



***Understanding and Teaching
New Cooperative Structures***


Michael L. Cook
Graduate Institute of Cooperative Leadership
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ACE – Alexandria, VA






Frameworks


- Framework: Evolution Approach
- Framework: Life Cycle Approach
- Framework: Ownership Rights Approach






Framework I

***Evolution of the Cooperative
Business Model***





In the beginning — agricultural cooperatives were - ?





“ cooperatives were:

- Strategically Defensive
- Organizationally Simple
- User Driven
- Exclusively Inclusive “





“ cooperatives were:

- Proportionately Funded
- Disproportionately Controlled
- Geographically Homogeneous
- Focused “



//// *Today, agricultural cooperatives in general are:*


- Attempting to be Strategically “Offensive”
- Organizationally Complex
- User - Investor Driven
- Increasingly Exclusive

//// *And*


- Disproportionately Funded
- Still Disproportionately Controlled
- Geographically Heterogeneous
- Struggling with Ambiguous Multiple-Purpose Objective Functions
- A Membership with an Increasing Set of Objectives


//// *The Original Model of an Agricultural Cooperative Was*

- Easy to Understand
- Relatively Transparent
- Generated Member Passion, and
- Usually Achieved Its Defensive Objectives
(i.e., protected the value of their members’ assets)



Framework II
A Lifecycle Approach





Phase One

- Economic Justification
- Origin — High Degree of Economic Homogeneity





Phase Two

- Organizational Design
- Period of Strong Commonality





Phase Three

- Growth and Consequences
- Onset of Heterogeneity
- Emergence of Organizational Conflict






Phase Four

- Recognition of Conflict
- Introspection
- Debates Over
 - Ownership rights
 - Control rights
 - Capital structure






Phase Five
Restructure Time

Options

Choice One: Exit

Choice Two: Tinker (moderate)

Choice Three: Radical Change



Choice One: Exit

- Liquidate
- Merge / Combine with Other Cooperative
- Demutualize


Choice Two: Tinker

Moderate Changes


- Patronage Pools - Multiple
- Capital Pools - One / Two
- Governance Pools - One


Choice Three: Radical

- Patronage Pools - Multiple
- Capital Pools - Multiple
- Governance Pools - Perhaps Multiple




Once the choice is made, the life cycle starts over again – but now members are more aware of ownership and control rights





The Life Cycle

- Phase I = Economic Justification
- Phase II = Organizational Design
- Phase III = Growth and Consequences
- Phase IV = Introspection
- Phase V = Restructure Time





***Cooperative Life Cycle
Phase II***

Organizational Design





Early Stages:

Cooperatives were formed around

- Common geographic locale
- Common grievances
- Common visions
- Relatively homogeneous group of farmers





Early Stages:

This commonality provided

- Strong sense of member ownership
- Strong sense of member control
- Strong sense of member commitment
- Strong sense of "them against us"





Definition

Defensive: Form to PROTECT Value of Members' Assets

Offensive: Form to ADD to Value of Members' Assets



Origin

- Low Prices — Excess Supply
- Low Prices — Market Failure
- An Opportunity

} Defensive

} Offensive

Reasons for Collective Action

- Defensive
 - Market power abuse
 - Risk reduction
 - Better terms / service
 - Missing service / market

Reasons for Collective Action

- Offensive
 - Scale / scope economies
 - Profit at another level
 - Coordination advantages

//// *Six Major Types of Rural Cooperatives Emerged*


- Farm credit
- Rural utilities
- Local multipurpose
- Regional multipurpose
- Bargaining cooperatives
- Marketing cooperatives

//// *1920 – 1935 Cooperative Philosophy*

<u>Nourse</u>	<u>Sapiro</u>
– Grassroots	– Single Commodity
– Multipurpose	– Centralized
– Geographic	– Monopolize
– Federated	– Contract
– Cost of Goods Sold	– Pooling
– Competitive Yardstick	


//// *1920 - 1935*


- “Defense” Grand Strategy Dominated
 - keep them honest
 - force prices toward market price
 - limited offense




*Cooperative Evolution
Phase III*

Growth and Its Consequences





*Let's review what
organizational design
emerged during this
embryo stage.*





*What is a Traditional
Cooperative?*





- Open membership
- No supply control
- Growth capital: earnings
- No secondary market






For cooperatives that maintained high degrees of homogeneity of economic interest, the traditional model continued to work well.






