LARGE AGRICULTURAL COOPERATIVES: ON THE ROAD TO WHERE?

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The cooperative and the common-stock corporation are highly flexible forms of business organization. The cooperative has been put to use by people with highly divergent interests and beliefs. This diversity leads to some confusion as to how cooperatives are perceived by both members and nonmembers.

This paper suggests some of the variety of uses of cooperatives and develops a certain evolution over time. However, the paper does not attempt a history of cooperatives. This presentation highlights by its incompleteness.

There can be little doubt about the basically anticapitalist ideology of the famed Rochdale weavers. The 34 Rochdale pioneers included more socialist thinkers than weavers (Bonner). Those early British cooperatives emphasized mutual aid, equality, democracy, decentralization, and the poor instead of competition, hierarchy, and unlimited&accumulation (Wiles).

U.S. agricultural cooperatives owe as much to the American frontier as to Europe. "Cooperating" in barn raisings, threshing, and other large-scale activities was a virtue born out of necessity on the frontier. It was a short step from shared labor and shared machinery to shared enterprises serving essential needs for insurance, farm supplies, or simple marketing. Of course, there were personal and intellectual connections with the European cooperative movement, and the so-called Rochdale principles were widely adopted as guidelines.

Sixty years ago one of the founders of our profession with an intense interest in cooperatives, E. G. Nourse, enumerated the Rochdale fundamentals and discussed their then-current relevance. The three fundamentals were:

1. Reduced costs through increased efficiency and/or reduced services;

2. Popular distribution of savings (net earnings);

3. Democratic control--one-member/one-vote.

Nourse argued that each of these fundamentals was a protest against perceived shortcomings of the economy. First was the perception of a wasteful system that had much excess capacity and that provided several services for which a large market segment would prefer not to pay (e.g., retail credit in 19th century England). Nourse argued in 1922 that U.S. farmers still perceived cooperative opportunities for reducing overcapacity, streamlining services, and reducing some of the other costs associated with nonprice competition among investor-owned firms (IOFs). A few years later the new theory of monopolistic competition would explain why competitive markets could have overcapacity and extra costs while being at a zero-profit equilibrium.

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*The author appreciates helpful reviews by James Shaffer, Harold Breimyer, Charles Cramer, and C. Brice Ratchford.

The second complaint arising from Rochdale days was the belief that stockholders should not be the residual claimants of firms. That anticapitalist notion was the justification for cooperatives paying minimal interest on capital stock and paying out the rest as patronage refunds. By 1922, Nourse saw clear erosion of the basic complaint. American farmers shared no anticapitalist ideology with labor. Nevertheless, the principle of patronage refunds still was strongly held.

The third perceived shortcoming was the closely allied belief that economic control of IOFs by stockholders (and often a relatively few of them) was basically antidemocratic. While a cooperative, even as an IOF, is a union of people and capital, the cooperative ideology emphasized the primacy of the people. Nourse notes that U.S. cooperatives still were holding tenaciously to the one-member/one-vote working rule. Democracy of control fitted well with American populist ideas and the antitrust sentiments of the early 20th century. There also was the pragmatic perception that democracy is very compatible with the cooperative philosophy of bringing together farmers with a common need.

Nourse summarized by noting that cooperatives have been utilized by three social classes--each attempting to enlarge its class share of the fruits of the economy. Labor tried cooperatives but soon turned to trade unions. Consumers tried cooperatives with little success except in England where Nourse astutely observed that they had overreached and were on the way to socialism. Farmers, only mildly class-conscious in Nourse's judgment, have used cooperatives in a very pragmatic way to improve their position in the economy. Their purpose has been "functional reorganization" rather than "comprehensive economic regeneration" (Nourse 1922).

In Europe and North America, most agricultural cooperatives were organized in reaction to agricultural distress. In Europe it was the agricultural crisis of the 1880s that spawned many farm cooperatives (Natronale Cooperatieve Raad). The Grange in the 1870s organized cooperatives and supported populist causes. Later the Farmers' Alliance in the South and the Farmers' Union and eventually the Farm Bureau helped to organize more locals (Bakken and Schaars). Although farm cooperatives were part of a general reform movement and were seen as a corrective to the unequal bargaining power of farmers, their members placed them in a capitalist perspective. Cooperation per se was extolled as virtuous but the dominion of the market was accepted.

