

THE LEGAL BUSINESS ORGANIZATION AND CAPITAL STRUCTURE  
OF GRAIN ELEVATOR COMPANIES IN KANSAS

by

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## PREFACE

The success or failure of grain elevators is not dependent upon a form of business organization per se. It is the human beings operating them who sometimes fail. Since this is the case, it is up to the owners and managers to become aware of the advantages and shortcomings of each type of legal organization and take advantage of all opportunities which will assure growth and survival.

All the basic methods of legal business organization are found in the grain elevator business. The individual proprietorship, partnership, ordinary corporation, and the cooperative each has its place in this segment of the free enterprise system of the United States. In addition to the basic methods of legal organization, the cooperative breaks down into the exempt and non-exempt status so far as some aspects of Federal income taxation are concerned. The small grain elevator corporation can elect to apply undistributed taxable income to the gross income of the shareholders, provided certain qualifications are met, thereby avoiding corporate income tax.

The advantages and disadvantages, both real and imaginary, are responsible for much of the confusion existing between advocates of each of the types of legal business organization. Clear-cut information is needed which will point out the advantages and disadvantages of the various forms of legal organization as they apply to the grain elevator business. With this in mind, consideration will be given in this study

to determine:

1. The basic differences among the types of legal organization which yield a competitive advantage.
2. The inherent advantages of one form of business over another which stem from the law and those which are a by-product of a distinct type of legal organization.
3. The effects of the inherent advantages upon the capital structure of grain elevator businesses organized according to the principles of each form of legal organization.

The determination of the advantages and the effects of the advantages of one form of business organization over another requires an understanding of the differences in basic organizational structure. In order to consider this problem, attention must be given to the various organizational patterns which are used by grain elevator businesses.

Most of the various characteristics which are a part of a particular type of business organization are enumerated in the books which have been written on business organization. These characteristics must be viewed as objectively as possible in determining whether or not they constitute competitive advantages or disadvantages to the individual business.

Interviews with grain elevator owners and managers were conducted in an effort to get first hand evidence of the feelings of people intimately associated with the grain elevator business. Their thoughts and comments helped the writer arrive at some of the conclusions developed within this thesis.

This opportunity is also taken to give thanks to the many people who have been of much assistance, especially to Dr. Leonard W. Schruben, Dr. Milton Manuel and Mrs. Ruth E. Clifton. Their time, patience, and understanding has proved invaluable and is greatly appreciated.

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## CHAPTER I

### INTRODUCTION

The United States has experienced an era of tremendous growth and progress in the past 15 years. The evidence of this growth is found easily. A drive through any progressive city or town will show the on-looker new buildings, new homes, new industries and a hustle which was not there a few short years ago.

A trip through a rural community will serve as a means to point out more signs of the changes taking place. With advancing technology and progress, the farmers have been forced either to change their methods of doing business or find another occupation. The thousands of empty farmsteads are mute testimony to the course taken by many farmers.

Further indications of the rapid changes now taking place are found with the grain elevators which dominate the rural landscape in many areas. In the past 15 years, many small grain elevators have gone out of business and of those which have survived and grown, many bear little resemblance to those of years gone by.

A brief description of an early grain elevator will serve to point out some of the changes which are taking place.

The Grange elevator at Indianola, Iowa, is the largest building of the kind in the country. The size of the main building is 38 by 89 feet, with a wheelhouse 20 by 22 feet and the height to the top of the elevator is 36 feet. It is divided into 8 bins, each having a capacity of 32,000 bushels.<sup>1</sup>

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<sup>1</sup>Daniel H. McVey, "Growth of Cooperative Grain Marketing in the United States," American Cooperation--1960, (Washington: American Institute of Cooperation, 1960), p. 417.

The above description is one of an elevator constructed and operated in 1874. Its description is not far different from many of those operating in the early 1900's and there are a number of grain elevators operating in the state of Kansas today which are not as large as the above described elevator. It has been only in the past 15 years that technological change has really made itself felt in the grain elevator business. The results are the towering structures of concrete and steel that are seen today.

There are changes taking place other than those in the construction process. The management and business organization of grain elevator businesses has undergone a thorough "overhaul" in many cases. Management personnel and owners have been forced to take a long look at their particular organization in relation to their competition and the business world in general. Failure to do this has caused undesirable consequences, such as the loss of credit, and in extreme cases the business has failed to meet its obligations and has been forced to liquidate.

Grain elevator operations may be organized using any one of the four basic methods of business organization. These include the individual proprietorship, partnership, ordinary corporation and the cooperative (which may or may not be incorporated). No single method of organization has been successful at all times in the grain elevator business as there have been many failures of elevators organized on the basis of each of the above legal types of business organization.

In many communities, there is only one elevator where there were once four or five separate grain elevator businesses. The survivor may be a partnership organization and those which failed might have been cooperatives or individuals or corporations. In any case, no matter



which elevator business survives, those who failed have said many bitter words concerning the type of organization used by the survivor. The essence of these words comes down to statements such as these: Co-ops are getting too big. You can't fight corporations and win. It isn't fair to the small grain elevator businessman.

What is the answer? Are co-ops really getting too big? Should the corporation be more heavily taxed? Should the small elevator be subsidized in some manner?

Regardless of who is complaining about the advantages of the other fellow, he should give much consideration to the words of the President of the American Bar Association, John C. Satterfield. In January of 1961, Mr. Satterfield told the National Council of Farmer Cooperatives that:

Under our constitutional form of government, the unalienable rights of life, liberty, and pursuit of happiness necessarily carry with them the rights of individuals to do business as they see fit within the framework of our federal and state constitutions and statutes. An individual, a partnership, an association, a conventional corporation and a cooperative fit into our free enterprise system, one as well as the other.<sup>2</sup>

There has been much written and more said about the various advantages and disadvantages of one type of legal business organization over another. From these writings and comments, questions such as these arise: Are there basic differences among the types of legal business organization which yield a competitive advantage? If so, do these competitive advantages stem from the law or are they merely a by-product of one particular form of legal organization?

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<sup>2</sup>John C. Satterfield, "Cooperative Contributions to the American Way of Life," GTA Digest, (St. Paul: Farmers Union Grain Terminal Association, May 1961), p. 49.

## CHAPTER II

### BASIC LEGAL ORGANIZATIONAL PATTERNS

In basic legal structure, grain elevator businesses are either incorporated or unincorporated. As far as this study is concerned, the individual proprietorship and general partnerships will be the only unincorporated businesses considered. The fact that some grain elevator cooperatives are unincorporated is recognized but the percentage is so small they will be disregarded. The cooperatives under discussion will be considered corporations. For purposes of eliminating possible confusion between the cooperative corporation and ordinary business corporation, the cooperative corporation will be referred to as a cooperative and the ordinary business corporation will be referred to as a corporation throughout this study.

Any business, whether individually owned or a corporation jointly owned by thousands of people, has two objectives. The first of these is to satisfy human wants and the second is to make a profit. While it may be debatable as to which of these are of greater importance, it can be said that business managers and owners of grain elevators undoubtedly get much satisfaction out of supplying the needed services to a rural community. In exchange for the services provided by the entrepreneur, the community is willing to pay a price which yields a profit to the business. Thus meeting the second objective. While the primary function of a business is to satisfy human wants, in this competitive world, it

is profit which supplies the incentive to operate with maximum efficiency, which in turn results in greater productivity.<sup>1</sup> Profit is the ultimate goal of the organizers of a business, whether it be an individual owner-manager or the member-patron-owners of a cooperative.

The difference lies with the fact that in the case of the individual proprietorship, one man will reap the profit as compared to many who will realize net savings by doing business with a cooperative. Whatever the type of organization; the objective in organizing for business is maximum profit or savings to the owners.

#### The Individual Proprietorship

The individual proprietorship is the oldest form of business organization, having been used by the ancient Greeks and Romans.<sup>2</sup> It is the most simple to organize, operate and dissolve. In this type of organization, ownership is held by a single individual who is the recipient of all profits and assumes all the risks involved in the operation of the business. The owner-manager of a grain elevator organized as an individual proprietorship has full responsibility for the business. He makes his own operational and organizational decisions with no one to lean on or with which to quarrel.<sup>3</sup>

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<sup>1</sup>Ferdinand F. Mauser and David J. Schwartz, Introduction to American Business, (New York: American Book Company, 1956), p. 3.

<sup>2</sup>Ibid., p. 44.

<sup>3</sup>Richard Phillips, Managing for Greater Returns, (Des Moines: Garner Publishing Co., 1957), p. 16.

The internal organization of grain elevator businesses undoubtedly varies with each operation. The ideas, abilities, and progressiveness of the individual owner-manager determine the internal organization. When the business is in its infancy, the owner-manager will usually be very active in the elevator departmental decisions dealing with both management and operation. But normally, as the business grows and becomes more complex, the owner will be forced to delegate managerial responsibility to others. This is done by putting certain employees in charge of and making them responsible for the operation of the various departments which make up the business (see Figure 1). The departmental managers are responsible to the owner-manager for the operation of each individual department. The owner-manager of a grain elevator operation as large as that indicated in Fig. 1 will find himself occupied with the many details of managing the business as a whole and not with the day to day details of departmental operation.

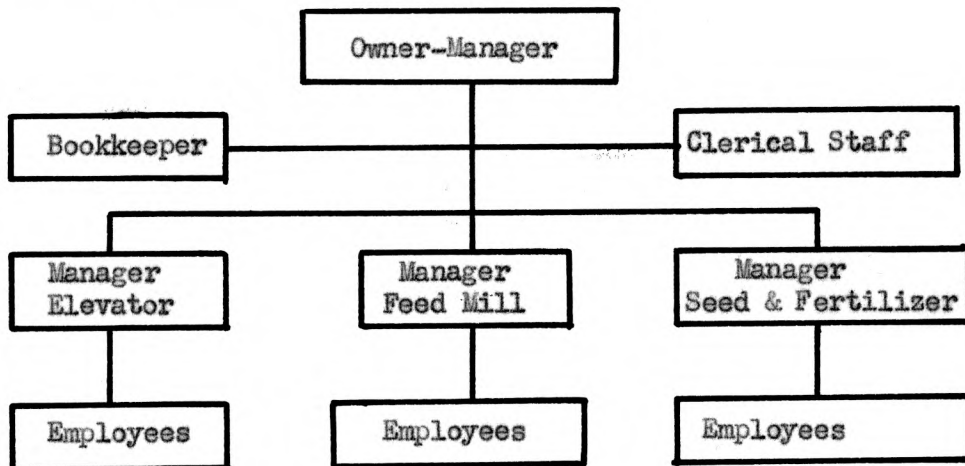


Fig. 1.--Business Organization Chart for an Individual Proprietorship Grain Elevator

## The Partnership

The partnership is very similar to the individual proprietorship in many ways. It has some advantages not found in the individual proprietorship and also some disadvantages which will be discussed later.

Partnerships are associations of two or more persons as co-owners of a business for profit.<sup>4</sup> They are found principally in retail and service industries and as such are common to the grain elevator business.

Profits of the business are divided among the partners in a manner agreeable to all. By the same token, the partners must absorb any losses accruing to the business. The partners have joint responsibility for the management and operation of the business (see Figure 2). Since they must work closely together, it is imperative that the partners be able to work in harmony toward their common goal of an efficient and profitable business.

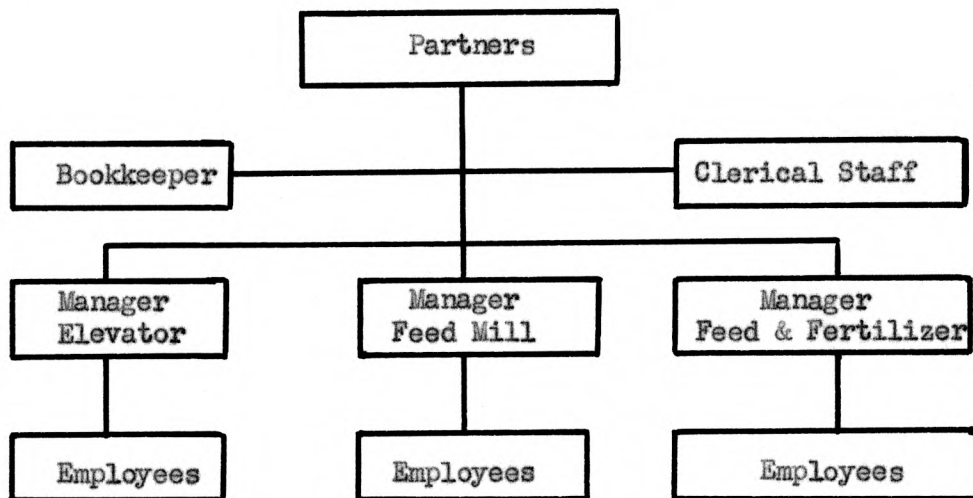


Fig. 2.--Business Organization Chart for a Partnership Grain Elevator

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<sup>4</sup>Mauser and Schwartz, *op. cit.*, p. 47.

While unincorporated businesses do not have articles of incorporation which indicate their legal structure, it is imperative that a contractual arrangement of some description be made between and among the owners. This agreement may be written, oral, or implied by the acts of the partners. However, it is definitely preferable that the agreement be written as this alleviates future misunderstandings. The partnership agreement should include the following as parts of the contractual arrangements:

1. Name of each partner and name of the firm.
2. Kind of business to be conducted and its location.
3. Kind of partnership being established.
4. Delimitation of the authority of the various partners.
5. Duration of the partnership agreement.
6. Amount of the investment made by each partner.
7. Description of how profits and losses are to be divided.
8. Manner in which each partner is to be compensated.
9. Limitation on the amount of money that can be withdrawn by a partner.
10. Statement of accounting procedure to be followed.
11. Procedure for admitting new partners.
12. Procedure for dissolving the partnership.
13. Signatures to the agreement.<sup>5</sup>

The points covered in a partnership agreement will vary somewhat, depending on the type business involved and the wishes of the individual partners. A grain elevator business partnership agreement should specify the relationship of the business to each of its owners, provide for its basic financial structure, method of control, method of operation and method of distribution of earnings. An agreement spelling out these points should eliminate any major misunderstanding.

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<sup>5</sup>Loc. cit.

## Corporations

A grain elevator business organized as a corporation operates under a legal business structure much different from that of the unincorporated business.

By way of example, the unincorporated business exists only as a part of the personal assets of the owners in the eyes of the law.<sup>6</sup> Any property of the business must be in the name of one or more of the partners. Personal assets of the owners are subject to claim by creditors, if business debts cannot be satisfied in any other manner. There are other points which will be discussed later but those mentioned will be sufficient to keep in mind while the corporation is being considered.

How does a corporation differ from an individual proprietorship or a partnership? There are numerous variations given the definition of a corporation but the most widely accepted is that given by Chief Justice John Marshall in 1819:

A corporation is an artificial being, invisible, intangible and existing only in the contemplation of the law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or as incidental to its existence.<sup>7</sup>

If the above definition is recognized and accepted, the corporation is a legal entity and as such is granted many of the same rights as individuals. As contrasted with the unincorporated business, the corporation may own property, has the right to sue in the name of the corporation, and the personal assets of owners cannot be claimed by creditors even

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<sup>6</sup>Phillips, op. cit., p. 62.

<sup>7</sup>Dartmouth College vs. Woodward, 17 U. S. (4 Wheaton 518) 1819, p. 659.

in the case of bankruptcy. In addition, the legal structure varies from one corporation to another. All corporations have articles of incorporation which specify the precise legal structure of the business. The articles of incorporation contain such information as to who may be a director and how they are to be selected as well as the duties and powers of the board. They indicate the basic financial structure of the business and how risk, economic benefits and distribution of assets, in case of dissolution, are to be shared among the owners. They specify how ownership may be transferred from one person to another. When these points plus any other desirable provisions are included in the articles of incorporation, the exact nature of the legal business organization has been determined.

As opposed to the individual proprietorship and partnership, the ownership and management of a corporation are separated. The owners (stockholders) of a large corporation can exercise only an indirect type of control over management of the business. There is a greater degree of control by owners of a small corporation where the board of directors will more than likely be made up of the majority stockholders. However, in both the large and small corporation, the stockholders will elect a board of directors which is responsible for policy decisions and for efficient management of the business. The board of directors will appoint the essential corporate officers who are responsible to the board of directors for carrying out business policies. Figure 3 shows an example of the internal business organization which could be used by a small independent grain elevator corporation.