Within several generations, the original commonalities began to erode





- Membership started to become more heterogeneous — (size, off farm income, scope, etc.).
- Common grievances began to fade.
- Cooperatives began to expand their services to meet the growing, diverse needs of their members.
- Grievances against the cooperative began to emerge.





Cooperatives whose membership profile — especially from an economic interest point of view — started to become less homogeneous, encountered a set of emerging organization conflicts.

We'll call these the vaguely defined property rights challenges.





Free Rider Problem

Members/Nonmembers Use Resource For Individual Benefit -- Property Rights Not Sufficiently Defined Or Enforced to Ensure Members/Nonmembers Bear Full Costs And/Or Receive Full Benefits





Horizon Problem

Member's Residual Claim
On The Net Income
Generated By An Asset
Is Shorter Than Productive
Life Of That Asset





Portfolio Problem

Members Prevented From
Adjusting Their Cooperative
Asset Portfolio
To Match Their Personal Risk
Preferences





Control Problem

Agency Costs Associated With
Divergence Of Interests
Between Principal And
Agent

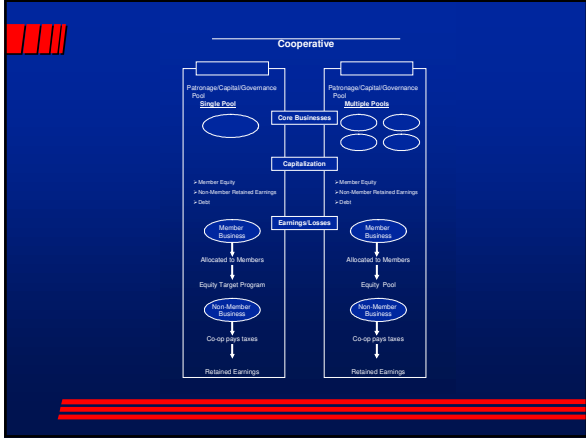



Influence Costs

Distribution Of Wealth
Decisions Generally
Create Influence Activities

Organizational Structure
Characterized by


- Free rider problem
- Horizon problem
- Portfolio problem
- Control problem
- Influence problem







*Cooperative Evolution
Phase IV*


Introspection







The late 1980's was a period of deep introspection and reflection on the part of U.S. agricultural cooperative leaders. They had witnessed unimaginable events:






- Had the concept outlived its usefulness?
- Was it a business structure of the past?





*In the mid-1980's the U.S. Senate asked the same questions about cooperatives. They commissioned a study which resulted in the 1987 USDA report:
Positioning Farmer Cooperatives for the Future.*


The report, written with contributions from many cooperative leaders and organizations, revised the cooperative principles to:


- user owned*
- user control*
- user benefit*



*Cooperative Evolution
Phase V*

Restructure Time




- Exit
- Moderate Remodeling (Tinkering)
- Radical Remodeling






Exit Options


- Liquidate
- Convert to IOF Structure
- Drop Out and Start New Generation Cooperative





Moderate Remodeling Options

- Proportional Capital
- Alliances
- Business Unit Focus
- Consolidations
- More Pools
 - Patronage
 - Capital
 - Control?



Radical Restructuring

- Complete Mergers
- Conversion to New Generation
- Allow for Nonmember Ownership Rights
- Allow for Nonmember Control Rights

*Simple Observation :
Can't Separate
Risk Capital Issues
from
Overall Organizational Design*

Issues

Control *versus* Ownership


Control *versus* Capitalization




Framework III


Ownership Rights Approach






Once the choice is made, the life cycle starts over again – but now members are more aware of ownership and control rights





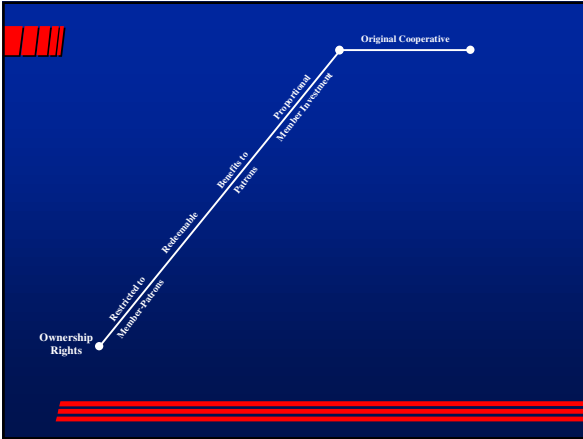
Basic Question

Can the evolving cooperative model be as successful as the original ?