Some Cooperatives Became Large-Scale Organizations

Regional cooperatives developed in the early 20th century in a variety of ways. Farm organizations often promoted them. In a few cases, able entrepreneurs, seeing the opportunities to serve locals, developed the regional organizations. For the first time in the U.S. experience some cooperatives became large firms after World War II.

While American cooperative theory, as previously shown by Nourse, had adopted readily to capitalist cooperatives, it had not foreseen large cooperative firms and their implication. Nourse had fought the Sapiro cartel concept, which was certainly conducive to large cooperatives.

Nourse's views were to be characterized later as the competitive yardstick role for cooperatives. The objective of cooperatives was to stimulate competitive performance but not to supersede other business forms. Cooperatives could serve a real purpose by entering agricultural markets in which services were inadequate or were provided inefficiently. Once cooperatives had innovated superior methods or broken a monopolistic bottleneck, Nourse urged a halt to further cooperative growth. **[Cooperatives] should then be content merely to maintain 'stand by' capacity, or a 'yardstick' operational position rather than try to occupy the whole field or a dominating position within it. In some cases, they may be well advised in entirely terminating operations once they have stimulated regular commercial or manufacturing agencies to competition amongst themselves" (Nourse 1945).

Study of large-scale organizations indicates the small probability of the management of any large firm--cooperative or IOF--taking a passive standby position or terminating the firm because its objective has been accomplished. Any large-scale organization is greatly different from a small organization. A hierarchy of management develops bureaucratic procedures. In large firms, there is a greater gulf between owners and management. Boards of directors find the large firm less easy to comprehend and the performance of its management more difficult to evaluate. The operating philosophy is not the competitive yardstick but rather: This firm must survive.

Some later writers of the Chicago school have abandoned the tenuous arguments that IOF stockholders have either the motivation or the institutional mechanisms for directly monitoring the behavior of management (Fama). But they insist that effective monitoring exists. The monitoring is by the board of directors, which generally consists of top management plus some outsiders. According to this view, the nationwide market for managerial talent motivates managers to be good monitors of each other and to be helpful to board members in assessing performance. The stockholders' indirect role is exercised through their market-revealed attitudes toward the firm's stock. A bearish attitude conveys a negative signal. Likewise the attentions of a potential raider stimulate the monitors and management.

While there are obvious differences among modern theorists as to how completely the market does pressure the managers of large-scale corporations to keep their shoulders to the wheel and their noses to the grindstone, there is a common emphasis on conceptualizing the firm as an organization.

Various authors stress various views of the large organization. Williamson emphasizes the hierarchial nature of the firm and the advantages of fiat in solving certain transactional difficulties arising out of the inevitably conflicting goals of firm members. Galbraith, impressed by the breadth of technical information assembled in modern decisionmaking, refers to the firm as a hierarchy of committees. Fama and Jensen focus on the organization as a nexus of written and unwritten contracts among managers, employees, suppliers, and customers. If somehow all those contracts were to be destroyed in one fell swoop, the organization would have likely lost its ability to survive. The focus on contracts emphasizes the pervasive impingement of the markets for people and commodities on the decisionmaking within the organization.

Earlier in this century, Commons anticipated much of the current discussion about transactions and firms as organizations. A firm is a going concern--"a visible, tangible, living body of men animated by a common purpose** (p.144). There is no facile assumption that a firm is nothing but a money-making machine. However, such an organized mass movement as a firm expects income; if that expectation fails, the promised corporate immortality is a casualty. A going concern exercises purposeful control over property and people. The members of the organization are guided by two sets of working rules--those internal to itself, and the external rules and laws of the state. To a considerable extent the state has granted industrial self-government to those aggregations exploiting economies of size. Everyone in a going concern has some discretion in performing his or her duties (the higher the rank the more the discretion) and thus each contributes to "the collective will." A going concern is a set of transactions guided by the precedents and customs of the past. As an association, a set of future transactions may be anticipated extending beyond the expected life of any individual in the group. Working rules for an organization are essential "to hold together in a continuing concern the overweening and unlimited selfishness of individuals pressed on by a scarcity of resources" (p. 138). Working rules are all of those laws, regulations, business ethics, and norms that guide transactions among people.