Large corporations with many departments would possibly eliminate



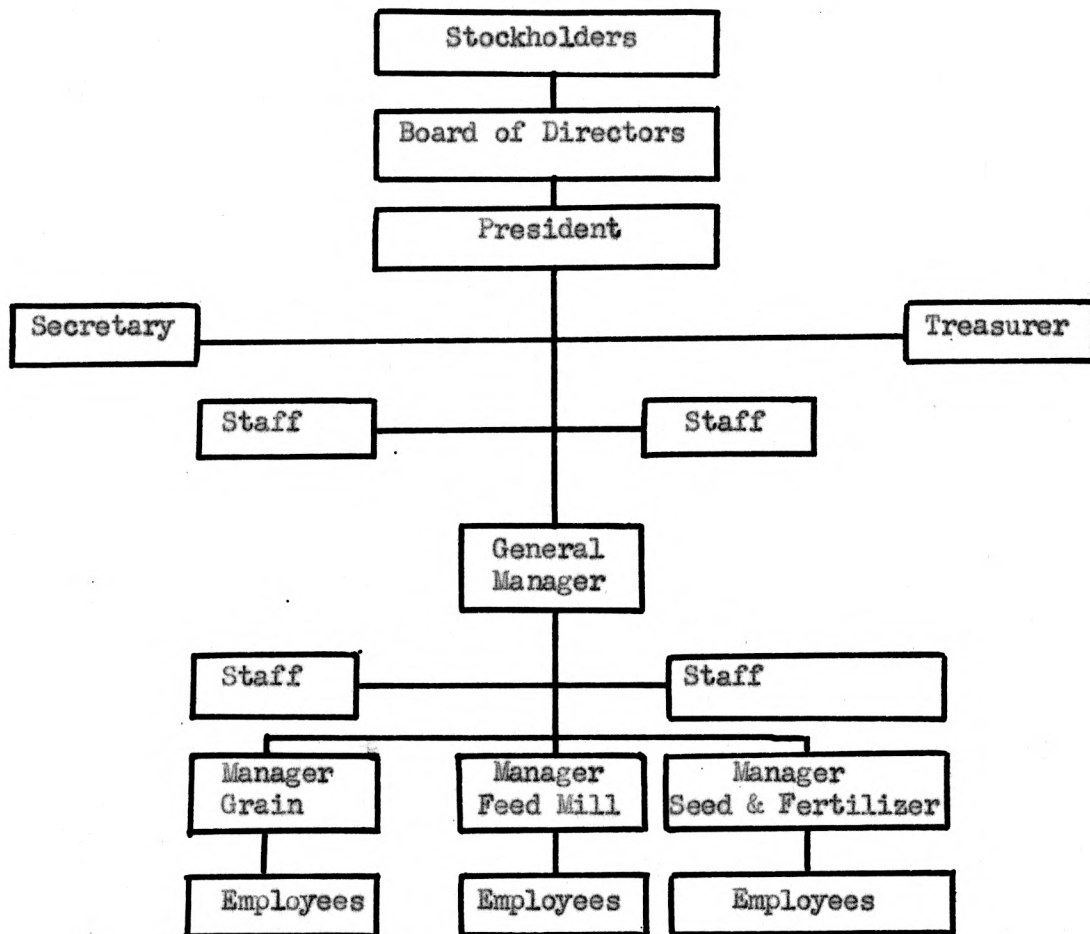


Fig. 3.—Business Organization Chart for a Grain Elevator Corporation

the General Manager's position and create a vice-president for each individual department. There are any number of organizational variations which could be used in a grain elevator corporation, but the most important factor to consider is that of making sure the internal organization meets the objectives of the business.

What happens to corporate profits? After expenses, taxes and dividends have been paid, the income remaining belongs to the corporation.

The board of directors is free, within the realm of discretion, to use the profit as it sees fit for the growth and expansion of the business. This is in contrast to the unincorporated business where the owners receive all profits to their personal accounts.

### The Cooperative

Cooperatives are much like ordinary business corporations in many ways. The cooperative has the same rights and privileges as a corporation. Actually, many of the differences are slight but there are some points which have caused a great deal of controversy. Not the least of these is that of defining a cooperative. There seems to be much indecision as to where and how the cooperative fits into business organization in the United States.

Cooperatives have been defined many times and in various ways.

According to Packel, a cooperative can be defined as follows:

A cooperative is an association which furnishes an economic service without entrepreneur or capital profit and which is owned and controlled on a substantially equal basis by those for whom the association is rendering service.<sup>8</sup>

A second definition, which is perhaps more complete, is found in Evans and Stokdyk:

An agricultural cooperative is a business organization, usually incorporated, owned and controlled by member agricultural producers, which operates for the mutual benefit of its members or stockholders, as producers or patrons on a cost basis after allowing for the expenses of operation and maintenance and any other authorized deductions for expansion and necessary reserves.<sup>9</sup>

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<sup>8</sup> Israel Packel, The Law of the Organization and Operation of Cooperatives, (Albany: Matthew Bender and Co., 1947), p. 3.

<sup>9</sup> Frank Evans and E. A. Stokdyk, The Law of Agricultural Cooperative Marketing, (Rochester: Lawyers Cooperative Publishing Co., 1937), p. 302.

In 1947, editorial writer, Roscoe Fleming of the Denver Post put the distinctive nature of a cooperative corporation in apt popular terms.

He wrote:

Actually, cooperation is neither a panacea, nor menace, but simply a form of business and economic organization which has many merits and some defects.

A cooperative put in the simplest terms, is a business which is owned by its customers. They patronize themselves. They split up the profits, or savings.<sup>10</sup>

The cooperative, when it is incorporated, is considered to be a legal entity and as such is treated as an individual in the business world. It may own property, it has the right to sue and by the same token, may be sued in the name of the cooperative, and the owners enjoy limited liability.

Cooperatives must have articles of incorporation just as do ordinary corporations. The articles of incorporation are commonly looked upon as the charter after its acceptance and approval by the official of the State to whom application for incorporation is made. Again, as in the corporation, the articles of incorporation indicate the exact legal structure of the business. They contain such information as:

1. The name of the cooperative.
2. Purposes of the association.
3. Location of principal office.
4. Number of directors.
5. Amounts and form of capital stock.

In addition to the articles of incorporation, most cooperatives, as well as corporations, make up a set of by-laws. The purpose of by-laws

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<sup>10</sup>The Denver Post, Aug. 31, 1947, Editorial page.

is to provide the rules for regulation of the affairs of the business. They constitute the working plan. Among the points usually considered in the by-laws of a cooperative are the following:

1. Requirements for membership.
2. Provisions for shareholder meetings.
3. Qualification, election, duties and compensation, if any, of directors.
4. Powers and meetings of the board of directors.
5. The essential corporate officers, their duties and compensation, if any.
6. Certificates for shares and the form and method of transfer of ownership.
7. The fiscal year.
8. Selection and duties of the manager.
9. Disposition of patronage savings.
10. Capital expenditures.
11. Amendments.

The charter and by-laws of both the corporation and the cooperative cover similar general topics but there are some differences due to variations in organization. For example, a glance at Fig. 4 will show the observer that the general manager is administratively responsible to the board of directors, but in a corporation, the general manager is responsible to the president (see Figure 3). While there are differences in the chain of command between a cooperative and a corporation, the internal organization, as a whole, is quite similar. Grain elevators organized by either method will offer the community those services demanded and which are economically feasible.

The directors of a cooperative are elected by the members from their own rank. This is sharp contrast to the large corporation whose directors may be from all walks of life and may have no connection whatever with the corporation.

As has already been indicated, the directors of a small corporation

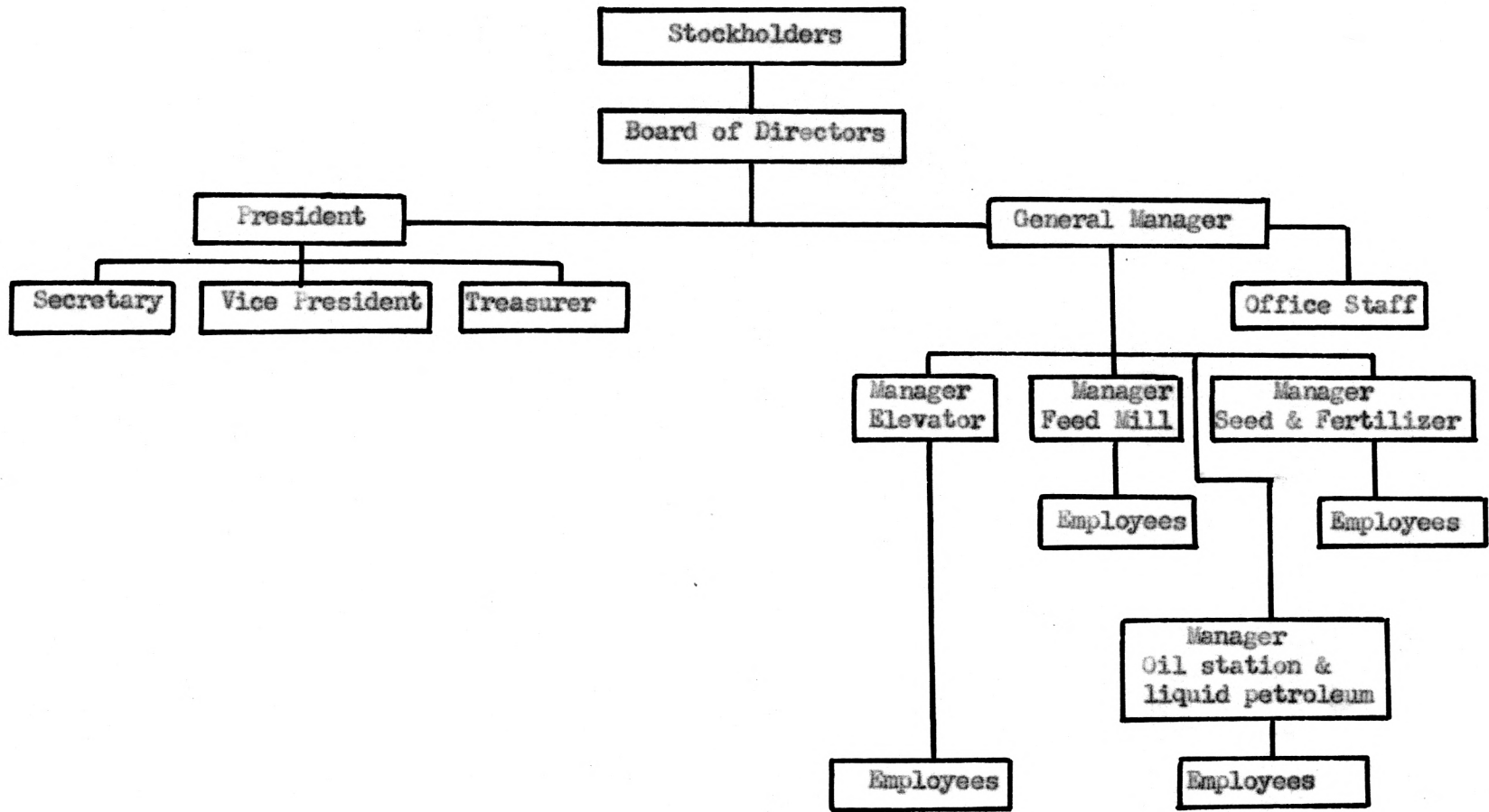


Fig. 4. Business Organization Chart for Cooperative Grain Elevator Corporation

may be elected from the shareholders and in all probability those holding the most stock in the company will be on the board of directors.

One of the more important differences between the cooperative and a corporation which should be considered is that of a comparison of the disposition of profit in a corporation and the net savings in a cooperative. As indicated previously, the corporation is free to use the undistributed profit as it sees fit. This is not true in the case of the cooperative. In farmer cooperatives, the members are the residual owners. The business is merely an integrated extension of their farming activities. Any capital which accrues as a result of sales being greater than the cost of sales is known as gross savings. Gross savings minus expenses leaves what is called "net savings." This corresponds roughly to undistributed corporate profit. However, the board of directors of a cooperative is not necessarily free to use this capital as it may wish. Unless provisions have been or are made to the contrary, the net savings will be refunded to the farmer-owners in the form of a patronage refund. The size of the patronage refund going to each member is dependent upon the size of the per unit patronage refund and the volume of business he has done with the cooperative.

The per unit patronage refund is determined by dividing net savings by the total volume of business. In cases where there is more than one department (see Figure 4), the per unit patronage refund will ordinarily be computed for each operational area. Table 1 shows the per unit patronage refund or rebate by operational area of a cooperative grain elevator in Northcentral Kansas. Notice that grains are figured on a per bushel basis and all other sections are computed on the basis of per

TABLE 1

PER UNIT PATRONAGE REFUNDS BY OPERATIONAL AREAS OF A  
NORTHCENTRAL KANSAS COOPERATIVE GRAIN ELEVATOR<sup>a</sup>

Operational Area	Per Unit Patronage Refund for May 1, 1960 to April 30, 1961
Grain handled or stored at elevator	8.35¢ per bushel
Purchases at elevator	5.76% of dollar value
Mill feed	15.98% of dollar value
Anhydrous ammonia	34.06% of dollar value
Liquid petroleum	18.48% of dollar value
Gas and oil	10.63% of dollar value
Food stores	2.39% of dollar value

<sup>a</sup>Source: Annual Report of Operations, Mitchell County Farmers Union Cooperative Association, Beloit, Kansas, May 1, 1960 to April 30, 1961, p. i.

dollar value.

On the basis of only one point, that of the variation in the distribution of profit or net savings, it may be anticipated that one form of business organization will have a definite advantage over another. Is this really true? This point, along with others, will be considered as the advantages and disadvantages of each type of legal organization are discussed.

## CHAPTER III

### COMPARISON OF BUSINESS CHARACTERISTICS FOUND IN THE VARIOUS TYPES OF LEGAL BUSINESS ORGANIZATION USED IN GRAIN ELEVATOR OPERATIONS

#### Rights of Owners

The owners of individual proprietorships or partnerships have full charge of the business. Ownership and management are not usually separated. Owners make all managerial and operational decisions, accept the risk, and receive any profit.

Corporate owners have control of the business, however, ownership and management are separated in the open corporation. This may not be true in the closed or family corporation where the owners may also be the management. In addition to helping elect directors, the stockholders have the right to:

1. Receive dividends.
2. Inspect corporation records.
3. Vote on amendments to by-laws.
4. Vote on amendments to corporation charter.
5. Share in assets upon dissolution.<sup>1</sup>

Owners of a cooperative have a type of control similar to that exercised by owners of a corporation but are usually much more closely in touch with management than is the open corporation. Ownership and management are separated for the most part in that it would be rare for a farmer member to also be on the management staff. The owner-members elect the board of directors from their own group. In addition to this privilege, they also have the right:

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<sup>1</sup>Mauser and Schwartz, op. cit., p. 59.



1. To choose and remove the directors.
2. To adopt or change its by-laws.
3. To require the officers and directors to keep within limits of the law, the association's charter, its by-laws, and its marketing contracts.
4. To hold the officers and directors who do so accountable for any losses suffered by members by reason of any departure.
5. To bring a suit to protect the interests of an association when the directors are parties to wrong doing.
6. To require associations of which they are members to account to them correctly and in adequate detail, and to deal with them without discrimination.
7. To challenge the right of directors or officers to act as such.
8. And to examine the books and property of the association. This is subject to such restrictions as agreed to and the request to examine the books and property must be made in good faith and at a proper time.<sup>2</sup>

#### Legal Formalities Imposed

Owners of individual proprietorships or partnerships can commence or cease business as desired without formality. In the State of Kansas, the organizers of both the cooperative and corporation must apply to the State Charter Board and the Secretary of State for a corporate charter before the business can act or conduct business as a cooperative or a corporation.<sup>3</sup> The formal instrument (whether called articles of incorporation, articles of association, or certificate of incorporation) is commonly looked upon as the charter after its acceptance and approval.

By the same token, if an incorporated business votes to dissolve, there are certain legal formalities which must be satisfied. For example,

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<sup>2</sup>L. S. Hulbert, Legal Phases of Farmer Cooperatives, (Washington: U. S. Government Printing Office, 1958), pp. 53-54.

<sup>3</sup>General Statutes of Kansas, (Topeka: State Printer, 1950), p. 501.

if the directors elect to dissolve a corporation, they must then:

1. Mail notice of such action to all the stockholders in the United States.
2. Have a notice in the county newspaper which serves the area within which the corporation is found at least two weeks before the date set for the stockholders to vote on the dissolution problem.
3. If the stockholders vote to dissolve, a certificate to this effect must be filed with the Secretary of State.<sup>4</sup>

The corporation is considered dissolved when the certificate is filed, but there is still a three year period during which the business may prosecute or bring suits, distribute assets, dispose of and convey property and to settle and close the business in general. The dissolution procedure for non-profit corporations with capital stock and those with membership certificates should follow the general corporate dissolution statutes as nearly as possible.

#### Ability to Take Action as Needed

The individual proprietor is not required to consult with others in making management and operational decisions. Since this is the case, he can take prompt action as desired.

Partnerships generally tend to be clumsy from an administrative point of view.<sup>5</sup> It is to the best interests of the business if all partners agree on major decisions. This may take valuable time, thus preventing prompt action. Unless the partnership agreement specifies the conditions under which a partner may withdraw, a sharp disagreement

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<sup>4</sup>Ibid., p. 576.

<sup>5</sup>William H. Newman and James P. Logan, Business Policies and Management, (Dallas: Southwestern Publishing Co., 1959), p. 419.

might end in dissolution.

An incorporated organization has centralized authority. This enables both the cooperative and the corporation to act with unity. Although there are others to whom they are responsible, managers can take prompt action as required by the particular situation at hand.

