As one prominent advisor to NGCs put it, "People in suits don't sell farmers, farmers sell farmers." Leaders (or "project champions," as they are sometimes called) are agricultural producers who will be members of the NGC. Although outside advisors such as cooperative development specialists will be needed during the formative stages, these individuals are there to contribute to rather than control the project. Leaders need to understand the economic objective of the NGC. They should have a realistic vision of what the NGC is to accomplish. Leaders need to have the time and energy available to devote to the project. Do not underestimate the time required to guide a cooperative through its formative stages. One expert has noted, "it's almost astounding how much human capital it requires to bring something from the idea stage to operational stage." Leaders are part of a steering committee, whose members are responsible for guiding the cooperative though its development stages. Steering committee members are responsible for coordinating a feasibility study.

- **Feasibility study**

Preliminary research is required to determine if the idea is economically viable and to gauge the potential level of support from producers. A feasibility study should be undertaken to determine if the project has the potential to succeed. As well, a producer survey and seed money drive help to measure the level of support for the project among producers and raise money for early development activities.

- **Business plan**

If the results of the feasibility study are positive, a comprehensive business plan should be prepared as a formal guideline for the NGC. A business plan serves as a blueprint that helps interested investors and lenders determine the potential success of the NGC. The importance of a business plan should not be underestimated. One of the main reasons why businesses fail is a lack of adequate planning. The business plan should indicate that the NGC has hired, or will be hiring, a capable management team to run the organization. The members on a NGC's board of directors are most often agricultural producers who may not have the managerial expertise nor the time required to run a specialized processing and distribution company. A competent and experienced management team is needed to oversee the day-to-day operations of the NGC.

- **Member equity**

A sufficient level of member equity must be committed to the NGC. Member equity is raised through the issuance of membership shares and special investment shares, the latter of which may create delivery rights or obligations. Before they agree to provide debt financing, U.S. financial institutions have often wanted to see 40 to 50 percent of the cooperative's capital needs funded by member equity. The level required by Canadian financial institutions remains to be seen; NGCs will most likely be evaluated on a case-by-case basis. The NGC's organizers need to plan and conduct a successful equity drive to meet its member equity financing needs. If the targeted member equity level is not met, then the NGC will be unable to begin operations.

- **Legislative requirements**

The NGC's organizers need to ensure that all legislative requirements have been met. For instance, the NGC needs to be aware of applicable legislation when the time comes to incorporate the business and issue shares. Lawyers and accountants should be consulted to ensure that the articles and bylaws of the cooperative are properly drawn and that they meet the stipulated legislative requirements.

In addition to the above, a set of critical success factors regarding new cooperatives has been noted.

The following sections of this manual describe in more detail some of the preceding items. Their objective is to outline some of the issues to consider when forming a new generation cooperative.

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Leaders

Leaders must guide the NGC, especially through its early stages. Finding quality leaders is a prerequisite for success. Past experience has demonstrated that leaders must come from within the producer group. Although external advisors will be needed during the development process, these individuals should not lead the overall initiative. Leaders, sometimes called project champions, should be agricultural producers who will become members of the NGC. Leadership may come from an individual or small group. Either way, these leaders must be willing to put in the time and energy required during the project's early stages.

What qualities should leaders possess?

The following criteria may help in measuring an individual's potential to become a project champion:

- **Credibility and competence**

Leaders should be individuals who have gained respect in their communities because of their sound judgement skills and their ability to accomplish tasks. If the project's leadership lacks competence, then there will be a lack of confidence among prospective members.

- **Industry knowledge**

Leaders need to be able to understand the industry in which the NGC will be competing. Since NGCs represent vertically integrated operations, leaders need to have a solid understanding of activities that take place beyond commodity production, including processing and marketing to the final consumer. Individuals who understand the importance of market research will be in a better position to lead the NGC than those who only understand the production side of the business.

- **Financial stability**

Because the creation of a NGC can be time-consuming, leaders should be individuals who are in a position to devote time to the cooperative without jeopardizing their personal operations. In addition, individuals who have experienced failures in the past, such as personal bankruptcy, may not be able to gain the trust of potential members and lenders.

- **Patience and balance**

Leaders will sometimes be criticized or insulted, and they will often find themselves in high-pressure situations. Individuals who are willing to lead should have the ability to handle these sorts of situations. Individuals who possess patience, good communication skills and the ability to not take things personally are more likely to be effective leaders.

- **Ability to separate emotions from business judgement**

Leaders should not let emotions cloud their common sense. A successful NGC is built on sound business judgement. Even though the enthusiasm and emotions that surround rural cooperative development are great motivators, they should not be the controlling factors.

Steering Committee

Project leaders are part of the NGC's steering committee. The steering committee is responsible for identifying the critical questions that need to be answered before the cooperative can begin. It is an informal group that schedules and oversees the tasks that are necessary in order to start the NGC. This group should be comprised of people who possess sound business judgement and are well respected by potential members and lenders. Not all members of the committee need to be agricultural producers. For instance, individuals who represent economic development organizations may be included. Typical activities performed by the steering committee include:

- communicating with other interested producers and potential members
- organizing meetings
- overseeing the completion of a producer survey to determine the level of potential member support
- preparing the scope of work required in a feasibility study and selecting a consultant to conduct the study. In addition, the committee members will participate in the feasibility study process.
- obtaining funding to pay for the feasibility study and other start-up costs
- obtaining the necessary legal and accounting services
- setting deadlines for the completion of tasks

The steering committee works with outside advisors to determine whether the project has the potential to succeed. If the feasibility study shows that it does, then the business planning stage begins. Once the decision is made to incorporate the cooperative, the steering committee is disbanded and an interim board of directors takes its place.

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Adapted from:

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Early funding requirements

Funding will be needed to support the development stages of the NGC. In the early stages, funding is needed to identify support for the project and to finance research activities. For instance, the cost of the feasibility study, travel expenses and the cost of renting halls and preparing handouts for producer informational meetings need to be considered. Funding sources for these types of expenses may include seed money provided by potential members and government grants or loans.

Seed money

"Seed money" is a term used to describe money raised to fund an NGC's organizational costs. The NGC's organizers may solicit seed money from producers who are interested in the business idea. The seed money is not an investment in the cooperative and it cannot obligate or entitle the producer to invest at a later date. Seed money is not refundable to the producers, even if attempts to start up the business fail. Requesting seed money is helpful because it helps to distinguish between those producers who vocally support the NGC idea and those who support the idea and are willing to show their support with their own money. It helps the NGC's organizers to identify at an early stage how serious producers are in their support.

The amount of seed money solicited may be based on the size of a producer's production base or business, or it may be a fixed amount. For instance, in its formative stages, one American NGC asked producers to contribute $0.05 (U.S.) per bushel of the commodity to indicate their level of interest in the project. This seed money drive raised approximately $150,000 from 1,200 producers. Another U.S. cooperative asked producers to contribute $200 (U.S.) each. A livestock NGC asked producers to indicate their interest in the cooperative by contributing $1 (U.S.) per head of cattle that they would be willing to deliver to the cooperative. Even though this cooperative managed to raise seed money from over 3,000 producers, it failed to garner enough support later on, during its equity drive.

Even though seed money is important to an NGC in its organizational stages, it is not a guarantee that the NGC will achieve its equity target later on.

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Feasibility study

A feasibility study's main goal is to assess the economic viability of the proposed business. The feasibility study needs to answer the question: **"Does the idea make economic sense?"** The study should provide a thorough analysis of the business opportunity, including a look at all the possible roadblocks that may stand in the way of the cooperative's success. The outcome of the feasibility study will indicate whether or not to proceed with the proposed venture. If the results of the feasibility study are positive, then the cooperative can proceed to develop a business plan.

