

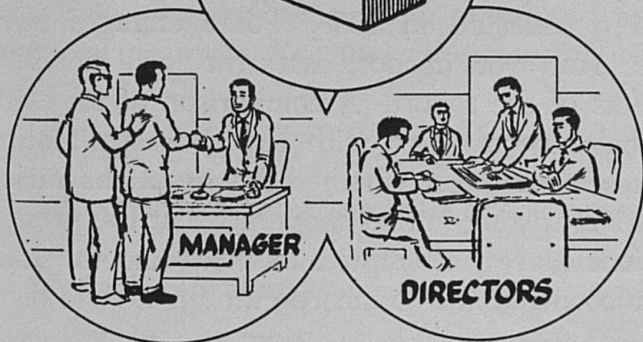
HOW KENTUCKY RURAL ELECTRIC COOPERATIVES ARE CONTROLLED



By
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ounces = 1 pint. Wettable powders and granules vary in density and thus need to be weighed instead of measured.
per gallon; and pt = pint.
abbreviated; Gram granules; W.P. = wettable powder; E.C. = emulsifiable concentrate; lb = pound; oz = ounce; lb/gal = pounds

PREFACE

This report is designed primarily to be used by managers, boards of directors and other personnel of the "management team" of rural electric power distribution cooperatives. It attempts to bring to the attention of these key decision-makers some important facts and questions of policy which may be facing these organizations.

Rural electric cooperatives have made significant improvements in their operations, and their accomplishments have been important.¹ The determination of desirable policy for the future is the job of members, boards of directors, managers, and other personnel within cooperatives. It involves many factors outside the scope of this study. However, if a report such as this is to be useful to the "management" of Kentucky rural electric cooperatives, it must focus attention on unsolved problems and possible future improvements; that is, on situations where some evaluation of alternative policies may be needed.

The situations described, questions raised, and alternatives suggested in this report may appear unduly critical if the purpose and the intended audience are not kept clearly in mind. When we draw attention to such situations we do not imply that they are "bad," or that improvements are not constantly attempted and made. Our intent is to be constructive and to help Kentucky rural electric cooperatives carry on their important work with increasing effectiveness. To do this, we believe that we must call attention to those perplexing unanswered questions which appear to be important to their future as cooperative business associations.

The report is based primarily on information supplied by managers of local power distribution cooperatives. In some cases these managers may not have possessed complete information on certain practices and aspects of their operations. Information supplied by managers has been checked, as far as possible, with that supplied by personnel of the statewide association. Throughout the report we have attempted to call attention to the source of our information and its possible weaknesses.

Finally, the data were collected in 1955. Some changes have occurred since that time. However, in most cases they will not seriously impair the usefulness of the report. A comparison of an existing situation in a particular cooperative with the general situation described by the report will establish whether the questions raised are pertinent to the situation existing in that cooperative at the present time. We have, at various places, attempted to recognize the likelihood that changes have occurred and to incorporate up-to-date data.

¹ *Can We Solve the Farm Problem*, by Murray R. Benedict, 20th Century Fund, New York (1955), p. 70. "For the majority of farm people, the program has removed one of the major disadvantages of farm life."

How Kentucky Rural Electric Cooperatives Are Controlled

By WENDELL C. BINKLEY and ELDON D. SMITH²

INTRODUCTION

A cooperative can be no better than its management. Its contribution is a result of a vast number of decisions by members, their elected representatives (board of directors), and the paid employees of the association. In addition, the laws under which some types of cooperatives operate empower various regulatory bodies and supervisory agencies to make important decisions affecting the operation of the cooperative.

This is notably true in rural electric cooperatives, which obtain loans from the Rural Electrification Administration. Such loans are contingent upon accepting certain types of supervision. This supervision supplements the regulatory powers of the Kentucky Public Service Commission which has responsibility for establishing rate structures and service territories. The Commission is also authorized to require various reports and audits necessary to assure the public of fair rates and adequate service.

Members, their representatives (directors) and paid employees, operating within the framework established by law and by responsible supervisory and regulatory agencies, constitute the management of the cooperative. Therefore, an understanding of cooperative problems involves, among other things, the following: (1) understanding some of the ways that decisions are made by various parts of the "management team;" (2) understanding who makes individual types of decisions; (3) understanding how the various members relate themselves to each other, and to others, in making management decisions; (4) understanding the overall structure of powers

² The authors recognize a debt of gratitude to all of the managers of the 26 rural electric cooperatives who willingly gave of their time and energies in answering many questions and providing information from their files and records, and to Willard Minton of the Department of Agricultural Economics, who assisted in collecting much of the data and made some preliminary tabulations. Personnel of Kentucky Rural Electric Cooperative Corporation have provided many items of information and provided other services too numerous to mention. Particularly we wish to thank J. K. Smith, H. L. Spurlock, C. M. Stewart, T. C. Long and the Hon. Philip Ardery for reviewing the manuscript in draft and submitting several very constructive suggestions. Without such cooperation the study could not have been made.

and responsibilities in the organization; and (5) understanding the legal and social forces that affect management.

This study is based largely on a comprehensive survey of some selected phases of these management processes. The survey was conducted in 1955 and covered all of the 26 rural electric power distribution cooperatives in Kentucky. A major part of the study is based on facts and opinions obtained from interviews with managers of such local cooperatives.

The study attempts mainly three things: (1) To make an inventory of existing organizational structures and management practices in these cooperatives, (2) to focus attention on some important questions relating to their management, and (3) to explore some of the possible consequences of existing practices to these cooperatives.

Rural Electric Cooperatives Today and Yesterday

In 1935 only about 11 percent of the farms in the United States were served by electric power lines. A few more had private power plants, but the kerosene lamp and the gasoline engine, respectively, provided the main source of light and stationary mechanical power. President Franklin Roosevelt, by executive order, established the Rural Electrification Administration (R.E.A.) in 1935. The agency was given legislative sanction in the Rural Electrification Act of 1936.

A primary objective was to provide electric service in rural areas of the United States. The R.E.A. accomplished its objectives by extending loans to companies (mostly cooperatives) set up to provide electric service to rural areas.³ Interest rates were comparable, initially, to the average yield on government long-term securities. A 1944 amendment specified a maximum of 2 percent interest irrespective of the yields on U. S. securities and extended the amortization period from 25 to 35 years.

Justification for this liberalized policy was that of facilitating the extension of electrical service to rural areas which could not otherwise be feasibly served. The intent of Congress that extension of loans would be contingent upon complying with the "area coverage policy" was clearly set forth in the record of hearings and has been so interpreted by the R.E.A. in its lending policy.⁴ Managers reported that 22 of the distribution cooperatives in Kentucky were organized in the three years immediately following passage of the Rural Elec-

³ By 1959 R.E.A. had extended loans to only 24 private (noncooperative) power companies, and four such companies were active borrowers in 1959.

⁴ Reference is made to the policy and the earlier hearings in *Hearings before a Subcommittee of the Committee on Government Operations*, United States Senate Second Session on Senate Bill 2990, U. S. Government Printing Office, 1958, especially pp. 157-160 and 182.

trification Act of 1936. (See Fig. 1 for present operating territories.)

Under this act rural electric service expanded to the point that 96 percent of all farms in the United States were electrified by 1959, with more than half of them being served by R.E.A. borrowers. Ninety percent of Kentucky farms had electrical service, according to the 1954 Census of Agriculture, compared with 4.3 percent in 1930 and 16.7 percent in 1940 (Fig. 2).

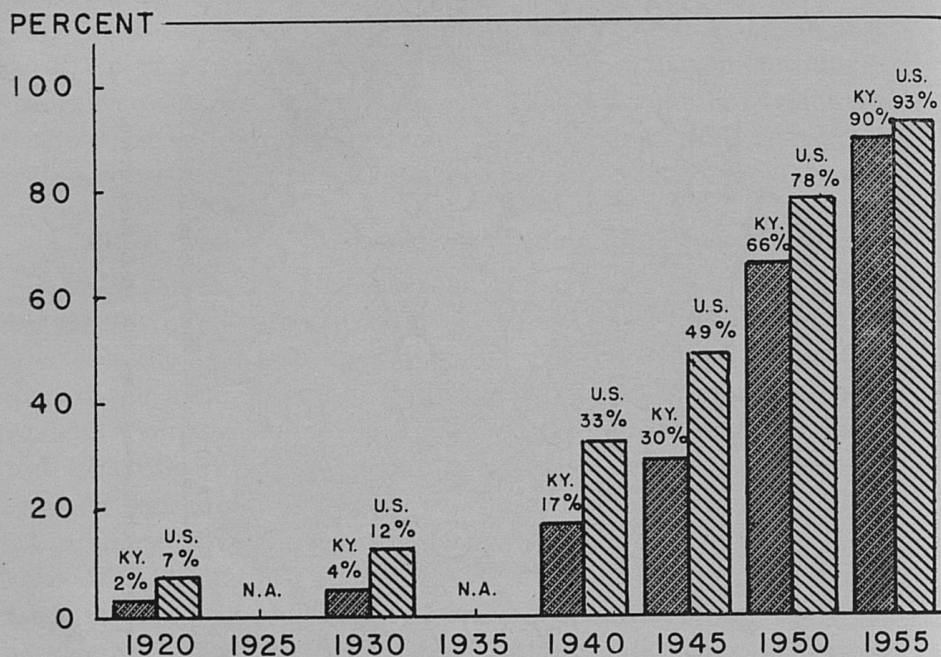


Fig. 2.— Proportion of farms with electrical power. (Source: U. S. Census of Agriculture.)