#### Special Taxes

There are no special taxes paid by either the individual proprietorship or the partnership.<sup>6</sup>

The corporation is subject to several special taxes. Among these are found the initial application fees and taxes plus a filing and recording fee (see Table 2).

TABLE 2

PURPOSE AND AMOUNTS OF SPECIAL TAXES PAID BY  
CORPORATIONS TO THE STATE OF KANSAS<sup>a</sup>

Purpose of Fee	Amount of Fee
Application	\$25.00
Filing and recording	2.50
Articles of incorporation	2.50

<sup>a</sup>Source: General Statutes of Kansas, 1949, p. 565.

In addition to the above special taxes, corporations are also subject to a capitalization fee based on authorized capital stock (see Table 3). If additional capital stock is authorized, a capitalization fee is levied using the same rates as were used originally.

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<sup>6</sup>Ibid., p. 418.

Corporations are also subject to payment of an annual fee upon continuation of corporate life. This fee is commonly called a franchise tax. The payment of which by a business gives it the right to be, and exercise the powers of, a corporation. Banking, insurance, building and loan associations or corporations are exempt from the franchise tax.<sup>7</sup>

TABLE 3

CAPITALIZATION FEES PAID BY CORPORATIONS  
AS BASED ON AUTHORIZED STOCK<sup>a</sup>

Authorized Capital Stock	Fee
Up to \$100,000	1/10 of 1% of authorized stock
Over \$100,000	\$100 plus 1/20 of 1% of authorized stock in excess of \$100,000
Minimum fee	\$10.00

<sup>a</sup>Source: General Statutes of Kansas, 1949, p. 498.

The franchise tax is paid on the basis of paid up capital stock (see Table 4). Payment is made to the Secretary of State and is paid at the time of filing the annual report.

Cooperatives are also subject to special taxes although they are not the same in every respect as the special taxes applied to corporations. For example, cooperatives do not pay a franchise tax but instead are subject to an annual license fee. Cooperatives must pay a fee upon filing of the articles of incorporation and an additional amount with each amendment (see Table 5).

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<sup>7</sup>General Statutes of Kansas, 1949, p. 508.

TABLE 4  
 RATES OF CORPORATE FRANCHISE TAX AS DETERMINED  
 BY PAID UP CAPITAL STOCK<sup>a</sup>

Paid up Capital Stock		Fee
Over	But not Over	
\$ 000,000	\$ 10,000	\$ 10.00
10,000	25,000	25.00
25,000	50,000	50.00
50,000	100,000	100.00
100,000	250,000	125.00
250,000	500,000	250.00
500,000	1,000,000	500.00
1,000,000	2,000,000	1,000.00
2,000,000	3,000,000	1,500.00
3,000,000	5,000,000	2,000.00
5,000,000		2,500.00

<sup>a</sup>Source: General Statutes of Kansas, 1949, p. 508.

TABLE 5  
 PURPOSE OF AND THE AMOUNTS OF SPECIAL TAXES PAID BY  
 COOPERATIVES TO THE STATE OF KANSAS<sup>a</sup>

Purpose of Fee or Tax	Amount of Fee
Filing articles of incorporation	\$10.00
Filing amendments to the articles	2.50
Annual license	10.00

<sup>a</sup>Source: General Statutes of Kansas, 1949, p. 545.

#### Special Reports

In the cases of both the individual proprietorship and the partnership, there are no special reports to make. However, corporations are required by law to make an annual report on the condition of the business at the end of each calendar year. Every corporation for profit makes

this report to the Secretary of State and it is due on or before March 31.

The corporation's annual report is complete and should contain the following:

1. Name of corporation.
2. Location of principal office.
3. Name and addresses of the president, secretary, treasurer and the board of directors.
4. Date of the annual election of officers.
5. Amount of authorized capital stock and the par value each share.
6. Amount of capital stock authorized, the amount issued and paid up.
7. Nature and kind of business in which the corporation is engaged and places of business.
8. A complete and detailed statement of the assets and liabilities of the corporation.
9. Names and addresses of stockholders and the number of shares held by each.
10. The change or changes, if any, in the above particulars which have been made since the last annual report.<sup>8</sup>

This report must be duly signed and sworn to and then forwarded to the Secretary of State.

Cooperatives, which are incorporated under the laws of Kansas, must file an annual report on forms furnished by the Secretary of State. As in the case with corporations the report is rather detailed although there are some differences. The information asked for is as follows:

1. Name of the association.
2. Principal place of business.
3. Amount of paid up capital stock and number of stockholders, if a stock association. The number of members and the amount of membership fees received, if a non-stock association.
4. Total expenses of operations.
5. Amount of indebtedness or liability.
6. A set of balance sheets.

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<sup>8</sup> Ibid., p. 508.

## State Income Taxation

Individual proprietorships pay no income tax on the business as organized. Since all profits or losses are received by the owner, any income tax is levied against the individual's taxable income. The law provides that a tax shall be levied, collected and paid annually (see Table 6).

TABLE 6

KANSAS INCOME TAX RATE SCHEDULE FOR INDIVIDUALS<sup>a</sup>

Amount of Taxable Income	Percent
\$ 000 to \$2,000	1 1/2
2,000 to 3,000	2 1/2
3,000 to 5,000	3
5,000 to 7,000	4
All over 7,000	5 1/2

<sup>a</sup> Source: Supplements to General Statutes of Kansas, 1961, p. 1242.

Taxation of partnerships is identical to an individual proprietorship with one exception. In partnerships, a return must be made for each taxable year stating the items of gross income and allowable deductions. The names and addresses of the individuals who would be entitled to share in the net income and the distributive share of each individual should also be stated. The return may be signed by any one of the partners.<sup>9</sup> However, since this is only an information type return, no tax computations are made.

The individual owners of a partnership are liable for income tax

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<sup>9</sup>Supplements to General Statutes of Kansas, 1961, p. 1252.

only in their individual capacity. The gross income of each partner includes his distributive share, whether distributed or not, of the partnership's net income for the year.

Corporations are required to pay a corporate income tax equal to 3 1/2% on the entire net income as defined in the statutes.<sup>10</sup> According to Kansas law:

All corporations subject to taxation under the Kansas Income Tax Act, including but not limited to, all farmers . . . associations organized and operated on a cooperative basis . . . shall make a return, stating specifically the gross income and the deductions and credits allowed by this act.<sup>11</sup>

Corporations are subject to taxes on net income before capital stock dividends are paid.

Cooperatives are taxed to the state much as they are to the Federal government. The main difference being that the rates are not the same. State income tax rates applied to cooperative taxable income are 3 1/2%, the same as for corporations (see above). The exempt and non-exempt status of cooperatives holds true for state income tax purposes as well as federal. The deductions allowed in the computation of the Federal income tax of exempt cooperatives are not restated in the General Statutes of Kansas. However, it has been the policy of the State Department of Revenue to follow the lead of the Federal government so far as taxation is concerned. In doing so, Federal exemption from taxation has been accepted by the state and until recent years, there has been no need for an exempt cooperative to file a return. However, the procedure has

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<sup>10</sup>Ibid., p. 1242.

<sup>11</sup>Ibid., p. 1251.



changed in the past few years and at present an information return is required by the State Department of Revenue.<sup>12</sup>

### Federal Income Taxation

There are no income taxes levied against the individual Proprietorship as a business. The Federal government recognizes that all profits and losses are a part of the personal income of the owner and are taxed as such. If the individual can qualify as a head of a household, the tax rates are less than otherwise. The tax schedule for those who can file a joint return are more favorable yet, as a general rule. Table 7 is a reproduction of the tax rate schedule used by those filing a joint return as of January 1, 1964.

In a partnership, it is the partners, and not the partnership, which are subject to taxation. Persons who make up a partnership are liable for income tax only in their individual capacities.<sup>13</sup> In the determination of his income tax, a partner should take into account his share of all profits, losses, and allowable deductions before distribution occurs. Then the income tax rate schedule (see Table 7) is applied to the individual's taxable income, if he is the head of a household.

Partnerships, if they meet certain qualifications, can elect to be taxed as domestic corporations. In brief, these qualifications are as follows:

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<sup>12</sup>Interview with C. Morgan Booe, State Department of Revenue, July 27, 1962.

<sup>13</sup>Internal Revenue Code of 1954, (Washington: U. S. Government Printing Office, 1954), p. 239.

TABLE 7

## TAX RATE SCHEDULE USED FOR FILING JOINT RETURN

Taxable Income	Amount of Tax
Not over \$4,000	20% of taxable income
Over \$4,000 but not over \$8,000	\$800, plus 22% of excess over \$4,000
Over \$8,000 but not over \$12,000	\$1,680, plus 26% of excess over \$8,000
Over \$12,000 but not over \$16,000	\$2,720, plus 30% of excess over \$12,000
Over \$16,000 but not over \$20,000	\$3,920, plus 34% of excess over \$16,000
Over \$20,000 but not over \$24,000	\$5,280, plus 38% of excess over \$20,000
Over \$24,000 but not over \$28,000	\$6,800, plus 43% of excess over \$24,000
Over \$28,000 but not over \$32,000	\$8,520, plus 47% of excess over \$28,000
Over \$32,000 but not over \$36,000	\$10,400, plus 50% of excess over \$32,000
Over \$36,000 but not over \$40,000	\$12,400, plus 53% of excess over \$36,000
Over \$40,000 but not over \$44,000	\$14,520, plus 56% of excess over \$40,000
Over \$44,000 but not over \$52,000	\$16,760, plus 59% of excess over \$44,000
Over \$52,000 but not over \$64,000	\$21,480, plus 62% of excess over \$52,000
Over \$64,000 but not over \$76,000	\$28,920, plus 65% of excess over \$64,000
Over \$76,000 but not over \$88,000	\$36,720, plus 69% of excess over \$76,000

TABLE 7--Continued

Taxable Income	Amount of Tax
Over \$88,000 but not over \$100,000	\$45,000, plus 72% of excess over \$88,000
Over \$100,000 but not over \$120,000	\$53,640, plus 75% of excess over \$100,000
Over \$120,000 but not over \$140,000	\$68,640, plus 78% of excess over \$120,000
Over \$140,000 but not over \$160,000	\$84,240, plus 81% of excess over \$140,000
Over \$160,000 but not over \$180,000	\$100,440, plus 84% of excess over \$160,000
Over \$180,000 but not over \$200,000	\$117,240, plus 87% of excess over \$180,000
Over \$200,000 but not over \$300,000	\$134,640, plus 89% of excess over \$200,000
Over \$300,000 but not over \$400,000	\$223,640, plus 90% of excess over \$300,000
Over \$400,000	\$313,640, plus 91% of excess over \$400,000

1. Partnership must have no more than 50 members.
2. No partner, having more than a 10% interest in the business, may have more than a 10% interest in any other unincorporated business enterprise taxable as a domestic corporation.
3. No partner may be a non-resident alien or a foreign partnership.
4. Capital must be a material income producing factor, or, 50% or more of the gross income . . . consisting of gains, profits, or income derived from trading as a principal or from buying and selling real property, stock, securities, or commodities for the account of others.<sup>14</sup>

Any partnership considering the possibility of taxation in this manner should give much thought to all possible aspects before making

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<sup>14</sup>United States Code, Annotated, (St. Paul: West Publishing Co., 1955), Title 26, Sec. 1361, p. 665.

the decision because it is irrevocable except under a special condition. This condition comes about only when the electing partners have an interest of 80% or less in the profits and capital of the enterprise.<sup>15</sup> When this occurs, the enterprise is not considered a domestic corporation until the business makes the tax option election again.

Corporations are subject to taxation upon their taxable income. The tax consists of a normal tax and in addition, a surtax is applied if corporate taxable income is great enough (see Table 8). The normal tax rate of 30% is applicable to taxable years beginning before July 1, 1963.

TABLE 8

RATE OF NORMAL AND SURTAX APPLICATION TO CORPORATE  
TAXABLE INCOME<sup>a</sup>

Kind of Tax	Tax Rate in Percent
Normal	30
Surtax on Taxable Income over \$25,000	22
Combined Rate (On Taxable Income over \$25,000)	52

<sup>a</sup>Source: Federal Tax Guide I, p. 810.

The normal tax rate applicable to taxable years beginning after June 30, 1963, will be lowered to 25 per cent.<sup>16</sup> The only corporations to which the above corporate income tax schedule does not apply is where certain kinds of corporations are subject to taxes imposed in lieu of those discussed.<sup>17</sup>

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<sup>15</sup>Loc. cit.

<sup>16</sup>Federal Tax Guide II, (New York: Commerce Clearing House, 1962), p. 4008.

<sup>17</sup>United States Code, (Washington: U. S. Government Printing Office, 1959), Vol. 5, Title 26, p. 4263.

Certain small business corporations have the tax option of not being taxed as a corporation. In order to qualify for this tax option, a domestic corporation must not be a member of any affiliated group and in addition must not:

1. Have more than 10 shareholders.
2. Have as a shareholder, a person (other than an estate) who is not an individual.
3. Have a non-resident alien as a shareholder.
4. Have more than one class of stock.<sup>18</sup>

Once this tax option election has been made, it is in effect until terminated. However, an election may be revoked at the will of the shareholders, provided all vote for revocation. The tax option election will be revoked involuntarily, if at any time the corporation no longer meets the above qualifications. Taxation of the taxable income of an electing small business corporation is accomplished through the individual shareholders. Each shareholder includes in his gross income the amount equal to his portion of the dividends, whether received or not. In order to account for any net operating losses, each shareholder may deduct from his gross income an amount equal to his portion of the corporation's net operating loss. The amount of the loss any one shareholder can claim is determined on a prorata basis by the number of shares held by the individual each day of the taxable year.<sup>19</sup>

Cooperatives are subject to corporate income tax at the same rate as corporations. The exempt status of some farmer cooperatives does not eliminate them from payment of Federal income tax. Section 521 of the Internal Revenue Code of 1954 states that "A farmers' cooperative

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<sup>18</sup>Ibid., Sec. 1371.

<sup>19</sup>Loc. cit.

organization . . . shall be exempt from taxation . . . except as provided in section 522." In section 522, there is information stating that exempt cooperatives are subject to a corporate income tax. However, in computing taxable income in addition to the regular deductions, exempt cooperatives may make the following deductions from gross income:

1. Amounts paid as dividends during the taxable year on capital stock.
2. Amounts allocated to patrons from income not derived from patronage, regardless of the form of allocation and whether the income was derived during the taxable year.
3. Patronage refunds to patrons with respect to their patronage in the same or preceding years.<sup>20</sup>

It was the intention of Congress that all patronage refunds would be taxed either to the patron or the cooperative. However, many loopholes were found in Section 522 of the 1954 Internal Revenue Code. It was found that farmers computing tax on the cash basis could avoid paying tax on non-cash allocations since they did not actually receive cash, and also, the cooperative was not liable for taxation on the non-cash allocation. With these thoughts in mind, Congress has, through Sections 1381-1383, 1385 and 1388 of the 1962 Tax Act, provided that all patronage refunds must be accepted as a part of gross income either to the patron or to the cooperative. This has been accomplished by using explicit language in describing the qualifications which non-cash allocations must meet before being taxable to the patron. If they do not meet these qualifications, the allocations are to be included as a part of the cooperatives gross income.

Non-exempt cooperatives are taxed at the same rate as the exempt

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<sup>20</sup>Ibid., p. 4378.

cooperative and the corporation. In fact, the only difference in the computation of taxable income between the non-exempt cooperative and the corporation is that non-exempt cooperatives may deduct true patronage refunds from gross income.<sup>21</sup> The non-exempt cooperative cannot deduct dividends paid on capital stock nor can it deduct allocations to patrons from income which was not derived from patronage.

#### Property Taxes

All real and personal property in the State of Kansas, not expressly exempt, is subject to a property tax. Real property includes "not only the land but all buildings, fixtures, and improvements . . . ." Personal property takes in everything subject to ownership and "includes capital stock, undivided profits and all other assets of every company, incorporated or unincorporated, and every share of interest in such stock, profit or assets" regardless of what name by which they may be designated.<sup>22</sup>

#### Owner Liability for Business Debts

The owner of an individual proprietorship and each member of a partnership is subject to unlimited liability for all claims and debts against the business.<sup>23</sup> However, since it has been established that incorporated businesses are independent identities, the owners, or shareholders, are subject to only limited liability. When an incorporated firm

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<sup>21</sup>Hulbert, op. cit., p. 209.

<sup>22</sup>General Statutes of Kansas, 1949, p. 2534.