If the results show that the project is not a sound business idea, then the project should not be pursued. Although it is difficult to accept a feasibility study that shows these results, it is much better to find this out sooner rather than later, when more time and money would have been invested and lost.

It is tempting to overlook the need for a feasibility study. Often, the steering committee may face resistance from potential members on the need to do a feasibility study. Many people will feel that they know the proposed venture is a good idea, so why carry out a costly study just to prove what they already know? **The feasibility study is important because it forces the NGC to put its ideas on paper and to assess whether or not those ideas are realistic.** It also forces the NGC to begin formally evaluating which steps to take next.

The NGC's organizers will typically hire a consultant to conduct the feasibility study. Because the consultant is independent of the cooperative, he or she is in a better position to provide an objective analysis of the proposed venture. The consultant should have a good understanding of the industry as well as the new generation cooperative model of business. He or she should have previous experience in directly related work. To get an estimate of the costs of a feasibility study, prepare a rough outline of the work needed to be done. Contact several consultants and provide them with a copy of this rough draft to see what sort of estimates they give. When the time comes to hire a consultant, prepare a formal request for proposals that outlines the information that is needed and send this to several consultants.

It might be tempting to choose the lowest-cost consultant or a personal acquaintance of one of the NGC's organizers, but always remember that quality work is the most important factor when choosing a consultant. Make sure that the consultant can provide an independent assessment of the business opportunity. For instance, hiring an engineering firm or an equipment manufacturer to conduct market analysis may lead to biased results in favor of proceeding with the venture. Engineering firms and equipment manufacturers may have an incentive to show positive results so they can obtain contracts with the cooperative once it chooses to start up operations. Engineering firms and equipment manufacturers are needed in order to provide information about equipment requirements and costs, but an independent consultant should conduct the overall feasibility study.

A feasibility study should examine three main areas:

- market issues
- technical and organizational requirements
- financial overview

Market issues:

The primary area that the feasibility study needs to address is potential market opportunities for the cooperative. If an adequate level of demand does not exist for the product and the NGC does not know how to differentiate its product so that it can compete with established industry players, then the proposed venture should not be pursued.

Questions that need to be answered in this area of the feasibility study include:

- What type of industry is the NGC planning to enter? What are its primary features?
- What are the possible target markets for the NGC's product? What demographic characteristics do they possess? How large are these markets? Where are they located? Is the market expected to grow in the future?
- Will the NGC be competing in a mature industry or a growth industry?
- Who are the NGC's competitors in this market? How large are these competitors? How established are they? How do they price their goods? How will these competitors react to the entrance of the NGC?
- How will the NGC differentiate its product from those of its competitors? What are the competitors' strengths and weaknesses, and how would the NGC compare against them? How does the NGC plan on gaining market share?
- What is the projected market share for the NGC?

Data that can help to answer these questions may be found in already-published information or through primary research activities such as market surveys conducted on behalf of the NGC. Relevant information may be found through various sources such as government statistical publications, trade journals, industry reports, or companies such as Dun & Bradstreet. The Internet has also opened up new routes to obtaining information.

The answers to market-related questions should help the NGC develop realistic estimates of the projected demand for the NGC's product for the first several years of operation. Based on this projected demand, the NGC can determine its anticipated level of business volume, which is needed in order to design the processing facilities. If the projected business volume is not large enough to justify a processing facility, then the project is not feasible.

Technological and organizational requirements:

This area concerns the internal set-up of the cooperative. Questions to be answered in this area include:

Plant and equipment issues:

- What type of equipment and technology will the business need to produce its product? What are the costs involved? This includes both the initial purchase and installation costs of the equipment as well as the operational costs of running the equipment.
- Who are the potential suppliers of this equipment? Where are they located? What sort of service and warranties do they provide? How long will it take to acquire the equipment and begin operations?
- Based on its projected business volume, how much raw product will be required by the NGC? What are the quality specifications? Will the NGC have a sufficient membership base that can provide the raw materials?
- What are the possible locations for the NGC's facility? What size of facility is needed? What are the costs of the building? Does the proposed location have adequate access to infrastructures and services such as major highways, railways, and utilities? Will the NGC build its own facility, or purchase an existing location?
- Where will the facility be located relative to the NGC's customers? Who will be

responsible for the transportation of goods between the facility and the market? What are the transportation costs involved?

Managerial and organizational issues:

- Is the NGC organizational structure the right one for this business? How important are delivery contracts and a fixed source of supply to the success of the business?
- What qualifications are needed to manage these operations? What are the key staff positions that need to be filled?
- What type of experience should management have? Are there potential candidates available to fill such positions? What will be the cost factor involved in finding and retaining acceptable candidates?

Financial overview:

Based on the estimates that have been gathered from the preceding sections of the study, the NGC needs to determine its overall financial situation. Sources and uses of financing should be listed. Questions such as the following need to be considered:

- What are the total start-up costs required in order to begin operations? For instance, what are the capital costs of the land, plant and equipment, and other start-up costs such as legal and accounting costs?
- What are the operating costs involved? These include the daily costs involved in running the business, such as wages, rent, utilities, and interest payments on outstanding debt. These will determine the cash flow requirements of the NGC.
- Based on the estimated demand, what are the NGC's revenue projections? How will the NGC determine its pricing arrangements?
- What are the possible sources of financing for the NGC? Who are potential lenders? What will be their required terms and limitations of borrowing?
- Based on the estimated revenues and costs, what is the projected profit(loss) of the NGC? What is the break-even point?

If the results of the feasibility study indicate that the proposed venture is economically viable, then the NGC can begin to develop a business plan.

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Business plan

The business plan builds on the information that was obtained through the feasibility study, but provides a more detailed and specific blueprint that maps out the NGC's strategy. A business plan is similar to operating a company on paper. It sets out the goals of the NGC and how the NGC intends to reach those goals.

Why write a business plan?

There are two primary purposes of a business plan:

- **External purpose**: The business plan helps to obtain financing from potential lenders and members. Basically, the business plan should provide an answer to the question, "Why should I invest in this business?" Lenders, such as banks, want to see that the NGC's organizers have properly analyzed the business opportunity and planned accordingly. Lenders want to see that the NGC is based on realistic expectations. Potential members want to see that the organizers of the NGC have carefully thought out the details of the proposed venture. The business plan becomes the primary selling tool for the NGC. It should provide an honest and straightforward examination of the business opportunity.
- **Internal purpose**: A business plan provides a blueprint for the NGC to follow. It maps out the activities of the NGC and forces the organizers to evaluate all aspects of the business. In addition, a business plan can serve as a benchmark against which the NGC can compare its performance, so that it knows when it is veering off course.

The business plan should be written in clear and concise language. Although there is no set rule, the average length of a business plan tends to be about 30 pages. An executive summary and table of contents are usually included at the beginning. Business plans come in many different forms.

In general, areas that need to be addressed in the business plan include:

Background information about the NGC

- When was the NGC formed? What factors prompted its creation?

Industry description and outlook

- Include general industry information such as total sales.
- Describe industry trends, including whether or not the industry is in a growth, maturity, or decline stage. Is the industry going through a restructuring stage? Are firms merging or entering into strategic alliances?
- Are there potential barriers to entry? Are there any small players in the market, or does there seem to be some minimum efficient scale of operations? Are there special licensing requirements? Does government regulate the industry?

The product

- Describe the product that the NGC is planning to sell. Assess its strengths as well as its weaknesses.

- What characteristics of the product will give it a competitive advantage over others?
- Are there any patents, trademark or copyright issues?

