WHAT GIVES COOPERATIVES A BAD NAME?*

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Introduction

From time to time we hear comments such as: “I don’t want to have anything to do with cooperatives”, or “Cooperatives are prone to failure”, or “I would quit farming before I would deal with a cooperative”, or “We do not want to organize as a cooperative because state law requires that we have the word ‘cooperative’ in our name.”

Yes, some cooperatives have failed, costing members the equity they had invested. Others have not pursued effective strategies for the long run benefit of their members. In still other cases, farmers have had unrealistic expectations concerning a cooperative’s ability to exert market power or improve prices. In many cases, cooperatives have probably received a bum rap.

Over the years we have observed that if farmers lose money in their dealings with a non-cooperative they rack it up to experience, quickly wipe the incident from their minds, and go on with their lives. However, if the same farmers are actually or believe that they have been wronged by a cooperative, they have very long memories. In fact, we believe some farmers pass their bad experience with cooperatives down from generation to generation.

There is nothing inherent in the legal or organizational structure of cooperatives that destines them to poor performance[1]. It all comes down to the behavior, performance and expectations of their boards, management and members.

The purpose of this article is to outline and discuss some of the reasons that cooperatives have acquired a bad name. They are divided into two general categories: reasons some farmers have a general dislike for cooperatives, and reasons for poor cooperative performance.[1]

A GENERAL DISLIKE OF COOPERATIVES BY SOME FARMERS

Lack of Market Alternatives

As the food system consolidates, farmers are left with fewer alternatives through which to market their products or purchase their supplies and services. People like to have alternatives, and as the alternatives become fewer, they can feel constrained and frustrated.

Interestingly, the last alternative in a market is often a cooperative. Sometimes the cooperative comes about by farmers starting a new organization because of lack of markets or services. At other times, and a source of greater resentment, a monopoly arises by a cooperative merging with another cooperative or buying out a non-cooperative competitor. The surviving cooperative’s objective is typically not to create a monopoly and exert market power against

1 Poor performance includes lose of equity, extended redemption of equity, low or no patronage refunds, unfavorable prices, as well as poor quality of products and services.

members. Rather, it is to achieve greater efficiencies and to provide farmer members with a more secure market for their inputs and outputs. If the firms taken over were having financial difficulties, the surviving cooperatives may be forced to reduce service or product lines. This can also increase the resentment of the dominant cooperative.

Farmers rarely consider the economic alternatives to a cooperative monopoly. They can include: uncompetitive prices, bankruptcy, a non-cooperative monopoly, or no market whatsoever. There is a high probability that any of these alternatives would create a considerably worse situation for producers than a cooperative monopoly.

Some farmer members will resent the cooperative for having a monopoly, no matter how well they are treated. Because members have few alternatives, except to quit farming, the role of voice and voting becomes more important to cooperative democracy.[2] In fact, cooperatives are likely to find that members will become much more critical of their organization if it is the only alternative left.

Overcoming Monopolistic Behavior

If a cooperative achieves a monopoly position it must change it's member relations strategy. It cannot yield to it's natural instincts that it must behave in a monopolistic manner. Quiet the opposite. The cooperative must make a greater effort to communicate and constructively dialogue with members in an increased variety of mediums, e.g. focus groups, meetings, e-mail, mailings, press releases, web sites, etc. A different tone is required that suggests to members that their cooperative is listening and trying to do what is indeed in their best interests.

Also, the cooperative must develop quantifiable measures of how the organization does improve the economic well being of members, and how it makes a difference. For example, a few marketing cooperatives compare their pay price to competing companies.

Members Don't Like Large Impersonal Organizations

Many members long for "the good old days" when the closest cooperative facility was just down the road, cooperative headquarters was in a nearby city, members knew all the directors and many employees by first name, and management knew them. But for many cooperative members, those days are gone forever in the name of efficiency and competition.