Commons's view of the firm complements that of those who focus on market forces. Commons focused on rules and customs that evolve in a society to handle interpersonal relationships. Conflict within and between associations of people is recognized as inevitable. The working rules define duties and rights and the processes for the achievement of some common purposes by an organization. These working rules guide much of the self-monitoring and board-monitoring so central to numerous modern theories of the firm. These working rules evolve as perceived circumstances change. What is right and/or legal for a manager in 1950 is not necessarily identical to what is right and/or legal in 1980. What a society expects of its industrial empires will change with accumulated experience, and those changing expectations will impact on the working rules according to Commons.

Red ink on the bottom line can lead to belt-tightening (i.e., new corporate rules), dismissals of lower level managers, and, at the worst, to selection of new top managers. Management teams may reflect other market forces as they set goals for themselves of continued growth in sales or in net earnings, or the continuity of stable dividends. These market influences are interwoven with the working rules already described. The size of top executive compensation and the depth of the associated perquisites is decided within the context of both market comparisons and ideas of equity. Similar forces affect the wage contracts negotiated with the unions.

Cooperatives and IOFs

The cooperative has much in common with IOFs--more commonalities than differences. The differences arise less in market forces imposing on them than in the set of working rules that apply to each type of firm. In view of the anticapitalist origins of English cooperatives, there is irony in the difficulties frequently perceived in distinguishing large regional cooperatives from other large corporations in our capitalistic economy..

The cooperative board is structured to have more independence from management than is the case with IOFs. Generally members of management, with the possible exception of the president, are not voting members of cooperative boards while IOF boards typically have several members from management. The election of cooperative boards also is structured to be representative of the broad range of members via democratic voting procedures and the absence of proxy voting. The typical IOF board is a self-perpetuating closed group except when a crisis or a raider breaks the network.

Whether the actual performance of a cooperative board is much different from an IOF board still is the subject of much debate. A lot has been said about the possibilities that farmer board members are too unsophisticated and uninformed to monitor management effectively. IOF boards often include outside experts in finance and marketing while cooperative boards rarely include any nonmembers. If there is widespread apathy among voters--as might appear rational when members number in the tens of thousands--then the cooperative board may become a self-perpetuating closed group. Undoubtedly the degree to which the structural potential for "owner control" actually is realized depends on the quality of leadership and acceptance of cooperative ideals in both the cooperative board and management.

Cooperative growth--and even survival--depends on a continual infusion of capital. If cooperative ideals are assumed away, then each member tries to minimize their capital contribution. It is frequently observed that members are reluctant to subscribe to new capital and that they want their dividends in cash. Management, to preserve the organization, must protect it against the chipping away by individual members that would destroy it. Members may perceive as empire building by management the actions that managers perceive as proper stewardship of the organization. The debates about plans for equity redemption and allocated versus unallocated reserves reflect--among other things--attitudes as to whether rules on capital should be used by members to control cooperative size (Cobia et al.; Royer; Murray).

The Hunter Cooperative

Those who guide the long-term planning and decisionmaking of large firms must decide the range of potential activities that will be considered. Many firms have been committed to a single industry. For generations, the family firm may have been in a single business: tentmaking, banking, or whatever. A railroad firm with its immense fixed assets has been presumed to remain a railroad firm into perpetuity. All the great advantages of industry know-how were passed down through the years as assets--intangible but valuable.

However, technological advances frequently have invalidated single-industry commitment. The harnessmaker faced a disastrously declining demand. The railroad encountered a no-growth future. The railroader was encouraged to consider himself or herself in the transportation business, not the railroad business. The final step was simply to consider himself or herself as being in business--free to enter and leave industries at will as he or she hunted for the best opportunities for the firm.

Modern business schools have stressed the flexibilities of good managers. Their MBAs are trained to manage anything in any industry. The large conglomerates of the 1960s and 1970s epitomized the hunters. Go wherever the dollars beckon.