Marketing plan

- Identify the target market. Describe its demographic characteristics. Where is the market located? How large is the market?
- Identify the competition. Include estimates of their respective market shares and financial health, as well as characteristics (such as quality, price, and brand image) that distinguish their products from others. Assess each competitor's strengths and weaknesses in comparison to those of the NGC. What will give the NGC a marketing advantage? Will it be product quality? Price?
- Describe the distribution system. Will the NGC sell to wholesalers and/or to retailers? Have relationships been established with wholesalers and other distributors?
- Describe the pricing policy of the NGC.
- Describe the sales and marketing activities of the NGC. Will the NGC have an internal sales force as well as brokers? What sort of advertising and promotional activities will be used? Describe the timing of market entry.
- Estimate sales levels for the first several years. Also describe the NGC's targeted level of market share.
- Remember "the 4 P's" of marketing: product, price, promotion, and place. Has this section included all relevant information regarding these aspects?

Management

- If possible, include an organization chart showing key personnel and their functions
- Describe the skills and expertise possessed by key management. Demonstrate why these people are capable of managing the NGC.
- Describe managerial compensation arrangements.

Operations

- This section describes how the product will be produced. It includes a description of the physical requirements for the business, including land, buildings, and equipment. Describe contractual arrangements with engineering and construction firms.
- Describe the workflow of the NGC: list the procedures that are required to manufacture the product. What sort of quality control measures will be implemented? How will the NGC manage inventory levels?
- Describe the plant site, including available services such as water and waste disposal. What environmental standards must be met? What about zoning requirements?
- Explain how the NGC chose the location for its facility. Choosing a facility location can often be a contentious issue when forming a NGC. Producers as well as communities will lobby the NGC's organizers to choose a location that meets their individual preferences. However, the site selection should be based on economic factors that give the NGC the best chance of success. Factors to consider when choosing a location are its proximity to the NGC's target market as well as to its members, transportation costs, access to transportation routes, taxes, and the availability and costs of utilities and labor.
- How will raw materials be procured from the members? What procedures are in place to ensure that members can supply raw products that consistently meet quality

specifications? What sort of producer agreement will the members be required to sign?

- How will other supplies and materials be obtained?
- Provide an operations schedule that shows a detailed production timeline.
- List the number of employees that will be required.

Financing plan

- This section should identify the (potential) sources and uses of funds
- Uses of funds include:
  - Start-up costs: The total funds required to begin operations, including the capital costs of purchasing or leasing buildings and equipment. Be sure to include items involving professional advisory costs (such as items involving lawyers and accountants).
  - Operating costs: The amount of money required to operate the business once it begins operations, including the cost of raw materials and utilities
- Potential sources of funds include:
  - Members: how much delivery rights shares will be issued, and at what price?
  - Lenders: how much debt will be required? What will be the repayment, interest, and collateral terms?
  - Non-member investors: Will investment shares be offered to non-members?
- Include projected financial statements for the first few years, including a cash flow budget.
- Include break-even calculations that take into account fixed and variable costs.
- Indicate the projected returns on investment for the first several years of operation.

Risks

Clearly outline the risks involved with the NGC. Do not attempt to gloss over the negative aspects of the business. Anticipate problems before they occur. Include a sensitivity analysis of key risk factors. For instance, how would the NGC be affected if one of its competitors decided to expand its operations? What if the cost of raw materials rose significantly due to a poor growing season?

The president of a bank that figured prominently in financing U.S. new generation cooperatives has outlined five major risks that should be addressed by new ventures:

- **Market risk**

This is the primary risk to address. The NGC must determine whether there is a market opportunity for its product. Market risk involves assessing who your potential customers and competitors are. One of the problems most often encountered by new ventures is overly optimistic market projections.

- **Technological risk**

The NGC must determine what type of technology it will use and the risks associated with that technology. Questions to ask include:

  - Are there any new processes on the horizon that may quickly render the cooperative's technology inefficient?
  - Does the technology require a certain minimum or maximum plant size?
  - What if product specifications need to be changed? Will the technology allow

for this flexibility?

- Is the brand of equipment chosen by the cooperative well-reputed in the industry, or is it known to have frequent breakdowns?

- **Construction risk**

The NGC must consider the risk of construction cost and time overruns. Construction contract problems is another one of the most often encountered difficulties for new cooperatives. Questions to consider include:

- Are estimated construction costs reliable? Is the proposed construction timetable reasonable?
- Is management capable of evaluating construction bids from contractors and then monitoring performance?

- **Operating risk**

Usually, it is safe to assume that the start-up period of a new cooperative will not go as smoothly as planned. The NGC needs to ensure that it can withstand the early operating period. Questions to ask include:

- Are the projected expenses too low? Are the sales price assumptions reasonable?
- How low can sales prices reach or how high can expenses get before the NGC's ability to service its debt is impaired?

- **Government policy risk**

The NGC must determine which government policies can affect its performance. For instance, how do government policies affect market prices or operating costs? The NGC must also consider whether any pertinent government policies are likely to change.

The NGC's business plan should address these risks.

In addition, the business plan should address the worst case scenario. How much can the business afford to lose and still remain viable?

Include a timeline for the activities to be undertaken. A business plan should cover the first 3 to 5 years of operations.

Although it takes a lot of work, proper planning is essential. In fact, one of the main reasons for business failure is a lack of adequate planning. Always remember the saying, "The business that fails to plan, plans to fail."

Professional help is often required to write a sound business plan. In addition, there are other available resources such as books and Internet sites. Some sites, such as the government's Canada Business Service Centres web site, have interactive business planners available to the public.

The business plan serves as an ongoing guide for the NGC. It can be updated as the company begins operations and new information is gathered.

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Pinson, Linda and Jerry Jinnett. 1996. *Anatomy of a business plan* (3rd ed.). Upstart Publishing Company.

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Equity Drive

Once the business plan is prepared, the NGC is ready to conduct an equity drive. An equity drive's purpose it to raise capital by selling membership and special investment shares in the cooperative. The cooperative may also plan to issue investment shares to non-members. Capital is raised to finance the NGC's purchase of assets such as land, buildings, and equipment. Capital is also raised to finance any start-up losses and initial working capital requirements.

The number of special investment shares (i.e. those that convey or create delivery rights) issued will be set according to the level of processing capacity that was determined in the business plan. It has been noted that many American NGCs raise between 30 to 50 percent of their total capital requirements from the sale of shares that convey delivery rights. This percentage may vary according to the level of risk perceived by the NGC's lenders. Lending institutions such as banks will usually require a minimum level of equity in the NGC before they agree to provide debt financing. Organizers of Canadian NGCs should meet with prospective lenders to determine what their requirements will be.

Membership shares in an NGC are usually priced at a nominal amount. These shares have a stated par value that does not change.

> **Example**
>
> Previously, in the "Early Funding Requirements" section, we noted an NGC that raised $150,000 by asking producers to contribute $0.05 per bushel to indicate their level of interest in the project. Suppose that, after using this seed money and other funds to conduct a feasibility study and business plan, it was determined that the minimum amount of commodity required to be processed each year in order for the facility to be viable is 2.5 million units. (In order to keep this example as general as possible, the unit of measurement is "units" rather than bushel, tonne, animal, etc.).
>
> Suppose a well-designed plant, built to the recommended specifications, along with start-up operations, was estimated to cost approximately $10 million. Suppose the cooperative set a target of 40% of this required capital to come from equity financing. Each special investment share would obligate the producer to deliver one unit of commodity to the cooperative every year. In order to meet its annual supply requirement of 2.5 million units, the cooperative planned on issuing 2.5 million special investment shares. The cooperative determines the price per special investment share by dividing the targeted equity requirement (which is 40% of $10 million) by the number of special investment shares to be issued (2.5 million). The price per special investment share would therefore be $1.60. Each producer is required to purchase a minimum of 10,000 special investment shares, so that the minimum investment in the cooperative is $16,000. (Setting a minimum investment level is common practice among NGCs). Each producer would also be required to purchase one membership share at a price of $100.