<sup>23</sup>Newman and Logan, op. cit., p. 418.

borrow or incurs other obligations, the corporation is responsible and not the shareholders. The most shareholders can lose is the value of their stock.<sup>24</sup> In addition, stockholders, or members in the case of non-stock cooperatives, can be compelled to pay the amount which they have agreed to pay for stock in a corporation or for membership in it.<sup>25</sup>

#### Profit Disposition

All profits of an individual proprietorship and a partnership accrue to the owner or owners of the business. In the case of a partnership, they are divided according to the partnership agreement.<sup>26</sup>

Net profits of a corporation, after income taxes, belong to the corporation. The corporation must pay for the use of money invested by the owners so each stockholder may receive a dividend, the amount depending upon the kind and value of the stock owned. The board of directors makes the decision as to the total amount to be paid out as dividends, the remainder to be kept in the business as undistributed profits to be used at the discretion of the board of directors. It has been a common practice in America to plow earnings back into the business.<sup>27</sup>

It is customary to refer to the net profits of a cooperative as net savings. These savings belong to the business, just as they do in a corporation. The difference lies with the fact that in addition to the payment of stock dividends, patronage refunds are usually paid

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<sup>24</sup>Ibid., p. 420.

<sup>25</sup>Hulbert, op. cit., p. 24.

<sup>26</sup>Newman and Logan, op. cit., p. 418 and 420.

<sup>27</sup>Ibid., p. 392.



to each member owner. The amount is based upon the degree to which the individual member uses the cooperative. It is worthy of note that all patronage refund allocations are not in the form of cash. A part of the savings may be allocated in a non-cash form. Examples of which are capital stock certificates of indebtedness, notes or book credits.<sup>28</sup> When this occurs, the actual cash is retained in the business as a part of the revolving fund or as reserves.

### Length of Life

The individual proprietorship has limited life as the business is officially terminated with the death of the owner. Even though the business may continue under a successor, it is not the same business and the personal credit of the new owners is now the credit of the organization.<sup>29</sup>

Partnerships are the least permanent of any of the forms of business ownership.<sup>30</sup> This is because the death, bankruptcy, or withdrawal of any one member of the partnership terminates the business. This true even though the agreement may state conditions under which withdrawal can be made and also may provide for the automatic formation of a new partnership upon the loss of a member.

On the other hand, corporations and cooperatives have what is called continuous life. This is due to the ease of share transfer and the fact that neither war nor new members have any effect on the business as such. The death of a stockholder has no effect on the life of a

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<sup>28</sup>Hulbert, op. cit., p. 212.

<sup>29</sup>Joseph H. Bonneville and Lloyd E. Dewey, Organizing and Financing Business, (New York: Prentice-Hall, Inc., 1947), p. 28.

<sup>30</sup>Mauser and Schwartz, op. cit., p. 49.

cooperative or a corporation.<sup>31</sup> Corporations and cooperatives can be dissolved in only four ways:

1. By court order, as in the case of bankruptcy or engagement in any illegal activity.
2. By the approval of the stockholders. In some cases a majority vote is sufficient and in others a unanimous consent of stockholders must be obtained.
3. By expiration of the corporate charter. The corporate charter is easily renewed so this is a mere formality in most instances.
4. The charter may be revoked by the state for non-use or misuse of franchises and powers.<sup>32</sup>

#### Size of Equity Capital

The biggest handicap of an individual proprietorship is that of adequate finance. Equity capital is limited to what the owner himself can provide and in many cases this is inadequate.<sup>33</sup>

When compared to an individual proprietorship, the partnership is usually in a stronger financial position. This is because two or more people are normally able to invest more money in a business than a single individual. Therefore, equity capital should normally be greater in a partnership.<sup>34</sup>

The corporation and cooperative usually have a great deal more equity capital available. This is due to the sale of stock or memberships to a large number of people and to the relative permanency of an

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<sup>31</sup>General Statutes of Kansas, 1949, pp. 498 and 542.

<sup>32</sup>Hulbert, op. cit., p. 60.

<sup>33</sup>Newman and Logan, op. cit., p. 418.

<sup>34</sup>Mauser and Schwartz, op. cit., p. 48.

incorporated business. If the corporation is a closed or family corporation, there is usually considerable wealth held within the family that can be used as equity capital.

#### Ability to Borrow

The ability of an individual proprietorship to borrow is ordinarily limited or restricted by the size of the owner's personal assets. This is because creditors hesitate to increase their interest in a business out of proportion with that of the proprietor.<sup>35</sup>

Partnerships are normally able to attract more loan capital than can an individual proprietorship. The reasons for this are that creditors can consider the total assets of the firm and the personal property of all partners as security.

In general, corporations and cooperatives are able to borrow more readily than an unincorporated business. There are several reasons for this, notably—the ease of transferring ownership and the permanent life of the corporate form of ownership.

#### Specialization of Management

There is typically a lack of specialized management found in the individual proprietor-type of business. The owner must serve in many capacities and in doing so, some phases of the business operation may suffer.<sup>36</sup>

One of the advantages of a partnership over the individual

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<sup>35</sup>Newman and Logan, loc. cit.

<sup>36</sup>Mauser and Schwartz, op. cit., p. 46.

proprietorship is that of additional managerial skill. Many times, the various partners are able to pool their various skills and abilities into a smoothly operating, highly efficient business enterprise.<sup>37</sup>

In general, businesses operating under the corporate form of ownership are usually able to acquire and use specialized personnel to a greater extent than can unincorporated businesses.<sup>38</sup> The owners of corporations and cooperatives are unable and are normally not qualified to participate in the active management of the business. However, there are exceptions in that in some family corporations, the stockholders do an admirable job of managing and operating the business.

#### Flexibility of Movement

Individual proprietorships and partnerships are both free to operate their businesses in any state in the union. The Federal Constitution (Art. IV, Sec. 2) guarantees the right of an individual to carry on his business in any state with the same freedom as a citizen of that state.

Businesses using the corporate form of ownership are normally relatively free to move much as they please. However, they must file information and pay foreign corporation fees and taxes in the state or states within which they expect to do business.<sup>39</sup>

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<sup>37</sup>Ibid., p. 48.

<sup>38</sup>General Statutes of Kansas, 1949, p. 501.

<sup>39</sup>Bonneville and Dewey, op. cit., p. 68.

### Affects of Owner Reputation

The personal reputation of the owners of partnerships or individual proprietorships is very closely connected to the business. Just the opposite is true so far as corporations and cooperatives are concerned. Instead, business reputation depends mainly upon the honesty and integrity of the board of directors and the management. However, in closely held corporations where the owners, directors, and officers may be the same persons, there is a direct tie between personal and business reputation.

### Secrecy of Operation

The individual proprietorship is the only type of ownership in which trade secrets may be kept confidential and if the business is large enough to warrant many subdivisions, it may be difficult to maintain secrecy even when using this type of business organization. It is even more difficult to keep trade secrets when organized in any of the other three ways of doing business since many people have access to business records.

### Business Incentive

Partnerships and individual proprietorships both supply a maximum incentive for business success. In the individual proprietorship, all profits accrue to the owner. Therefore, it is to his personal advantage to work hard, make careful decisions and to expand operations, if possible. The same can be said of partnerships because what is beneficial to the

partnership is also obviously beneficial to each partner.<sup>40</sup>

There could easily be a lack of business incentive where the incorporated business is concerned due to the impersonal nature of many such organizations. One thing that is common in bringing about greater incentive is that of greater remuneration or bonuses sufficient to spur the managers and employees to do their utmost to increase business profits.

#### Personal Element

In some types of business, people like to deal directly with the owners. Maximum personal element is found with individual proprietorships and with partnerships, if they are not too big.

There can also be considerable personal element found in small family corporations but in large corporations or branches of large corporations, there is very little of the personal element.

The case of cooperatives presents still a different situation since the owners are also the users. Perhaps it could be said that cooperatives, at least the local cooperatives, are completely integrated by the personal element with the management being the tie that holds the owners together in their common interests.

#### Management Control

Partnerships are subject to divided control or authority and therefore are clumsy from the administrative viewpoint.<sup>41</sup> This is

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<sup>40</sup>Mauser and Schwartz, op. cit., p. 419.

<sup>41</sup>Newman and Logan, op. cit., p. 419.

not true where management control is centralized as in the individual proprietorship, corporations and cooperatives. The fact that there is a single owner or single governing body to make decisions, enables a company to act with unity.<sup>42</sup>

#### Business Identity

Individual proprietorships and partnerships have no business identity as such. However, all business using the corporate form of ownership are considered to be legal entities in the eyes of the law. They are identified as being separated from the lives of their owners.

#### Business Restrictions

Unincorporated businesses may enter into nearly any field desired. If a partnership wishes to add another line of products to that already offered the public, there are no restrictions.

Corporations and cooperatives are permitted to engage only in the activities specifically stated or implied in their charters. If a corporation wishes to make a major change or addition to its operation, an amendment to the corporate charter might be required. This would depend on the wording of the charter itself. While amending a corporate charter is relatively simple, state approval must be secured and the proper fees paid.<sup>43</sup>

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<sup>42</sup>Ibid., p. 421.

<sup>43</sup>General Statutes of Kansas, 1949, p. 565.

### Ease of Ownership Transfer

The difficulty experienced in disposing of an entire business is one of the disadvantages of individual proprietorships. Even the disposition of one member's share in a partnership may often be hard to bring about. Ownership transfer normally involves several thousand dollars, sometimes much more, which is very difficult for many people to obtain.<sup>44</sup>

A very important advantage which accrues to the corporation and cooperative is the ease with which ownership may be transferred.<sup>45</sup> In the case of giant corporations which have their stock listed with a stock exchange, it is very easy for a stockholder to sell or buy additional stock. For those situations where the corporation is small, or in the case of a local cooperative, the stock would normally be bought and sold within a relatively small area. The availability of buyers or sellers would be limited but stock would normally be easier to dispose of than the entire business. Non-stock cooperatives may or may not allow members to transfer their memberships to other people.

### Interest of Owners and Employees

The owners and employees of an individual proprietorship or partnership normally exhibit much personal interest in the operation of a business. Of course, as a business gets larger, the personal interest of employees may lag.

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<sup>44</sup>Mauser and Schwartz, op. cit., p. 54.

<sup>45</sup>General Statutes of Kansas, 1949, pp. 543 and 599.



Except in the case of the small family or closed corporations, the owners of corporations take little interest in the management of the business. As a result, corporations will at times come under the control of inefficient leaders. When there is absentee ownership, employees may tend to feel less loyalty toward the business than they do to an individual proprietorship or partnership.<sup>46</sup>

Where cooperatives are concerned, there is a rather high degree of owner interest. This could be attributed to the fact that at least a part of any savings will be received by the owners in the form of a patronage refund. Also, the very fact that cooperative owners are the users contributes greatly toward owner interest in the business.

#### General

It is important to understand that the characteristics just discussed may be an advantage under some circumstances and a disadvantage under others as concerns each method of doing business. In addition, it is well to remember that some of these characteristics come about by way of the law and some of them are by-products of a distinct type of legal organization (see Table 9). The fact that a part of these characteristics are the result of legislative action leaves them open to controversy and is the cause of much disagreement and ill-feeling between businesses.

A particular business characteristic may be considered an advantage or a disadvantage, depending upon whether it is looked at from a personal

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<sup>46</sup>Mauser and Schwartz, op. cit., p. 56.

or business point of view. When considered from the business or competitive side, personal advantages may reverse themselves and become disadvantages. The next section of this paper will concern itself with this particular aspect of the problem.

TABLE 9

BUSINESS CHARACTERISTICS WHICH RESULT FROM LEGISLATIVE ACTION OR ARE BY-PRODUCTS OF LEGAL ORGANIZATION

Characteristic	Legislative Action	By-product of Legal Organization
Rights of owners . . . . .	X	
Legal formalities imposed. . . . .	X	
Ability to take action as needed . . . . .		X
Special taxes. . . . .	X	
Special reports. . . . .	X	
State income taxation. . . . .	X	
Federal income taxation. . . . .	X	
Property taxes . . . . .	X	
Owner liability for business debts . . . . .	X	
Profit disposition . . . . .	X	
Length of life . . . . .	X	
Size of equity capital . . . . .		X
Ability to borrow. . . . .		X
Specialization of management . . . . .		X
Flexibility of movement. . . . .	X	
Affects of owner's reputation. . . . .		X
Secrecy of operation . . . . .		X
Business incentive . . . . .		X
Personal element . . . . .		X
Management control . . . . .		X
Business identity. . . . .	X	
Business restriction . . . . .	X	
Ease of ownership transfer . . . . .	X	
Interest of owners and employees . . . . .		X

## CHAPTER IV

### ADVANTAGES AND DISADVANTAGES FOUND WITHIN THE TYPES OF LEGAL ORGANIZATION AS VIEWED FROM A COMPETITIVE STANDPOINT

The analysis of business characteristics as to whether they are advantages or disadvantages from a competitive standpoint is not altogether objective. A great deal depends upon the abilities of the management. Also, the size of the business is going to play an important part in the determination of whether a certain characteristic is an advantage or a disadvantage. For example, consider a two man partnership as opposed to a 40 man partnership when it comes to making rapid management decisions. The ability to take action as needed is "money in the pocket" and a 40 man partnership could very well be at a distinct disadvantage since so many personnel must be satisfied.

As far as this paper is concerned, management ability and effectiveness will be considered excellent for all types of operations. In order to arrive at a logical conclusion when considering such items as State and Federal taxation, special taxes, special reports and others, an elevator operation of definite size must be established. With this thought in mind, an elevator with a business volume of \$1 million will be used in the observations made. Expenses will be considered equal to \$900,000, leaving a net of \$100,000 from which taxes, dividends and refunds will be paid. All four types of legal organization will be used, an individual proprietorship, a partnership consisting of four partners, a corporation with 10 stockholders and a cooperative with 100 members.

## Rights of Owners

Is there a competitive advantage accruing to one particular type of business organization when considered from the standpoint of owner rights? The owner or stockholder in a corporation or cooperative may feel that he personally has little to say about the operation of the business. However, if equal management ability is assumed, there would be little, if any, competitive advantage accruing to the individual proprietorship or partnership due to this particular characteristic.

## Legal Formalities Imposed

It is said that much "red tape" is found when commencing or ceasing business as a corporation or cooperative. When considered as either a competitive advantage or disadvantage, this same red tape amounts to very little. In fact, the incorporated business, as well as the owners, may find itself in a much more desirable position upon either commencing or ceasing business than would a like individual proprietorship or partnership. From the standpoint of the owners, the fact that an incorporated business is considered a legal entity could make situations such as law suits much easier to settle. With this thought in mind, the legal formalities with which an incorporated business must contend could very well be considered an advantage.

## Ability to Take Action as Needed

Any business which has centralized authority will be able to take rapid action to meet situations as they arise. Partnerships are considered

to be more clumsy from the administrative point of view. This depends upon the number of partners and the conditions under which a partner may withdraw. The threat of dissolution is never good for a business, therefore, care would need to be taken to insure business continuity as nearly as possible. It is apparent that a partnership could be at a competitive disadvantage when it comes to making decisions and taking prompt action, especially if there are many partners. However, the four member partnership being used in this paper would probably be at little disadvantage.

#### Owner Liability for Business Debts

Where this point is concerned, corporations and cooperatives both have a competitive advantage over the other two forms of doing business. The knowledge of business debt liability may prevent the owners of an unincorporated business from borrowing in order to make needed expansion or improvement. However, the board of directors of an incorporated business would not have this problem as individuals and so would not hesitate in making a decision to expand operations.

#### Profit or Net Income Disposition

Twenty years ago, the individual proprietorship and partnership undoubtedly had a competitive advantage where profit disposition was concerned. This was because close attention to business would result in direct gain to the owners. On the other hand, the impersonal nature of a corporation sometimes resulted in lack of incentive to do a top notch job. However, when the highly competitive nature of today's world

is considered, it would seem that disposition methods and amounts of net income reverting to the business may have considerable to do with success in the grain elevator business. When the amounts of net income available for reinvestment in the business are compared among the four types of legal organization, it is easy to see that with a given amount of net income a cooperative has a definite competitive advantage.

#### Length of Life

This factor undoubtedly gives a competitive advantage to the corporation and the cooperative. Unlimited life certainly puts a business organized along these lines in a more favorable position when it comes to borrowing large sums of money. A more stable business is always an asset. The limited life found with individual proprietorships and partnerships is one of the main disadvantages to operating as an unincorporated business. The partnership is considered least permanent due to the ease of dissolution. This in turn may prevent borrowing large amounts of capital for long terms on the general credit of the business.

#### Size of Equity Capital

The individual proprietorship is normally at a distinct disadvantage when it comes to providing equity capital. This is true since equity capital is limited to the owner's assets, as a general rule.

Partnerships will normally have more equity capital available because two or more people should be able to invest more money in a business than just an individual. Thus, the partnership has an advantage when compared to the individual proprietorship.

Corporations and cooperatives can usually provide a great deal more equity capital through the sale of stock, or memberships in the case of a non-stock cooperative, than can an unincorporated business.

In the case of small corporations or family corporations, there will generally be considerable wealth held among the stockholders that can be used as equity capital.

#### Ability to Borrow

Corporations and cooperatives are normally going to be able to borrow greater sums of money than is true in the case of unincorporated grain operations. The fact that there is unlimited life, ease of ownership transfer (except in the case of some membership or non-stock cooperatives), and limited liability of owners are major contributing factors. Thus giving a definite competitive advantage to the incorporated business.