For reasons of efficiency, rural electric cooperatives serve both farm and nonfarm consumers in their operating territories. The total number of consumers served by Kentucky rural electric cooperatives was 207,168 as of January 1, 1956.⁵ This was more than the total number of farms reported by the 1954 Census of Agriculture. It represents an increase of about 870 percent over 1941 (Fig. 3). During the same period, mileage of energized lines increased from 8,985 to 47,504 miles, a 530 percent increase (Fig. 4).

The state association of rural electric cooperatives (Kentucky Rural Electric Cooperative Corporation) estimated that rural electric cooperatives were serving between 130,000 and 140,000 farms in 1953, or around four-fifths of all electrified farms in the state.⁶ If one as-

⁵ Agricultural Statistics, U. S. Department of Agriculture.

⁶ A Market Analysis, The State Association of Rural Electric Cooperatives, Louisville, Ky., 1953.

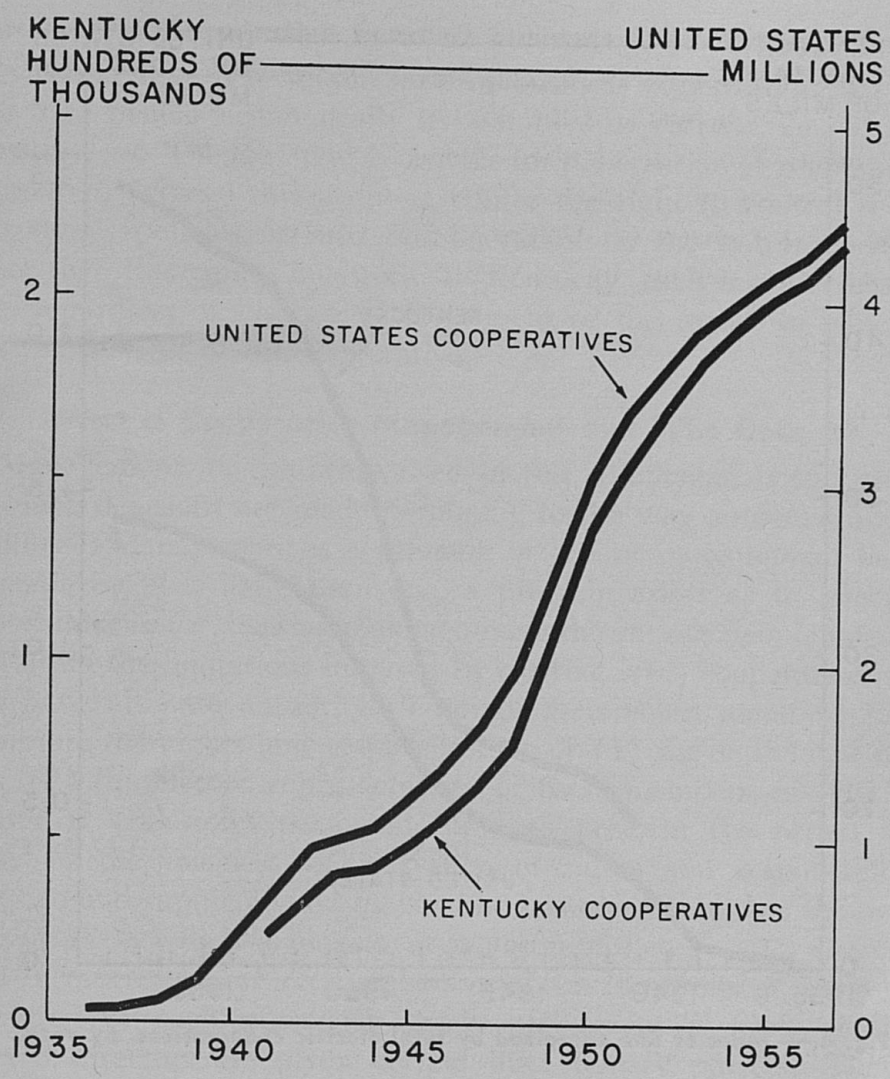


Fig. 3.— Number of consumers served by rural electric cooperatives.

sumes that revenues from farm and nonfarm consumers are roughly proportional to the electrical energy they use, rural electric cooperatives supplied farmers about \$18,000,000 worth of electrical energy in 1957, an average of about \$100 for each farm served.

The outlook for rural electric cooperatives is somewhat different from that for other types of cooperatives. Since they have already extended service to most rural areas, possible expansion in numbers of consumers, or miles of line, may be limited. Attempts are being made to reduce unit fixed costs by promoting greater use of electrical power by existing customers. In an industry characterized by a very high ratio of fixed to variable costs this is highly important.

The general increase in energy use has been so rapid that capacities of transformers and lines, as well as power sources, have become

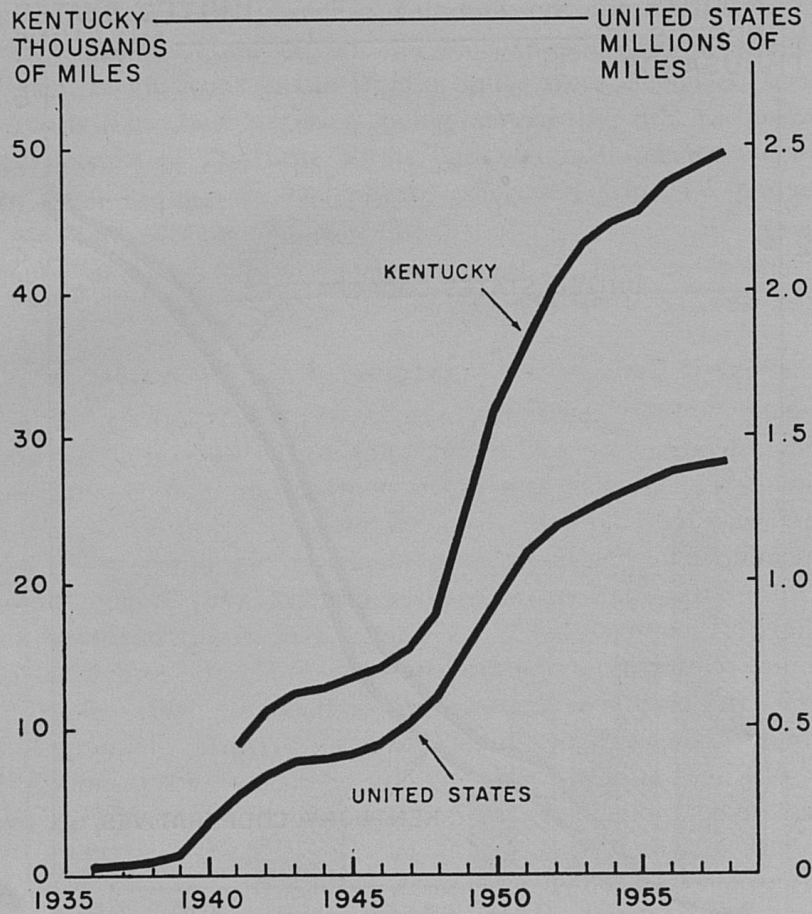


Fig. 4.— Miles of line energized by rural electric cooperatives, by years.

inadequate and problems of expanding them have become acute. However, the more dramatic problems and accomplishments associated with building lines, generating plants, and so forth are now fading into the background. Observation indicates that under these circumstances membership interest and participation tends to decrease unless successful efforts are made to forestall this possibility. With low levels of member understanding and interest, inadequate management and inefficiency sometimes result because members and members only have the power to maintain competent directors who will dependably fulfill their responsibilities.⁷

⁷ Other studies, including an unpublished one by the junior author, have shown that understanding of the affairs of the cooperative by members is directly connected with the extent of use of cooperative service, in addition to its effect on participation in the annual meeting and other policy making activities. Questions have been raised regarding the assumption that members have the ability
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The Cooperative Form of Business Organization

A cooperative is a unique form of business organization. Its purpose is to benefit economically its members *as patrons*, i.e., as *users* of its services. The laws which provide for the creation of cooperatives, in order to achieve this purpose, confer the right to control the organization's policies or mode of operation on the patron-members, rather than the capital investors. In Kentucky, each member has one vote, regardless of his capital investment or the extent to which he uses the services of the cooperative.⁸

What is Cooperative Management and Who Does It?

Management, in the sense used in this discussion, is the process by which decisions are made pertaining to the way an economic unit functions. Management is a function of one or more human beings. When it involves more than one, a problem arises as to allocating responsibilities for decision-making among the various people involved.

Within the limitations imposed by existing laws, cooperative members have ultimate authority. Through their votes, members jointly determine the rights and responsibilities of (1) the individual members, (2) the elected representatives of these members, and (3) the appointed (salaried) personnel hired to perform the actual operations of the business. This system of rights and responsibilities, enforced and supplemented by law and custom, establishes the overall framework in which management is accomplished.

The process by which members establish the limits of managerial discretion of each person or group of persons is partly indirect. Elected directors are given certain discretionary powers. They, in turn, can jointly decide, within broad limits, what responsibilities (management decisions) are delegated to the salaried manager and his subordinates. Within these established limits, the salaried manager exercises discretionary powers over his subordinates, and so forth. Thus, in considering management problems, *we must consider the system of delegation* which determines who performs each management function.

Some aspects of the management of rural electric cooperatives are supervised or controlled by the Kentucky Public Service Commission. This degree of supervision by regulatory agencies is not

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to judge management efficiency "due to their limited knowledge of the operation of an electric utility." If, in fact, this assumption is invalid, it denies, on its face, the principle of control by and in the interest of patron-members—which is perhaps the one truly distinctive feature of any cooperative.

⁸ Required by the Kentucky law under which rural electric cooperatives are organized. Chapter 279, par. 5, Kentucky Revised Statutes.

characteristic of most other types of cooperatives. Rate schedules, extensions of service, criteria for service discontinuances, safety standards and accounting systems are regulated by the Commission. In addition, the Rural Electrification Administration makes "feasibility studies" to determine whether new facilities or line extensions may reasonably be expected to pay for themselves. If not, a desired loan will not be made and the facility likely will not be constructed, regardless of the desires of members, directors, or the manager.