The strength of the business plan and the credibility of the NGC's interim board of directors will play a huge role in the equity drive. Producers will not be willing to invest in a cooperative if they don't believe in the merits of the business plan or the trustworthiness of the directors.

Because many producers who decide to invest in the NGC will need to borrow funds, the NGC's organizers may find it useful to meet with agricultural lenders prior to the equity drive to inform them of the cooperative's plans. For instance, the Manitoba Agricultural Credit Corporation (MACC) has programs such as the Agricultural Co-op Share Financing Initiative to help producers purchase equity shares. It may be helpful for the NGC's organizers to meet with MACC representatives to discuss the cooperative's upcoming equity drive.

Experienced advisors are required when preparing an equity drive. The cooperative must ensure that it is complying with applicable laws such as the Manitoba Cooperatives Act and The Securities Act.

Planning and conducting an equity drive involves many decisions. The NGC's organizers must decide on the timing of the equity drive and ensure any necessary regulatory clearances are obtained and all supporting documents are ready. One cooperative development specialist recommends that the best time to hold an equity drive occurs between November and March, when producers are not too busy with their own operations. Decisions regarding the number and location of equity drive meetings to hold and the deadline date to invest must be made. The cooperative also needs to consider how it will promote the equity drive. The time and cost involved in scheduling tasks should not be underestimated. Some NGCs have held more than 30 grower meetings as part of their equity drive.

If the NGC fails to meet its minimum requirements in the equity drive, then the money raised is returned to the producers. If the equity drive fails, the NGC's organizers may decide to revise their business plan and attempt another equity drive later on, or vote to dissolve the cooperative. If the equity drive succeeds, then the NGC is ready to move forward with its plans and begin operations.

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Manitoba Agricultural Credit Corporation. 2000. Web site. Agricultural Co-op Share Financing Initiative. www.gov.mb.ca/agriculture/macc/aaa21s10.html.

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Who chooses to invest in a new generation cooperative?

The decision to invest in a new generation cooperative can be complex. In 1996, researchers at North Dakota State University wanted to determine whether or not there were differences in the attitudes, perceptions, and characteristics of agricultural producers who chose to become members in a value-added cooperative and those who did not. Their research suggests that producers' personal and farm characteristics as well as their attitudes were important factors in the decision to invest in value-added cooperatives.

The following are some highlights of the research results:

Personal and farm characteristics

- Producers who chose to invest in NGCs were, on average, younger, had higher levels of education, and had more off-farm income and higher net worth than those who did not invest.
- In contrast to a traditional cooperative, in which farm size is a strong predictor of the level of producer patronage, average farm size was not indicative of investment in value-added cooperatives

Perceptions and attitudes

- The best predictor of NGC investment was how producers viewed themselves in the food system. Producers who chose to invest in NGCs perceived their role in the agricultural industry to extend beyond production agriculture and into food processing more strongly than nonmembers did. Investors also anticipated that the time spent in these value-added roles would increase in the future.
- When comparing investment returns and risks of the NGC to similar investments in stocks, bonds, mutual funds, certificates of deposit, agricultural land, and other on-farm enterprises, producers who chose to become members of the NGC considered the returns from the investment in the NGC to be similar or slightly higher than the alternatives. Nonmembers perceived the returns of the investment in the NGC to be slightly less than the alternatives. Investors seemed to have a good understanding of the inherent risks involved with investing in new generation cooperatives.
- Producers who chose to invest in NGCs felt more strongly that the NGC was not a last-ditch effort to survive or a get-rich-quick scheme. They also disagreed more strongly with the notion that NGCs could not compete with investor-owned firms.

New generation cooperatives can differ greatly from one another, and so can their members. The cooperative's organizers should try to become aware of the type of producers most likely to be interested in investing in the business. This may help when conducting an equity drive.

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Kibbe, Theron F. 1998. Value-added contract cooperatives: Investor and noninvestor differences. *American Cooperation*: 193-97. National Council of Farmer Cooperatives.

Olson, Frayne, Theron F. Kibbe and Gary A. Goreham. 1998. *New generation cooperative membership: How do members differ from nonmembers?* Extension Report No. 40. North Dakota State University: NDSU Extension Service.

Legal requirements involved in creating a cooperative in Manitoba

A cooperative can be formed under the federal Canada *Cooperatives Act* or under provincial statute, such as the *Cooperatives Act* in Manitoba. (In Saskatchewan, the applicable legislation is The *New Generation Co-operatives Act*). Cooperatives that incorporate under federal legislation must carry on business in two or more provinces and have a fixed place of business in more than one province. Most cooperatives choose to incorporate under provincial legislation.

A cooperative incorporated under Manitoba legislation can conduct business in Manitoba and areas outside of Manitoba, to the extent that is permitted by legislation in those areas. Even if a cooperative qualifies for federal incorporation, there may be reasons to incorporate provincially instead. For instance, there may be certain financial or legal advantages to choosing one jurisdiction over another. Legal advice should be sought to identify which jurisdiction will be the most appropriate for the cooperative.

If a cooperative formed under any legislation other than the Manitoba *Cooperatives Act* wants to carry on business in Manitoba, it has to register under The *Corporations Act* (Manitoba).

Since most cooperatives choose to incorporate under provincial legislation, this section will focus on provincial rather than federal legislation. The following concerns the applicable Manitoba legislation, namely the *Cooperatives Act*.

Who can incorporate a cooperative?

In Manitoba, application to incorporate a cooperative must come from either

- three or more individuals who are 18 years of age or older and who are not bankrupt; or
- two or more corporations; or
- one or more cooperatives.

Name search and reservation

Before preparing articles of incorporation, a name search and Request for Corporate Name Reservation must be carried out at the Companies Office. The name chosen for the cooperative also requires the approval of the Registrar of Cooperatives (see below). Since a small fee will apply for the name reservation, it is best to obtain the approval of the Registrar before undertaking the Request for Corporate Name Reservation at the Companies Office.

The Companies Office is located at:

1010 - 405 Broadway,
Winnipeg, MB R3C 3L6
Phone: 945-2500
Toll-free: 1-888-246-8353 (in Manitoba)
e-mail:
companies@cca.gov.mb.ca

Information about the Companies Office and various forms are located online at www.gov.mb.ca/cca/comp_off.html .

The results of the name search and reservation must be submitted, along with the articles of incorporation, to the Registrar of Cooperatives.

Articles of Incorporation

Application for incorporating a cooperative occurs by sending articles of incorporation to the Registrar of Cooperatives. The Registrar is located at:

315 – 258 Portage Avenue
Winnipeg, MB R3C 0B6
Phone: (204) 945-4466
Fax: (204) 945-0864
e-mail: coop-cu@cca.gov.mb.ca

Various *Cooperatives Act* legal forms, including those relating to articles of incorporation, are available from the Registrar. These forms can be found online at the Registrar's web site.

The articles of incorporation outline the nature of the cooperative and its fundamental components.

The articles must set out:

- the name of the cooperative. The corporate name of a cooperative must follow certain guidelines.
- the location of the cooperative's registered office in Manitoba
- whether the cooperative will be incorporated with or without membership share capital. Where there is membership share capital, the articles must set out
  - the par value of the membership shares
  - the limit (if any) on the number of membership shares to be issued
  - the limit of individual holdings of membership shares
- whether or not the cooperative will issue investment shares
  - If the articles provide for the issuance of investment shares, then the particulars of the investment shares must be set out. The articles must set out the number of classes of investment shares and the preferences, rights, conditions, restrictions, limitations, and prohibitions attaching to the investment shares in each class. The articles would have to indicate whether or not investment shares may be issued to non-members.
- a statement regarding the nature of any restrictions placed on the issue, transfer, or ownership of shares (both membership shares and investment shares)
- the number, or the minimum and maximum number, of directors. In addition, the names and addresses of the first directors of the cooperative need to be included.
- a statement that the cooperative will issue share capital
- any restrictions placed on the business that the cooperative may carry on

- any restrictions on or qualifications for membership in the cooperative
- a statement that the cooperative will be organized and operated on a cooperative basis
- the maximum rate or return payable on membership shares, member loans, and patronage loans. Note that the regulations of the Cooperatives Act have set a maximum rate of return on these instruments at the Bank of Canada rate plus four percent per year.
- provisions for the distribution of the cooperative's property upon dissolution. The articles may provide that each member who owns special investment shares is entitled, on the liquidation and dissolution of the cooperative, to a pro rata share, dependent on the number or percentage of special investment shares owned, of all remaining property of the cooperative after payment of all debts and liabilities.