Unincorporated businesses are limited to the owners assets as collateral for borrowed money and cannot use the points in the above paragraph which accrue to the incorporated business.

#### Specialization of Management

This is one of the major disadvantages to the individual proprietorship. As the operation expands, the owner finds himself pulled in many directions and so may do a mediocre job in several areas of his business operation. This will be true of a good manager and unless he is willing to delegate responsibility to other competent personnel, the business will suffer.

Partnerships have the advantage of more personnel with additional skills at the managerial level and so may specialize in various fields.

Corporations and cooperatives have the greatest competitive advantage when considering this characteristic, because competent managers can be hired to do the job. The importance of competent managers cannot be overexaggerated as evidenced by the large number of business failures which have been attributed to this one particular fault. Many small elevator businesses over the state of Kansas are in financial trouble because of the inability or unwillingness of the owners to pay for good specialized management.

#### Flexibility of Movement

The unincorporated business can move freely from state to state. This is also normally true for corporations and cooperatives but they must abide by the corporate laws of the state within which they intend to do business. While it may take some time to file the necessary information and pay the required fees in order to operate in a neighboring state, the legal form of business organization to be used will not generally be a deterring factor.

#### Effects of Owner's Reputation

The personal reputations of the owners of individual proprietorships, partnerships and small corporations are definitely linked to the success of the business. This factor could put these businesses to a disadvantage when compared to a large corporation or a cooperative where the owners are normally not the operators of the business. The business



reputation of the board of directors and management is of primary importance in businesses which are incorporated.

#### Secrecy of Operation

So far as secrecy of operation is concerned in the grain elevator business, there appears to be little if any competitive advantage accruing to any one of the various forms of legal business organization. While it is true that an individual owner could certainly keep business methods to himself, it would take an exceptional manager to overcome the advantages of specialized management found in large corporations.

#### Personal Element

The personal element factor between owners and users may or may not be important to the grain elevator business. This is partially dependent upon the size of the business. A small business using any of the four types of legal organization would have considerable personal element involved but this would have a tendency to decrease as the business increased in size, with the possible exception of cooperatives. Cooperatives will have a tendency to retain this personal element at the local level regardless of size. This is due to the complete integration found in the makeup of cooperatives where the owners are also the users.

#### Management Control

Very little needs to be said regarding possible advantages accruing to one form of organization over another so far as management control is concerned. Any business which has central authority can act with greater

unity than one which must satisfy the whims of several people. This may give a disadvantage to the partnership, depending on the number of partners involved.

#### Business Identity

Only the incorporated organization has a business identity in the eyes of the law. This is a definite advantage to the corporation and cooperative because the business is treated as an individual and is separate from the personal lives of the owners.

#### Business Restrictions

It is normally thought by many people that an incorporated business is restricted in the type and kind of products and service offered the public. While it is true that a corporate charter may have to be amended, state approved and certain fees paid, this is not something that would restrict incorporated businesses from a competitive point of view. So their appears to be little competitive advantage accruing to any of the different types of business organization.

#### Ease of Ownership Transfer

This is an advantage found in the incorporated business. The ease with which ownership can be transferred through the sale of stock is a competitive advantage if a corporation needed additional capital and did not wish to borrow, or could not borrow sufficient capital to meet the needs of the business. A stock cooperative would be in a similar situation.

Unincorporated businesses and membership cooperatives cannot transfer ownership so easily and therefore find themselves at a disadvantage.

#### Interest of Owners and Employees

As the business gets larger, employee interest may lag no matter what type of legal organization is used. But when considering owner interest, the corporation is at a decided disadvantage. Here again, as in former instances, this is dependent upon the number of stockholders. The greater the number of stockholders, the less will be the personal interest of owners in their own business. A corporation with only ten stockholders would retain much owner interest.

Unincorporated business owners will normally show the greatest interest in the business from the standpoint of management and operation.

Cooperatives are unique since the owners are also the users of the business. Since this is the case, owner interest should remain fairly stable, regardless of size.

#### Special Reports and Special Taxes

As has been mentioned previously, corporations and cooperatives must make special reports each year. While these reports are time consuming, they do not constitute a real disadvantage from the competitive point of view.

The same is true of the various special taxes which must be paid. These fees and taxes are so low that the amount of money involved is certainly not important to going grain elevator businesses. From the

competitive standpoint, little if any advantage will accrue to any of the types of legal organization.

#### Property Taxes

All personal and real property is subject to a property tax. Since this is true, there would seem to be no advantage accruing to any one of the four ways of organizing a business.

#### Federal Income Taxation

The problem of equitable income taxation among the four types of business organization has long been a source of irritation resulting in many bitter court fights. When considering legal organization from the taxation standpoint, there is a definite competitive advantage going to the cooperative form of doing business. There is also some advantage going to the partnership. The individual proprietorship is at the greatest disadvantage.

This opinion is not shared by all the owners and managers of grain elevator businesses. Upon talking to various people in the grain business, it was found that non-cooperative personnel felt the present tax status of cooperatives gave them a real competitive advantage. This attitude was also found at the bank for cooperatives and at one of the stronger local cooperatives in Kansas.

However, this was not the case with personnel of regional cooperatives. One individual said that there is no prime advantage accruing to cooperatives

through present tax laws.<sup>1</sup> Another person indicated that he felt co-operatives had no tax advantage over individual proprietorships or partnerships but did have some advantage over corporations to the extent that farmers are in a lower income tax bracket than corporations.<sup>2</sup> This indicates that the graduated income tax scale used for individuals is the real reason for any advantage and the present tax status of co-operatives.

In order to make a comparison of Federal income tax paid out of a specific amount of net income by each type of business, a hypothetical situation must be assumed which indicates the same dollar volume of business, the same total expenses and the same net income or margin after all allowable deductions (see Table 10).

In order to prevent overgeneralizing from Table 10 and the following paragraphs, it should be understood that a true comparison of the tax liabilities according to the form of business organization is very complicated and all the variables within each form of business cannot be explained here. However, all individual taxes are computed using the tax rate schedule for joint returns. In addition, the amount of tax due the Federal government from dividends and patronage refund income is figured at the lowest rate on the tax schedule.

It is recognized that comparisons of the individual proprietorship, partnership and cooperative are apt to be misleading because tax rates on individual incomes of different sizes are actually being compared rather

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<sup>1</sup>Interview with Harold Hamil, Consumers Cooperative Association, July 1962.

<sup>2</sup>Interview with Glenn Fox, Consumers Marketing Association, July 1962.

TABLE 10

FEDERAL INCOME TAXES ON BUSINESS<sup>a</sup>

Items	John Doe Individual	Brown & Smith Partnership	John Mfg. Co. Corporation	Farmers Inc. Cooperative Corporation
	Single Pro- prietorship	4 Partners	10 Stock- holders	100 Members
Sales	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Expenses	900,000	900,000	900,000	900,000
Net margin	100,000	100,000	100,000	100,000
Federal Income Taxes Paid				
Single Proprietorship				
By the business	000,000			
By the owner	53,640			
Partnership				
By the business		000,000		
By the 4 partners		28,920		
Corporation				
By the corporation			41,500	
By the 10 stockholders on dividends received			3,900	
Cooperative Corporation				
By the cooperative				000,000
By the 100 members on patronage refunds received				20,000
Total Federal Income Taxes Paid	53,640	28,920	45,400	20,000
Percent of Net Margins Paid in Federal Income Taxes	53%	29%	45%	20%

<sup>a</sup>Adapted from H. H. Hulbert, American Cooperation—1957, p. 115.

than taxes on these three kinds of business organization. This is true and yet it can be considered a valid comparison because the business itself, in each case, gains its identity from the people who own it. The capital left after taxes is a direct result of the tax, regardless of the tax bracket.

Table 10 points out clearly that out of \$100,000 net income, John Doe will pay \$53,640 in Federal income taxes.

In the case of the four-man partnership, equal division of profits is assumed and each partner will be liable for taxes on \$25,000. At current tax rates each partner would pay \$7,230 and altogether, the four partners would pay \$28,920, or approximately 29% of the net income, to the Federal government.

Under the latest laws relating to Federal taxation of corporate income, \$41,500 would be paid directly as income tax by the John Manufacturing Company. This leaves \$58,500 which the corporation can use to increase operating capital, add to reserves or pay dividends to stockholders. Hulbert has indicated that many corporations pay out approximately 35% of their net profits after taxes to the stockholders as cash dividends.<sup>3</sup> This would amount to approximately \$20,000 or \$2,000 to each stockholder. After making allowance for the \$50 dividend credit allowed by the tax laws, each stockholder would pay \$390 as income tax. This would make a total of \$3,900 in addition to the \$41,500 to be paid from corporate income as Federal tax.

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<sup>3</sup> Helim H. Hulbert, "Net Margins, Taxes, and Public Relations," American Cooperation--1957, (Washington: American Institute of Cooperation, 1957), p. 116.

The cooperative in the example has 100 members and all net margins have been allocated to the members, who were the sole users of the business. Since the cooperative is under an obligation to allocate all net margins to the members, there is no Federal income tax liability. Each member is assumed to have received \$1,000 either in cash or as a qualified allocation upon which he must pay income tax. This would amount to \$200 each or a total of \$20,000 to be paid as Federal income tax.

By way of general analysis it appears that individual proprietors will pay the greatest amount of Federal income tax from a given amount of net income and the net margin of a cooperative is liable for the least amount.

#### State Income Taxation

When the various amounts of State income taxes paid by all four types of business organization are compared, there is a competitive advantage found with the cooperative corporation (see Table 11). The cooperative as a business pays no tax but the partnership will pay \$2,824, the individual proprietorship pays \$1,983 while the corporation pays \$1,872.

Further analysis of Table 11 will show that after Federal and State taxes, the payment of dividends and patronage refunds (the bulk of which will remain in the cooperative business), a cooperative and the partnership have a distinct financial advantage over the individual proprietorship or a corporation.



TABLE 11

## AVAILABLE CAPITAL AFTER TAXATION, REFUNDS AND DIVIDENDS

Items	Individual Proprietorship	Partnership 4-Partners	Corporation 10 Stockholders	Cooperative Corp. 100 Members
Sales	\$1,000,000	\$1,000,000	\$1,000,000	\$1,000,000
Minus Expenses	<u>900,000</u>	<u>900,000</u>	<u>900,000</u>	<u>900,000</u>
Net Margin	\$100,000	\$100,000	\$100,000	\$100,000
Federal Taxes	53,640	28,920	41,500	
State Taxes	2,259	3,149	2,047	
Dividends			20,000	
Patronage Refunds				20,000
Total Taxes, Refunds and Dividends	<u>55,899</u>	<u>32,069</u>	<u>63,547</u>	<u>20,000</u>
Available Capital for Reinvestment	44,101	67,931	36,453	80,000

## General

The decision as to whether differences among the various types of legal business organization yield a competitive advantage is subject to many variables. A different criteria than that used in this paper could very well indicate different answers. For example, as the number of owners or stockholders of a business change, the degree of competitive advantage may increase or decrease.

As the business grows, other changes take place within the organization such as ability to borrow larger sums of money, the addition of specialized personnel, taxes may go up or down, management control may shift and there may be other changes in addition to those mentioned.

Table 12 is meant to show how the four ways of doing business compare with each other when considered in the light of the business characteristics listed. A sliding scale running from zero to ten was used and each value arrived at after considering the information gathered concerning each characteristic. For example, under Federal income taxation, partnerships received a seven and the corporation a four thus indicating a competitive advantage going to the partnership.

TABLE 12

ADVANTAGE COMPARISON OF BUSINESS CHARACTERISTICS AS VIEWED FROM THE COMPETITIVE STANDPOINT<sup>a</sup>

Item	Individual	Partnership	Corporation	100 Member Cooperative	
	Proprietorship	4 Members	10 Stockholders	Exempt	Non-exempt
Rights of Owners	0	0	0	0	0
Legal Formalities	0	0	2	2	2
Ability to take Action	10	0	8	8	8
Owner Liability	0	5	10	10	10
Net Income Disposition	3	7	0	10	9
Length of Life	0	0	10	10	10
Size of Equity Capital	0	3	10	10	10
Ability to Borrow	0	3	10	10	10
Specialization of Management	0	5	10	9	9
Flexibility of Movement	0	0	0	0	0
Effects of Owner Reputation	0	1	10	10	10
Secrecy of Operation	1	0	0	0	0
Personal Element	10	7	0	10	10
Management Control	10	0	9	9	9
Business Identity	0	0	10	10	10
Business Restrictions	0	0	0	0	0
Ease of Ownership Transfer	0	2	10	9	9
Owner-Employee Interest	10	10	8	7	7
Special Reports and Taxes	1	0	0	0	0
Federal Income Taxation	0	7	4	10	8
State Income Taxation	3	0	5	10	8

<sup>a</sup>In order to show comparatively how each business characteristic affects the competitive strength of the business as compared to other types of organization, the following sliding scale was used:

0 ← —————→ 10  
 No Competitive Advantage                      Maximum Competitive Advantage

## CHAPTER V

### THE CAPITAL STRUCTURE AS AFFECTED BY COMPETITIVE ADVANTAGES AND DISADVANTAGES

What effect might a competitive advantage have upon the capital structure of a partnership? A corporation? It can be said with few reservations that any competitive advantage, or disadvantage, will affect the capital structure of a grain elevator business, regardless of the type of legal organization. This effect may be direct or it may come about indirectly through the subtle effects of a business characteristic.

There is considerable interdependence found within the competitive advantages and disadvantages. For example, business identity, legal formalities, management control, and ability to take action are very closely related and there are others which could be included also.

For the most part, competitive advantages or disadvantages will affect capital structure in a fairly direct manner. In only one characteristic, that is the personal element involved, is there evidence of true indirect effects on capital structure. Upon interviewing a small independent grain elevator owner, it was found that he believed farmers would bring their business to him rather than to a cooperative because of what he termed "sympathetic tax."<sup>1</sup> In other words, his business had just as much personal element involved as did the farmers business and

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<sup>1</sup>Interview with Ralph Dockstader, individual grain elevator owner, July 1962.

since the farmers know the individual grain elevator operator pays taxes on the same basis as they do, there is a tendency on the part of the farmers to bring their business to the individual proprietor rather than to the cooperative.

In this case, the amount of net earnings brought on as a result of tax sympathy could conceivably reduce the amount of borrowed capital necessary for business.

### Business Identity

As has all ready been indicated, unincorporated businesses are not recognized as having a business identity. This characteristic is the basic underlying advantage to being an incorporated business. The fact that a corporation has an identity separate from its owners brings about the majority of the advantages and disadvantages. These in turn have a profound effect upon the growth and survival of a grain elevator business. The reason for the effect being attributed to the influence they have upon capital structure.

### Legal Formalities

When a business chooses to go through the problems involved with the incorporating process, it will generally be open to new sources of capital which are closed to unincorporated businesses. The individual proprietorship and partnership cannot sell stocks or bonds. Since this is true they must develop a capital structure around net business income and borrowed money along with the original ownership capital. There are instances where there is considerable monetary reserve in the family which

was built up during the years before income taxes were a reality.<sup>2</sup> However, these cases are undoubtedly fewer than are those who must depend on net income and borrowed capital for business use.

On the other hand, large incorporated businesses can sell stocks and bonds. If the organization is large, it may have its securities listed with the Securities Exchange. Small corporations will have little opportunity to sell bonds and must rely on local buyers for any new stock sales which will limit the amount of stock that can be sold. The point is, the act of incorporating opens the doors to new owners and creditors.

#### Ability to Take Action and Management Control

These two characteristics are very close in their relationship to the financial structure of a business. The ability to take immediate action may mean the difference between a profit and a loss, or greater profit. Therefore, it is evident that a successful business must have management control that is centralized in a manner that will allow freedom for decision making. The individual proprietor has the greatest freedom of action and can take advantage of the highest markets for his grain. This fact may be responsible for bringing about greater profit which he wouldn't have if a board of directors or several partners had to be consulted and satisfied.

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<sup>2</sup>Loc. cit.

Owner Liability, Length of Life, and Ability  
to Borrow

Owner liability and length of life are very closely tied to the ability of a business to borrow money. As indicated earlier, creditor or borrowed capital is an essential part of the financial structure of all successful and growing businesses. The amount of money a business can or will borrow is limited by two things. First, the judgment of the owner or board of directors, and second, the loan policies of the credit agencies used.

If a business is going to borrow money, a reasonable amount of equity capital to creditor capital should be maintained. It has been suggested that a ratio of two dollars of equity for each dollar of creditor capital is a sound rule of financing.<sup>3</sup> This same rule has been echoed by the manager of a successful cooperative in Northcentral Kansas.<sup>4</sup> Normally, individual proprietorships and partnerships are going to be at a disadvantage since their equity base is generally going to be smaller than that of an incorporated business.

Another important point partnerships must consider is that of being able to show the relative share of the net worth belonging to each partner on a year to year basis. The reason for this is that partnerships, as a form of legal organization, are not stable and if a partner withdrew or died, the original partnership is dissolved and a

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<sup>3</sup>Milton L. Mamel, Kansas Farmer Cooperatives III, Financing, p. 6.