The hunter firm may lose something in its unbounded chase after earnings. Peters and Waterman's best seller, <u>In Search of Excellence</u>, suggests that excellent performance requires commitments to certain values involving customer service. McDonalds is committed to QSCV (quality, service, cleanliness, and value). IBM is committed to service of the business machines they sell. People are buying IBM's home computers because they believe IBM will be there to service them when many other firms are gone. IBM's commitment, as much as its relative size and strength, are the bases for that belief.

Peters and Waterman argue that earnings are a necessary, but not a sufficient, condition for a firm's excellence. Profits are like health, they say, necessary and the more the better. But also like trying to be healthy, one does not focus exclusively on getting profits. <u>Fortune</u> conducts an annual survey of executives concerning the most admired large corporations (Perry). "The most admired U.S. companies believe that their ultimate success depends on how they are perceived by the public. ... Repeatedly, corporations with first class reputations are seen to put quality, integrity, and respect for the customer alongside profits on the bottom line" (p. 56). In 1983, Dow Jones was second only to IBM among admired companies. Dow Jones's CEO, Warren Phillips, is quoted as saying: "Lots of companies set as a goal maximization of earnings, return on equity, etc. We set high standards of performance in terms of content and quality. Financial excellence follows from that" (p. 54).

Commitment to service and to excellence obviously is not identical with an unchanging commitment to a single line of activity. A committed service harnessmaker still would have gone out of business. However, a commitment to service and excellence is even further away from indiscriminate profit-hunting. The committed firms do not view themselves as solely financial managers seeking the top dollar of returns. The committed firms move with technology and with the times but they strive to be experts in a limited set of activities, not in anything and everything.

Owners of most large IOFs generally do not determine the firms' long-run strategies. It is the firm's employees and especially its top management and directing board that set a corporate culture and the long-term objectives. Despite elaborate attempts to argue otherwise (Fama; Fama and Jensen), the relationship of ownership to firm direction and control for most large IOFs generally is seen as exceedingly tenuous. Moreover, because IOF owners are seldom major customers of their firm, they really do not care about its customer service and commitments so long as the earnings are produced somehow.

Cooperatives are different from IOFs because many or all of their customers are their owners. Cooperative owners care about commitment to customers' service because they are the customers. In the beginning, the cooperative was set up by its potential customers to serve their needs. The cooperative's owners demanded the firm's commitment to themselves as customers. The classic cooperative with its special form of vertical integration of farm and agribusiness is the epitome of commitment.

Shifting Membership to Support Cooperative Growth

The life cycle of the classic cooperative was as follows: Set up by members for a specific purpose; served that purpose for decades; disbanded when no longer needed. This classic life cycle doubtlessly has applied to many smaller cooperatives. It does not apply to the large regionals.

The participants in any large organization generally desire its survival as a minimum and its rapid growth and prosperity as the standard. While the performance of any firm is affected by its economic, political, and cultural environment, much depends on the quality of its participants and the way they interact. Theorists such as Fama conceptualize a firm as a nexus of contracts among the participants. While this concept properly emphasizes the valuable coordination of specialists made feasible by the firm, it lacks a flesh-and-blood dimension. As Williamson and Leibenstein emphasize, contracts must necessarily be incomplete so the exercised discretion of the people in a firm is an important factor in firm performance. Firm performance is a social achievement and, as such, is quite variable among organizations.

Large cooperatives frequently face lack of growth or even decline if they stick with their original purposes and their original members. It is hardly thinkable that a cooperative management will so commit itself to its original purposes and membership as to accept firm stagnation or decline. It is difficult to fault such managerial decisions. The question is how far shall the cooperative swing toward the other extreme. Shall it become an aggressive hunter, seeking new members and activities wherever a profit seems likely? How readily shall it drop old activities and members when associated earnings shrink? What equity issues arise in transferring the cooperative owners from the old set of owners to the new set?