In addition to the above provisions, the articles of incorporation may also

- restrict, in whole or in part, the powers of the directors to manage the business of the cooperative; and
- include any provisions that might normally be set out in the by-laws.

The articles of incorporation must be signed by the incorporators. In addition, the articles must have attached to them the consent of any first directors who were not incorporators of the cooperative. If the Registrar is satisfied with the articles of incorporation and is also satisfied that the cooperative will be organized and operated, and will carry on business, on a cooperative basis, then a certificate of incorporation will be issued for the cooperative.

Organizational meeting

After the certificate of incorporation has been issued for the cooperative, the directors must hold a meeting to conduct any business that is needed in order to organize the cooperative. For instance, the directors may

- pass by-laws
- authorize the issue of securities of the cooperative
- admit persons to membership in the cooperative and issue membership shares
- appoint officers of the cooperative
- make banking arrangements for the cooperative
- establish what the fiscal year for the cooperative will be
- approve any agreements necessary to adopt and implement the business plan of the cooperative

Member meeting

After holding the organizational meeting, the directors will call a meeting of the members without delay. At their first meeting, the members of a cooperative will

- confirm by-laws for the cooperative;
- elect directors; and

- appoint an auditor. Note that a cooperative that does not issue securities to the public may resolve not to appoint an auditor.

By-laws of the cooperative

The by-laws indicate the rules and procedures under which the cooperative will operate. There are several mandatory provisions that must be included in the by-laws.

The by-laws must provide for the following:

- the qualifications, and the procedures for acceptance, of members
- the rights of persons who hold memberships jointly
- membership obligations, including any obligation to use the services of the cooperative or pay fees
- whether a member's interest can be transferred or assigned and, if so, any conditions or restrictions that apply
- the conditions on which membership may be terminated, whether by withdrawal or by involuntary termination
- details involving member meetings:
    - the mode of holding member meetings
    - the quorum for the meetings
    - the voting rights of members
    - procedures for making, repealing, and amending by-laws or regulations
    - the right to vote by ballot or mail, or both; and
    - the manner, form and effect of votes at meetings
- details about directors, committee members, and officers:
    - the election, qualifications, and term of office of these positions
    - the removal and replacing of persons in these positions
    - the powers, duties, and remuneration of these positions
    - the procedure and quorum at board of directors meetings
- the terms of any contract between the cooperative and its members that all members may be required to sign, and the terms of any renewals of such contracts
- the appointment of auditors
- the refunds, interim, and final payments to be made to members; and
- the distribution of surplus earnings

In addition to the mandatory provisions, the by-laws of the cooperative may also include other provisions that the members feel are necessary or desirable. For instance, the by-laws may provide for the referral of disputes between the cooperative and a member to a process of dispute resolution.

The cooperative needs to send a copy of the by-laws to the Registrar within 30 days after they have been adopted by the members. The Registrar may order changes to the by-laws if the by-laws are not consistent with the *Cooperatives Act* and Regulations.

Model by-laws can be obtained from the office of the Registrar or from the Cooperative

Development Services branch of the department of Industry, Trade and Mines.

Directors of a cooperative

A cooperative must have at least three directors. Before a person can be elected as a director, he or she must meet some basic qualifications. The *Cooperatives Act* stipulates that the person must be an individual who is 18 years of age or older and who is not of unsound mind or bankrupt. A cooperative may also include additional qualifications or disqualifications of its directors in its by-laws, so long as they are consistent with applicable human rights laws. The *Cooperatives Act* stipulates in section 184(3) that, unless it is a worker cooperative, the majority of directors may not be full-time officers or employees of the cooperative. In addition, a majority of the directors must be resident in Canada. Directors, other than those who are elected by the cooperative's investment shareholders, must be members of the cooperative.

Members elect directors at the first member meeting as well as each succeeding annual meeting at which an election is required. The term for which a director is elected must expire no later than the close of the third annual meeting of its members following the election. The mechanics of proper elections are covered in the *Cooperatives Act*.

Investment shareholders may be permitted to elect one or more directors of their own. If this right is provided for in the cooperative's articles, the investment shareholders will vote at an election that is separate from the election of directors by the members. There is no member requirement for directors who are elected by investment shareholders. However, in cooperatives where investment shareholders are allowed to elect directors, not less than 80 percent of the cooperative's directors must be members. There is also a maximum placed on the percentage of directors that can be elected by investment shareholders. According to the *Cooperatives Act*, investment shareholders cannot elect more than 20 percent of the board of directors.

Corporate name

The *Cooperatives Act* sets out some requirements for the corporate name to be used by a Manitoba cooperative:

- the corporate name must include the word "Cooperative", "Co-operative", "Coopérative", "Pool", or the abbreviation "Co-op".
- If the cooperative has share capital, then the corporate name must end with the word "Limited" or "limitée" or the abbreviation "Ltd." or "ltée".
- The corporate name of a cooperative without share capital (i.e. not an NGC) must end with the word "Incorporated" or "Incorporée", or the abbreviation "Inc.".
- The name must include one or more words that suggest what type of cooperative it is.

A cooperative can carry on business under or identify itself by a name other than its corporate name, as long as the name is approved by the Registrar.

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Industry Canada. 1999. Your guide to government of Canada services and support for small business. Chapter entitled "Your business and federal legislation". Online. http://strategis.ic.gc.ca/SSG/mi02983e.html. Retrieved May 10, 2000.

Manitoba *Cooperatives Act*. S.M. 1998, c. 52 – Cap. C223.

Other Start-up Considerations

In addition to the requirements stipulated in the *Cooperatives Act*, organizers of an NGC need to consider other legal issues that relate to starting a business. For instance, the following areas may be applicable:

- acquiring a Business Number from Revenue Canada
- Goods and Services tax
- customs/duties
- provincial taxes
- employment contracts
- environmental approval
- licenses and zoning

A good starting point to research these areas is the Canada/Manitoba Business Service Centre (C/MBSC). The purpose of the centre is to provide a “single window” through which both federal and provincial government information can be accessed. The main office of the C/MBSC is located at:

Room 250-240
Graham Avenue
Winnipeg, Manitoba
Phone: (204) 984-2272
Toll-free: 1-800-665-2019
Online: www.cbsc.org/manitoba

The C/MBSC also has smaller “Regionalization centres” located throughout the province.

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Share Structure of New Generation Cooperatives

Recent changes to the Manitoba *Cooperatives Act* have altered the ways in which cooperatives may be financed. These recent changes may have a significant impact on the potential for the creation of NGCs in Manitoba; the expanded range of available financing may provide a stimulus for investment in NGCs.

Cooperatives may offer several types of shares:

- membership shares
- investment shares
    - includes a special class of investment shares

Membership shares

Every producer who wants to become a member of the cooperative will be required to purchase one or more membership shares. The by-laws will stipulate the minimum number of membership shares needed to be held by a producer in order to become a member. Typically, each member is only required to purchase one membership share. The cooperative can have only one class of membership shares and these shares must have a par value. The par value of the membership shares does not change. These shares are typically sold at a nominal value, which is the par value. A cooperative does not have to file an offering statement for an issue of membership shares in which the aggregate par value of the membership shares that qualify a person for membership is $500 or less.