These, plus the provisions of the law under which all Kentucky rural electric cooperatives are organized,⁹ determine to a considerable degree the organization and mode of operation of the cooperative. The purposes of these legal restrictions and requirements are: (1) to protect the loan security of the federal government, (2) to protect the interest of patrons, and (3) to protect the interest of the general public. They set limits to the discretionary latitude of internal management. These limits must be considered in evaluating the various elements of management.

Most of the power distribution cooperatives in Kentucky are members of the Kentucky Rural Electric Cooperative Corporation. This is a federated organization with voluntary membership which, among other services, purchases various items for the member associations, provides billing service, printing and duplicating and mailing service, personnel training, transformer repair, and publishes a magazine designed to serve as a public relations and information medium.

A major activity of the statewide association is a program of public relations involving roadside signs and newspaper, television and radio advertising. Through K.R.E.C.C. activities at the state level and through membership in the National Association of Rural Electric Cooperatives (NRECA), concerted efforts are also made toward enactment of legislation favorable to rural electric cooperatives and averting punitive or unfavorable legislation. An example of legislative activities is the long struggle over interest rates on loans by the Rural Electrification Administration to rural electric cooperatives. However, the local "member" associations operate as essentially autonomous units. Their membership in K.R.E.C.C. does not require surrender of managerial prerogatives to the state association.

THE ANNUAL MEMBERSHIP MEETING

The annual membership meeting is, for most cooperatives, the only occasion when members have a legally guaranteed opportunity to evaluate past performance and to exert their collective influence

⁹ Kentucky Revised Statutes, Chapter 279.

over the way their organization is operated. By evaluating operational reports, electing directors, voting on amendments to bylaws or articles of incorporation, and by proposing and voting on various resolutions, members determine the way their organization functions.¹⁰ If members do not participate in these management decisions they, in effect, delegate to those who do participate the right to control the affairs of the organization.

The members of most types of cooperatives are guaranteed the right to indirectly manage their association by the legal mandate to hold annual membership meetings.¹¹ There is no such legal mandate in the Kentucky Rural Electric Cooperative Law.¹² However, most rural electric cooperatives have, of their own volition, provided for such meetings in their legal papers. Special meetings may be called by vote of the board of directors.¹³

All annual meetings of rural electric cooperatives are held in the summer months, according to reports by managers. Bylaws of some associations do not specify the date of the meeting but leave this to the discretion of the board of directors. Most associations which are members of the statewide association plan their meetings so that they may have the assistance of this organization in both planning and conducting the meeting. This service is provided on a contractual basis.

Attendance

Attendance at annual meetings of rural electric cooperatives was reported as "extremely large." Seven of the 26 managers were unable to provide even an estimate. For the 18 cooperatives for which managers provided data, estimated average total attendance exceeded 6,600. Four of the cooperatives reported 10,000 or more total attendance.

Attendance was composed of many nonmembers in addition to

¹⁰ In other types of cooperatives the day-to-day threat of economic competition from other firms provides stimulus to operate in a manner consistent with members' interests and needs. However, because each rural electric cooperative is granted an exclusive franchise for a given territory, member participation in the organization and in political pressure on regulatory agencies may provide the more important ways for members to assure themselves of adequate service.

¹¹ K.R.S. 272.160 "Each association shall provide in the bylaws for one or more regular meetings annually." (Marketing and purchasing cooperatives.)

¹² K.R.S. 279.210 (3) "The provisions of the general corporation laws of this state . . . apply . . . except when such provisions are in conflict or inconsistent with the express provisions of this chapter." See K.R.S. 271.295 for provisions on annual meetings. They are *not* required annually.

¹³ No explicit provision is made in the Kentucky law under which rural electric cooperatives are incorporated for petition by the members to hold special membership meetings. As is true in the case of annual meetings, this appears to be a weakness of the law. Some (possibly all) of the cooperatives provide for petition by members in their bylaws or articles of incorporation.

members. In some cases, managers supplied fairly accurate data on numbers of members registered and voting. In other cases, they were able to make only crude estimates. However, on the basis of all estimates, it appears that *member* attendance averaged about 880 for 18 cooperatives. This was equal to less than one-sixth of the total attendance. That is, over 85 percent of those attending did not register as voting members of the association, according to the data supplied by the 18 managers. Despite this extremely large attendance, apparently only about 10 percent of all members attended.¹⁴

The Business Meeting

Although business considerations provide the primary justification for an annual membership meeting, major emphasis in terms of activities and time spent appeared to be placed on nonbusiness activities, such as entertainment, meals, and refreshments. Actually, only a few managers (nine) were able to provide even crude estimates of the total time devoted to the business meeting. Personnel of Kentucky Rural Electric Cooperative Corporation estimate that about 45 minutes is usually devoted to the entire business meeting, which includes (1) reading minutes of the last meeting, (2) the annual report to the membership, (3) the report of the nominating committee, (4) elections, and (5) any discussion from the floor.

All rural electric cooperatives have an annual audit. This is required for any public utility. However, not all cooperatives provided members with copies of the financial statement. Five managers reported neither distributing financial statements at the meetings nor mailing them to members. The most common procedure reported was to mail them out but not to hand them out at the meetings (15 co-ops). Typically, the manager (14), or one of the directors (9), read the abbreviated report at the meeting, without comment or interpretation. Sixteen reported that total time devoted to reading and discussion of the report was *10 minutes or less*. From this, it would appear that in most rural electric cooperatives, the financial report to members at the annual meeting is hardly more than a formality.¹⁵ Certainly the financial report when it is so briefly

¹⁴ This is slightly higher in percentage terms than farm credit cooperatives which have much smaller memberships. This figure was computed by dividing estimated member attendance reported by managers by actual membership figures taken from official records.

¹⁵ It is recognized that the intricacies of a complex organization cannot be completely communicated to members in a single day. It must be recognized that even a general picture of operations may be better than complete ignorance, but in a 10-minute period it is doubtful that more than a recitation of gross statistics is possible. For most, this would create no basis for evaluation of performance.

handled, can be neither educational nor a way of focusing attention of members on important problems.

All but one of the rural electric cooperatives reported provision for member discussion, "if people had questions or comments." Only one-fourth reported *any* member participation. This does not necessarily mean that members were not interested in the report. If the report were hurriedly presented, with no interpretation or visual aids, it would be surprising if there were more than occasional and limited member discussion. Ten of the 22 cooperatives reporting on this point said that they had, at some time, prepared questions to stimulate discussion. The Kentucky Rural Electric Cooperative Corporation reportedly designed questions for this purpose in a few cases.¹⁶ Such questions, of course, can be more effective if members have some understanding of the financial statement.

Considering the large memberships and large areas served, annual meeting attendance by members was relatively high. However, one wonders whether the meetings serve as very effective instruments for control by members. Certainly there was little indication that members were making any direct evaluation of the status and problems of their organization in the business meeting.

Entertainment and Other Nonbusiness Features

An annual meeting can be conducted at practically no cost, if purely business features are the only activities and if no prizes, entertainment, refreshments, etc. are provided. However, reports by local cooperative managers indicated that *local* costs of annual meetings averaged \$1,385 for all rural electric cooperatives. The reported range was from \$300 to \$3,160.¹⁷ The Kentucky Rural Electric Cooperative provided equipment, entertainment, personnel, and, in most cases, outlined and helped conduct the entire meeting program. The local association is charged \$800 for this service. Prizes are often donated by appliance dealers, and the \$800 fee is probably less than actual cost for services provided for the local association.

Among the nonbusiness features, "door prizes" and entertainment of some type were common to nearly all annual meetings. (Only two reported no entertainment.) Fourteen associations reported serving a meal, all but one of which was paid for, in part at least, by the

¹⁶ Six cooperatives were not affiliated with K.R.E.C.C. at survey time. Some of these were affiliated with Tennessee Valley Public Power Association. At the present time only four are not affiliated with K.R.E.C.C.

¹⁷ Reports by officials of K.R.E.C.C. indicate that some of these differences result from differences in local policies for allocating various costs to the annual meeting. Some charge the salaries of all employees for the time spent to the annual meeting; some do not, etc.

individual. Apparently because of the large crowds attending, free refreshments were not served except in rare cases. The entertainment was reported as entirely professional in five cases; the remaining 18 cooperatives reported use of both professional and amateur entertainment.

In most cases, the annual meeting involved both an evening and a day program, often covering a period of over 6 hours. It seems apparent that the meeting was much more than an occasion for reviewing past performance, making business decisions, and electing directors. The business meeting may have been, in fact, somewhat incidental to advertising, public relations, recreational, and informational activities. This raises questions regarding the purposes an annual meeting might serve, their relative importance, and to what degree they conflict. Can a meaningful business meeting be conducted in an atmosphere of festivity with large numbers of children, guests, and other nonmembers present? Will members who have to be attracted by door prizes and professional entertainment be sufficiently interested to contribute to intelligent consideration of business affairs? Will they recognize such as a "business meeting of *their* association?"

Member Participation and Refund Policy

The "Capital Credits" plan has been accepted, at least to some extent, by practically all rural electric cooperatives. This is a system by which (1) patrons are charged rates sufficient to cover operating costs and to retire debt obligations and (2) each patron is "credited" with his pro rata share of the equity resulting from the retirement of the corporate debt. The procedure recommended by the Rural Electrification Administration is for each cooperative to *notify each patron each year* of his equity (ownership) accumulated in the cooperative during the most recent fiscal period.