Cooperative theory has hardly recognized the issue of a cooperative abandoning much of its membership. Much has been written about "disloyal" members deserting their cooperative, but not the reverse. Theories dealing with cooperatives with large earnings generated by market power often have argued that an influx of members will dissipate the excess earnings. However, much of cooperative theory implicitly takes an existing membership as a constant. When economists have modeled agricultural cooperatives, they have often included the earnings of both the organization and <u>a given set</u> of farmer members. One considerable debate concerned whether the cooperative even should be considered as a maximizing unit separate from its individual members (Phillips vs. Helmberger and Hoos). The one group of cooperative papers that relates even indirectly to this membership issue is that on the revolving of ownership equities associated with death, retirement, or other reasons for members' leaving the cooperative (Cobia et al.; Royer; Murray).

Hunter cooperatives may contribute in some ways to more competitive markets. An alert and sophisticated cooperative management can likely organize a new cooperative activity better than can a group of producers organizing a cooperative de novo. The large existing cooperative is likely to have a better appraisal of markets and of input costs and be better at producing information. In some industries, the entry barriers are sufficient that de novo entry is difficult while the existing regional cooperative can more readily project its capital and managerial skills into those industries.

It can be argued that many of the cooperative successes of the past half century have been achieved by cooperative managers enlisting members and developing cooperation rather than by farmers building cooperatives. Federated regionals often are built top down by a cooperative that captures the business of locals rather than bottom up by locals uniting to create a regional.

Other Issues Associated with Hunter Cooperatives

There are various ramifications of this new organizational force. Members are obtained by "merchandising" rather than by their own organizing. Consequently, membership loyalty is lost in two ways: (1) The new members had no particular occasion for developing loyalty differently from the way cooperative satisfied customers of IOFs might develop it; (2) the old members likely become estranged as they perceive the resources and interests of "their" cooperative being diverted into new fields. Management of a hunter cooperative must develop expertise in seeking out profitmaking opportunities and in selling its board on them--in much the same way an IOF does. Management finds it more difficult to keep in mind the cooperative's basic objectives when the membership base is not a constant, but a variable that can be manipulated. Serious equity issues arrive when capital contributed by one group of members is switched to the use of a new group (see next section).

In the case of federated regionals that provide farm supplies or market grains and oilseeds, their hunting leads to competition with other regionals and with IOFs for the business of local cooperatives. The local cooperative often winds up buying feed from one regional, fertilizer from a second, farm chemicals from an IOF, and fuel from a third regional while marketing grain through a fourth. In such a situation, it would be surprising if any sense of a cooperative system or of particular cooperative loyalty would be developed by either the local management or its farmer members. Another hunting result is intensified competition among regionals. The head-to-head competition of regionals for the business of locals and the various "invasions" of one regional's "territory" by another regional leads to cooperatives becoming most uncooperative with each other.

Still large cooperatives are not likely to become as aggressive and far-ranging hunters as the conglomerate **IOFs.** The old owners do exercise some voice for restraint in their cooperatives through various channels, including the elected boards. Boards typically are- torn between continued service to old members and the tempting potential profits of new, but less familiar, enterprises. The difficulty of cooperatives in raising new capital is another important constraint. Some cooperatives have ties to State farm organizations that tend to delimit their market boundaries.

When a hunter cooperative tends to stand some traditional cooperative ideas on their head, is it worthy of Capper-Volstead protection and the support of the cooperative community? The answer may depend on where the cooperative falls on the commitment-hunting scale. A cooperative that is genuinely committed to the interests of its current members and serves them with enthusiasm and dedication and hunts only as necessary to maintain the organization is serving those needs that Capper-Volstead was meant to support. A cooperative that is strictly an earnings-oriented maximizer and that does not allow service and current member interests to get in the way of such earnings maximization has a less obvious claim to uniqueness. Even the classic defense **of the** cooperative monopoly--that it does not really monopolize because the flow through to members of earnings encourages producer supply response rather than supply restriction--would not apply to a cooperative management that diverts its earnings into developing new enterprises and markets. The difficult cases are those in between the polar cases just discussed.

