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COOPERATIVE PERFORMANCE

by

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BANK OF IRELAND CENTRE
FOR COOPERATIVE STUDIES
University College, Cork

BANK OF IRELAND CENTRE FOR CO-OPERATIVE STUDIES

The Centre was established in 1980 to foster studies, research and education about co-operatives. The Centre's activities, which are multi-disciplinary, include the promotion of undergratuate and post-graduate courses on co-operation, post-graduate and staff research projects, post-experience courses for managerial staff, courses for director-training personnel and directors as well as preparation and publication of teaching material for a wide variety of formal and informal courses. The activities of the Centre are sponsored by the Bank of Ireland and the Irish Co-operative Organisation Society.

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About the authors .....

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FOREWARD

Working papers are a new informal series of publications from the Bank of Ireland Centre for Cooperative Studies. Their purpose is to focus on issues important to Irish cooperatives, their members and their governing bodies. Working papers are designed to provide a basis for discussion by those having either a vested or an academic interest in cooperatives. They are not necessarily end pieces of research, but rather a combination of existing research and professional experience of the Centre's personnel. I believe these "working" papers will contribute to the development of the concepts and practices of Irish cooperatives. They will be published at irregular intervals as appropriate.

In accordance with normal practice, while working papers are being published by the Centre, responsibility for the views and opinions expressed resides with the authors.

Denis I. F. Lucey
Director

February 1984

EXECUTIVE SUMMARY

1. The need to evaluate performance of business firms is currently receiving increased attention. The performance of cooperatives is of special concern to member-shareholders, to governments, and to the public in general. Methods and problems of evaluating cooperative performance, and appropriate criteria are discussed.

2 Identifying the most relevant performance criteria, and then measuring performance consistently and regularly, is a key responsibility of the board of directors and the chief executive, who has a great deal of the responsibility for informing the board of directors of appropriate performance results.
In recent years numerous cooperatives worldwide have experienced severe commercial reverses, or losses in earnings. Many of these have either gone into receivership, have been forced to merge with another cooperative, or have been acquired by proprietary interests. The authors believe that while many of these events may have resulted from the international economy, virtually all such instances also involve either an inadequate evaluation of performance by key decision makers (the board of directors and the chief executive), or gross misjudgement in assessing information. It appears that in many cases "early warning systems" were not in effect, and penetrating direct questions were not asked by key decision makers.

3. The business performance of a cooperative and other corporations should be evaluated in much the same manner. They face the same economic conditions, buy their manufacturing supplies from the same sources, face the same consumer preferences, borrow money in the same capital markets, hire employees from the same labour pool and, in many other ways, are no different in terms of business operations. Even though cooperatives have some social objectives in their structure, they nonetheless are primarily economic institutions.

4. Despite their main economic mission, cooperatives are expected to perform in such manner as to maintain democratic structures and decision processes and to fulfill social and public expectations.

5. Performance indicators are categorized into three groupings: Economic Performance; Performance as a cooperative organisation; and Social Performance. Each of these is sub-divided into areas under which specific criteria can be identified, i.e. under Economic seven headings provide a classification of the criteria. These groupings, sub-groupings and proposed criteria should provide cooperative boards and managing directors a basis upon which to construct a meaningful performance measurement model for their particular cooperative.

6. Four problems of performance measurement that make difficult the task of performance evaluation are identified:

   i) Deciding on relevant dimensions to be measured and acceptable values for each;

   ii) The multiple dimension of cooperatives and their dual objectives;

   iii) Measuring performance when objective measures are difficult to find; and

   iv) Determining the appropriate time period for analysis.

COOPERATIVE PERFORMANCE

INTRODUCTION

The Relevance of Cooperative Performance

"..... Time is an everlasting progress, and human endeavours take on a new shape every fifty years, so that an institution which in the year 1800 has been perfection, might be defective in the year 1850 ....." (Goethe, spoken to Eckermann, 4 January, 1824).