Some doubt has been expressed by personnel of rural electric cooperatives as to whether there is any real possibility of developing informed member interest under the present system of "Capital Credits." Under this plan, accrued member savings are not normally refunded to the member unless total accumulated credits of all members equal 40 percent of the assets of the cooperative. This is in accordance with R.E.A. recommendations.¹⁸ Any other policy might affect the ability of the local association to float new loans either through R.E.A. or other sources. If refunds are made they must be

¹⁸ One loan contract specifies that no dividends, no patronage refunds, etc., will be made "unless, after such payment . . . the liquid assets of the corporation, after deducting . . . all current liabilities, will equal at least 40 percentum of the reserves for depreciation. . . ."

made in order of accumulation, by years. In no local cooperative in Kentucky had accumulated credits reached the 40 percent level at the time of the survey.¹⁹

As of 1959, the average reported "member equity" in Kentucky cooperatives was about 16 percent of total assets. Therefore, the patrons had not been able to realize fully either (1) the implications of "at cost" operations or (2) the influence of managerial efficiency on net cost of electrical services. Under this program it appears that "savings" in a given fiscal year probably cannot be returned in cash for 25 to 30 years, if historical rates of accumulation are continued in the future.²⁰ This, plus the fact that capital credits have restrictions placed on transferability, and bear no interest,²¹ makes their economic value uncertain.

¹⁹ Reportedly one Kentucky rural electric cooperative paid a cash refund in 1958 and 1959.

²⁰ Bulletin 102-1, Rural Electrification Administration, August 28, 1959, pp. 5-7 states: "The *usual* contract establishing capital credits is a bylaw provision reading in part as follows: . . . Capital credited to the account of each patron shall be assignable only on the books of the Cooperative pursuant to written instruction from the assignor and only to successors in interest or successors in occupancy in all or a part of such patron's premises served by the Cooperative *unless* the board of directors, acting under policies of general application, shall determine otherwise." (Italics ours) Note that this is not necessarily "recommended," and that it is discretionary with the local cooperative. Justification for this provision in any cooperative organization is not apparent to the writers. If the cooperative is designed to benefit patrons, it would seem appropriate to make these equities as easily and conveniently marketable as possible. Transfer of the claim on the assets of the corporation need not be accompanied by a transfer of voting rights. Of course, with the indefinite repayment date and with no interest payable on retained credit, it is very doubtful that these accumulated equities have any market value. If they do have any, it is extremely small.

²¹ Bulletin 102-1, Rural Electrification Administration, August 28, 1959, pp. 14 and 15 states, under "INCOME TAX TREATMENT OF ELECTRIC COOPERATIVES": ". . . Section 501(c) (12) of the Internal Revenue Code of 1954 is the provision that has been held generally applicable to electric cooperatives. . . . Tax exemption is not automatic and may be established only after a cooperative has filed an application therefor with the appropriate District Director of Internal Revenue. An organization that is authorized to pay or pays dividends on its stock or membership fees as distinguished from patronage refunds or capital credits would not be eligible for exemption under Section 501(c) (12) according to the position taken by the Internal Revenue Service."

Certain of the electric cooperatives in the TVA area have been held exempt under Section 101(8) of the Internal Revenue Code of 1939 (Section 501(c) (4) of the Internal Revenue Code 1954 as "organizations for the promotion of social welfare." Kentucky Revised Statutes 279.090(1) states: "No person may become or remain a member of any corporation formed under this chapter with capital stock except a farmer, a person engaged in the production of agricultural products or livestock, a cooperative association as defined in the Farm Credit Act, or a corporation organized under this chapter." In view of this provision, even though the electric cooperatives in Kentucky are organized on a membership, rather than a capital stock basis, it apparently would be possible for a rural electric cooperative in Kentucky which limited its membership to the above specified groups to qualify for tax exemption under the provisions of Section 521 of the Internal Revenue Code of 1954. Under such section there would seem to be no hazard to the tax status of the cooperative if it paid "reasonable" dividends on capital credits.

Not all managers of local cooperatives reported having adopted the capital credits plan at the time of the survey, and many of those which had were not implementing its provisions. Of all managers reporting, only 11 indicated that they were operating under a capital credits plan, 8 said that they were not, 5 did not supply information on this point. At the time of the survey only three cooperatives reported notifying their members of savings realized during the year. Only eight reported that the amount of an individual member's share in accumulated savings could be readily ascertained from existing records.²²

The evidence, we may conclude, suggests that members of many rural electric cooperatives have very little tangible evidence that their cooperatives benefit them more when competently managed than when they are not. The philosophy of the rural electric cooperatives is to provide electric services at the lowest possible cost consistent with sound business practices, and the obligation to retire indebtedness to the Rural Electrification Administration under the contractual program of amortization. This means that users of electric energy pay enough for such services to cover all operating costs AND to provide funds with which to retire the REA indebtedness on schedule. Capital credits, properly handled, clearly provide the basis for notification to each user, within a reasonable period of time following the close of the fiscal year, of his "contribution" to the capital of the corporation. This is his pro rata "investment," and therefore "ownership" increase in the cooperative, as the following quotation states:

"In order to induce patronage and to assure that the Cooperative will operate on a non-profit basis the *Cooperative is obligated to account on a patronage basis to all its patrons* for all amounts received and receivable from the furnishing of electric energy in excess of operating costs and expenses properly chargeable against the furnishing of electric energy. *All such amounts in excess of operating costs and expenses at the moment of receipt by the cooperative are received with the understanding that they are furnished by the patrons as capital.* The Cooperative is obligated to pay by credits to a capital account for each patron all such amounts in excess of operating costs and expenses. The books and records of the Cooperative shall be set up and kept in such a manner that at the end of each fiscal year the amount of capital, if any, so furnished by each patron is clearly reflected and credited in an appropriate record to the capital account of each patron, and *the Cooperative shall within a reasonable time*

²² Only limited progress has been made since the time of the survey. Of the directors of the Statewide Association in attendance at the November 24, 1959 meeting of the board, only six reported being up-to-date in terms of computing capital credits and notifying members of their pro rata share.

after the close of the fiscal year notify each patron of the amount of capital so credited to his account. All such amounts credited to the capital account of any patron shall have the same status as though they had been paid to the patron in cash in pursuance of a legal obligation to do so and the patron had then furnished the Cooperative corresponding amounts of capital." (Italics added)²³

Interestingly enough, the above wording of the "usual" bylaw provision relative to the handling of capital credits in electric cooperatives is practically identical to the wording of provisions for capital contributions in many other types of cooperatives, in which "contribution" clearly does not mean "gift." It would seem readily apparent that those patrons who receive such notices each year would at least have one means of evaluating the performance of their cooperative which would not be available to those patrons of rural electric cooperatives which do not provide such notifications to each patron annually.

Finally, for many members who use very small amounts of energy, the savings they might realize, in the form of capital credits, are very small. The average consumer, including nonfarm consumers, uses only about \$100 worth of electricity annually. Many use much less than this. For these patrons it is doubtful that, from the standpoint of strictly economic benefits, the necessary costs of travel and loss of time justify participation in the annual meeting. Only a combination recreational and business meeting can rationally justify their attending.

Such conditions suggest but do not prove that effective member participation in the control of rural electric cooperatives may be very difficult to achieve. Perhaps in view of this some consideration should be given to modifying the Rural Electrification Act and/or the state rural electric cooperative law in a manner which will assure members of these associations that their personal equities will be protected, and that their current economic value can in some manner be realized.²⁴

²³ Bulletin 102-1, Rural Electrification Administration, August 28, 1959, p. 6, under "usual bylaw provisions."

²⁴ At present there is neither the administrative machinery to do this, nor a legal unambiguous statement of the property rights of members. For example, inconsistencies appear, even in the Kentucky Rural Electric Cooperative Law, as shown by the following:

"KRS 270.090 (5) Each member of a corporation organized under this chapter with or without capital stock shall have only one vote. *The property rights and interests of each member of a corporation organized without capital stock shall be equal*, and when a member of such a corporation has paid his membership fee in full he shall receive a certification of membership, setting forth the nature and extent of his interest in the corporation." (Italics ours). (At least one at-

(footnote continued on next page)

Who Influences the Annual Meeting Program?

As we have indicated, it may be possible to achieve only nominal participation by members in the annual meeting under present procedures. It may be that the entertainment, door prizes, etc., are necessary to encourage even membership attendance. However, there still is some question as to whether somewhat broader participation might not be both possible and desirable.

A rather common procedure for generating interest in an activity is to involve a large number of individuals, preferably leaders, in its planning and execution. Many of the farm supply purchasing cooperatives, for example, use several member planning committees to develop the various parts of the annual meeting program. The program is developed with the help of guides supplied by the regional cooperative with which they are affiliated. Depending on the nature of the guides, and the way the members are involved, these procedures may help develop intelligent member interest in the affairs of the cooperative.

Of all the rural electric cooperatives, only three reported using members to assist in planning the annual meeting. For most of the local distribution cooperatives affiliated with the statewide association (K.R.E.C.C.) the entire meeting was largely planned and executed by personnel of the statewide association, with some consultation with local managers and board members.²⁵ Generally speaking, the meeting program was quite similar for all these cooperatives.

While this makes for a well organized, well executed program,

(footnote continued from preceding page)

torney has interpreted this provision to mean that property rights shall be equal—taking into account the amount of capital contributed on a patronage basis.)

But, in other sections of the law the following provisions appear:

“KRS 279.160 (3) *Revenue not needed . . . shall be returned to the members as a patronage dividend or refund on a pro rata basis according to the amount of electric energy consumed . . . payable either in cash, common stock, certificates of indebtedness or other property . . .*” (Italics ours)

“KRS 279.180(4) Dissolution . . . ratable distribution of the net assets to members of the corporation.”