Cooperative leadership needs to deal more openly with this issue. Cooperatives are a special form of vertical integration undertaken to obtain efficiencies, to secure continued access to markets without fear of opportunistic exportation, to reduce uncertainty, and for other reasons. Generally those objectives require commitment. A member whose cooperative can abandon him or her at any time does not have much incentive to be a member. But a cooperative that can never turn away from old members is likely a firm condemned to eventual insolvency. Hence a middle way must be followed between the twin dangers. Understanding and statesmanship by cooperative leadership--management and **board--** is essential to maintaining the merits of committed service cooperatives while allowing that freedom for the cooperative to seek new avenues when it is essential to the continued economic viability of the organization.

For example, more attention needs to be given to the equity issues within the cooperative. Because risk capital is hard to get from members, managers typically make it even more difficult for the members to get it back. Consider the following scenario. A marketing cooperative has served successfully a group of members (designated as Set A) for 2 decades and has built up a net worth of $100 million. However, demand for the crop produced by its members is dropping and eventually the first loss is encountered--a million dollars in 1 year. Managers decide that net earnings likely could be restored to $5 million a year by shifting activities to serve a largely new group of members (call them Set B). When should the shift be made? Should there first be a major effort to cut costs and/or restore demand so as to continue serving Set A? The true hunters would say the cooperative should shift immediately. Set A members might reply that the cooperative can shift when their net worth of $100 million is exhausted, which implies a shift in 100 years! Alternatively, the Set A members might demand their shares of the cooperative in cash. Or Set A members might demand that all capital and expenses associated with Set B must be provided by Set B producers. Obviously, there is a genuine and major conflict of interest between Set A members and management. Compromises need to be found that are acceptable to all. The bargaining problem is similar to those discussed by Staatz.

Obligations and Legitimate Activities of Cooperatives

Observers are frequently struck by the extent to which the young, able, middle-managers of cooperatives deny the uniqueness of their organizations. Have large cooperatives lost their uniqueness and their rationale for being? Does the management of cooperatives face a set of obligations and legitimate activities that differs from those of IOF management? This section is directed at those people who have trouble with these questions.

Cooperative managers seem to agree that their goal is "to improve the economic position of members (French et al.). The goal is roughly similar to that of "profit maximization" that is generally attributed to IOF management. It seems that much of cooperative management views these two goals as having similar or even identical implications for firm management. They are not identical.

I believe that the usefulness of the cooperative to its members depends on three conditions:

1. The degree to which its members can rely on the cooperative to serve their specialized needs in vertically adjacent operations;[1]

2. The degree to which the cooperative can provide an economic return over time (higher marketing prices and/or lower input prices) as compared to competitors;

3. The degree to which economic returnsin the entire market have been improved by the presence of the cooperative.

The third condition--an externality- -is Nourse's competitive yardstick. While it may have been sought by a cooperative's founders, it tends to become invisible or at least unconvincing to later generations of members (see Rhodes). Thus, we ignore its possible relevance to the obligations of cooperative management.

Obligations of an IOF Management to Its Owners

Management is expected by IOF owners to:

1. Operate within the law and the general culture;

2. Not mislead owners or potential owners as to the financial position of the firm and its reasonable expectations for future profits;

3. In some general sense, maximize net earnings over some vaguely defined time span.

Beyond that brief list, managers of today's larger IOFs--with board approval--are relatively free to operate as they please. Managers of a railroad or chemical factory are free to move assets into other wholly unrelated businesses consistent with these obligations, even if such moves may be inconvenient to current customers. Managers are free to shift services, adopt new practices, close facilities and do whatever else is consistent with the listed expectations.

Obligations of a Cooperative Management to Its Owners

Management of a cooperative is generally expected by the owners to:

1.-3. Follow the rules listed for IOFs;

4. Provide, where feasible, the services desired by members and continue to provide them as long as feasible;

5. Fully inform members so as not to mislead them in any way--not even in ways generally accepted as legal and moral;

6. Deal properly and fairly with each group of customers and their investments where various products and/or services are handled (i.e., do not cross-subsidize enterprises too much).

Independent economic units do business with each other in a free marketwhen transactions are to their mutual benefit. When pairs of firms find themselves to its members depends on trading regularly, they may place more emphasis on the worth of the continuing business relationship than on the gains of each specific transaction. Nevertheless, no firm can expect that a trading relationship will survive any significant series of transactions that is unprofitable for one or both parties.