".. .. Many questions were being asked within the cooperative movement about its present relevance and performance, such questions, for example as these: ..... what is the end and purpose of it all? What is expected of cooperatives? How is success of cooperative enterprise to be measured? By the same criteria by which other business is judged? If not the same, then what criteria?". (A.F. Laidlaw, 1980, p. 9).

"Once established on a firm foundation, cooperatives have a remarkable resilience and staying-power through both good times and bad". (Laidlaw, p. 10).

"But now ..... cooperative systems ..... are faced with what may be called an ideological crisis. It arises from the gnawing doubts about the true purpose of cooperatives and whether they are fulfilling a distinct role as a different kind of enterprise. If cooperatives do nothing more than succeed in being as efficient as other business in a commercial sense, is that good enough? And if they use the same business techniques and methods as other business, is that in itself sufficient justification for the support and loyalty of members? Moreover, if the world is changing in strange and sometimes perplexing ways, should cooperatives change in the same way, or should they not strike off in a different direction .....?" (Laidlaw, p. 9).

Such profound questions strike at the roots of what society expects from the rights and privileges which society, through public policy and administrative means, bestows upon cooperatives. Questions such as these are raised not only about cooperatives, but properly so, about all business entities, private or state in ownership. Cooperatives, because of their quasi-public nature and because of their economic significance to a chronically depressed economic sector (agriculture) often are openly questioned more frequently than are other private and state businesses.

The authors take the position that the nature of questions such as those asked of cooperatives by Laidlaw be likewise asked of all

commercial ventures, rather than curtailing the evaluation of cooperatives. The economic significances of most businesses are so imposing, that more, rather than less, questions about objectives, conduct, and performance will be helpful in assessing whether society's (the public's) expectations are being met.

We do not undertake such a grandiose mission in this paper, nor are the resources adequate for our doing so. Ours is a much more limited mission — to describe the methods and problems of evaluating performance, and to propose for discussion, some criteria deemed relevant for measuring cooperative performance. Even this narrower task is fraught with limitations; each cooperative membership sets expectations specific to its economic and cultural heritage; specific to its economic and social needs and resources; and specific to the commitment a cooperative's membership is willing to make. Thus, what we propose as general performance criteria may not be applicable to every cooperative or to every situation, but if they are, certainly the standard ranges of acceptable performance levels will vary among cooperatives.

We believe this exercise and the proposed criteria have much practical as well as theoretical application. In recent years numerous cooperatives have experienced severe financial reverses, and an alarming number have gone into receivership or have had to merge with another cooperative. While much of this may have resulted from the world-wide depressed economy, our experience suggests that virtually all such instances involved inadequate evaluation of economic performance by the key decision groups — the board of directors and chief executive officer. In all such cases, adequate "early warning systems" were not in effect, because the right questions were not being asked by such decision-makers. More concern is often given to short-run matters such as current producers' payments than assessing whether the cooperative's performance is adequate for long-term survival. The makings of an "early warning system" are based on identifying the appropriate performance criteria, and then measuring performance consistently and regularly. While the main responsibility for assessing performance is with the top decision centre - the board of directors and the chief executive officer, the membership and advisory bodies bear the ultimate authority. However, from a practical consideration, by the time members and advisory bodies (and unfortunately, sometimes the board) become adequately aware of trouble, creditors have often left shareholders as residual claimants.

Our research suggests three categories for measuring cooperative performance:

1) as an economic (business) entity,

2) as a cooperative organisation with structural and process variables, and

3) on social and public expectations.

Criteria for measuring performance were collected from a search of cooperative literature, but in most cases, the criteria were not explicitly stated as performance criteria by the authors. Except for two sources (Lang, and Purdue University), the criteria were limited implicitly as desirable expectations.

In the pages that follow, we describe these categories and propose criteria considered appropriate for measuring performance under each category. However, we do not have specific values or standards for each of the criteria we are proposing, since our sources have not done so, and what we would provide at this time would be too subjective. (We have underway a research project which we expect will provide standards for these criteria).