As business organizations operating in increasingly competitive global markets, cooperatives must achieve the necessary efficiency. This is the driving force of most mergers and consolidations. It is a fact of cooperative and non-cooperative business life.

Large organizations reduce the "feeling of membership". Members like to communicate

[2] The option of exiting the cooperative has limited strategic value, except if it involves enough members to send a negative message to management.

with cooperative officials on a personal, one-on-one basis. Also, they like to vote on as many issues as possible This is natural and heightens the feeling of membership. One knows someone is listening and voting gives the same feeling of satisfaction as a participative sport - which sometimes it becomes in a cooperative. Mail ballots, cooperative officials personally unknown to members, and the need to communicate via telephone, or e-mail can make the cooperative significantly more democratically impersonal.

While a member's physical distance for direct contact can increase with mergers and consolidation, a member's psychological distance to the cooperative has probably increased by a magnitude greater than the physical distance.

Overcoming the "Bigger Is Worse" Attitude

As cooperatives get bigger they all vow to substitute better member information and education for the personal contact they know will be lost. However, it is not the same thing. In addition, over time either with a change in leadership or when the need to reduce costs arises, member information and education is an all too easy target for budget cuts. The reason is that it is difficult to measure the return on investment from such expenditures.

Active member communications by the top leadership of the cooperative can be the most effective means of dealing with bigness. While members typically do not require personal attention, they do desire personal contact. After every quarterly board meeting of one major national cooperative, the Chief Executive Officer (CEO) and Board Chair would visit each of their major regions to outline the decisions made at the board meeting, and engage in a question and answer period until there were no more questions. Another strategy is to structure membership through locals, districts and regions in such a way that members know they have access to their regionally elected cooperative officials. Finally, it takes an extra effort in member communications and education when an organization is large. A large cooperative should have the resources and talent to make that happen.

General Attitudes Toward Cooperatives

Research on farmer attitudes towards cooperatives indicates that among any group of farmers about 30% prefer to deal with cooperatives and are loyal to some degree, 30 % dislike cooperatives in various degrees, and about 40% are more or less indifferent about dealing with cooperatives.

Depending on farmers' individual and group experience with cooperatives, the relationship may take on other forms. Also, cooperatives, individually and as a group, have the ability to influence the shape and position the relationship with farmers.

MISCONCEPTIONS ABOUT COOPERATIVES

There can be a number of negative misconceptions about cooperatives. The following are some that one often hears.

Abandonment of Original Purpose

This misconception is often packaged in this manner: "This cooperative was started by and for small farmers, and now it has abandoned its original purpose." It is true that the loyalty of small farmers was important to the early success of several cooperatives. However, three facts are often forgotten. First, in the first half of the 20th century most farmers were small. Second, if one reads the history of cooperatives, one will often find that the founding leaders were not small farmers, but farmers with larger operations. And third, the early success of many cooperatives was dependent on the patronage of larger farmers.

While a few cooperatives were formed with the specific intent of serving small farmers, there are not many. In other words, there is rarely an overt effort by large farmers to wrestle control from small farmers. Rather many cooperatives have realized that in order to survive and prosper they need the patronage of large farmers. Many have also come to realize that the true spirit of cooperation is to treat members equitably rather than equally.[3]

However, this issue does tend to cause resentment among members. In fact, it is often a case of the cooperative is damned if it does (by small members if it adopts policies favorable to large members) and damned if it doesn't (because larger members will go elsewhere and reduce the efficiency of the cooperative).

The Perception of Large Member Dominance

Lets apply the old "80 - 20 Rule" to cooperatives. It would suggest that about 20 % of the members are responsible for 80 % of the cooperative's business. On the other hand, the other 80 % of members are responsible for only 20 % of the cooperative's patronage but have 80% of the control of the cooperative when voting is based on one-member one-vote.