<sup>4</sup>Interview with John Schulte, General Manager Co-op Elevator, Beloit, Kansas, July 1962.

new one formed. Therefore, if each partner's share of the net worth is known arrangements can be made for other partners to purchase his part of the business or to take in a new partner. In this way, there is no interruption of business and the credit rating of the business is unimpaired.

Even though an unincorporated business has as much net worth as a corporation, it is unlikely that they could borrow as much capital as the corporation. The reasons are the limited length of life and owner liability for business debts. The corporated form of business is very stable since it does have a permanent life and the owners are not liable for business debts. Therefore, even though there are some very successful individual proprietorships and partnerships, they may be at a distinct disadvantage when it comes to obtaining a maximum amount of loan capital.

Upon consideration of the various types of legal organization and the ability of each to acquire borrowed money, the cooperative appears to have the greatest advantage. This is because of the ready availability of funds from the Bank for Cooperatives.

The first time a cooperative acquires a large loan, such as a facility loan, it must go through the process of loan application, appraisal of facilities, analysis of the business statement of the cooperative and be able to provide a first mortgage as collateral. In addition, the loan must be approved by a two-thirds vote of all the stockholders. This last point is sometimes waived by the by-laws of the organization. In this case, the board of directors is empowered to act for the members in borrowing money.

After the first time a cooperative has borrowed from the Bank for



Cooperatives, it is quite a simple process to obtain future loans. This is assuming the cooperative has a good reputation for repayment of loans. Since approximately 90 per cent of the cooperatives in the Ninth Farm Credit District have had loans from the Wichita Bank for Cooperatives, it is evident that only a small number of cooperatives have not used the available facilities.<sup>5</sup>

Cooperatives have a tendency to use the Bank for Cooperatives for their larger loans, such as facility and commodity, and commercial banks for operating and seasonal loans. While interest rates will vary slightly from place to place, it is not uncommon that commercial banks make operating loans at the same rate as the Bank for Cooperatives.<sup>6</sup>

In discussing the availability of money to cooperatives, it was found that there is some feeling that since the source of a cooperatives money market is with the farmer, it may be at a disadvantage to a corporation, depending on the size.<sup>7</sup> However, so far as successful cooperatives on the local level are concerned, there is no shortage of loan capital. So it can be said that there may be instances when the Bank for Cooperatives is a competitive advantage to the small cooperative but there is no evidence to that effect concerning large cooperatives.

Some indications of bitterness toward the Bank for Cooperatives

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<sup>5</sup> Interview with Gilbert Terpening, Bank for Cooperatives, Wichita, Kansas, July 1962.

<sup>6</sup> Schulte, loc. cit.

<sup>7</sup> Fox, loc. cit.

have been noted. Two reasons lay behind this feeling, first, non-cooperative people do not have a source of money similar to that available to cooperatives, and second, the Bank for Cooperatives may have a tendency to make appraisals which are too high, thus allowing a great deal of money to be borrowed easily.<sup>8</sup> Even though there is some bitterness apparent on the part of non-cooperatives, there are no indications of a shortage of loan capital to these businesses. Personal interviews with personnel of unincorporated grain elevator businesses show that securing loan capital should be no great problem to any efficient and successful organization.<sup>9</sup> However, as indicated earlier, cooperatives and corporations will have a competitive advantage when it comes to raising a maximum amount of loan capital.

#### Specialized Management

Having experienced and efficient management of all departments is of the utmost importance to grain elevator businesses. This is a competitive advantage generally thought of as accruing to corporations and some instances, cooperatives. However, in the past few years cooperatives have made great strides toward the use of specialized management, as have partnerships and in some cases, the individual proprietorship.

Specialized management will affect capital structure both directly and indirectly. This characteristic normally brings about increased earnings through greater efficiency. This, in turn, could conceivably

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<sup>8</sup>Interview with Dean Evans, Evans Grain Co., Salina, Kansas, July 1963.

<sup>9</sup>Loc. cit.

allow operations with less borrowed money. On the other hand, if a large amount of borrowed capital is desired, this increased efficiency can be noted upon analysis of the business statement and cause greater amounts of loan capital to be made available. Thus, the capital structure of a business can be materially affected by the availability of specialized management.

#### Effects of Owner Reputation

Capital structure is affected by this characteristic only if the owners are directly connected with the operation of the business. With this thought in mind, it can be said that the capital structure of co-operatives and corporations (excluding small family corporations) is not affected in any way by the personal reputation of the owners.

However, in a business where the owner or owners are directly connected with the business operation, personal reputations will have much to do with the success of the business. For example, rumors of dishonesty concerning the owner of a grain elevator owned by an individual may have the effect of a reduction in the volume of business, thus reducing net income.

Further effects may be felt when this particular owner attempts to borrow additional capital. He may find his money supply cut down or even eliminated altogether. It is evident that a good personal reputation is high on the "must" list of small grain elevator businesses, specifically, unincorporated organizations and small family corporations.

### Ease of Ownership Transfer

While this characteristic is considered a competitive advantage found in corporations, its effect on the capital structure of small grain elevator businesses is not expected to be of great importance. Ownership stock is normally held quite closely and the sale of this stock to outsiders could have the effect of the loss of control by the organizers of the business. So even though common stock may be issued from time to time, it will normally be purchased by the owners. Regardless of whether the stock was purchased by owners or outsiders, the relative ease with which the stock might be sold assures additional capital for use in the business.

Stock cooperatives do not have the prerogative of selling stock to either owners or people who are not producers. They must keep their stock within the producers and users of the organization. So there is a limiting factor so far as ease of ownership transfer helping the capital structure.

### Interest of Owners and Employees

It has been said that a business grows because of the "vision of the leadership and employees."<sup>10</sup> The grain elevator that has leadership and employees who have the ability to see ahead and be prepared to take advantage of opportunities as they arise is certainly going to be ahead of the organization which drifts with the tide. This is true whether the leadership is vested in the owners or in a board of directors.

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<sup>10</sup>Fox, loc. cit.

So far as the owners are concerned, the effects of their interest on the capital structure will be felt only as long as they are directly involved in the business operation. The attitude and abilities of the leadership will directly affect the net earnings and the amount of loan capital available to the business. This is also true of the employees because the presence of an uninterested employee can and will cause loss of business, resulting in a reduction of net earnings.

In large corporations where owner interest is at a minimum, employee interest may drop off also. It is important that this interest be maintained so various methods are employed to encourage the worker to do a top notch job. One of the more common of these is that of a bonus for a job well done.

#### Size of Equity Capital

It has all ready been stated that unincorporated businesses will not normally have as much original equity capital as that found in incorporated businesses. Furthermore, if a ratio of equity capital to borrowed capital of about two to one is maintained, the individual proprietorship and partnership may be at a disadvantage to the other types of business organization from the standpoint of the availability of adequate amounts of loan capital.

Increases in equity capital, over the years, must come from reinvested net earnings, especially where the business is individually owned. This serves to bring home the point that one of the primary prerequisites for growth and survival is that of efficient management coupled with the ability to look into the future.

There has been much said and written concerning the continued rapid growth and expansion of cooperatives and corporations. This is done in one of three ways:

1. Merger.
2. New facilities.
3. Purchase of available facilities.

It is logical to assume that the larger the equity base, the more solidly entrenched a business will become. How large should this base be? Where will the capital come from with which to increase the equity base? The size of the equity base is not determined by any hard and fast rule. However, it is important to not expand beyond economical use of facilities. Government storage payments prompted grain elevator organizations to expand using upright storage. Now, many of these same grain elevators have empty storage bins which will yield no return on investment. One possible alternative would have been to have used a flat type of storage facility for at least a part of the expansion project. Then when the government storage payments run out, the facilities could be used for other purposes.

The accumulation of capital is one way by which new facilities could be financed. Due to the fact that all earnings after taxes belong to a corporation, there is an opportunity for the accumulation of large quantities of capital which can be used at any opportune time.

So far as cooperatives are concerned, the opportunity to build large reserves is not good. This is because patron-owners won't stand for the accumulation of large amounts of capital in reserves.<sup>11</sup> However,

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<sup>11</sup>Hamil, loc. cit.

if an expansion project is a good risk, the Bank for Cooperatives is available from which to borrow money. This loan can then be repaid from deferred patronage refunds. Even though corporations can accumulate reserves to a greater extent than can cooperatives, due to revolving fund capital, cooperatives can undoubtedly pay off loans in a shorter length of time. It is the writers belief that, over a period of time, there would be little difference in the total equity accumulation of a cooperative and a corporation. This is assuming equal opportunity for expansion and growth.

#### Profit or Net Income Disposition

What happens to net income? In the individual proprietorship and partnership, it goes to the owners to use as they see fit. The more net income available, the easier it is to purchase facilities, equipment and to meet the necessary expenses of operation. Greater amounts of net income will have a tendency to reduce the amount of borrowed capital. For example, one individual proprietor interviewed indicated that it was not necessary for him to borrow for working capital at all. He used net earnings for this purpose.<sup>12</sup>

In a corporation, the net income after taxes and dividends is available for use at the discretion of the board of directors. It can and will normally be used for debt retirement, build up of reserves and investment.

The board of directors of a cooperative has the same privilege

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<sup>12</sup>Dockstader, loc. cit.

as a corporate board of directors, when it comes to net income disposition. However, the capital structure of a cooperative will be affected differently than in a corporation. This is because of the fact that out of every dollar of net margin, the corporation must pay Federal and State income tax. Cooperatives are largely exempt from this tax, because of the manner in which income is defined. So, the greater amount of money available to the cooperative gives it quite an advantage when it comes to debt retirement. This fact serves to motivate greater expansion and development for cooperatives as compared to corporations or any other type of legal organization.

#### Federal and State Taxation

Possible inequality of taxation is one of the main bones of contention between the various types of legal organization. The amount of money left after taxes can and does have a serious effect on the ability of a grain elevator to grow and survive. If a business cannot show a profit, it is not reasonable to expect creditors to be generous with their loan capital nor can individuals and other companies be expected to invest in an organization which fails to make money for its owners.

Federal and State taxation affects capital structure in two ways that are immediately obvious, first, taxation reduces the amount of earnings available to plow back into the business, and second, a small equity base has the effect of limiting the amount of available loan capital. This sort of situation puts the most pressure on individual



proprietorships. Although it has all ready been shown that partnerships don't pay tax at as high a rate as do corporations, they cannot sell securities in the effort to raise capital. While a partnership could possibly come by additional funds by taking in more partners, this action might cause loss of control by the original owners.

On the other hand, corporations and stock cooperatives can sell common stock, preferred stock and in some instances will sell bonds. This increases the available capital by either a greater equity base or from investments by other individuals and companies. In addition, cooperatives have the use of the revolving fund as a part of their capital structure. It is recommended that the revolving fund make up 25 per cent of the capital structure. If so, this is money which allows decreases in the amounts necessary to borrow and in that from investment sources. Since the revolving fund is essentially "free money," there is no interest to pay on investment made from this source of capital. This kind of capital is also relatively tax free and this has the effect of providing extra money over and above that available from a corporation which has the same net margin (see Table 11).

The Revenue Act of 1962 has provided some changes in the treatment of revolving funds. There have been instances when non-cash allocations of patronage refunds were not taxed to patrons and were deductible by the cooperative. The 1962 Act provides specifically that cooperatives are not required to take patronage refunds paid in money, written qualified allocations, or other property, except non-qualified allocations, into account in determining taxable income. In addition, deductions can be made for non-qualified allocations when they are redeemed.

So far as the patron is concerned, these same amounts (to the extent not attributable to purchases for personal living expenses or capital items) are to be included as taxable income in the year received.

By way of definition, qualified written allocations are defined as including first, those which may be redeemed in cash within 90 days after being issued or second, allocations which the patron has consented to take into account at the stated dollar amounts as a part of gross income. In addition, the term "qualified written notice of allocation" does not include any written notice of allocation unless 20% or more of the amount of the refund or payment is paid in money or by qualified check.<sup>13</sup> Since this is the case, cooperatives must pay a 20% cash refund if they wish to exclude the entire patronage refund from taxable income.

Patron consent must be given in one of three forms: (1) consent in writing, (2) obtaining or retaining membership in the organization after such an organization has adopted a by-law to this effect, (3) if neither of the first two forms applied, the endorsing and cashing of a qualified check which is accompanied by written notice of allocation. The check must be cashed within 90 days after the payment date of the cooperative for patronage dividends in order for the non-cash allocation to be treated as a qualified allocation.<sup>14</sup>

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<sup>13</sup>United States Code, Congressional and Administrative News,  
87th Cong., 2nd Sess., 1962, Vol. I, p. 1237.

<sup>14</sup>United States Code, Congressional and Administrative News,  
87th Cong., 2nd Sess., 1962, Vol. II, p. 3418.

A qualified check is one which is paid as a part of a patronage refund to a patron who has not given consent in either of the first two forms mentioned above. A statement must be imprinted on the check stating that cashing the check constitutes consent of the payee to include in his gross income the stated dollar amount of the entire patronage refund which includes the non-cash allocation as well as the qualified check.

However, even though new laws spell out the tax treatment of patronage refunds in more detail, the writer feels that cooperatives which are going concerns will not be hindered in their growth and development. In fact, it may bring about a more desirable business relationship between types of business since all patronage refunds will be considered in computing taxable income either by the individual or the cooperative.

Payment of 20% of the patronage refund as cash will serve to put pressure on cooperatives just getting started or those with inefficient managers. But over all, it is evident that individual proprietorships, partnerships and corporations will have to pay closer attention to maintaining a proper balance between creditor, ownership, and investment capital than will cooperatives of comparable size. The problem of maintaining a capital structure which will allow a business to take advantage of the tax laws, not be consumed by high interest payments and still maintain a desirable level of ownership capital is of utmost importance.

## CHAPTER VI

### THE CAPITAL STRUCTURE OF GRAIN ELEVATOR BUSINESSES

Regardless of the type of legal organization used by a grain elevator business, it is imperative that an effective financial structure be employed if the business is to survive and grow. The most effective financial structure for an elevator will be that which most efficiently provides the total capital necessary for the operation of the business.

The capital structure of a business is made up of the entire liabilities and net worth side of the balance sheet. This includes all stock, bank loans, accounts and notes payable. In order for this structure to continuously meet the needs of the business, it must possess certain characteristics. These are as follows:<sup>1</sup>

1. Security and stability for the business--The financial structure of a business should be such that total capital needed to finance the assets will be secure over time.

2. Flexibility for adjusting to changing conditions--So that the total capital used by the business can be increased or decreased as desired for more efficient operations. It should permit adjustments in the relative amounts of capital provided by each method of financing.

3. Provision for business growth over time--Provision should be made for increases in total capitalization of the business over time as profitable expansion is warranted. The structure should provide for increases in capital to provide needed funds for increases in total assets without sacrifice of security or flexibility.

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<sup>1</sup>Phillips, op. cit., p. 219.

4. Consistency with the nature of the business operation--The financial structure should be consistent with the nature of the commercial operations of the business. If total assets vary seasonally and from month to month, the structure should permit similar variations in the total capital of the business.

5. Equitable distribution of the business risks among the owners--The risks of owning and operating the business should be placed with the residual owners and the risks should be distributed equitably. In the unincorporated business, special attention should be given the financial structure to insure meeting this point.

6. Investment security to the creditors of the business--Insure that the risks assumed by creditors of the business are limited to the amount leased to the business.

7. Systematic operation--The financial structure should operate systematically with a minimum of administrative supervision. Constant supervision is objectionable because the total capitalization plan of the business needs a good deal more permanence than it could possibly have if the financial structure required constant administrative supervision.

8. Optimum total capital for the business--The total quantity of capital available to the business should be just sufficient to finance the total assets which can be used most profitably. If there is over-capitalization, some of the capital will not be used effectively and the marginal productivity of the capital in the business will be reduced. Under-capitalization will result in capital rationing which results in low efficiency and profitability in the business.

9. Low cost financing--A combination and balance of financing methods should be used which will satisfy each of the above eight points and do it at least capital cost on suitable terms to the business. No method of financing should be used that adds more to total capital cost than some alternative method, unless it adds sufficiently to one or more of the first eight characteristics.

Usually the most suitable financial structure will consist of a balance of different financing methods. Each of these should contribute toward a particular part of the requirements needed in the capital structure.

## Raising Capital

There are actually four ultimate sources of capital to business whether operated as an individual proprietorship, partnership, corporation or cooperative. They are:<sup>2</sup>

1. The owner or owners of the business.
2. Net operating income.
3. Creditors.
4. Trade accounts.

The business owners contribute the basic capital to the organization. This fund is raised in various ways, some of which are transfers from personal to business accounts, sale of common stock, preferred stock, memberships, bonds and notes. Unincorporated businesses are limited to transfers from personal to business accounts but the incorporated business may use all the above mentioned methods. However, the membership type of cooperative would be unable to issue stock.

An important source of capital in nearly all elevator businesses is that of net operating income. It consists of undistributed capital, such as surplus and reserves, and allocated capital which is divided among the owners but kept in the business. Examples of this are certain kinds of stock and (in cooperatives) revolving fund capital.