THE BUSINESS PERFORMANCE OF COOPERATIVES

There is reason to argue that one would evaluate the performance of cooperatives and general corporations in much the same manner. After all, they face the same economic conditions, buy their production inputs from the same general sources, face the same consumer preferences, borrow money in the same capital markets, hire employees from the same labour pool and in many other ways, are no different in terms of business related activities from general corporations. "The real difference between cooperation and other kinds of economic organisations resides precisely in its subordination of business techniques to ethical ideas. Apart from this difference, the movement has no finally satisfactory reason for its existence". (W.P. Watkins). Laidlaw recognizes the same concept.

"However, though they are both economic and social in their aims, cooperatives are primarily economic and must succeed in business in order to continue at all. A cooperative that fails in a commercial sense can hardly be a positive influence in a social way, especially if it must

close down operations. Thus, while economic and social are as two sides of a coin, viability as sound business must enjoy prior claim ....." (page 38).

We concur with these opinions, but have segregated the economic performance criteria to reflect that we are concerned with a cooperative organisation, albeit, in most business respects there may be only slight distinction. Accordingly, we have classified business performance criteria under seven headings:

1) farm level,

2) market and processing level,

3) pricing/output operational level,

4) finance,

5) consumer considerations,

6) public business considerations, and

7) other.

Farm Level performance criteria reflect mainly income and cost related impacts, adequacy and types of services provided, and availability of economic information that facilitates farmers' planning decisions.

Market and Processing Level factors evaluate how effectively firms recognise and respond to consumer and trade requirements, and how they have engaged in market expansion activities.

Pricing/Output Operational criteria relate to the efficiency of operations, and the effectiveness of the cooperative in being a viable competitor.

Finance criteria are fairly straightforward — they evaluate balance sheet and operating statement matters.

Consumer Considerations relate to product price-quality considerations, and stability of prices.

Public Business Considerations relate to progressiveness and innovations.

The Other category includes criteria that do not fit well under any of the previous ones.

The criteria and their sources for each of these areas follow.

ECONOMIC PERFORMANCE INDICATORS

A. Farm Level

(1) Higher final returns than paid by proprietary firms. (Purdue) (Lang) (Foxall) (FCS)

(2) Lower costs and reliable sources of farm production inputs. (Purdue) (Foxall) (FCS)

(3) Provide timely technical farm services at reasonable costs or of higher quality. (Purdue) (Foxall) (FCS)

(4) Provide shareholders with reasonable credit policies or provide production credit. (Purdue) (FCS) (Torgerson)

(5) Provide or endorse other appropriate services, such as insurance. (FCS)

(6) Inform farmers of price expectations before planting. (Lang) (Garoyan)

(7) Differentiate prices paid to farmers to reflect quality differences. (Lang)

(8) Provide marketing security (dependable outlets) to members. (Purdue) (Foxall)

B. Market and Processing Level

(1) Perform marketing functions at lower costs (Lang), or at the same costs with profits allocated and returned to producers.

(2) Provide better product flow to markets (timing and seasonality of production/processing/marketing). (Lang)

(3) Provide customers with a wide range of products based on commodities available from members. (Product diversification). (Lang)

(4) Maintain balance in growth in sales v. profitability. (Avoid product and size proliferation that costs more than products return. (Duft) (Purdue) (Garoyan)

(5) Develop and maintain market shares in sufficient proportions to be an effective market force. (Foxall)

(6) Engage in vertical integration at efficient levels to enhance value added. (Foxall) (Garoyan)

(7) Engage in joint ventures when profitable and unable to diversify alone. (Foxall) (Purdue)

(8) Engage in or support market research. (Foxall)

(9) Maintain a marketing orientation by providing members with economic information that influence their production decisions more in line with consumer preferences and market conditions. (Purdue) (Garoyan)

(10) Engage in or support product development research. (Purdue)

(11) Improve productivity. (Garoyan)

C. Pricing/Output Operational Level

(1) No undue (excessive) enhancement of wholesale prices. (Bain)

(2) No excessive persuasive sales promotion expenses relative to production costs. $\left(\frac{\text{Sales and promotion costs}}{\text{production costs}}\right)$. (Bain)

(3) Absence of chronic excess capacity; Maintain efficient levels of productivity. (Bain) (Purdue)