The Rural Electrification Administration questions whether the allocation of nonoperating revenues may not endanger the tax-exempt status of these cooperatives (p. 16, REA Bulletin 102-1). Such nonoperating revenues even now are significant in some of the electric cooperatives, and likely will become even more so in the future. Therefore, it seems likely that considerable sums of money may be accumulated by the cooperative, for which there is no legal accountability to the patrons if the R.E.A. interpretation is correct and if no change in the code or its interpretation is effected. This interpretation seems incongruous because, unless the corporation has a legal obligation to return such revenues to the patrons, they would appear to constitute revenues to the corporate entity and to the corporate entity only.

²⁵This appeared to be true also of the major regional farm supply purchasing cooperatives' work with local cooperatives, despite considerable involvement of members in planning activities.

some question might be raised about the feasibility of taking greater advantage locally of the annual meeting planning activity as an educational opportunity. Furthermore, the present procedure may create the possibility of so planning the annual meeting program that member participation in the control of the local organization is, to some extent, limited and discouraged.

COOPERATIVE DIRECTORS—THE POLICY-MAKING BODY

Cooperative members exert influence or control over their organization in several ways. However, in electing directors and delegating powers of decision to them, members probably exert more influence over the way their organization functions than in all other ways combined.²⁶ Therefore, the process by which elected representatives are chosen, and the type of men selected, are important to the entire success of the organization.

It is important to remember that local rural electric cooperatives are essentially autonomous, "independent" operations despite the fact that they may be members of a statewide association. The statewide association provides various services, including legal counsel and technical assistance. However, the local association has the complete right to ignore any or all advice received from the statewide association regarding its management. Management responsibility, except for aspects which are publicly regulated, rests entirely with the local association.

Election of Directors

The number of directors varies from one cooperative to another. The most common number is 7, but 4 cooperatives had only 5, and one had 11 directors. The Kentucky law under which they are organized provides: (1) for not less than 5 directors; (2) that directors need not be members of the corporation; (3) that no director shall be elected for a term longer than three years.²⁷ According to reports of managers, the most frequent term of office is three years (18 co-ops), but four reported a term of only one year and two reported two-year terms. All with more than one-year terms reported that terms were staggered so that all of them did not expire the same year. All

²⁶ If we look at this from the national or state level, the most important influences may be through political processes whereby the laws under which these cooperatives operate are established and revised from time to time. See the discussion in preceding sections regarding supervisory and regulatory agencies affecting rural electric co-ops. Here, we are concerned with the more direct phases of management over which members have direct control.

²⁷ KRS 279.080 (1) However bylaws may provide that only members can become directors.

cooperatives reportedly allowed directors to succeed themselves without limit, subject only to re-election.

The practice of allowing directors to succeed themselves makes possible more continuity of directorship and accumulation of experience and understanding of the organization over the years. However, it has the disadvantage that it permits continuation of incompetent directors, in the event that membership apathy permits them to continue in office. When only one or two consecutive terms are allowed, new men *must* be selected, insuring some infusion of "new blood," and directors with experience could be eligible for re-election after having been "off the board" for one year or "a term."

In all but four rural electric cooperatives, a nominating committee was reportedly used to select nominees. In all but two cooperatives, directors, or the directors and the manager, selected the nominating committee, according to information supplied by managers. In no case did cooperative members who were not on the board share the function. However, practically all rural electric cooperatives reported using nondirector members on the nominating committee itself. If members participate in the selection of the nominating committee and also serve on the committee, more incentive may be provided for considering candidates other than those in office. This may be particularly important in cooperatives where the committee is not required to select two nominees for each office, and where directors can succeed themselves without limit. Frequently directors seem reluctant to select candidates to run against existing board members for fear of offending these board members. In most cases (19 of 21 reporting) the nominating committee was *not* required to submit more than one nominee for each office.

The advantage of a nominating committee is that it provides additional opportunity for careful consideration of the qualifications of various men for the job. However, to capitalize fully on this opportunity it would appear to be desirable to inform members prior to the annual meeting of (1) the names of nominating committee members and (2) names and other pertinent information about nominees selected by the committee. The survey data provided no evidence of whether there was this type of follow-through prior to election.

While the nominating committee procedure, properly used, has advantages, in the absence of a genuine opportunity for floor nominations the committee can become a tool for maintaining control over the association by a small group. Floor nominations provide a way for the members to exercise their right to control their organization and provide a check against any possible incompetent or irresponsible selections of nominees.

All cooperatives in the study reportedly provided at least nominal opportunity for nominations from the floor, but managers reported that the opportunity was "rarely" or "never" used. Interpretation of this is difficult: (1) this might reflect members' confidence in the ability and integrity of the nominating committee, (2) it might reflect membership apathy or reluctance to "speak up" in apparent disagreement with the committee, or (3) it might reflect a tendency (one noted in many types of meetings) to close nominations hurriedly after the report of the nominating committee is received. When members have not known of nominees in advance, this provides them with little time to think of alternate candidates who might be acceptable to a majority. It could be that a bylaw provision for advance notification to the members of the selections of the nominating committee, preferably at the time when notice of the annual meeting is published, would partially alleviate this problem. An advance picture and fact sheet on each nominee might also be worthwhile. However, such practices seemed to be unusual in the rural electric cooperatives at the time of the study.

A secret ballot is generally accepted as a way of freeing individual members from social or economic pressure that might influence their vote. This may be particularly important in rural communities where tradition, friendships, and family ties are recognized as strong forces in shaping decisions of individuals. However, only 11 of the rural electric cooperatives reported using a secret written ballot, 9 used a show of hands, and all others used a voice vote. Observations indicate, however, that rural electric cooperatives generally make a substantial effort to have members, and members only, vote in elections. Such care was not as evident in certain other types of cooperatives.

In summary, it is apparent that procedures for election of directors frequently deviate substantially from practices generally believed to be conducive to the free, deliberate choice of directors. Meeting mechanical standards of formal election procedures, however, does not insure the election of desirable directors. For reasons noted earlier (p. 20) member apathy, lack of understanding of desirable qualifications for directors, or misplaced confidence in local leaders might still result in weak boards of directors, even with the soundest election procedures. Unless members exhibit a genuine interest in the competent management of their cooperatives, actual achievement of competent direction of their off-farm business affairs is by no means assured.

Characteristics and Tenure of Board Members

As one would expect, directors of rural electric cooperatives tend to be considerably older than in some other types of cooperatives which

do not allow directors to succeed themselves. Half the managers reported that the average age of their directors was over 55 years. Four managers reported an average age of over 60 years for members of their boards.

The average tenure of directors was also relatively long. Average uninterrupted tenure was reported as nine years. Many incumbents had been charter members of the board.

Long continuous tenure is not objectionable, if based on demonstrated capability to serve effectively and to keep abreast of changing conditions. In fact, if a director continues to learn more and more as his experience is extended, his value may increase over a relatively long period. However, some dangers are apparent. Membership apathy may result in perpetuating a board member in office, even though he is, for any of several reasons, no longer serving effectively. He may not have been very capable to begin with, or he may have been capable at one time but served beyond his productive years. Continuous tenure by a single group may tend to create the impression that it is futile for members to express their views or to vote and may discourage further participation in cooperative affairs by members.

One of the most publicized abuses by board members involves using the position to obtain employment for friends or relatives (nepotism). All but six managers of electric cooperatives reported specific provisions to avoid this.

Frequency of Board Meetings

Board meetings are held at least once a month in most rural electric cooperatives. Managers reported an average of 13 board meetings in the previous year. Members were allowed to attend these board meetings in most cases (23). These cooperatives have no competition; they have exclusive rights to their service territory. Therefore, the problems of local business strategy that beset many types of cooperatives may be less important, and such personal matters as evaluating credit risks or handling delinquent loans are not involved in rural electric cooperatives. Therefore, open board meetings are feasible and make it possible for members to bring their ideas and suggestions to the attention of the board and to see their directors transact business, without creating the usual hazards.

Director Compensation

Questions are often raised about the policy of compensation to directors for their services. All rural electric cooperatives pay per diem to those attending board meetings. Reported per diem varied

from a low of \$5 to a high of \$20, and averaged \$13. In addition, all but one cooperative paid mileage to directors; 7 cents per mile was the most common rate (19 co-ops).

Comparisons with different types of cooperatives are patently questionable. Some cooperatives hold day-long board meetings which conflict with farm work, others meet only briefly and at night. Some cover small operating territories; others cover large ones.

Does relatively modest compensation invite disinterest and apathy on the part of those who are potentially most valuable to the association? Conversely, if compensation is excessively high, is it possible that directorship may become primarily a source of revenue to those who have relatively limited farm operations? Evidently many motivations other than direct financial rewards prompt individuals to serve.

However, it may be in order for some of the rural electric cooperatives to review their policies regarding remunerating directors for attendance at board meetings and other important functions, in the light of their own experiences.

THE SALARIED MANAGER

The salaried manager of a rural electric cooperative is the person who makes the day-to-day decisions which implement the policies of the board of directors. He also provides the board with detailed information about problems, needs and the like which are essential in making various types of decisions. He has responsibility for executing the member education and information program and a host of other things which ultimately affect even the composition of his board of directors and the policies they adopt. He is, indeed, a key individual in the management of the cooperative business.

Characteristics and Qualifications

The average (median) age of managers was 42 years, which is younger than managers of farm credit cooperatives, but about 7 years older than managers of farm supply purchasing cooperatives. The average tenure was about 8 years, which means that their average age, at the time they assumed top managerial responsibilities, was about 34 years. Reportedly, these cooperatives had changed managers about three times, on the average, during their entire history. This means that previous managers had served substantially shorter periods than those managing at the time of the survey. Approximately half of these men were employed directly as managers, the remainder having some other position within the cooperative

prior to employment. Managers reported that they had served in managerial capacities in other businesses in a majority of cases. On the average, they had been employed in noncooperative businesses 9 years; only three had no such experience. Ten reported experience in some other rural electric cooperative before employment by the specific associations of which they were managers.