Firms, including farmers, with needs for specialized inputs or for specialized marketing services must find someone to perform the service or must perform it themselves. Economies of scale in farming and in the adjacent input and marketing stages usually are different enough that farmers cannot individually integrate forward or backward. However, they often have united as a cooperative "to perform a service for themselves." Over time, those cooperatives often have expanded into other services and other territories. Eventually, the cooperative--a separate legal entity[2]--may find it uneconomic to continue to perform a particular service or operate a particular facility. The affected farmers cannot expect that either a cooperative or an IOF will continue indefinitely to engage in a stream of losing transactions.

Cooperative owners have some legal and moral claims to the cooperative's assets. In many cooperatives, the discounted value of those claims for any individual owner is relatively small because equities are rotated slowly and sometimes not very dependably. The claims of ownership then become largely a rather intangible claim to service (cooperative obligation no. 4). It is this dual owner-customer status that makes cooperatives unique. The claims to service are defined by custom and procedures rather than hard and fast laws and regulations. Each obligation contains such significant modifiers as "where feasible" and "properly and fairly." No member can be absolutely sure of service. The early rural electric cooperatives (RECs) took pride in serving everyone even if the practice meant running a line an obviously uneconomic distance to an isolated farmstead. In times of high interest rates, hard-pressed REC boards and managers no longer will subsidize such distant customers.

Suppose a regional cooperative that emphasizes milk marketing and farm supplies finds that its poultry operation is losing money according to the cost accountants. If the accounting numbers are bad enough, the poultry member surely will lose his or her claim to service. If the numbers are a little better, but not good, a "political decision" may determine his or her claim to service. Certainly, the cooperative member, as an owner, has a *'right** to expect some consideration and some cost justification for a loss-of-service decision, while an IOF manager is free to make such decisions without providing any consideration or justification to his or her customers.

Suppose a farm supply cooperative has been built through the efforts of management and many relatively small farmers. As times change, the managers perceive that the larger volume of business lies with larger farmers. They propose to transfer the assets "owned" by the smaller farmers into facilities and practices that will serve better the larger farmers but will largely abandon the present "owners." Would it be surprising if the current owners exercise a claim to service and if they argue that management is failing its responsibilities? In the game-theoretic bargaining discussed by Staatz, the small farmers may have little bargaining power to enforce their moral claims.

In summary, one of the unique obligations of cooperatives is a commitment to the continuation of past and present member service that goes beyond that of the IOF. While there is no easy or lucid way to define the difference in commitment, it exists and its existence is important. A frequent criticism of cooperatives is that they stay too long in losing businesses. The presence of such criticism suggests that many cooperatives have stayed with their commitments longer than have IOFs.

The dual customer-owner status of cooperatives applies to the problem of providing information and avoiding deception of any sort in advertising and all types of communication (obligation no. 5). It is unlikely that cooperative management will "improve the economic position of members" while misleading them. A farm supply cooperative should view itself as the <u>procurement</u> representative of farmer members; instead it often views itself as <u>marketing</u> to farmers.[3] The difference is important. A profit made by exploiting the ignorance of cooperative members is an empty profit indeed. Again, the differences in management practices of cooperatives compared with many well-run, consumer-oriented IOFs will not be large. The point is that the very nature of the cooperative demands a customer-benefit standard of conduct that is beyond that of the ordinary IOF.

The sixth obligation of a cooperative is very close to the fourth. Because of the customer-owner duality, the conglomerate or diversified cooperative faces some special problems of equity. Owners of an IOF have no concerns about cross-subsidization of enterprises within a firm as long as they contribute to the firm's objectives. But the cooperative that markets widgets and gidgets has problems when the widget producers are different people from the gidget producers. Assuming that there are "economies of scope" that justify the union of the two enterprises on a cost basis, each group benefits from the other.[4] Then each group can afford to share a bit when there is a need for investments or for meeting a shortfall in cash flow. However, neither group can expect a continual subsidy. An economic limit to cross-subsidy can be defined. When either group is potentially better off without the other group in the cooperative, the limits of cross-subsidy have been reached.