(4) Be an effective competitor in the markets, enabling the cooperative to have market impact. (Purdue)

(5) Engage in ethical trade practices — no abuse of market power. (Purdue)

D. Finance

(1) Maintain access to capital through prudent capital management. (Foxall) (Garoyan)

(2) Monitor extent of full cost pricing (marginal income management) by ratio of $\frac{\text{sales value}}{\text{overhead costs}}$. (Duft)

(3) Reasonable credit policy execution through analysis of dated accounts payable and receivable. (Garoyan and Mohn) (Duft)

(4) Tests of profitability related to investment and sales. (Garoyan and Mohn)

(5) Tests of liquidity as indicators of the cooperative's ability to meet its current obligations. (Garoyan and Mohn)

(6) Tests of solvency to indicate the cooperative's ability to meet interest and debt service. (Garoyan and Mohn)

(7) Inventory turns to reflect efficiency of cash employment. (Garoyan and Mohn)

(8) Return on investment (and assets employed).(Garoyan and Mohn) (Purdue)

(9) Growth in shareholder equity. (Purdue)

(10) Stability (regularity) of revolving of earnings to members. (Purdue)

E. Consumer Considerations

(1) Stability of prices over time, consistent with indices of inflation. (Lang)

(2) Relationship of consumer product prices and quality. (Purdue)

F. Public Business Considerations

(1) Progressiveness of the firm in product development and production techniques relative to levels attainable. (Bain) (Purdue)

(2) Evolutionary growth. (Bogardus)

G. Other

(1) Ability to influence government pricing policies. (Foxall) (Garoyan)

(2) Existence of long range plans and evidence of their achievement. (Purdue) (Garoyan and Mohn) (Garoyan)

INDICATORS OF PERFORMANCE AS COOPERATIVE ORGANISATIONS

If cooperatives do in fact have unique characteristics that distinguish them from other forms of businesses, it should be possible to measure how well cooperatives are performing on such characteristics. We use the concept that cooperatives have unique characteristics that as a process involves carrying out the principles of cooperation (Briscoe et al). We define the cooperative process as those elements involved in how the cooperative is run. We have, in addition, identified structural characteristics that maintain the cooperative as an entity of joint activity among people with common objectives. (In some cases we admit having had difficulty in making a choice).

A. Structural Elements

(1) Membership commitment. (Laidlaw) (Foxall)

(2) Education of internal groups on cooperation - shareholders and employees. (Laidlaw)

(3) Education of general public. (Laidlaw)

(4) Efforts to develop and maintain a favourable cooperative image. (Laidlaw)

(5) Ability to develop and maintain sectoral solidarity (cooperation among cooperatives). (Laidlaw) (Foxall)

(6) Shareholder patronage loyalty compared with non-member patronage. (Torgerson) (Foxall)

(7) Ease/Difficulty of becoming a member (voluntary or open membership policies). (Torgerson)

(8) Maintaining democratic control processes (equal v. equitable (patronage) voting). (FCS)

(9) Maintaining practices and policies facilitating opportunities for election to the board of directors and advisory boards. (FCS)

(10) Increasing membership involvement. (Kravitz)

B. Process Elements (Relating to ways to maintain cooperative principles)

(1) Democratic principles are maintained with the membership. (Torgerson) (Foxall) (Kravitz)

(2) Efforts are made to obtain shareholder participation on matters within their jurisdiction. (Laidlaw)

(3) Existence of specific programmes for development of leadership among shareholders. (Laidlaw)

(4) Risks, costs and benefits are shared equitably among members. (Torgerson) (FCS)

(5) Existence of policies and their implementation that allow membership service costs to reflect true costs of doing business by size. (Differential charges to reflect transaction costs at different volumes). (FCS)

(6) Extent to which net earnings are allocated to members (shareholders) proportionately. (Torgerson) (FCS)

(7) Extent to which processes exist for shareholders voice and control on cooperative policies. (Purdue)

(8) Extent to which processes exist for more shareholders voice and control in government agricultural decisions. (Purdue)

SOCIAL PERFORMANCE

There are three easily identifiable camps on cooperatives:

(1) those who view them as economic institutions within the free-enterprise (capitalistic) system;

(2) those who only see them as the ideal social institution for restructuring the entire economy, and

(3) those who recognise the plurality of cooperatives.

