



What Is A Cooperative? And How Do You Start One?

By [Abigail Oencia](#) on October 9, 2017 | [Business Law](#), [Glossary](#) | [Comments \(0\)](#)

A cooperative, or co-op, is an organization owned and controlled by the people who use the products or services the business produces. Cooperatives differ from other forms of businesses because they operate more for the benefit of members, rather than to earn profits for investors.

Cooperative businesses can be as small as a [community buying club](#) or as large as a Fortune 500 company. People typically join a cooperative business to enjoy the benefits of [group purchasing](#), pooled risk, and the empowerment of owning and controlling the company.

Co-ops are organized to provide competition, improve bargaining power, reduce costs, expand new and existing market opportunities, improve product or service quality, and obtain unavailable products or services (products or services that profit-driven companies don't offer because they see them as unprofitable).

Co-op Ownership and Control

Unlike in business ownership, which is based on the percentage of the business a person owns, ownership in a cooperative is based on equity contribution or how much of the products or services the member purchases. This is the primary characteristic that distinguishes a cooperative business form from other organization structures.

For instance, in traditional business ownership you don't need to invest in Apple, Inc. just to buy an iPhone or iPad. Similarly, you could invest in Apple by purchasing stock without having to buy their products. But with a cooperative, only those who are currently using the products or services or have used them in the past own it and have access to their products and services.

In terms of control, traditional corporations allot one vote for each share, which allows investors to purchase as many shares as they want to gain a certain number of votes. In a cooperative, each member is given only one vote, providing each member with equal voting rights. All members are expected to participate and share the responsibility of running the organization.

Advantages and Disadvantages of a Cooperative

As with any business structure, cooperatives have their own set of strengths and weaknesses.

Advantages of a Cooperative

1. Equal Status

One of the greatest benefits of having a cooperative model in business is the democratic style of management. All the needs of members can be met without a single person dominating the decision-making process. This kind of structure typically makes the organization more stable. Members can come and go without having serious implications in the business. And because of the 'one-member-one-vote' policy, all the members stand on equal footing regardless of the number of shares they own.

2. Lower Debt Risk

Shareholders, directors, and employees have no responsibility for the debts of the cooperative unless those debts are caused by negligence or fraudulent activities. The liability of the members is limited to the extent of their investment in the cooperative.

3. Economic Benefits

Generally, each type of cooperative comes with its own set of economic advantages. For [consumer cooperatives](#), members are entitled to receive patronage dividends, which are determined by the amount the members spend on their products. Members who work within the cooperative are also qualified to get significant merchandise discounts.

4. More Control

Since cooperatives are member owned and controlled, they enjoy more autonomy compared to businesses controlled by investors. Plus, all members and shareholders have to be active in the organization so the load of work can be divided almost equally.

5. Tax Advantage and State Assistance

Unlike other forms of business ownership, a cooperative society is exempt from income tax up to a certain limit. Members are taxed once on their income from the cooperative itself, and not separately on an individual and corporate level. For-profit cooperatives are generally taxed as normal companies but they can reduce tax exposure by issuing [patronage dividends](#) (refunds issued to people purchasing their goods or services). The government also offers grants, loans and financial assistance to the cooperative societies.

6. Social Benefit

The basic philosophy of cooperatives is mutual help. Basically, cooperatives help instill moral values among members for a better living. It promotes the spirit of tolerance, cooperation, and self-help.

Disadvantages of a Cooperative

1. Financing

Since cooperatives have less capital incentives, they don't appeal to big investors. While it is attractive for smaller investors, big players won't be interested when they know that greater contribution does not lead to greater shares. Plus, a cooperative usually has trouble getting loans from well-established financial institutions, such as banks. This makes the cooperative business model only ideal for those with lower start-up costs.

2. Longer Decision-Making Process

Traditional businesses can quickly respond to issues as they grow because of the centralization of power. But under a cooperative model, members need to be involved in the decision-making process, making it more time-consuming. In cases where decisions must be made fast, cooperatives might not be effective. Many people have control and authority so resolutions often take time.

3. Lack of Business Acumen

Most cooperative societies can't employ professional managers because of their limited resources. Cooperatives tend to not attract specialized skills to run its affairs simply because it can't afford to pay higher salaries. Ultimately, many co-op firms fail due to ineffective organization and management.

4. Lack of Interest

Business success requires sustained efforts over a period of time which. This can be quite a challenge in many cooperatives due to the absence of profit motivation. As a result, many cooperatives become inactive.

Starting a Cooperative

When starting a cooperative, it is important to have an understanding of the big picture. Here are the basic steps to help you develop a realistic idea of what starting a cooperative takes as well as how to keep the development process running smoothly.

1. Establish a steering committee

You need to have a group of people who represent the cooperative's potential members. Identify your mission and core values. Develop a plan and a timetable for researching and developing the organization. Coordinate a meeting of potential members to test out the level of interest in the co-op idea.

2. Carry out a feasibility study

Examine critical opportunities and obstacles that might make or break the formation of the organization. Consider the usual challenges like market issues, operating costs and availability of financing. In some cases, local or state governments may provide financial and technical assistance in conducting a feasibility study.

3. Draft Articles of Incorporation and Bylaws

All cooperatives have to be [incorporated under the appropriate state statute](#). Select a legal counsel to draft or review the articles of incorporation and bylaws. Make sure to specifically describe the kind and scope of the organization's business. Your cooperative can start out with very basic bylaws and just refine them after developing the business plan.

4. Create a business plan and recruit more members

Prepare a detailed [business plan](#) that will serve as a blueprint for the development and initial operation of the organization and as supporting documentation for members, financial institutions and investors.

A typical business plan includes an executive summary, description of the company, market analysis, product research and development, marketing and sales plan, organizational structure, and financial data.

5. Secure financing

Whatever your cooperative aims to do and whoever the members are, it's likely to require money to allow the business to function and grow. This cash injection can come from a variety of sources. Most of the time members invest some of their own money. Many cooperatives apply for a [business loan](#) while some may be eligible for start-up grants.

The amount of capital needed to get up and running varies. The amount and type of financing needed by the co-op and the means to get it should be included in the business plan.

6. Launch

Set up an office and hire staff if applicable. Then open the doors and start providing goods and services in response to member needs. At this stage you should have a viable business up and running.

Takeaway

A cooperative offers a flexible model for new businesses. It can be set up by employees, consumers, local residents and organizations. There are plenty of different models for this process so you should explore your options to determine what best suits your group's needs.

Unsure if this is the right business model for your company? Check out our guide for more information on the [best business structure options](#) for small businesses.

About the Author



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Abi Orenca is a staff writer at Fit Small Business with extensive experience in SEO, social media management, e-commerce, and other areas of digital marketing. Outside of work, Abi enjoys traveling, hiking and almost any kind of outdoor activities.