It is tempting for cooperative managers to use the funds available regardless of the lack of relationship between the groups (enterprises) generating the funds and the groups that will benefit from them. Farmer groups usually are patient about cross-subsidy within cooperatives when it involves the short term and relatively small sums. Member perceptions may differ widely from reality. It frequently is easy for significant cross-subsidization to occur without farmer awareness. However, if some crisis develops, farmers may imagine far more damage from cross-subsidy than has in fact occurred. Thus management bears a special responsibility to try to keep cross-subsidy within the economic bounds previously specified. Cooperative policy in funding new enterprises generally should be that the new group must provide its own capital ("each tub sits on its own bottom"). It also is proper to insist that the "accounts" should be assessed as the average of several years rather than each group trying to obtain its precise share of benefits each year. Situations should not be allowed to arise that will cause farmer-members to become obsessed with keeping score.

Social theorists have had great difficulty in explaining the rationality of loyalty or any allegiance to a group that seems to contradict immediate self-interest. The best answer to date seems to be that many individuals recognize the problem and are ready to foreswear free riding if they are convinced that a reasonable number of others will match their behavior (Guttman). The voluntary contributions to the dairy PACs (political action committees) by thousands of dairymen is a case in point. Under those assumptions of matching behavior, one's actions make a difference and it becomes rational to support the cooperative rather than take a slightly better option elsewhere.

To sum up this section, the customer-owner status of cooperatives continues their uniqueness. The differences of cooperatives from IOFs create different obligations for management in the three areas of: (1) continued service of current members needs as defined by members, (2) full information in sales and service, and (3) limitations on internal cross-subsidization.

Summary

A cooperative is an organization linking assets, business activities, and people in a distinctive way. The dual status of people as both customers and owners of the cooperative--with earnings distributed according to customer patronage--has been the important constant in cooperatives. Much else has changed about cooperatives in the past century. The large agricultural regional cooperative is far different in organization, management, and ideology from the Rochdale weavers' cooperative. More changes can be expected as the cooperative's participants continue to adapt it to their current needs.

The ultimate cooperation in the regional cooperative is between managers, board, and members as they develop an organization that adequately serves all their needs. A cooperative management does have some obligations to the owners that are unique to cooperatives. A cooperative management faces tighter constraints on its actions than the management of a conglomerate IOF. Members of a cooperative expect a high degree of managerial commitment to member service. It is gratifying to note that some of the most successful IOFs have a deep commitment to customer service. Instead of being a burden, the cooperative's member commitment can be a shared mission that energizes and guides the entire organization.

Some firms are hunters--continually seeking new activities in any parts of the economy that promises a better return on investment. Owners of IOFs may appreciate managers that are aggressive hunters, although the long-run consequences may not be as impressive as often suggested. Hunter cooperatives present a special problem. A conflict of interest can develop quickly between the old member-owners of the cooperative fearful of losing service, capital, and influence and the new members. These very divisive potentials need to be faced squarely. In a changing world, it is usually unreasonable to expect a cooperative management to do no hunting. However, the consequent equity problems need to be managed carefully to protect the legitimate interests of new and old members and of management. There is a strong caution to managers. If their concern for future growth and security leads to aggressive hunting that endangers the mutual commitments of members and cooperatives, they endanger the cooperative in its special role in society and the Capper-Volstead protections it has enjoyed.

Notes

1. "Some of the greatest benefits of cooperatives arise from greater stability of prices and returns, retaining decision making authority at the producer level, assuring producers of an outlet for their products and assurance of input supplies" (Knutson, p. 11).

2. Because farmers united to form a cooperative, they may feel that they <u>are</u> the cooperative. They, as owners, are an important part of the cooperative, just as cooperative management and cooperative boards also are important parts. Together, they form an organization which both legally and operationally is an entity separate from each of them.

3. Schaars expressed this idea many years ago in his argument that the cooperative is the 'agency" of its members.

4. See the definition of economics of scope and an extensive discussion of the attributes of multiproduct cost in Baumol, Panzar, and Willig.

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