Normally, owners do not draw all the annual net income from the business but leave part, or in some cases all of it, in the business operation. In the growing business, this means an increase in net worth, over time, and an increase in equity or total assets or both.

Net operating income also includes stock or other securities

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<sup>2</sup>Ibid., p. 221.

purchased out of earnings.

Creditor capital includes all that capital which has been leased to a business in return for an interest fee. This includes capital from banks, trusts, insurance companies, and other businesses plus individuals.

In the unincorporated business, this type of capital is generally limited to that obtained from mortgages and notes. It may be secured by general and personal assets, inventories, insurance policies and occasionally a prominent citizen will co-sign a note. Many times loans are unsecured, depending upon the reputation of the business owner or owners, the amount of capital desired and the length of time involved.

Incorporated businesses can use notes and mortgages plus the various kinds of securities. Examples of these are bonds, certificates of indebtedness, certain classes of preferred stock and building notes.

Trade accounts are another important source of capital. This makes up the very short term credit which is essential to grain elevator businesses and is composed of accounts payable, trade notes payable (money borrowed from wholesalers to finance inventories or accounts receivable), and sight drafts which are drawn on a wholesale buyer. In this case, the bill of lading is used as collateral for security.

#### The Capital Structure of Individual Proprietorships and Partnerships

When compared to an incorporated business, the capital structure of an unincorporated business is quite simple. This is due to the nature of this type of legal organization. The unincorporated business cannot

issue securities and therefore is limited to owners' savings and borrowed money when it comes to satisfying original capital needs.

How much loan capital should be used? The owner of this type of business must keep the unlimited liability disadvantage in mind when securing loans. However, the thoughts of having to pay off loans should not inhibit the use of this type of capital so long as it is profitable to the business.

Long term loans may be used effectively provided they are economically feasible and can be obtained on favorable terms.

Short term loans which can be repaid easily should be used to finance seasonal working capital needs. Trade accounts should be used to the extent that cash discounts are not lost. Also trade notes payable should be used so long as they are an economical source of capital. Close attention must be paid to the terms of all loans used by the business.

The amount of liability capital used by these types of businesses varies considerably. So far as the proportions of liability capital to total capital in the business is concerned, ownership capital and that accumulated from net operating proceeds can profitably make up from 40 to 80 per cent of the total capital in the business.<sup>3</sup> This ratio is dependent upon several factors among which is found the nature of the business, how long it has been operating and the amount of capital the owners have to invest in the business.

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<sup>3</sup>Ibid., p. 233.



## The Capital Structure of a Small Grain Elevator Corporation

There is considerable difference in the capital structure of small corporations when compared to the immense grain elevator corporations which have their securities listed with the Stock Exchange. Since this paper is concerned primarily with the smaller businesses, a capital structure which might be used by a small grain corporation will be discussed here.

In the capital structure of any corporation, a most important point is the relative proportions on common stock, preferred stock, capital reserves or surplus, bonds or other securities which may be used.

Since the common or ownership stock contains the voting control, the amount of ownership stock which is issued should be carefully considered. It has been suggested that common stock make up about 25 per cent of the total capitalization.<sup>4</sup> This figure can and will vary considerably but as the business increases its capital and reserves, the relative proportion of common stock to total capital will gradually decrease.

The balance between preferred stock and bonds, or similar securities, is dependent upon several factors. One of the most important is that of the risk involved concerning the possible net operating income. If net operating proceeds cannot be predicted with a reasonable degree of certainty, it seems logical that preferred stock would be

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<sup>4</sup>Ibid., p. 234.

preferable to the issuance of bonds. However, if future earnings are expected to be fairly stable and well above interest and sinking fund requirements, a bond issue should be used.<sup>5</sup> There are some advantages to using bonds instead of preferred stock. Among these are the possibility of a wider source of capital to tap, lower rates of interest and the interest on bonds is deductible from taxable income.<sup>6</sup>

The ratios of preferred stock to bonds has a great deal of variability. In all probability, a ratio of preferred stock to bonds of two to one would be desirable in the newly organized elevator corporation. A business which is a going concern and has adequate surplus and reserves may find it profitable to reduce this ratio to the point of one dollar in preferred stock to two dollars in bonds.

The amount of surplus a small grain elevator corporation has will also vary a great deal and is dependent upon such factors as the length of time in operation, profitability of the business and the rate of growth and expansion. An old established business could have a surplus of as much as 80 per cent of the total capital. In this case, most of the earnings would have been reinvested for expansion or debt retirement. By the same token, lesser amounts of net proceeds applied to expansion will result in a surplus representing a smaller proportion of total capital.<sup>7</sup>

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<sup>5</sup>Loc. cit.

<sup>6</sup>Mauser and Schwartz, op. cit., p. 128.

<sup>7</sup>Phillips, op. cit., p. 235.

## The Capital Structure of Cooperative Corporations

The capital structure of a stock cooperative has many similarities to a corporation of comparable size. Stocks and bonds are issued using basically the same criteria. However, the total capital structure will be different due to the nature and needs of a cooperative.

One of the greatest differences in capital structure between a cooperative and a corporation is when the cooperative does not issue stock. Ownership is shown by means of membership certificates rather than by stock certificates. A non-stock cooperative uses the sale of memberships to raise money just as a stock cooperative sells stock for this purpose. Many times capital stock is sold at a price comparable to the cost of a membership certificate. With this in mind, it would be possible in theory to raise as much money through the sale of membership certificates as it would be through the sale of stock certificates.<sup>8</sup> In actual practice, it is obvious that this theory will break down due to the lack of people qualified for membership in a cooperative. Kansas laws allow non-profit corporations to set the terms of membership.<sup>9</sup> Since this is true, grain elevator cooperatives commonly restrict their membership to producers. An example of this restriction is that used by the Mitchell County Farmers Union Cooperative Association. The by-laws of this particular cooperative state that:<sup>10</sup>

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<sup>8</sup>Hulbert, op. cit., p. 47.

<sup>9</sup>General Statutes of Kansas, 1949, p. 565.

<sup>10</sup>By-Laws of Mitchell County Farmers Union Co-operative Association, 1963, Article IV, Sections 1 and 2.

All persons engaged in the handling of agricultural products to be handled by or through this association including the lessees and tenants of lands used for the production of such products and any lessors and landlords who receive as rent part of the crops raised on the leased premises . . . shall be eligible to membership in this association, provided however, such person is not engaged in a business that is in competition with the business of the association.

Because of this membership restriction, non-stock cooperatives may be at a disadvantage when it comes to raising capital.

A second important difference in the capital structures of a cooperative and a corporation is the use, by cooperatives, of a revolving fund for financing purposes.

The revolving fund is composed of net operating proceeds which have been allocated to the patrons but have been kept in the business. The capital retained in the revolving fund is kept with the consent of the patron. It is used for whatever purpose deemed necessary by the board of directors, with the members approval.

A revolving fund plan for financing allows the accumulation of capital to rather large sums. The number of years before a fund revolves varies but the five-year revolving fund plan is common. In other words at the end of five years accumulation (this may have been invested), money supplied by current patrons is used to retire the oldest outstanding investments of patrons. These are commonly called deferred patronage refunds.

Like corporations, cooperatives also have the problem of determining the various amounts of permanent ownership capital, revolving capital and invested capital. One breakdown for this has been suggested as

follows:<sup>11</sup>

1. One-third permanent ownership capital.
  - a. Common stock or membership fees.
  - b. Certificates of ownership.
  - c. Unallocated reserves or surplus.
2. One-third revolving capital.
  - a. Deferred patronage refunds.
  - b. Patronage deductions.
3. One-third member invested capital.
  - a. Preferred stock.
  - b. Certificates of indebtedness.
  - c. Building notes.
  - d. Bonds or similar securities.

If this is used as a guide, about two-thirds of the member equity is shared on a relatively proportional basis. The other one-third is not proportionate and is supplied by members who have money to invest outside their farming interests.

The above breakdown is very similar to a guide suggested by Glenn S. Fox.<sup>12</sup> In the breakdown used by Fox, it is suggested that 25 per cent of the total assets be in the form of revolving funds, 25 per cent or more in foundation capital, 25 per cent from investments not only from members but other investment sources as well, and it is recommended that 25 per cent of total assets consist of loans or creditor capital.

The capital structure is one of the most important assets to any grain elevator business. With an efficient management and a workable and efficient capital structure, any grain elevator business should be a success insofar as success is dependent on this factor.

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<sup>11</sup> Phillips, op. cit., p. 236.

<sup>12</sup> Glenn S. Fox, "Financing for Growth and Strength," American Cooperation—1961, p. 53.

There are few instances when the measure of success of a business is not tied directly to the amount of net operating income. Since this is true, it may be difficult to maintain a favorable balance between the methods of financing a business. Furthermore, if it is a fact that taxation differences exist between the various kinds of business organization, it follows that businesses which are favored can reach the most desirable ratios between the four sources of capital before other types of business are able to do so. This will serve to strengthen their position all the way from being able to fire incompetent personnel to the opening of new doors in the money market.

## CHAPTER VII

### POSSIBLE TAXATION ALTERNATIVES AVAILABLE TO GRAIN ELEVATOR BUSINESSES

The owners and managers of all types of businesses should continually seek new ways to increase the net income of their particular business. This may be done in various ways. One of the most important considerations is that organizational characteristics which yield competitive advantages should not be ignored. These have a profound effect on capital structure and may mean the difference between success and failure.

If it is assumed that all grain elevator businesses have equal efficiency and skill in the utilization of capital, it is the opinion of the writer that advantages found in the Federal and State laws are by far the most important characteristics which will affect the capital structure of a going concern. The reasoning behind this statement is simple because it is a fact that most grain elevator businesses have a respectable net margin. But variation in the ways businesses are organized makes them subject to various methods of taxation. This in turn can have a tremendous effect on the rate of growth of any organization. It would behoove all grain elevator businesses to make study of all methods of taxation applicable to business. There are times when a business has alternatives in the area of taxation. For example, corporations may elect to be taxed other than as a corporation if they so desire and can meet the qualifications. Non-exempt cooperatives can

become exempt cooperatives and unincorporated businesses can elect to be taxed as corporations, if they so desire, provided certain qualifications are met.

Unincorporated businesses that desire to be taxed as corporations should take a long hard look at the possible future of the business. If the future looks good and the qualifications can be met (see Chapter 3), the grain elevator owners should weigh the advantages against the possible disadvantages before making the final decision.

An individual proprietor finds that one of his biggest tax problems is that every penny of profit is taxed to himself as owner and operator of the business. But in the case of a corporation, although it pays a tax on its profits, the owners are not taxed on corporate profit unless the profits are distributed to them. Therefore, as long as the individuals tax rate is higher than the corporate tax rate, a saving is possible. If savings can be made, reporting as a corporation has decided advantages. Consider the following example of an individual proprietor who has a taxable income of \$50,000 and files a joint return. His tax amounts to \$20,300.

However, if this individual had reported as a corporation, a saving is evident. Consider that the individual is paid a salary of \$20,000 for his management of the business. This leaves the "corporation" with a taxable income of \$30,000 upon which is paid \$8,600 under the corporate tax law which went into effect July 1, 1963. The corporate tax of \$8,600 plus the tax of \$5,280 on his individual income amounts to a total of \$13,880. The tax saving for reporting as a corporation would be \$6,420 (\$20,300 minus \$13,880). The \$8,600 corporate tax plus \$20,000 salary



comes to a total of \$28,600 leaving \$21,400 that can be used in the business. This \$21,400 plus the \$14,720 (salary after taxes) equals \$36,120 which could be used in the corporation. Contrast this with the \$29,700 which the individual proprietor has left after taxes and which can be used for reinvestment in the business.

While this looks very good on the surface, care must be taken that the individuals salary does not exceed the limits of "reasonable compensation." He is also subject to the danger of accumulated earnings tax. So long as the business can continue to expand, accumulated earnings are not a problem, but once the practical expansion limit has been reached, care must be taken to see that earnings do not accumulate over the allowable \$600,000 just as in regular corporations. If this happens, individual income tax on unavoidable distribution of business income must be paid in addition to corporation tax.

Another point to consider is that if it should turn out that being taxed as a corporation costs more than as an individual, the election to be taxed as a corporation can be revoked. Section 63 of the Technical Amendments Act of 1958 permits direct revocation of the election provided the revocation is made within a specific time period and all owners sign the statement of revocation. Most important, revocation is retroactive to all the years to which the election applied. Therefore, the business owners would have to file amended returns covering these years, just as though they had never made the election. While the possibilities of having to revoke the election are real in a business which is successful and is increasing its net earnings each year, it is possible that having additional capital with which to work in early years will pay dividends to

the extent that additional taxation upon revocation would be a relatively minor item.

Given the right set of circumstances, a business could grow and progress indefinitely. If an individual proprietorship showed a taxable income of \$100,000 after deductions, individual taxes under a joint return would be \$53,640 and as a corporation the total tax would be \$41,500. On a \$200,000 taxable income, individual income tax would be \$134,640 as opposed to a total tax of \$88,500 when taxed as a corporation.

Should a partnership consider taxation as a corporation? It has all ready been shown that the total tax paid by a four-man partnership would be considerably less on a \$100,000 taxable income than a corporation would have to pay on the same amount of income (Table 10). Furthermore, if the partners had a taxable income of \$200,000, each one would have to pay \$20,300 or a total of \$81,200. This example assumes equal division of net income. In the same situation, a corporation would have to pay \$88,500 as corporate tax. Not until taxable income reaches approximately \$300,000 do the partners pay more in the way of taxes than a corporation. In this case, total Federal income tax is \$144,280 for the partners compared to \$135,500 for a corporation.

What about corporations? Are they confined to the use of only one method of taxation? It seems that the large corporations must abide by the corporate tax laws but certain small corporations can change their tax status. Here again certain qualifications must be met (see Chapter 3) before a business can be considered a "subchapter S" corporation. Taxable income from a corporation making this tax option election finds the stockholders taxed in a manner very similar to the partners of a partnership.

The undistributed taxable income of an electing small business corporation must be included in the gross income of the shareholders, this to be on a pro rata basis determined by the amount of stock held by each stockholder.<sup>1</sup> On the basis of this, a corporation with 10 stockholders sharing equally in ownership and with a taxable income of \$100,000 would find the total tax to be only \$22,000, when computed using the joint return scale. Under present law, a regular corporation pays a tax of \$41,500. With a taxable income of \$200,000, total tax of the shareholders of a small corporation would be \$52,800, while the regular corporation pays \$88,500.

Grain elevator cooperatives also have a choice as to how they are taxed by the Federal and State governments. As mentioned above, cooperatives may have either the exempt or non-exempt status so far as taxation is concerned. There is little difference in taxation between a non-exempt cooperative and a corporation. The differences are that cooperatives may exclude from gross income true patronage refunds for which provision has been made and distribution is made within a reasonable length of time after the close of the taxable year.<sup>2</sup>

Exempt cooperatives may take the usual business deductions and in addition may deduct dividends paid on capital stock during the taxable year, also, amounts paid to patrons, or allocated and disclosed to each patron, with respect to revenues not derived from patronage.<sup>3</sup> This last

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<sup>1</sup>United States Code, Annotated, (St. Paul: West Publishing Co., 1962), Title 26, Sec. 1373.

<sup>2</sup>Hulbert, op. cit., p. 209.

<sup>3</sup>Loc. cit.

deduction includes revenue from rent received, investment revenues, gain on the sale of depreciable property and capital assets, and accounts from business done with the United States Government (see Table 13).

There is more "red tape" associated with being an exempt cooperative than non-exempt and there are several conditions which must be met in order to qualify as an exempt cooperative. These conditions are found in section 521 of the Internal Revenue Code and are summarized as follows:<sup>4</sup>

1. Operating purposes must be restricted.
2. Operations must be mutual in nature, with equal treatment for all patrons.
3. Non-member business not to exceed that done with members.
4. Financial reserves to have necessary purpose and be reasonable in amount.
5. Patronage and equity records must be maintained on permanent basis.
6. Supplies and equipment purchased for non-members who are not producers must be limited.
7. Nearly all voting rights must be held by current patrons who are actual producers.
8. Substantially all capital shares, of participating type, must be owned by producers.
9. Interest on capital shares must be limited.
10. Legal structure must be cooperative in principle and not contain provisions inconsistent with the above requirements.

If cooperatives can meet these qualifications, especially stock cooperatives, it is to their advantage to apply for the exempt status. Any cooperative that collects government storage payments in substantial amounts will be money ahead because this income is subject to corporate income tax, unless the cooperative is exempt. It is hard to justify paying out \$88,500 on a \$200,000 storage payment, if it can be avoided.

There is one other possibility which corporations should examine

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<sup>4</sup>Ibid., p. 199.