The formal education of managers of rural electric cooperatives was about the same, on the average, as that of managers of local farm supply purchasing cooperatives. It was slightly less than the education of managers of credit cooperatives. Ten had some college training, and all but two of the remainder had completed high school. In appraising these facts, it may be important to keep in mind the size of the businesses they manage. These cooperatives were serving an average of about 8,000 patrons, using about 1,900 miles of energized line per co-op, and collecting about \$750,000 in revenues annually. A business this large requires high-caliber management.

As pointed out earlier, 40 percent of these managers had been employed by other cooperatives—usually other rural electric cooperatives. Their most frequent type of specialized training was engineering or business. None reported having had any specific formal training in cooperatives.²⁸ Thus, neither by formal education nor by experience were the managers of most rural electric cooperatives prepared to recognize their relation to the patrons in a cooperative business, and how it differs from the manager-customer relationship in an ordinary utility company. This may well explain in part why, in some cases, the manager exhibited little concern about obtaining participation by members in the control of the organization.

Conditions of Employment

While reports were not entirely complete, the average salary for 17 managers was \$5,250 for the year 1950, and had advanced to \$6,940 for the 22 co-ops reporting 1954 salary data. The lowest 1954 salary was \$5,400 and the highest was \$11,500. This wide range reflects, among other things, differences in the size and complexity of the rural electric cooperative, and the fact that each cooperative operates autonomously with respect to salary schedules.

Bonus and incentive plans are relatively unusual in rural electric cooperatives. Only five reported any such plans and none of these

²⁸ The National Association of Rural Electric Cooperatives provides institute and workshop programs for the training of managers and directors. Several of these programs have been conducted in Kentucky. However, copies of those programs that we have been able to review show no evidence of specific training in cooperative principles and their significance.

was specifically tied to measures of efficiency or progress. They were, in most cases, based on some percent of salary which was apparently discretionary with the board of directors at the end of the fiscal year.

About half of the co-ops reported providing partially or wholly prepaid hospital insurance; seven reported surgical insurance; six reported life insurance and six accident insurance. Eleven reported *no insurance of any kind*.

Retirement programs were not universally part of the personnel program of rural electric cooperatives. Ten cooperatives reported having no retirement programs at the time of the survey. No information was collected regarding the nature of the programs of the co-ops which did have them in operation.

Typically, rural electric cooperatives reported providing two weeks vacation for the manager. One reported providing only a week and one reported providing three weeks.

Certainly the "fringe benefits" provided by rural electric cooperatives did not compare very favorably at that time with generally accepted standards in many large corporate businesses.²⁹ The extent of fringe benefits that can be justified is always difficult to appraise. It is influenced primarily, perhaps, by what competing employers offer. The most important test is whether such benefits are sufficient to recruit, hold, and motivate the type of employees necessary to efficient operation.

Expressions of labor economists indicate that ordinary incentive systems such as profit-sharing have not been very successful in raising productivity *unless* other conditions have been met.³⁰ These conditions have included protection against health hazards, insurance protection, participation in planning the incentive system, adequate information about the purposes and provisions of these programs, and so forth. All could be construed by the worker as evidence of an element of concern for his welfare. In the absence of the opportunity to share in the ownership of the business usually accorded management of other (noncooperative) corporate businesses, these fringe benefits may take on added significance.

²⁹ Some changes have occurred since that time, but more recent data are not available.

³⁰ For example, Solomon Barkin says, "Management has increasingly learned the limitations of the wage incentive system as a single stimulus to worker cooperation."

"There is considerable realization among management leaders that proper social motivation and sanction for greater personal application and cooperation by workers as a group . . . can facilitate both development of plant morale and an interest in financial incentives." See "Management's Attitude Toward Wage Incentive System," *Industrial and Labor Relations Review*, Volume 5, Number 1, October 1957.

Determinants of Management Decisions

Elected representatives (directors) have a fairly wide range of discretionary powers. Similarly, the hired managers of the local power distribution cooperatives are ordinarily given wide ranges of discretionary power by the boards of directors. Furthermore, the manager is in position to know more about the detailed operations of the cooperative than the board of directors. The board must depend upon him for information and advice on a broad range of subjects. For this reason, he is in a position to influence decisions of his board affecting the rules under which he operates. He is in a position to exert influence over the way the annual membership meeting is conducted and may even influence the selection of directors by the members. The hired manager is in a most strategic position in shaping the management of the entire organization.

Decisions by Hired Managers

The manager of a cooperative is assumed to be influenced by three interrelated sets of factors in making managerial decisions. The first, which has been discussed before, is the scope of his assigned authority and responsibility. The second is his *knowledge* of things pertinent to these decisions, including knowledge of the scope of his assigned authorities and responsibilities. The third is the *perspectives* of the manager, i.e., the things which he considers to be important to his job as manager of the association. This, in turn, may depend upon the way he views his organization and its purposes, which involves knowledge as to the basic purposes of the organization.

Perspectives of Managers

The manager who views his organization as "just another power utility" is likely to make different decisions than one who views his job as that of a managerial employee of a group of individuals whose purpose is to provide themselves with power at minimum cost (service and capital credits considered). One who views his job to be that of providing maximum benefits to member patrons will probably place high emphasis on annually computing and reporting to members their accumulated capital credits. A manager who views his role in this way will likely decide whether to have patrons read their own meters on the basis of whether they can provide the service to themselves at decreased costs rather than on the basis of its effect on net revenues to the cooperative.

Manager Knowledge

These job perspectives may be important. However, if the manager does not understand *how* to accomplish the things he believes

to be important, the perspectives will have no significance to his performance as manager. The manager who views his job to be that of serving member needs will fail if he cannot ascertain their needs, or does not know how to achieve economic efficiency in serving these needs. A man who has developed no public relations ability will probably fail, regardless of his awareness of this aspect of his job.

Evidence of Manager Knowledge

In addition to formal school training and job experience, managers acquire knowledge in other ways. All rural electric cooperatives can obtain information and assistance on various subjects from the Rural Electrification Administration. Many free educational materials are provided by this agency. The statewide association provides its members with legal services and information, a staff of information and publicity specialists, etc. The National Rural Electric Cooperative Association provides personnel and plans for workshops and institutes which can be obtained on a fee basis. In addition, educational meetings and short courses are sponsored by various public educational agencies which provide useful training for managers.

To what extent have managers taken advantage of these opportunities to increase their understanding of problems with which they are confronted? Obviously, the many fields of knowledge that would be useful to managers cannot be covered in a single survey. Available data provide only brief insights into a few categories of manager knowledge regarding cooperative principles and laws affecting cooperatives.

Knowledge of Cooperative Principles

Two questions were asked of managers which reveal, to some degree, how well they grasp the "principles" of cooperation, namely:

- (1) business conducted at cost,
- (2) democratic control of the organization by vote of patron-members, and
- (3) limited return on invested capital.

The first question asked the manager for a definition, in his own words, of a "true" cooperative. The second question asked for "some cooperative principles that you feel should be kept before the members of this cooperative."

The principle of "operation at cost" was mentioned by 11 and 10 managers, respectively, in answer to the two questions (Table 1), or about half of those answering the questions. This compares favorably with managers of credit cooperatives and managers of farm supply purchasing cooperatives. However there is some doubt about

Table 1.—Indications of Knowledge of Cooperative Principles by Managers of Rural Electric Cooperatives, 1955

ITEM	Mentioned in defining a "true" cooperative		Mentioned as "principles to be kept before members"	
	No.	% of those reporting	No.	% of those reporting
Cost basis operation—precise	6	25.0	8	38.1
Cost basis operation—suggestive only	5	20.8	2	9.5
TOTAL	11	45.8	10	47.6
Democratic control—precise	4	16.7	2	9.5
Democratic control—suggestive only	0	0	11	52.4
TOTAL	4	16.7	13	61.9
Limited return on capital—precise	0	0	0	0
Limited return on capital—suggestive only	0	0	0	0
TOTAL	0	0	0	0
General collective effort concept without mention of precise principles	6	25.0	Not Applicable	Not Applicable
None of the above or no definition	3	12.5	3	14.3
TOTAL REPORTING	24	100	21	100

whether these managers correctly interpret the system of refunds (capital credits) adopted by their own cooperatives in terms of the degree to which the principle of operation at cost is applied.³¹

"Democratic control" was mentioned by only four managers in defining a "true" cooperative, but 13 mentioned it as "a principle to be kept before members." We cannot determine the reasons for this result with existing data. One wonders whether managers have not

³¹ Correspondence from personnel of rural electric cooperatives and personal conversations with them are indicative of some ambiguity regarding the purpose of capital credits. The term capital "contribution" through capital credits appears to be interpreted by some managers of rural electric cooperatives to mean a "gift" rather than a loan or investment. If capital credits accumulated measure the amount of each patron's "gift," then obviously they do not function as means of equalizing the charges for electric service with the costs of providing such service, and the organization does not in fact adhere to the principle of operation at cost.

Even in those cooperatives that had adopted the capital credits plan at the time of the survey, there is at least some doubt that the present patrons will ever realize, in cash value, the savings realized on their patronage. In the standard marketing or purchasing cooperative patronage refund plans provide that patrons will receive refunds in cash, in stock, or some other evidence of equity which can be redeemed in cash (on a definite schedule, in many cases). Interest or dividends on noncash refunds is typical and hence upon receipt they are true capital assets of the member. Capital credits bear no interest.

come to use "democratic control" as a public relations slogan which is kept before members but one which has not been recognized as having significance for the actual operation of the organization. This idea would at least be consistent with some of the practices followed in annual meetings and the like. The fact that 11 of the 13 mentioned it in only a vague and general way may lend support to this idea. On the other hand, it may indicate that member apathy is so great and member understanding so low that it has little present significance and that a consciousness of member control must be developed.