Regardless of how many membership shares must be purchased in order to become a member, each member has only one vote on all matters that are to be decided by the cooperative's members. In other words, the right to vote is attached to membership in the cooperative rather than to the membership shares. This is consistent with the democratic cooperative principle of one member, one vote.

Membership in a cooperative is governed by the cooperative's by-laws. Generally, a person cannot become a member unless the following conditions have been met:

- the person has submitted a written application for membership and this application has been approved by the cooperative's directors or by a person authorized to approve such applications; and
- the person holds the minimum number of membership shares and has complied with all other requirements for membership that are specified in the by-laws.

In an NGC, there may be a requirement that, in order to qualify for membership, the producer must also purchase a minimum amount of a special class of investment shares. These shares are outlined below.

A special class of investment shares

The new Manitoba *Cooperatives Act* includes a section that deals with a special class of investment shares. This section is of particular interest to new generation cooperatives, as it indicates that a cooperative's articles can allow for a special class of investment shares that

- can only be issued to members;
- does not have a fixed value;
- entitles or obligates the holder of these shares to conduct a specific amount or percentage of business with the cooperative. The specified level of business that the member must conduct with the cooperative depends on the number or percentage of special investment shares held by the member; and
- can share in the surplus of the cooperative if it sells its assets and winds up.

These special investment shares represent the typical NGC marketing/delivery rights shares that tie delivery rights to the level of equity invested by the member. By purchasing these special investment shares, the producer acquires delivery rights to supply the cooperative. Inclusion of this special class of investment shares is an improvement from the previous Act, in which the only method to tie producer supply to investment was by a par-value membership share which could never appreciate in value.

Because investment shares (including special investment shares) do not have a par value, they can appreciate or depreciate in value. Thus, if the business or assets of the cooperative grows in value, then the value of a producer's special investment shares can appreciate in order to reflect their underlying market value. Under the previous legislation, when all shares were required to have a stated par value, the potential for appreciation of share value was not possible.

Non-member investment

Because the cooperative's articles may set out that investment shares (other than the special class of investment shares) can be issued to non-members, the cooperative can choose to offer investment shares to the public. For example, communities could show their support for the cooperative by purchasing this type of share. Because investment shares are issued without par value, they have the opportunity to provide a flexible way of rewarding investors and to appreciate in value if the return on this investment (established at the time of purchase) compares favorably to fluctuations in the general marketplace. This feature increases the attractiveness of cooperative investment shares as an investment opportunity for non-members. The investment shares, however, could depreciate in value if the cooperative is unable to pay dividends or repurchase the shares after first meeting its obligations to its employees, suppliers, secured creditors and other creditors.

The cooperative's articles also set out the voting rights of investment shareholders. Subject to the articles, no right to vote at member meetings is attached to an investment share. However, the articles may provide that holders of investment shares may elect a fixed number or percentage of the cooperative's directors. Investment shareholders cannot elect more than 20% of the cooperative's directors. Neither the cooperative's articles nor unanimous agreement of the cooperative can change this 20% limit. Thus the amount of control that investment shareholders can exert on the cooperative is limited. This allows control of the NGC to remain in the hands of its members. If investment shareholders are allowed to vote, each investment share entitles the holder to one vote. In others words, holders of investment shares are given voting rights that are proportional to the number of investment shares they own. This is in contrast to the voting rights attached to membership shares, in which each member is only entitled to one vote, regardless of the number of membership shares he or she holds.

New Generation Cooperatives and the offering of securities in excess of $500.00

1) Governing legislation

Sections 88 to 91 of the Manitoba *Cooperatives Act* outline the regulation of securities issued and sold by a cooperative. The *Cooperatives Act* indicates that the *Securities Act* applies to the sale or issue of securities of the cooperative when the securities may be issued or sold to the public. The *Cooperatives Act* also indicates that the *Securities Act* does not apply to the sale or issue by a cooperative of membership shares or the sale or issue of securities that are restricted to members only. A difficulty arises with respect to the sale or issue of special investment shares that convey delivery rights to members in that subscribers to an initial offering of special investment shares will not be members at the time the offering is made.

2) Prospectus and registration requirements

In Manitoba, trading in securities is regulated by the *Securities Act* and its regulations. The *Securities Act* fosters investor protection by requiring the registration of people who are allowed to give advice to the public concerning the purchase of securities and by requiring that a prospectus be used when an entity sells securities to the public. In some cases, however, certain types of trades may be exempted from the registration requirement, the prospectus requirement, or both.

3) Offering statement requirements

In cases where the *Securities Act* does not apply, the cooperative must send to the Registrar an offering statement and obtain approval from the Registrar before issuing any securities. The Registrar indicates his approval of the offering statement by filing the offering statement and issuing a receipt to the cooperative. An offering statement must contain full, true and plain disclosure of all the material facts relating to the securities to be issued, and the purpose for which the money raised will be used. The Registrar may refuse to file and issue a receipt for the offering statement if, in his discretion, the offering statement contains such things as a false or misleading statement, omits a material fact, or does not comply with the *Cooperatives Act*.

Before a security is sold, a copy of the offering statement must be provided by the cooperative to the person who is purchasing the security. The Regulations of the *Cooperatives Act*, however, indicate that an offering statement is not required when the securities issue is comprised of membership shares that have an aggregate par value of $500 or less.

The preparation of a prospectus or an offering statement can be a time consuming and lengthy process. Legal advice should be sought by the NGC when considering the issue of securities. In addition, consultation with the Manitoba Securities Commission and the Registrar needs to be undertaken in order to determine the cooperative's reporting requirements.

Exemptions from the Requirement for an Offering Statement

Section 89(7) of the *Cooperatives Act* allows the Registrar to exempt a cooperative from the requirements for an offering statement. In such instances, the cooperative would be required to prepare a disclosure document. For more information regarding possible exemptions, contact the Registrar.

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Manitoba *Cooperatives Act* S.M. 1998, c. 52- Cap. C223.

Manitoba Securities Commission. Trading in securities. Online. Retrieved May 4, 2000. www.msc.gov.mb.ca/trading.html .

Manitoba Securities Commission. 1999. Order No. 2526. Blanket Exemption Order: Offerings of securities pursuant to the Cooperatives Act. Order dated June 10, 1999.

Taxation of Canadian Cooperatives

As a corporation, a cooperative is subject to both federal and provincial income tax on its taxable income. In most instances a cooperative will qualify for a special low tax rate on its first $200,000 of income. If the cooperative has taxable income greater than $200,000 it will pay a higher rate of tax on such excess.

Patronage dividends

The *Income Tax Act* (Canada) permits cooperatives to deduct any amounts declared as patronage dividends from its calculation of its taxable income. The payment of patronage dividends will both reduce the cooperative's taxable income and its liability for income tax. A cooperative which deals only with its members has an opportunity to reduce or eliminate its taxable income in a given year.

Definition of a Patronage Dividend Payment

A patronage dividend represents a payment that has been allocated to a customer according to the proportion of business that he or she has conducted with the cooperative during the year. In order to deduct patronage dividends, the cooperative must allocate dividend payments at the same rate to all customers who conducted the same level of business with the cooperative. In other words, preferential treatment cannot be given to one group of members over another. In cases where the cooperative deals with several different types of goods or goods that vary in terms such as quality, then different rates may apply to reflect these differences. If the cooperative conducts business with non-members and they either do not receive patronage dividend payments, or receive payments at a different rate than members, then limitations are placed on the amount of patronage dividends that the cooperative may deduct when computing its taxable income.

What constitutes a payment of a patronage dividend?