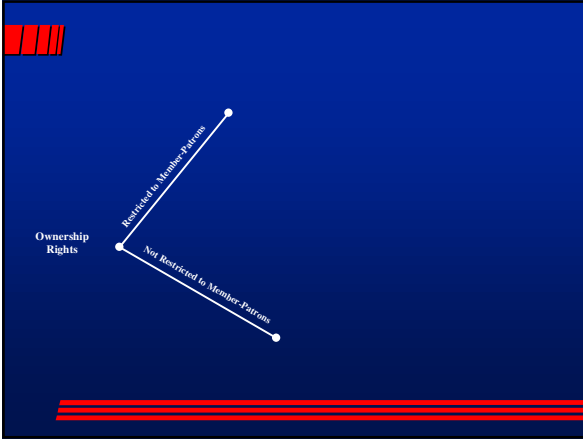
Let's develop a simple framework to facilitate exploration of this critical question.

- An original – pure cooperative has the following ownership rights:*
- Restricted to member-patrons
 - Redeemable
 - Non-transferable
 - Non-appreciable
 - Distributed proportionally to patronage



Analytical Framework is Derived from a Property Rights Theoretical Foundation

— Argument is:
Property rights (residual claims and residual control rights) are more clearly defined in an investor-oriented firm than in a user-oriented firm.



But over time a horizon problem emerges:

- All members receive some user benefits
- Senior members have a disproportionate amount of the capital invested
- Market value of organization can not be unlocked
- Exit does not mean capital is returned
- Voice vs. exit



And the membership becomes (from an economic point of view) more heterogeneous — that is to say — less homogeneous. Thus the portfolio problem emerges.

- Size
- Income source
- Farm portfolio
- Cost structure
- Ownership structure
- Age





These Investment Constraints

- Horizon
- Portfolio
- Internal Free Rider

Affect the Control Mechanisms, thus Creating

- Agency Costs
- Influence Costs





Consequently, as cooperatives evolve, many lose their original organizational characteristics.

Using equity capital investment as a proxy for ownership rights, a disproportionate distribution of ownership rights begins to emerge.





Emergence of Internal Conflicts: Capital Acquisition

Emergence of Capital Constraint Arguments

- a) Cooperative residual claims are restricted to members
- b) Members have inappropriate incentives to invest
- c) Growth capital acquisition tied to patronage
- d) Equity capital is not permanent
- e) Limited access to external finance

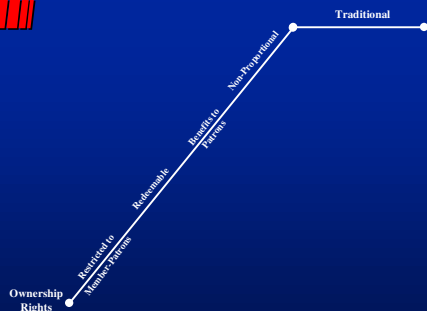




A traditional cooperative has the following property rights attributes: ownership rights are

- restricted to member patrons
- redeemable
- non-transferable
- non-appreciable
- distributed disproportionately among patrons







GICL uses these approaches and many cases to explain, explore, and learn about the changing cooperative structures.





GICL = Graduate Institute of Cooperative Leadership

Founded by

- Small endowment
- A visionary Dean
- Energetic Assistant Professor

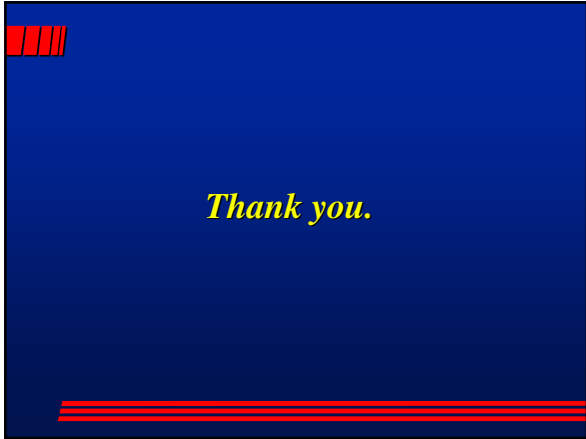




GICL now enters its 35th year based on two beliefs:

- Cooperation provides both
 - Private goods, and
 - Collective goods⇒ Consequently cooperation is a win-win
- Cooperative education matters.





Thank you.