There have been cooperative cases where smaller members have been able to capture control of the board, and institute polices to the benefit of small members and the detriment of large members. This may drive those large members away from the cooperative, and consequently reduce the long run efficiencies of the organization. On the other hand, too much dominance by larger members often causes conflict within the cooperative. Including both small and large scale members can be a "win - win" outcome when larger members enhance the efficiency of the cooperative, and smaller members add to increased political and market power.

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[3]Equitable means that members equally bear the costs and share the benefits they cause the cooperative. For example, small farmers often impose a higher cost on the cooperative per unit of product handled than larger members in terms of transportation, storage, administration, quality control, handling, etc.

Cooperative Practices Versus Principles

Fortunately or unfortunately, no one wrote cooperative principles[4] in stone and carried them down the mountain. Like the U.S. Constitution, cooperative principles are dynamic and have been adapted to changing business and social environments. For example, today very few cooperative cooperatives practice the principle of "cash trading". Most cooperatives currently extend credit to members. Also, two of the eight principles adopted by the International Cooperative Alliance, the self appointed global protector of cooperative principles, are of rather recent origin.[5]

Some "principles" may be better described as business "practices" rather than underlying principles. There are only three principles that are essential for an organization to operate in a cooperative manner. They are: net income is distributed according to patronage, democratic control and limited dividends on invested equity. At the same time, the practices of cooperatives are ever-changing, as they should be, to adopt to contemporary situations.

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Just Like Any Business

One often hears: "Its not a cooperative; it acts like any other business." The implication is that the cooperative should be making non-business like decisions or operating in an unprofitable way.

No doubt about it, cooperatives sometimes do not make decisions that are in the best interest of its members and to the detriment of the organization. For example, some cooperatives may pursue growth and/or diversification for its own sake. This may occur in management dominated cooperatives, where management's compensation is determined by the size of the organization.

On the other hand, cooperatives must remain efficient and competitive. This may mean pruning unprofitable operations, changing the way the cooperative serves members, or cutting services members took for granted.

Don't Care About Members

Occasionally it is stated: "The board and management don't care about members." This usually occurs when a change has been made in the way the cooperative operates. It could be a matter of pushing more responsibility or costs back to members or a reduction of services.

Anyone who has sat through a cooperative board meeting soon realizes that members are usually at the forefront of almost all proposals by management and decisions by the board. As a

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[4]In fact, in academic and popular literature it is difficult to find two identical lists of cooperative principles. For a comparative discussion of cooperative principles see (Barton, forthcoming).

[5]Barton.

result, decisions painful to members are often delayed to the extent possible and moderated to reduce the potential impact on members. The problem with this approach is that the strategies eventually adopted may not be as effective as they could, had the board acted quicker and with less concern for the immediate negative impact on members.

Government Favoritism

Cooperatives are treated somewhat differently than some other types of businesses. Government favoritism can occur in three primary areas: tax treatment, anti-trust legislation and access to cheaper borrowed capital. Generally, competitors do not like to see a playing field that is not level; unless they are the beneficiary. While government favoritism to cooperatives may not directly concern members, the jealousy of firms adversely impacted, may result in demeaning references to cooperatives.

Most cooperatives have the opportunity for Sub-chapter T and Limited Liability Corporation tax treatment which eliminates double taxation on operating income. Such types of tax treatment are afforded to specific groups, such as agricultural cooperatives, credit unions, mutual insurance companies, etc. Competing companies that do not enjoy the same tax treatment may engage in a negative public relations effort against those that do.

Agricultural producers and marketing cooperatives have the ability "to act together" under the Capper-Volstead Act of 1922. While this brings only limited structural anti-trust exemption, competitors may complain of the "unfair advantage" cooperatives have in this area.

Farmers, agricultural cooperatives and rural cooperative utilities have access to borrowed funds obtained through U.S. government agency status. Commercial bankers have been particularly active in trying to change the legislation that favors cooperatives' access to cheaper borrowed funds. While the claims of government favoritism are often exaggerated, they can contribute to giving cooperatives a bad name in some circles.

