New Producer Strategies: The Emergence of Patron-Driven Entrepreneurship

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New Producer Strategies: The Emergence of Patron-Driven Entrepreneurship

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Abstract—**Existing research treats the cooperative structure as relatively homogeneous. The proposed paper argues that all cooperatives are not created equal – and consideration of organizational structure is critical when analyzing the economic impact of cooperation. In recent empirical work, we observe cooperatives forming as single- or multi-purpose; generating equity capital passively, quasi-passively, or proactively; vertically integrating in a centralized, federated, or a hybrid fashion; governing through fixed or proportional control rights; and instituting open, closed or class-varying membership criteria. The emergence of multiple-level rent-seeking cooperatives challenges our traditional rent dispersion models of collective action. We call these multi-level, patron, rent-seeking entities a form of collective entrepreneurship. This paper develops a set of criteria enabling us to distinguish between traditional forms of cooperation and collective entrepreneurship. We employ these characteristics to analyze and contrast these two extreme forms of collective action. We propose a continuum from single-level rent seeking, traditional, patron, user-driven cooperative forms; through forms of hybrids and macrohierarchies; to multiple-level rent seeking, patron, user-investor-driven collective entrepreneurship.**

Keywords— **Collective entrepreneurship, Agribusiness, Property Rights**

The purpose of this paper is to advance the discussion of an emerging concept identified as "collective entrepreneurship". Our approach is to proffer a definition, then attempt to defend the definition by suggesting criteria that might inform the development of an organizational design that is encountered in an increasing number of countries where producers are seeking to extract rents in a joint vertical coordination set of activities.

While this article seeks to compare and contrast two extremes in organizational design, it is important to note that a large variety of cooperatives exist, spanning the continuum from traditional cooperation to collective entrepreneurship. Intermediate models of cooperation that incorporate a measure of both elements are in essence hybrids of the two extremes presented here. We develop our extreme examples of traditional cooperation and collective entrepreneurship. We then offer examples of hybrid models that may fall on a continuum between traditional cooperation and collective entrepreneurship.

The concept of collective entrepreneurship has been used by scholars in many disciplines and multiple sectors. Burress and Cook document a broad set of literature that covers the academic and practitioner usage of the term[1]. While some theorists argue that all entrepreneurship may be fundamentally collective in nature [2], there are also those who consider collective entrepreneurship as a subset of entrepreneurship [3]. However, there is little agreement on what constitutes collective entrepreneurship. For example, the term may refer to individuals or groups organizing to affect social change [4], public-private partnerships for technological development [5], entrepreneurship among collaborating firms [6], or recipients of residual income from a collective enterprise [7]. We, however, focus on collective entrepreneurship as it relates to risk-bearing, multiple level rent-seeking, patron-owned firms in the agriculture and food sectors. Thus, we utilize the term collective to refer to individuals jointly involved in the entrepreneurial process. And, in this paper, we rely heavily on a Knightian view which envisions an entrepreneur as the bearer of uncertainty [8].

Our definition of collective entrepreneurship is *the joint process by which patron-investors design, finance, and incorporate a path-dependent collective action form of multiple level rent generation.* This is a modification of the Cook-Plunkett definition which did not include "patron"[9]. This definition is formulated specifically for agricultural producer cooperative action but may be expanded to other sectors.

I. PURPOSE OF COLLECTIVE ACTION: DEFENSIVE VS. OFFENSIVE

Patron-generated collective entrepreneurship is observed in countries where production agriculture is dominated by family farm entities. We suggest that collective entrepreneurship has evolved over the last one hundred and fifty years from a defensive orientation intending to redistribute monopoly rents, toward this more offensive structure that intends to generate Ricardian and entrepreneurial rents at multiple levels. This path-dependent adaptation of organizational form and purpose fits the Schultzian concept of agricultural entrepreneurship [10].

Since the mid 1800s, scholars and practitioners have been developing taxonomies and typologies to describe group-oriented, commercial collective action. In Europe and North America, the emergent schools were not only influenced by the French and German cooperative philosophers, but by the pragmatic rules and subsequent principles of the British Rochdale Pioneers. In North America, three forms of agricultural cooperatives evolved: (1) the Rochdale-Nourse consumer-driven, multipurpose, spatial or local form of defensive cooperative (2) the Raiffeisen-inspired rural credit cooperatives; and (3) the Sapiro, producer-driven, single purpose, commodity-oriented, defensive, marketing cooperatives. In all of these forms of user-controlled, user-owned and user-benefited cooperatives, the primary objective was to obtain individual member benefits through joint action. Various terms in the cooperative lexicon have been used to identify the amount of financial capital remaining once total costs are subtracted from total revenues such as net savings, surplus, residual and profit. Traditionally, these residuals were distributed to member patrons in proportion to utilization of the cooperative entity's services.