"Limited return on capital" was not mentioned in response to either question. Since these organizations have no capital stock and uniformly pay no interest or dividends on accumulated capital credits, it is not necessary to limit formally returns on invested capital.³² Therefore, the principle has no practical significance, at the present time, in rural electric co-ops. As such, it was outside the scope of the managers' immediate job experiences. However, this does at least suggest that few, if any, of these managers had been exposed to the theory or "principles" of cooperatives in their formal training or through personal contacts with other types of cooperatives in their operating territories which actually employed this principle. Over one-third of those responding to the question could provide no definition whatever of a cooperative, and they were able to express only a vague, general idea that a cooperative was some kind of collective effort.

Together, these facts suggest that many rural electric cooperatives were at the time of the survey managed by men who are not aware of distinctive features of a cooperative business and what this means to them in terms of their responsibilities as managers. The existing procedures in membership meetings, educational and informational programs may reflect, in part, a lack of understanding of the relationship between patron-members, directors, and hired management in a cooperative.

Knowledge of Legal Status and Requirements

What a cooperative manager needs to know about the legal requirements of his organization or its legal status depends, to a large extent, upon the nature of the laws affecting it, upon the organizations with

³² However, the Kentucky law under which rural electric cooperatives are incorporated says the following: "KRS 279.130 (1) Obligations, etc. . . . but their period of maturity shall not exceed twenty-five years, or the rate of interest six percent, and the obligations shall not be made redeemable at more than par and accrued interest." This would appear to recognize and allow for the possibility of paying interest on such obligations as capital credits. If, on the other hand, the reference is to the borrowings from R.E.A., then the "25 years" is not in agreement with the changes made in the 1944 amendments to the act or with existing practices in Kentucky.

which it is affiliated, and arrangements that are made for the handling of such matters. Public utility corporations of all types are confronted continually with a battery of legal requirements for rate schedules, accounting methods, and so forth. Most rural electric cooperatives retain local legal counsel to advise them about matters relating to their operations. In addition, most of these cooperatives retain the services of a specialized accounting and auditing firm. This firm, as part of its service, files an informational federal corporation income tax return and takes care of the legal requirements related to taxation. Therefore, specific legal knowledge of the law under which incorporated, the existence or nonexistence of a "letter of exemption" from federal corporation income tax, etc., may not have been directly important to the manager, in terms of his current operational duties and responsibilities.

Eighteen managers knew the law under which their cooperatives were incorporated, and 23 reported the fact that they were legally income tax exempt. Only about three-fifths (14) had knowledge of whether they held a "letter of exemption" (Table 2).

Table 2.—Indications of Manager Knowledge of Legal Status and Legal Requirements of Cooperative

	Total	Yes	No	No Answer
Knowledge of law under which cooperative is incorporated	26	18	7	1
Knowledge of way bylaws can be amended	26	6	19	1
Knowledge of whether cooperative has exemption from payment of federal corporation income taxes	26	23	2	1
Knowledge of whether co-op has a "letter of exemption" from payment of federal income taxes	26	14	10	2

One item of legal knowledge is obviously important for managers and directors of rural electric cooperatives, unless their attorney attends all board meetings. This is knowledge of the procedures for amending bylaws and articles of incorporation. If directors failed to observe legal requirements for bylaw amendments, a change would be legally null and void. Operations conducted in accordance with a voided bylaw might create serious legal problems. In some cases, cooperative directors have been held personally liable for losses resulting. Yet, only six cooperative managers specified the correct procedure.³³

³³ KRS 279.070 ". . . The bylaws may be amended by a majority vote of the board of directors." KRS 279.050 "Amendment to Articles of Incorporation . . . shall first be approved by two-thirds of the directors and then adopted by a vote representing a majority of all the members of the corporation."

Evidence of Manager Perspectives

Partly as a result of training and understanding of the objectives of their organization, partly because of personality differences, and partly because of the differences in the demands of their job, managers of cooperatives become "sensitized" to different aspects of their potential functions and responsibilities.

In a cooperative, because of the legal provisions for control by its member-patrons, the potential scope of the manager's functions is enlarged. Among other things, he usually is in a position to inform and educate patron-members about the nature of the cooperative organization, its problems, and both their responsibilities and opportunities as members of the organization. He has similar opportunities to inform and educate his board members. Second, and closely related, the manager has considerable power to stimulate active, enlightened participation by members in the processes by which the organization is controlled. However, this aspect may present special problems in rural electric cooperatives for reasons explained earlier. Third, he may have some power to persuade and influence elements of public opinion, without necessarily informing or educating.

One aspect of public relations is called "customer relations" by most noncooperative businesses. Advertising is a part of customer relations. In a cooperative power distribution business which, by nature, is characterized by high fixed costs, this may be as important for efficient operation as in any other form of business. The power use programs, including the work of the home economists and electrification advisors employed by many rural electric co-ops, provide evidence that this has been accepted as an important function by managers of rural electric cooperatives.³⁴

Another public relations objective is to influence the various political bodies and social groups that establish the rules, laws and customs under which cooperatives operate.³⁵ The recurring public discussions of interest rates on REA loans provide examples of the significance of this type of public relations objective to rural electric cooperatives.

³⁴ Since most customers are also members in rural electric cooperatives, it is customary to refer to advertising and other merchandising activities as a part of a member relations program. However, it is important to distinguish between activities which are designed to affect members *as members* who collectively have the right to manage their own association and members in the capacity of *customers* or *patrons*. The problems and purposes involved are quite different.

³⁵ At least 20 of these power distribution cooperatives were members of the National Rural Electric Cooperative Association. One important function of NRECA is to favorably influence legislation affecting rural electric cooperatives. Others were members of the Tennessee Valley Public Power Association. The "Minutemen" program mentioned later (p. 35) apparently is designed primarily to favorably influence public opinion and legislation.

Finally, a manager may attempt to induce members to accept, on irrational grounds, ideas which he believes to be in their interest or ones which will benefit him personally. In the latter case, any success achieved is basically inconsistent with the principle of member-patron control, because it limits the ability of members to evaluate the policies of the organization in terms of their own interests.

While the relative interest in these factors cannot be precisely measured, several questions answered by managers provide clues regarding their comparative emphasis on public relations, education and information, and participation by members in the control of the organization. In Table 3, responses to four of these questions, all of which relate to the annual meeting, are summarized into four categories of perspectives.

Table 3.— Perspectives of Managers as Revealed in Responses to Opinion Questions Relating to the Annual Meeting

	Educational and informational aspects	Business aspects and member interest and participation	Public relations, recreation and social activity	Attendance	Number answering these questions	Number not indicating any of these aspects
	(number of managers mentioning)	(number of managers mentioning)	(number of managers mentioning)	(number of managers mentioning)		
Reasons annual meeting was or was not worthwhile	2	4	6	3	24	9
Evidences that annual meetings are getting better or worse	5	6	2	11	21	3
Stated weaknesses and strong points of annual meeting	3	13	12	17	25	0
Stated purposes of annual meeting	20	9	9	—	23	0

Interpretation of attitude expressions is always difficult because the respondents may be influenced by the way the question is asked and/or the answer they believe is expected. However, two or three things seem to stand out fairly clear. Managers' statements as to the *purposes* of the annual meeting *did not* highlight the transaction of business or obtaining maximum participation by members in business decisions. The "informational and educational" objectives seem to be the main stated purposes. However, the line here between advertising and public relations, and information and education, is probably not very clear. Information and education regarding power use, the ultimate goal of which is to increase power sales, may have been what managers meant, rather than information about the organization and its policies. Secondly, the emphasis was on *attendance* in two of the three questions where evaluations of the meeting were requested. In

the other question involving an evaluation of the meeting, over one-third of the managers provided no answer that fitted into one of the four categories.

In summary, the purposes to be achieved by annual meetings seem to have been rather poorly defined in the minds of managers. At least they seemed to be unable to apply their stated purposes in evaluating their annual meeting programs; but most managers did not appear to place any high value on participation of members in the control of business aspects of the cooperative. This may well be due to the fact that their training and experience have not been of such a nature that they appreciate the unique role of the patron-member in a cooperative organization. The evidence may suggest a need for an intensive discussion by local managers, local directors, and personnel of the statewide association about annual meetings and other membership contacts, and the objectives they should be designed to serve in a cooperative organization.

MEMBERS AND MEMBERSHIP RELATIONS

The type of directors elected, managers employed, their attitudes, and ultimately the nature of the entire management of a cooperative are determined by the members. At least this is true within the limits established by the regulatory agencies and the laws affecting these cooperatives. However, in a large number of cases, the members make policies and elect directors by default, by simply acquiescing and accepting, on faith, the opinion and wishes of a small minority. Unfortunately, minorities do not always have the will of the majority as their objective. Therefore, a cooperative is faced with the very real problem of obtaining effective expression of the rationally determined wishes of the majority. This is the reason that the problem of membership education exists and a partial explanation of why cooperatives use artificial inducements to attract members to the annual meeting and to encourage them to exercise their right to vote. (See discussion of annual meeting, pp. 10-15.)

How Memberships are Acquired

The way that rural residents become members of rural electric cooperatives may provide one clue as to the source of many of the difficulties experienced by those who have been trying to secure more effective and general membership participation. Every person in the service territory must get his power through that cooperative or go without electrical service. Before he can get electrical service he ordinarily must become a member. By paying \$5 or \$10, depending upon

the cooperative, he (1) becomes a member (upon approval of the board of directors) and (2) gets a meter and associated equipment installed.³⁶ Only four cooperatives reportedly notified each new member by special letter that his membership had been accepted. Two more reported other formal means, and six reported attempts to notify new members "informally." Over half reported no attempt at all to notify each new member.