Cooperatives Are Socialistic Institutions

It is probably unthinkable for younger generations to appreciate the negative connotations of labeling something as "socialistic". But for older generations socialism was directly linked to Leninism, Stalinism and Maoism. The mere mention of these schools of thought, however interpreted, conjured up extremely negative images for most people. It is interesting to note that during the 1950's (and 1960's) a presentation at the American Institute of Cooperation was often devoted to distancing western cooperatives from the socialist cooperatives of eastern Europe and Asia.

Not Really a Business

There are a few members that view a cooperative more as a social organization than a business. While competitive pressures in the market have generally changed this attitude, there are still members that continue to hold this view.

“Top Down” Cooperatives

In some countries cooperatives are imposed by the government. We typically call these “top down” cooperatives as opposed to “bottom up” cooperatives where grass root members take the initiative to organize a cooperative. The former type is particularly common in developing countries, and the latter in developed countries.

In addition to forcing the cooperative on reluctant members, “top down” cooperation has other disadvantages as well. Often there are no other alternatives to government sanctioned cooperatives. Managers and directors may be political appointees. The government may want the organization to pursue a broader set of political objectives such as economic development, providing employment, or implementing government programs.

REASONS FOR POOR PERFORMANCE

Certainly members will think negatively of their cooperative if it is not performing well as compared to other firms in their industry. But the problem of performance does not stop there. The poor performance of one cooperative can give a bad reputation to all cooperatives. Lets examine various reasons for poor cooperative performance.

Conflicting Goals

There are inherent goal conflicts in all types of cooperative organizations. The board of directors has a fiduciary responsibility to, in the short run, act in the best interest of the cooperative even if its actions have a negative impact on members. Examples of this would be increasing the amount of equity required from members, reduction of member services, increasing membership dues or fees, etc. Although such actions are often viewed as negative by members in the short run, the results should benefit members in the long run via a more efficient and financially healthy organization.

Management may pursue goals, with the approval of the board, that are not in the best interests of members. For example, since management compensation is often linked in some way to the revenues of the cooperative, management may pursue growth or diversification for its own sake rather for the benefit of members. In addition, there are times when growth and diversification are the appropriate strategies, but management does not have the experience to effectively implement these strategies.

A polarized membership may have conflicting goals. Members of different age groups, geographic areas or types of farm enterprise may not agree on a set of common objectives.

Poor Management

While it has changed considerably in recent years, historically cooperatives were notorious for their unwillingness to offer competitive compensation packages to attract the best or most appropriate management team. As a result, they would not attract managers with sufficient business experience to manage large cooperatives. Associated weaknesses include managers with insufficient vision and the ability to implement action plans.

Another common fault in cooperatives is the board not giving management sufficient control of operations, interfering with the implementation of cooperative strategies, or just plan meddling in operations. Finally, as member owned organizations, cooperative do not always have the opportunity to provide management with stock ownership or stock options based on a cooperative's performance.

Poor Board Performance

One of the common reasons given for poorly performing boards is that cooperative directors do not fully understand their fiduciary roles and responsibilities. The result is that directors may provide too little or too much oversight of the cooperative. The former often happens when performance has been acceptable for several years. The latter often happens when performance has not lived up to expectations and the board tries to micro-manage operations. To further compound the situation, some boards may have unrealistic expectations of what can be accomplished in terms of cooperative strategies, goals and plan implementation.

There is significant evidence to suggest that cooperative decision-making process takes longer than that in other types of firms.[6]

Inappropriate Strategies or Poor Implementation

With a desire to provide their members with "market security", cooperatives often enter the mature stage of the industry's life cycle.[7] That is, they often take over another firm or expand operations at the top of the industry, business or product life cycle. Some cooperatives take over unprofitable operations. The opposite can be also true with an unwillingness to exit money losing businesses, plants, products and services. Occasionally the board or management may have too much of an emotional investment in a particular business or product, or pay too much for an acquisition.