We believe most pragmatic people are found in the third camp. But, even so,

"..... keeping economic goals and social ideals in balance is never easy. ..... Idealism and business frequently make strange and uneasy partners. In fact, within the cooperative system there is always some tension and at times open conflict between the first two camps, those who are all for strictly business and economic gains, and those who wish more involvement in social reform. ..... What is needed ...., is commonsense balance in the whole system, a blending of economic and social, of business and idealism, of pragmatic managers and lay leaders with vision". (Laidlaw, p. 38).

We propose that the social responsibility performance criteria given below be considered with those identified earlier to present a balanced evaluation of performance by cooperatives which reflects the pluralistic nature of cooperatives.

Social Responsibility Performance

(1) Existence of policies and programmes for education and development of employees. (Garoyan and Mohn)

(2) Programmes for the social development of members. (Torgerson)

(3) Programmes for the improvement of rural viability. (Purdue)

(4) Programmes for the international development of cooperation. (Laidlaw)

(5) Relevance of cooperatives' activities to easing national problems. (Laidlaw)

(6) Programmes for the assistance to underprivileged groups in developing cooperative organisations. (Laidlaw)

(7) Record with regard to compliance with pollution regulations, waste disposal, and other environmental matters. (authors)

(8) Participation in community activities. (authors)

PROBLEMS OF PERFORMANCE MEASUREMENT

The ability to measure assumes a commonly accepted basis for measuring. For example, to measure distance, we have metric or English units, one inter-changeable with the other. There is no other property or characteristic of distance that allows for a different method of measuring its length. The measurement of performance by firms is not as well specified. The reasons are not always clear. In the first place, we must decide what it is about the firm's performance that we wish to measure, or what dimension of the firm's behaviour is most meaningful for the purpose of evaluation. If we were to measure the performance of the economy as reflected by government policy, we may include as appropriate criteria inflation rates, employment changes, taxes, trade balances, interest rates, changes in gross national product, incidences of crime and similar measures. Such measures of the economy are more aggregate than, for instance, the market and industry levels where we look for more specific performance based on variables under the influence of the market or the industry. Likewise, measures for the performance of individual firms are more specific than for the industry as a whole, unless of course, the firm and the industry are one and the same, as in a monopoly. We can look for specific ratios on financial performance by a firm, and compare that with other firms in the same industry, or to the firm's own goals. And, we can look at non-economic factors — the human side of the equation, such as a firm's performance on social factors.

This brings us to a second problem — the multiple dimensions of cooperatives arising from the pluralistic nature of their objectives. "Market dimensions focus on the performance of an industry in isolation from the rest of the economy; for this reason, they are not often comprehensive. That is, an industry (or firm) which is technologically progressive, efficient in the use of resources, responsive to customer demands, innovative in developing new products, and whose prices reasonably reflect costs would likely be judged to be performing well — in a market sense. The same industry (or firm) however, could be using discriminatory practices ... or be contributing to unemployment ... without serious efforts to retrain, relocate, or otherwise assist the employees involved. Here, economy-wide dimensions of performance are relevant (Marion and Handy, pp. 24-25). The same firm may be judged negatively in this matter, although by economic criteria it would rate high.

Cooperatives present a unique problem in this respect because although all firms have a recognised public interest and responsibility, the special nature of the cooperative where the customer (patron) is the owner places the owners (shareholders) in a position of having influence on matters that effect others in their community. The overriding concept present in all cooperatives is this: A group of people, small or large, with a commitment to joint action on the basis of democracy and self-help in order to secure a service or economic arrangement that is at once socially desirable and beneficial to all taking part. (Laidlaw, p. 32).

Cooperatives are described as:-

"different from ordinary corporations and capitalist business by virtue of their dual purpose, since they are not merely businesses but businesses with a social as well as an economic aim. This concept of economic objectives united to a body of social ideas is, in fact, one of the pillars of cooperative philosophy". (Laidlaw, p. 28).