The *Income Tax Act* allows for some flexibility in what actually represents a "payment" of a patronage dividend. Patronage payments may be carried out in a variety of ways. For instance, payments may be made in the form of cash, or by crediting a member's equity account in the cooperative. Regardless of what form the payment takes, the recipient of the patronage dividend must include it as part of his income for that taxation year. Thus, in the case where the member receives a patronage dividend in the form of a credit to his equity account in the cooperative, the member is still responsible to include that dividend as part of his personal income in that year, even though he may not receive the cash equivalent of the dividend for several years. The cooperative is required to withhold a tax of 15 percent on individual patronage payments in excess of $100 and submit this amount to the Receiver General on the customer's behalf.

In the case of a new generation cooperative, if the cooperative makes patronage dividend payments to its members, then the cooperative may deduct these payments when computing its income for tax purposes. The members of the new generation cooperative will be required to include these patronage dividends in their individual incomes.

This look at cooperative taxation is by no means exhaustive: as with corporate taxation, Canadian cooperative taxation can be quite complex. A tax professional should be consulted when dealing with taxation issues.

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Income Tax Act, R.S.C. 1985 (5th supp.) c. 1, as amended. Consolidated to July 20, 1998.

Ish, Daniel. 1981. *The Law of Canadian Co-operatives*. Toronto: Burroughs and Company.

Difficulties most often encountered by new cooperatives

A financial institution that played a key role in supporting new cooperative ventures in the northern United States notes the following problems as those most often encountered by NGCs:

- Plant specifications are not met
- Construction contract problems such as delays and cost overruns occur
- The chosen location for the business is noncompetitive
- Market projections are overly optimistic
- Operating cost projections are unrealistically low
- Government-based marketing assumptions are faulty
- Management problems occur
- The business has an excessive debt-to-equity ratio
- Leadership is coming from an outside promoter rather than from within the producer group

Other problems that may arise for a cooperative are:

- A failure to get assistance from advisors and consultants who have experience in cooperative development. Most start-up cooperatives need the help of outside expertise.
- A failure to conduct adequate planning, such as preparing a feasibility study and a realistic business plan.
- A failure to adequately finance the business. Many new businesses are underfinanced. It usually costs more to start a business than originally anticipated. This could be due to problems such as delays and plant start-up problems. It could also be due to faulty assumptions in the business plan. Adequate financing from both members and lenders is necessary, especially in the first few months of operations.
- A failure to adequately communicate with the cooperative's stakeholders, including potential members, lenders, and management. A lack of communication can create suspicion among these groups.

NGC organizers should keep these problem areas in mind. Difficulties can be mitigated if they are anticipated and planned for ahead of time.

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Potential Sources for Assistance

The following organizations may be able to help new generation cooperatives in some way. This list provides only some of the organizations and individuals who may be able to assist in the formation of an NGC:

Manitoba Industry, Trade and Mines' Cooperative Development Services
Manitoba Agriculture and Food
Manitoba Rural Adaptation Council Inc. (MRAC)
Manitoba Intergovernmental Affairs' Rural Economic Development Initiative (REDI)
Manitoba Agricultural Credit Corporation (MACC)
Farm Credit Corporation (FCC)
Farm Improvement and Marketing Cooperatives Loans Act (FIMCLA)
Western Economic Diversification Canada (WD)

Manitoba Industry, Trade and Mines' Cooperative Development Services

- Consultants in this provincial government department provide development assistance and organizational support to cooperatives. Cooperative Development Services is located at:

  7th Floor
  155 Carlton Street
  Winnipeg, MB R3C 3H8
  Phone: (204) 945-3748
  Toll-free in Manitoba: 1-800-282-8069

- Contact names, phone numbers, and e-mail addresses for the consultants are:

  Al Charr
  (204) 945-4451
  acharr@itt.gov.mb.ca

  David Kerr
  (204) 945-8650
  dkerr@itt.gov.mb.ca

  Don Maurer
  (204) 945-4450
  dmaurer@itt.gov.mb.ca

- Other areas within the Industry, Trade and Mines department may also provide assistance. For instance, the department is responsible for the Feasibility Studies Program, in which the Manitoba government may cover up to 50% of the cost of hiring an independent consultant to conduct a feasibility study or business plan. Industry, Trade and Mines can be accessed online at

- A good place to start looking for information about government programs may be the **Canada/Manitoba Business Service Centre**. The objective of the Centre is to provide a "single window" access about government information for businesses and entrepreneurs in Manitoba. The Centre is located at 250 – 240 Graham Avenue (on the second floor skywalk of the Cargill Building) in Winnipeg. It also has smaller Regionalization centres located throughout the province. The Centre can also be accessed online at www.cbsc.org/manitoba .

Manitoba Agriculture and Food

- Part of this provincial government department's mission is to enhance the economic well-being of participants within the agriculture and food chain. The department provides a range of services to help agriculture participants improve their net income.
- Contact one of the 40 Manitoba Agriculture and Food offices in the province for information about new generation cooperative assistance. In particular, the department's Agri-Ventures team of specialists may provide valuable technical advice and support. Their role is to enhance value-added initiatives in Manitoba. There are several specialists located throughout the province. The specialists, and their locations, are:

  Rachel Bosc
  Marketing & Farm Business Management Branch
  903-401 York Avenue
  Winnipeg, MB R3C 0P8
  (204) 945-3498

  John Corbey
  Southwest Region
  Box 850
  Virden, MB R0M 2C0
  (204) 748-3873

  Susan Nicoll
  Eastern/Interlake Region
  Box 2000
  Arborg, MB R0C 0A0
  (204) 376-5211

  Dennis Hodgson
  Northwest Region
  Box 370
  Swan River, MB R0L 1Z0
  (204) 734-3417

  Bob Wheeler
  Central Region
  Box 229
  Treherne, MB R0G 2V0
  (204) 723-2626
- Manitoba Agriculture and Food's web site is located at www.gov.mb.ca/agriculture/index.html

Manitoba Rural Adaptation Council Inc. (MRAC)

- Financed by Agriculture and Agri-Food Canada's Canadian Adaptation and Rural Development (CARD) fund, MRAC's mandate is to assist and encourage rural Manitobans in adapting to change through innovation. In general, MRAC will fund 1/3 of total project costs up to a maximum of $100,000. Business plan development, feasibility and market studies, and value-added processing are examples of activities that may be eligible for funding. Priority is given to projects in which industry partnerships have been formed and which are not eligible for funding through other government programs.

- MRAC is located at:

  508-800 Portage Avenue
  Winnipeg, MB R3G 0N4

- MRAC is accessible online at www.mrac.mb.ca .

Manitoba Intergovernmental Affairs' Rural Economic Development Initiative (REDI)

- REDI is a program that invests video lottery dollars back into the rural economy to encourage economic development and diversification. The program may be able to provide both technical and financial assistance to a project. For instance, REDI has a Feasibility Studies component that may provide businesses up to 50% of the costs they incur to hire independent consultants to perform feasibility studies.
- REDI has a toll free phone number: 1-800-567-REDI (7334)

Manitoba Agricultural Credit Corporation (MACC)

- MACC may provide help in financing the purchase of shares in new generation cooperatives. Both direct loans and guarantees on loans made by private sector lenders may be available from MACC. Contact one of the MACC field offices for further information.
- Information about MACC is available online at www.gov.mb.ca/agriculture/macc/index.html .

Farm Credit Corporation (FCC)

- A federal Crown corporation, the FCC is Canada's largest agricultural term lender. It may be able to provide financing products and services to value-added processing cooperatives and to individual producers who wish to finance the purchase of shares in a cooperative. The FCC evaluates each project on an individual basis to determine whether or not it will provide support for the project.
- The FCC has over 100 offices across Canada, including several in Manitoba. There is a toll free number: 1-800-387-3232.
- The FCC is accessible online at http://fcc-sca.ca/index.html .