Sometimes cooperatives are not willing or not able to invest in an appropriate strategy. This may be the reason a number of cooperatives market commodities rather than value added products and services. Often cooperatives are accused of being too risk averse. Because of their close relationship with members, there can be a strong tendency to maintain the *status quo*. These factors can also inhibit the organization from adapting appropriate strategies. Finally, some cooperatives have poorly implemented otherwise appropriate strategies.

Inadequate Capitalization

A common complaint of cooperatives is they do not have sufficient access to adequate capital. Being too dependent on debt is dangerous, especially with new operations or high risk

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[6]Henehan, B.M. and B.L. Anderson.

[7]Cobia, D. W. and B. L. Anderson.

operations. Sometimes cooperatives do not require a significant amount of equity from members. Usually if the return is high enough, members would be more willing to invest larger amounts of equity.

Another reason members are unwilling to invest more equity is because of poorly functioning equity programs, resulting in members not receiving their invested equity in a timely manner.

To maintain adequate capitalization requires excellent cash flow management. Many smaller and even some larger cooperatives have been unwilling to invest in modern cash flow management programs.

Lack of Member Oversight

Cooperatives are democratic organizations. There are three major alternatives for members to exert democratic rights: a) by voicing their opinion, b) by voting for directors and other issues, and c) by exiting the organization. To properly carry out their democratic responsibilities members must keep well informed about the cooperatives affairs and performance.

Also, members seem to demand a higher level of trust from cooperatives than from other types of market organizations. While members are often very trusting, if that trust is breached it takes a long time to regain it, if ever. This trust is usually built by a high degree of accurate communications between members and the organization whether from directors, management or employees.

In some cases, cooperatives are lax in providing sufficient, timely information about the organization and operations. For example, many cooperatives provide very little information about their financial performance until long after the end of their fiscal years. Public corporations, by contrast, must publish quarterly financial information on a timely basis. We have also observed that cooperatives tend to provide less financial information in bad times, probably when members need it most to exert their democratic rights. Also, some cooperatives allocate more coverage in publications to promoting products and services than keeping members informed about financial performance and operations. Finally, as all agricultural sectors have become more competitive, one area that has probably suffered a disproportionate share of cuts is member relations and information.

Members have an obligation to keep informed about their cooperatives. In studies we have conducted, it is obvious that a large portion of members do not read publications or attend cooperative meetings.

Overly Sensitive to Member Concerns

At times, cooperatives can be overly sensitive to member concerns. This tendency may impede them from adapting the best strategy for the cooperative and have a negative impact on long term financial performance. Examples include: treating members equally rather than equitably, accepting poor quality member products, not matching member production to market demand (i.e. allowing members to deliver whatever they want to produce), not requiring enough equity from members, providing an excess number of subsidized services, and adopting a too defensive corporate culture. We have found in our studies that those cooperatives that are most successful are those that are toughest on members.[8]

Summary

There is no reason to believe an organization should be any less successful just because it is a cooperative. Moreover, in this day and age of corporate scandals the likes of Enron, WorldCom, Tyco, Adelphia, one may come to the conclusion that most cooperatives practice a higher degree of ethics and exhibit less greed than a lot of public corporations. However, this does not guarantee financial success for the cooperative and its members.

We strongly feel that much of the bad name cooperatives have acquired is unjustified. However, members, directors and managers must take actions to assure that their cooperatives achieve the maximum amount of success possible.

So what must be done? 1) We firmly believe it all starts with the quality of the cooperative's board of directors. 2) This is primarily the responsibility of members to elect the best possible candidate with top level business and cooperative skills. 3) The board is then responsible for: the selection of management, development of a strong strategy and implementation of a sound financial structure. Finally, 4) members must be constantly vigilant in monitoring the performance of the cooperative, board and management. If these simple rules are followed we firmly believe that cooperatives can overcome a bad name.

[8] Henehan, B.M. and B.L. Anderson.

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