This is not a recent awareness. Alfred Marshall, a leading economist of the previous century, expressed it thus: "Other movements have a high social aim; other movements have a broad business basis; cooperation alone has both". (From an address in Ipswich in 1889, quoted by Laidlaw). Thus while performance of general corporations may often be measured mainly by economic criteria, and only implicitly on social grounds, cooperatives need to be assessed on economic and social criteria very explicitly.

While economic measurement criteria are quite similar for cooperatives and for general corporations, the lack of social criteria for either type of firm is a real handicap. As a result, cooperatives receive only casual evaluation on social criteria, while general corporations often escape evaluation completely until a specific crisis develops.

There are those who believe that a cooperative must also be measured against criteria related to its performance as a cooperative, i.e. democratic processes. This further compounds difficulties in arriving at a consolidated appraisal of performance.

This brings us to a third problem of measuring performance.

"There is a natural tendency to measure the easily measurable. Measures of profitability and, to a lesser extent, technical efficiency and progressiveness are more common because they can at least be quantified even if an unequivocal norm cannot be specified". (Jesse, p. 8).

But how do you measure employee morale along a scale of 0 to 10, for example, based on objective values? The problem exists to some extent even in areas normally considered measurable, for example, market shares. What is the relevant geographic market for determining market shares — an entire country? A county? Or a city? What is the relevant product market for, say yogurt, for which a product market share should be calculated. Does yogurt compete with nothing else? With ice cream? With cottage cheese? With milk? We could continue with questions of relevant customer or trade segments for a product but hopefully the point is made.

A fourth concern is the relevant period over which the performance evaluation should take place — the time period that is appropriate. For example, in one study we found that over a 16 year period (1966-81), members of a fruit and vegetable processing cooperative received the prevailing cash price plus an average of two percent more each year after we reduced their patronage refunds to reflect the time value of money. For many farmers this additional two percent payment was an important consideration for becoming a member of that cooperative. For a period of years there was a waiting list of farmers seeking to join that cooperative because of its financial performance, and because it offered a reliable home for their products. Thus, over the 16 years, the cooperative's performance would have been rated favourably. However, in 1983 this cooperative was forced into receivership, due to severe financial losses during the preceeding three years. Obviously, its current financial performance must be rated poorly.

For most purposes, a firm's performance needs to be measured in the current period rather than historically. Changes over the most recent year or two, or several years, reflect the current performance and, therefore, the cooperative's vitality and future viability. Accountants concentrate on the current period because that is most often the charge given them. Economists tend for the longer period of several or more years, but are also concerned on the current period for some purposes. No hard and fast rule exists even with cooperative members, who are often concerned more with their most recent payment than with the longer run.

These four factors, then, make difficult the task of performance evaluation:

(1) Deciding on relevant dimensions to be measured and values for each.

(2) The multiple dimension of firms and cooperatives and their dual objectives.

(3) Measuring performance when objective measures are difficult to reach agreement on.

(4) Determining the appropriate time period for analysis.

CONCLUDING REMARKS

The criteria for evaluating cooperative performance have been presented to invoke discussion, since the science of evaluating performance of business firms is still an art. The process becomes more difficult given the distinctive pluralistic objectives of cooperatives. "No one sector alone, public, private, or cooperative has been able, up to the present, to solve all economic problems and provide the perfect social order, nor have any two alone. The three together, working side by side and complimenting one another, may be able to achieve the best that is humanly possible". (Laidlaw, p. 42).

Failure of the top decision centres — the board of directors (and advisory committees) and the chief executive officer — to systematically evaluate their cooperative's performance in its' multiple dimensions will certainly have an adverse effect on the cooperative and its shareholders. That is, in fact and after all, the main reason for the existence of the board of directors.

Many, of course, would prefer not to have to measure if things appear to be satisfactory, lest they find something that is less than desired. But in a dynamic economy, performance evaluation is constantly occurring by some one, or by some group, often with inadequate information. It is better if the board led this effort.

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