Farm Improvement and Marketing Cooperatives Loans Act (FIMCLA)

- FIMCLA is a federal government guaranteed loans program that helps to increase the availability of loans to cooperative associations that process, distribute, or market farm products. A farmer-owned cooperative can have guaranteed loans outstanding to a maximum of $3 million. Loans can be made up to 80% of the market value of the property for which the loan was made. Cooperatives apply for these loans through lending institutions such as chartered banks.
- Information about FIMCLA may be found at:

- www.agr.ca/misb/nmp/fimcla
- your bank or lending institution
- a toll-free telephone number: 1-888-346-2511

Western Economic Diversification Canada (WD)

- Part of WD's mandate is to promote the development and diversification of the western Canadian economy. In recognition of the importance of value-added processing to the agricultural sector, WD has set up three Agricultural Value-Added Loan Programs jointly with the CIBC and the Farm Credit Corporation. The loans can be used for a variety of projects that are not normally financed by traditional lenders. Contact WD for further information.
- WD also offers other services such as business planning advice that may be useful to new generation cooperatives
- In Manitoba, WD's regional office is located at:

  Suite 712, The Cargill Building
  Winnipeg, MB
  Phone: (204) 983-4472

- WD also has a toll-free telephone number: 1-888-338-WEST (9378)
- WD is accessible online at www.wd.gc.ca
- In partnership with WD, **Community Futures Development Corporations (CFDCs)** are non-profit organizations whose mandate is community and business development. CFDCs can provide technical and advisory services to businesses in their area. CFDCs may also provide loans to small and medium-sized businesses. There are several CFDCs located in Manitoba. Information about CFDCs is available online at www.communityfutures.ca or from the WD web site www.wd.gc.ca .

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Useful Internet Links

The following documents and web sites, many of which have been used as sources in this site, may provide further information regarding NGCs:

"Guidebooks":

Agricultural cooperatives: A startup guide

- Source: Harris, Andrea
- Date: 1998
- Located at the Farm Business Management Information Network for B.C. web site. Can be accessed at http://farmcentre.com/bc/publish/coop1.pdf .

New generation co-operatives for agricultural processing and value-added projects: A development guide

- Source: Saskatchewan Economic and Co-operative Development
- Date: 1999
- Available online at http://www.gov.sk.ca/econdev/welcome/publicat.shtml
  Saskatchewan Economic and Co-operative Development
  1919 Saskatchewan Drive
  Regina, Saskatchewan S4P 3V7
  Phone: (306) 787-2215
  e-mail: art.newton@ecd.gov.sk.ca

Forming our co-operative: Information kit for entrepreneurs

- Source: Co-operatives Secretariat
- Date: Unknown
- Located at the Co-operative Secretariat's web site
  www.agr.ca/policy/coop/kitcoop/index.html

Cooperatives: A tool for community economic development

- Source: University of Wisconsin Center for Cooperatives
- Date: 1998
- Located at the Center for Cooperative's web site
  www.wisc.edu/uwcc/info/coopdev.html .

Creating 'Co-op Fever': A rural developer's guide to forming cooperatives

- Source: Patrie, Bill
- Date: 1998
- Located at the U.S. Department of Agriculture's Rural Business – Cooperative Service's web site
  www.rurdev.usda.gov/rbs/pub/sr54.pdf or
  www.rurdev.usda.gov/rbs/pub/sr54/sr54.htm

How to start a cooperative

- Source: U.S. Department of Agriculture
- Date: 1996
- Located at the USDA's Rural Business – Cooperative Service web site www.rurdev.usda.gov/rbs/pub/cir7/cir7rpt.htm or www.rurdev.usda.gov/rbs/pub/cir7/cir7.pdf

"Member-related" information:

Various North Dakota State University Extension Service booklets.
Located at the NDSU Extension Service's web site:

Five questions to ask before joining a new processing cooperative

- Date: 1996
- Located at www.ext.nodak.edu/extpubs/agecon/farmmgt/ec1108w.htm

Should I join a new processing cooperative?

- Date: 1996
- Located at www.ext.nodak.edu/extpubs/agecon/farmmgt/eb67w.htm

New generation cooperative membership: How do members differ from nonmembers?

- Date: 1998
- Located at www.ext.nodak.edu/extpubs/agecon/er/er40w.htm

What new generation cooperative officials should know about members and their concerns

- Date: 1998
- Located at www.ext.nodak.edu/extpubs/agecon/er/er41w.htm

Questions and answers about agriculture loan officers and farmers' investments in new generation cooperatives

- Date: 1998
- Located at www.ext.nodak.edu/extpubs/agecon/er/er42w.htm

Miscellaneous:

New generation cooperatives on the Northern Plains

- Project funded by Agri-Food Research & Development Initiative (ARDI)
- Source: Oleson, Brian and Michelle Bielik
- Date: 1999
- Located at the University of Manitoba's Department of Agricultural Economics & Farm Management web site: www.umanitoba.ca/afs/agric_economics/ardi/ .

University of Saskatchewan's Centre for the Study of Co-operatives

- The Centre's web site includes various material regarding NGCs, including links to other sources of information, some of which are already listed here.
- The site is located at http://coop-studies.usask.ca/NGC/NGC.html.

New generation co-operative development: The economic environment in North Dakota and Minnesota and lessons for Saskatchewan

- Source: Fulton, Murray and Julie Kennet
- Date: 1999
- Located at the University of Saskatchewan's Centre for the Study of Co-operatives web site www.coop_studies.usask.ca/pdf-files/NGCDevelopment.pdf

New generation cooperatives: Rebuilding rural economies

- Source: Stefanson, B., M. Fulton and A. Harris
- Date: 1995
- Located at the University of Saskatchewan's Centre for the Study of Co-operatives web site http://coop-studies.usask.ca/pdf-files/Rebuilding.pdf .

New generation cooperatives: Responding to changes in agriculture

- Source: Stefanson, Brenda and Murray Fulton
- Date: 1997
- Located at the University of Saskatchewan's Centre for the Study of Co-operatives web site http://coop-studies.usask.ca/pdf-files/BrendaNGC.pdf

Financing agricultural cooperatives: An overview

- Source: Harris, Andrea.
- Located at the Farm Business Management Information Network for B.C. web site. Can be accessed at http://www.farmcentre.com/bc/publish/coop2.pdf .

Farmers slow to embrace new generation co-ops

- Source: *Western Producer*
- Author: Sean Pratt
- Date: January 4, 2001
- Located at Western Producer web site

New Generation Cooperatives: A *Western Producer* Special Report, May 6, 1999

- Source: The *Western Producer*
- Author: Ian Bell
- Date: May 6, 1999
- Includes several articles relating to NGCs
- Located at the *Western Producer* web site

Agricultural adaptation: A co-operative approach:
Canadian Agricultural Co-operatives: Critical Success Factors in the 21st Century

- Source: Canadian Co-operative Association
- Date: 2000/2001
- Various reports outline the challenges and pressures that agricultural co-operatives are currently facing
    - Authors are Murray Fulton, Daniel Cote, and Julie Gibbings
    - Located at the Co-operative Association's web site

University of Wisconsin Center for Cooperatives

- Information about new generation cooperatives
- Located at the Center for Cooperative's web site www.wisc.edu/uwcc/info/newge.html

Legislation:

Manitoba *Cooperatives Act*

- Manitoba Government. Statutory Publications web site
- Located at www.gov.mb.ca/chc/statpub/free/legdbindexena-f.html

Business start-up:

Canada/Manitoba Business Service Centre

- provides "single window" access to all government programs and services
- located at www.cbsc.org/manitoba/index.html
- physical location is:
Room 250-240
Graham Avenue
Winnipeg, MB
Phone: (204) 984-2272
Toll free: 1-800-665-2019

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