The lack of knowledge about capital credits, the uncertainty regarding the eventual receipt of the cash value of capital credits and relatively small sums involved in many cases, combined with the above conditions, create a very difficult membership relations problem. Under these conditions, it is certainly not surprising that genuine member participation in annual meetings appeared to be nominal in many cases. It seems doubtful that the practice of making "members" of all patrons is very effective as a means of achieving effective member-patron control of cooperatives, when many of the patrons may have no interest in or understanding of the affairs of the cooperative.³⁷

It may present greater problems in rural electric cooperatives than for other types of cooperative because each has a territorial monopoly on electric service. In view of this, some thought perhaps should be given to granting membership only to those patrons who demonstrate enough interest to apply for membership and pay a separate membership fee and to developing changes in legislation and in the Internal Revenue Code to specifically sanction such procedures. It also suggests a real need for educating and informing farmers who involuntarily become members regarding the nature of the rural electric cooperative, their rights and responsibilities as members, and existing programs and problems.

Membership Education Programs

Membership education activities reported for local power distribution cooperatives were typically confined to (1) the annual meeting

³⁶ One cooperative reportedly does not require board approval of membership applications. For many, memberships are approved in groups rather than individually. This amounts to a mere formality. Few, if any, have been rejected. Also, this membership "fee" is generally equivalent, in amount, to the meter deposit required by "other utility companies" and is generally so regarded by co-op managers.

³⁷ Nor would this appear necessary under the Kentucky Law under which rural electric cooperatives are incorporated. See KRS 279.090 (3) and KRS 279.120 (2). However, the Internal Revenue Code of 1954 (Section 501(c) 12) states that cooperatives qualifying under this section for federal corporation income tax exemption can do so "only if 85 percent or more of income consists of amounts collected from members for the sole purpose of meeting losses and expenses." Although this appears to raise questions as to the effect of membership restrictions on tax status, the passage is somewhat ambiguous.

(14 co-ops), (2) local co-op inserts in the magazine distributed by the statewide association (8 co-ops), (3) mailed materials (6 co-ops), or (4) use of field personnel such as home economists and electrification advisors (6 co-ops).³⁸ These activities, when they were carried out, were usually planned without participation of member committees. Some combination of the manager, the board of directors, and representatives of the statewide association jointly plan these activities in a majority of cases (21). Five associations reported no membership education activities.

While managers reported that a "program" of membership information was conducted in only the ways indicated, they recognized that other means were used to inform members about the principles of cooperatives. Most of the 24 managers providing information reported that employees were trained to discuss the principles of cooperatives with patrons (19 managers), that they used the regular publication of the statewide association for this purpose (19 managers) and that they used newspapers, radio, television, and special wordings of financial statements, in addition to annual meetings (Fig. 5). However, as stated before, these attempts may not be very effective because managers themselves seemed to have only a sketchy understanding of these principles.³⁹ The *extent* or intensity of use of these media for this purpose may be nominal in many cases.

Youth Education

Since almost all heads of rural households in the service territory are members, a program of information and education for nonmember households is not necessary. However, some recognition has been made of the fact that member education is a long-run problem. Many people believe that some emphasis on informing and educating rural youth about cooperatives may be more effective as a means of creating

³⁸ More recently (1957) a nationwide program was initiated through the National Rural Electric Cooperative Association which attempts to develop a corps of "Minutemen" in various local cooperatives. "Minutemen," consisting primarily of lay people, both members and nonmembers, serve as direct means of communicating with key local people on matters deemed to be of importance to the total cooperative electric program and to the local rural electric cooperative. There is some indication that attention is focused primarily at the national level rather than on events and problems primarily of concern to the local cooperative. However, this corps of "Minutemen" doubtless serves a variety of informational and educational objectives including development of potential director replacements from the leadership of the various communities in the operating territory. Also, the nature of electric cooperatives is such that national policies and legislative developments definitely affect each local electric cooperative.

³⁹ When they use the magazine published by the statewide association, or the annual meeting (which is largely run by the staff of the statewide association), the understanding of co-op principles by the editor and other personnel of the statewide association becomes strategic.

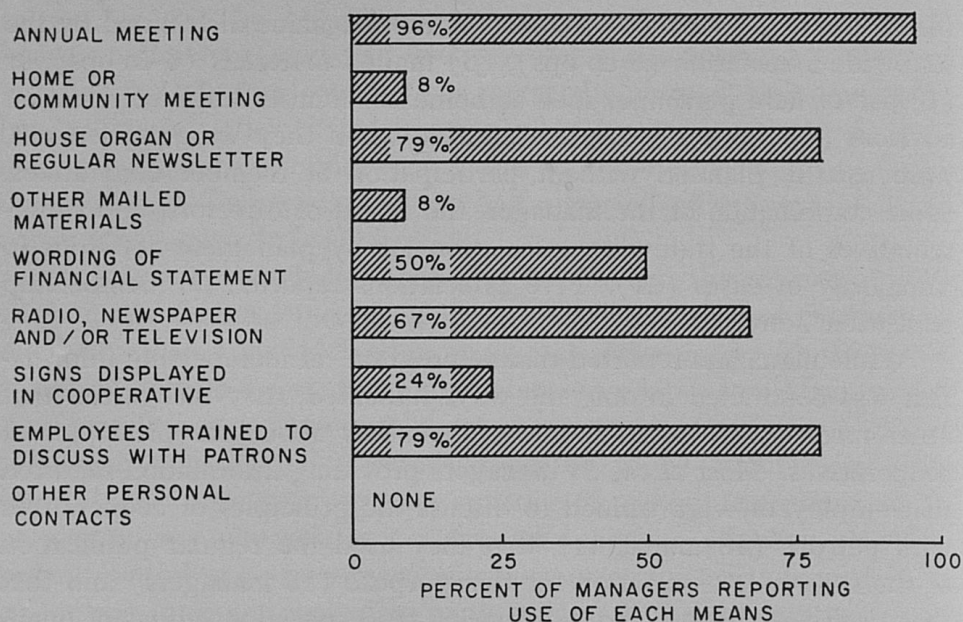


Fig. 5.— Proportion of managers reporting various means used to inform members about cooperative principles.

member understanding than trying only to inform adults. Youth organizations and the public schools provide means for contacting large numbers of youth, many of whom are potential members, at an age when their ideas are flexible and learning rates are rapid.

Eighteen cooperatives reported youth group activity of some kind. Fifteen reported working with Future Farmers of America, 17 with 4-H Clubs, 6 with Utopia Clubs, and 4 with agricultural classes for veterans of World War II.⁴⁰ Most of these contacts involved meetings conducted by the electrification advisor. Since the electrification advisor is primarily concerned with power use problems, one might expect that these contacts were primarily devoted to these subjects. The survey provided no data regarding the content of such meetings. These may have involved little or no education about rural electric cooperatives, as such, or about cooperatives in general. However, it should be stated that since the time of the survey most of the rural electric cooperatives have, through their memberships in the Kentucky Cooperative Council, joined with other types of cooperatives in sponsoring and supporting an active statewide program of youth education. This program was developed by the Kentucky Agricultural

⁴⁰ One co-op reported an essay contest program, handled in cooperation with high school English teachers, which dealt with rural electric cooperatives. Another had an on-the-job training program for bookkeeping students of the local high school.

Extension Service and the vocational agriculture personnel of the Kentucky Department of Education. Therefore, indirectly in some cases, both directly and indirectly in others, most rural electric cooperatives participate in a comprehensive program in the study of cooperatives.

CONCLUSION AND HIGHLIGHTS

This report describes situations existing in local electric power distribution cooperatives which call attention to several possible improvements and unsolved problems. These situations relate primarily to (1) procedures followed in annual membership meetings, (2) cooperative directors and the way they are elected, and (3) the hired local managers—their qualifications, attitudes, and selected elements of manager knowledge.

The main purpose of the study was to provide a basis whereby local managers and directors may compare their present situations with those generally found in other rural electric cooperatives at the time of the survey in 1955 with a view to identifying existing problems and needed changes. Many of the conditions described may have changed, but the usefulness of the data for this purpose will not have been seriously impaired by its age. No attempt is made to determine whether changes should be made, but some alternative policies are suggested which responsible boards of directors, local managers, and personnel of regional cooperatives may wish to consider.

The data appeared to indicate, among other things, that:

1. Relatively young, well educated managers were found in most local associations.

2. Few managers had any formal training specifically oriented to cooperatives, their special characteristics and their effect on responsibilities of boards and managers. Partly because of this, managers had a very sketchy knowledge of (a) cooperative principles, (b) the special legal framework of cooperatives, and (c) the importance of elections, review of cooperative performance, member participation and other aspects of the business portion of the annual membership meetings.

3. Directors of half of the cooperatives averaged over 55 years of age. All 26 power distribution cooperatives allowed more than one term for directors. This apparently contributed toward their having relatively old directors, with relatively long tenure on local boards.

4. The annual meeting of a rural electric cooperative appears usually to have been much more than an occasion for reviewing past performance, electing directors, and making business decisions. Roughly 45 minutes of a meeting which usually lasts the entire day

and an evening, was devoted to the business meeting. Perhaps some festive features are necessary to achieve even nominal participation by members, particularly in view of the ways in which memberships are acquired, the handling of capital credits, the small quantities of electrical energy used by most patrons and the large service territories. The purposes of the membership meeting and their relative importance should be considered in the overall design of the annual meeting if it is to contribute its full potential to the ultimate business success of an electric cooperative as a user owned and controlled business association.

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