TABLE 13

## FEDERAL TAXATION OF NET EARNINGS OF VARIOUS FORMS OF LEGAL BUSINESS ORGANIZATION

Item	Individual Proprietorship	Partnership	Exempt Cooperative	Non-exempt Cooperative	Small Business Corporation	Ordinary Corporation
Individual tax on all net earnings	All earnings taxed to the owners	Same as individual proprietorship	N/A*	N/A	Same as individual proprietorship	N/A
Corporate tax on all net earnings	N/A	N/A	N/A	N/A	N/A	Corporate tax on all net earnings
Patronage refunds	N/A	N/A	Not taxed to cooperative if qualified, but are taxed to individual	Same as exempt cooperative	N/A	Not normally allocated by ordinary corporations but deductible if agreement to this effect was made at beginning of tax year
Corporate tax on unallocated earnings	N/A	N/A	Taxed to corporation	Same as exempt cooperative	N/A	Corporate tax on all net earnings
Corporate tax on earnings allocated but retained	N/A	N/A	Corporation pays no tax on qualified allocations	Same as exempt cooperative	N/A	Corporate tax on all net earnings
Tax on stock dividends	N/A	N/A	Taxable to the individual	Taxed to the cooperative and the individual	Taxed to the individual	Taxed to the corporation and the individual
Non-patronage income (government storage, rent)	N/A	N/A	All not allocated is taxed to the cooperative, taxed to individual, if allocated	Taxed to the cooperative	N/A	Taxed on all net earnings

\*Not applicable

closely and that is the feasibility of adopting some of the cooperative principles of operation. It isn't reasonable to expect private and corporate enterprise to go all the way, so far as cooperative principles are concerned, as this would have a tendency to smother the profit motive and individual initiative. However, there is the area of income taxes which corporations must pay and from which cooperatives are exempt, for all practical purposes.

It is possible for corporations to allocate a portion of their net income on a patronage basis. At the same time, they could retain a portion of their net income for growth and expansion in the form of unallocated reserves. These would be taxable to the corporation. This solution could conceivably allow partnerships and corporations access to a greater amount of capital.

How can and why should this work out for corporations? Will they give back earnings to patrons when all profit could be retained? There is a profit motive behind all business transactions, a personal incentive to get rich or at least to make more money. It is this force which will cause corporations to use this cooperative principle.

Businesses are continually trying to find new customers, new trade areas, new markets for their products. One way to break into an established market is to offer profit incentives to the customers. There is a movement in the fertilizer industry in Mississippi that is beginning to attract attention.

Consider this situation: A fertilizer corporation wants to expand and grow but where is it going to get the money with which to do so? It could be borrowed or more ownership stock sold, but perhaps there is a

better way. The money could be raised by selling ownership stock, in equipment and facilities, that has no vote and does not pay a dividend. It could be called patronage stock because it is sold to customers on the basis of the amount they patronize the corporation.

As mentioned above, there would be no dividends but the customer would receive all net earnings, minus reserves, in the form of cash. The fertilizer corporation would sell stock only on its ability to furnish fertilizer as needed during the busy season. Only customers who owned stock could buy on the net income refund basis. Any fertilizer bought by stockholders over and above that for which stock is owned is not eligible for refunds equal to 100 per cent on the net income. Instead, 25 per cent is suggested as a probability. In this manner, growth and expansion can be readily financed without endangering the capital structure of the business. If it seems desirable to expand, money can be borrowed with which to do the job and then the debt is paid off by means of unallocated reserves.

In the author's opinion, this method of financing is not much different from that used by cooperatives where revolving funds are used as a source of capital. The main difference lies with the fact that refunds are strictly cash. Upon payment of the cash refund, stockholders may be urged to buy additional stock but even the sale of the stock is on a voluntary basis. If the customer could use additional fertilizer, he would probably buy the stock. On the other hand, if he was handling the maximum amount possible to sell, the customer is not obligated to buy additional patronage stock.

Corporations using this method of operation could possibly find

that the additional capital available would make it possible for them to expand much more rapidly than anticipated. This comes as a result of retained earnings of stockholders and as a by-product brought about by economies of scale for as the business grows larger, cost per ton of fertilizer produced decreases, thus allowing greater profit per ton.

It is still true that a business using these principles is still able to make a profit for its owners. This is accomplished by off-season and over-quota sales, which are not eligible for the patronage refunds, plus income from the increased and more efficient output. So even though the business is giving back some of its profit to its customers, increased volume and economies of scale will result in greater profit in the long run. It has been said that in this movement, all other forces being equal and particularly management and taxes, the independent operator will out maneuver the hired man.<sup>5</sup>

The above described situation is that being used in the fertilizer business. With modifications, why couldn't it be used in grain elevator operations? As an example, for every dollar of patronage stock bought in the elevator, the farmer or the seller of grain would receive the net income, less reserves, as a cash refund. This could operate in a manner very similar to the fertilizer set up and could very well reveal a source of income to the grain elevator operators which would have the effect of relieving some of the pressure put on capital structure at the present time.

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<sup>5</sup>Interview with Harold Boettcher of Boettcher Supply, Beloit, Kansas, July 1963.



## CHAPTER VIII

### SUMMARY AND CONCLUSIONS

These United States were developed to their present level by men of vision. Perhaps many important developments have come about by accident, but for the most part, the environment within which people live is planned. It is planned and although plans don't always turn out as desired, perhaps it is for the best.

That the business world is made up of individual proprietorships, partnerships, corporations and cooperatives is desirable from the standpoint of society. No one kind of legal organization is the answer to all problems for it has been found that each type has its advantages over the others. Whether business characteristics are advantages or disadvantages to a particular business depends somewhat on the individual owner or owners. What may be a disadvantage to one person may be an advantage to a second individual in the same kind of business.

The attempt has been made to show the basic differences in the legal organization of all four ways of doing business. This was done with the small to medium grain elevator setup in mind. The organizational structure of a large, successful individual proprietorship may be just as complicated in some ways as in a corporation. Many of the problems faced are the same but a corporation will solve them using methods different from those used by individual proprietorships.

Developing a balanced capital structure is one of the most important problems facing any grain elevator organization. Without adequate financing, a business will die a slow death. It is also important that the capital structure be flexible so that as capital requirements change over the years, these needs can be met without endangering the business.

There are many factors which influence the capital structure of grain elevator businesses. These factors are brought about by competitive advantages which accrue to each of the types of business organization. It has been brought out that capital structure is affected by every competitive advantage or disadvantage, although it is rather indirect in some instances. Sometimes a number of competitive advantages work jointly and depend on each other to produce a combined effect on capital structure.

However, the characteristic which has the greatest direct effect on capital structure is that of taxation. The reason for this is that taxation affects the amount of net income available for reinvestment. Regardless of the type of legal organization, if a business has no net income for reinvestment, it may be difficult to increase the equity base. The amount of capital a business can borrow is partially dependent on the size of the equity base so all business has this particular problem. When put down in black and white, it is obvious that the amount of income tax paid by an individual proprietor puts him at considerable disadvantage when compared to other kinds of business organization. As taxable income moves in excess of \$15,000, the tax advantage moves from the individual proprietorship to the corporation.

On the other hand, cooperatives especially exempt cooperatives, have more net income for reinvestment than any other type of business. This fact puts considerable pressure on individual proprietorships, partnerships and corporations. This is not meant to imply that cooperatives should be taxed to a greater extent, because the money in revolving funds and net income does belong to the patron-owners and not the business itself. In the author's opinion, the double taxation of corporate income which is distributed as dividends on capital stock is an injustice to the corporation. But the chances of relief from this area are very remote. It appears more likely that some method of taxing revolving fund capital will be found and initiated into our tax structure. If retained capital was taxed at the corporate rate, chances for growth and survival of all types of grain elevators would possibly be on a more equitable basis. However, this would eventually bring about even greater double taxation because when revolving fund money makes its way back to the patron, it would be taxed again, this time to the individual.

There is an old adage which goes like this, "If you can't lick 'em, join 'em." There is at least a possibility that non-cooperative businesses could use a part of the cooperative methods of doing business, that of patronage refunds. This does not need to destroy the initiative of private business since all earnings need not be distributed to patrons. Profit could still be realized, and in greater quantities than before, because of greater and more efficient output brought on by greater demand for the product under question.

In conclusion, it can be said that while there are many hindrances to capital growth due to taxation, the writer believes that regardless

of the type of legal organization used by grain elevator businesses, the owners, boards of directors, and managers should not be blind to the various tax alternatives open to them. It is true that there is "red tape" associated with changes such as have been suggested. However, all grain elevator personnel in positions of responsibility should consider the cost of not putting up with the additional paper work and other official routine. It could very well mean the difference between growth and survival or a slow death.

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Personal Interview with John Schulte, General Manager, Mitchell County  
Farmers Union Cooperative Association, Beloit, Kansas, July 1962  
and July 1963.

**APPENDIX**

The following form was used in the interview with Harold Hamil of Consumers Cooperative Association, Kansas City, Missouri.

1. What are the main sources of grain elevator capital?
2. Does one form of legal business organization have advantages over the others, in the money market?
3. Is it easier for a grain elevator corporation to raise large quantities of capital than it is for a cooperative of comparable size?
4. Does the one member one vote principle inhibit the raising of capital?
5. Do you believe it is easier for a corporation to accumulate large quantities of capital than it is for a cooperative?
6. Do you consider the Bank for Cooperatives a substantial competitive advantage to the cooperative?
7. What advantage does the ordinary corporation have which tends to counteract the above situation?
8. Do you believe grain elevators, regardless of legal organization, are making the best possible use of available credit? If not, why?
9. What has your experience been as to the effects of the influence which member owners have in financial decisions? Do they work to the disadvantage of the cooperative?
10. Do you believe there is a competitive advantage which accrues to the co-op through the present taxation laws? Do they favor cooperative growth rather than corporative growth?

The following form was used in the interview with O. G. Lo Vette of the Small Business Administration, Wichita, Kansas.

1. What types of loans do you make here in Kansas?
2. What general procedure must be followed by a business in obtaining a loan?
3. Can capital be obtained from you, if it is available from any other source?
4. What measures, other than legal, do you apply before making a loan?

5. What are the general conditions of repayment of a loan from this organization?
6. Do you have provisions for refinancing a loan in case payments cannot be met?
7. How do your interest rates compare to other lending agencies?
8. Do you loan to both the incorporated and unincorporated businesses?
9. Do you believe that grain elevators in the state are making maximum use of this organization or are they passing up a good source of credit?

The following questions were used in the interview with Ralph Dockstader, Jr., of the Dockstader Grain Company of Beloit, Kansas.

1. Where do you obtain capital to be used for expansion purposes?
2. What particular aspects of the business come under scrutiny when you borrow for expansion purposes?
3. Have you ever encountered difficulty in obtaining sufficient capital for expansion purposes? If so, in what respects?
4. What sources do you tap in obtaining working capital?
5. Are there sources of working capital not available to you which would be advantageous to the business?
6. In what ways are the possibilities of growth and progress of your business hampered?
7. Have you considered incorporating? If not, why?
8. Do you feel that you have advantages over the co-ops or a partnership or a corporation? If so, what are they?

The following questions were used in the interview with John Schulte of the Mitchell County Farmers Union Cooperative Association, Beloit, Kansas.

1. Where do you obtain capital to be used for expansion purposes?
2. Do you believe co-ops have as much loan capital available for their use as do ordinary corporations? Explain.
3. What particular aspects of the business came under scrutiny when you borrowed for expansion purposes?

4. Have you ever encountered difficulty in obtaining sufficient capital for expansion purposes? If so, in what respects?
5. What sources do you tap in obtaining working capital?
6. Are there sources of working capital not available to you which would be advantageous to the business? If so, what sources?
7. Do you feel that co-ops have a competitive advantage because of the tax status of retained patronage refunds? Why?
8. Do you feel this is an unfair advantage over the ordinary corporation? Why?

The following questions were used in the interview with Glenn Fox of the Farmers Union Cooperative Marketing Association, Kansas City, Missouri.

1. What are the main sources of grain elevator capital?
2. Does one form of legal business organization have advantages over the others, in the money market?
3. Is it easier for a grain elevator corporation to raise large quantities of capital than it is for a cooperative of comparable size?
4. Do you believe it is easier for a corporation to accumulate large quantities of capital than it is for a cooperative?
5. Do you consider the Bank for Cooperatives a substantial competitive advantage to the cooperative?
6. Do you believe grain elevators, regardless of legal organization, are making the best possible use of available credit? If not, give your reasons.
7. What has your experience been as to the effects of the influence which member owners have in financial decisions? Do they work to the disadvantage of the cooperative?
8. Do you believe there is a competitive advantage which accrues to the co-op through the present taxation laws? Do they favor cooperative growth rather than corporative growth?

The following form was used in the interview with Gilbert Terpening, Bank for Cooperatives, Wichita, Kansas.

1. What requirements must a co-op meet before you consider making a loan?
2. What procedure is followed by a co-op in obtaining a loan from the Bank for Cooperatives?
3. What legal measures do you apply in arriving at a decision to loan money to a local co-op?
4. What measures, other than legal, do you apply before approving a loan?
5. Is there a maximum amount which a single co-op could borrow on an expansion project?
6. How do your interest rates compare with other lending agencies?
7. If loans can be had from local banks for the same interest rate as from the Bank for Cooperatives, why go through the co-op bank?
8. Would you be apt to loan more on new elevator facilities than on just storage facilities alone?
9. Do you believe cooperatives have a competitive advantage over other types of business organization since they do have access to the Bank for Cooperatives?
10. Do you believe the present taxation laws tend to favor cooperative growth in preference to corporative growth? If so, in what ways?

The following questions were used in the interview with Dean Evans, Evans Grain Company, Salina, Kansas.

1. Where do you obtain capital to be used for expansion purposes?
2. Are there sources of capital not available to you which would be advantageous? If so, what ones?
3. In what ways is growth and expansion of your business hampered?
4. Given the same efficiency of management, do you feel cooperatives and corporations have equal opportunity for growth and expansion?

5. Do the present tax laws put you at a disadvantage when compared to a cooperative? A corporation?
6. Is the large number of local co-op elevators an important factor which may prevent an adequate supply of grain to you as a partnership?
7. Are the grain elevator corporations feeling pressure which can be traced directly to the cooperative way of doing business?
8. When considering the advantages of being a cooperative, why is it that more corporations don't reorganize using cooperative principles?

THE LEGAL BUSINESS ORGANIZATION AND CAPITAL STRUCTURE  
OF GRAIN ELEVATOR COMPANIES IN KANSAS

by

EARL E. BAUGHER

B. S., Kansas State University, 1958

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AN ABSTRACT OF A MASTER'S THESIS

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MASTER OF SCIENCE

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Manhattan, Kansas

1964



Why is it that some grain elevators will fail in a certain community while others are successful? Is it because one is a cooperative while the other is a partnership or an individual proprietorship?

The success or failure of grain elevators is not dependent upon any one particular form of business organization as such. It is the human beings operating them who sometimes fail. If this were not true, there would be only one kind of business organization used in elevator operations. As it is, the individual proprietorship, partnership, corporation and the cooperative are all found to be used. Each type of business organization has certain advantages and disadvantages which accrue to it. These advantages or disadvantages, whether real or imaginary, have brought about much of the confusion that exists between advocates of each type of business organization.

These business organizational characteristics need to be more clearly understood from the standpoint of the grain elevator owners and operators. With this thought in mind, consideration is given in this study to determine:

1. The basic differences among the types of legal organization which yield a competitive advantage.
2. The inherent advantages of one form of business over another which stem from the law and those which are a by-product of a distinct type of legal organization.
3. The effects of the inherent advantages upon the capital structure of grain elevator businesses organized according to the principles of each form of legal organization.

Two methods were used in arriving at the final conclusions. First, reviewing of references of various kinds on Business Organization and Finance was done to determine the basic differences among the types of

legal organization. Second, interviews with personnel in the grain elevator business were conducted to determine their opinions concerning the different characteristics of the types of business organization.

A total of twenty-four organizational characteristics were chosen for consideration in this paper. These differences were analyzed to determine whether or not they stem from the law or are by-products of a specific type of legal organization. The use of reference material was used extensively in this instance.

The determination of the characteristics which yield an advantage from the competitive point of view is not altogether objective since there are so many variables to consider. However, by setting up example businesses of the same size, other things being considered equal, a fairly accurate picture of the competitive advantages and disadvantages takes form. The use of interviews proved to be very valuable in making these decisions.

The decisions made as to how inherent advantages and disadvantages affect capital structure were made primarily from research information based on references and interviews.

In summary, it was found that fourteen of the twenty-four characteristics considered are influenced by legislative action. The remaining ten being relatively free of governmental action.

One of the most important competitive advantages that one business could have over another is that of a smaller tax load. Cooperatives have an advantage from this standpoint. This thought is echoed by both cooperative and non-cooperative personnel.

Even though there seems to be a very real competitive advantage

accruing to cooperatives through present tax laws, greater taxation of cooperatives did not appear to be the answer and little tax relief can be expected for businesses other than cooperatives.

Since there are hindrances to capital and business growth due to taxation, the owners, boards of directors and managers of grain elevators should determine if it is possible that they could take advantage of the favorable characteristics which accrue to other types of organization. For example, taxation alternatives are possible and the use of cooperative principles is not confined to cooperatives alone. Grain elevator operators and owners should make use of every available tool, if they expect to survive and grow in today's world.