A. *Traditional Cooperation as a Defensive Mechanism for Safeguarding On-farm Rent Generation Capacity*

Historically, the financial capital employed in the founding and growth of the Rochdale-Nourse stock type cooperatives was borrowed or generated from earnings and the residual was passed on to the consumer-member In the pooled payment, Sapiro-type, marketing cooperative, service at cost was followed very strictly . These types of cooperatives can be described as defensive in nature in that their primary objective was to pass risk-bearing to the cooperative level so that individual member patrons could maintain their on-farm rent generating capacity. However, as patron-member preferences evolved, cooperatives began experiencing internal conflicts resulting in increasing collective decision-making costs. As cooperative memberships became less homogeneous, in demographic and preference terms, challenges to low cost collective decision-making became more pronounced. Cook and Iliopoulos organize these challenges into two sets of collective decision-making constraints – investment preference conflicts termed internal free riding, horizon, and portfolio constraints and control constraints identified as influence costs and agency costs [11].

B. *Patron-Driven, Offensive Mechanisms for the Joint Bearing of Uncertainty to Seek Opportunities for Multiple-level Rent Generation*

During most of the twentieth century, successful European, Oceanic, and North American cooperatives created innovative selective incentives to maintain high degrees of homogeneity among their memberships. But some time in the late 20th century producers began to shift their preferences toward more multiple rent-generation and multiple risk-bearing strategies. It is from observing the actions of these groups of producers that the concept of collective entrepreneurship emerges. The emergence of multiple rent-oriented, patron-oriented producer groups in many countries is well documented [12], [13], [14], [15], [16], [17].

Some of the core concepts embedded in collective entrepreneurship derive their characteristics from the Sapiro school of agricultural collective action. These attributes include single commodity orientation, well-defined, long-term contracts obligating members to delivery, and a centralized membership structure. However, collective entrepreneurs have adapted organizational attributes from other legal forms of organizational design. Collective entrepreneurial organizations generally possess transferable delivery rights and obligations, appreciable equity shares/delivery shares, defined membership, and a minimum up-front capital investment requirement—attributes commonly found in limited liability joint stock companies.

These organizational design differences as explained in depth in the next two sections and summarized in Table 1 have considerable risk and rent-generation implications. These producer-formed entities incorporate a greater degree of incentive alignment, are offensive in design, seek to generate economic rents at multiple levels, and consequently create options for exit and wealth. There appears to be a continuum along which this process and these organizational designs may locate. Table 1 describes the characteristics in a dynamic framework with the left hand column describing single-rent, "traditional-defensive" producer-owned-and-controlled entities and the right hand column exhibiting the multiple rent generating, "offensive," patron-controlled organizations.

II. RENT GENERATION

Evaluating the anticipated rents to be generated from cooperation may help to distinguish between traditional cooperation and collective entrepreneurship. Two distinct purposes for organizing correspond to distinct economic justifications and expected methods of rent generation. Defensive cooperatives, in an effort to ameliorate some form of market failure, are often attempting not to create rents, per se, but rather primarily attempt to dissipate monopoly rents. Offensive cooperatives, however, organize in response to a perceived opportunity in the market and primarily attempt to generate Ricardian or entrepreneurial rents.

If we consider Rochdale cooperatives as an example of traditional cooperation, we note that the cooperative entity was constructed as a non-profit entity existing to pass the benefits of cooperation back to its members in proportion to patronage [18]. The cooperative was to retain only enough earnings in order to continue in its designated function. Under this philosophy, the cooperative primarily exists to protect its members from simple market power and ex post market power; reduce the risks of long-term contracting; ameliorate problems of asymmetric information including moral hazard, hold up, and costly strategic bargaining; credibly communicate patron preferences; compromise among diverse patron preferences; reduce alienation; and minimize credit or supply rationing [19-21].

The value of the cooperative was not in its earning potential. Typical examples of a cooperative's value were in its ability to attract enough members and volume to wield bargaining power when buying inputs or selling raw materials, to ensure quality products thus reducing moral hazard, or to ensure producers a market with reliable product grading. In the case of traditional cooperatives formed due to defensive reasons, the cooperative had the potential to dissipate monopoly rents by creating a bilateral monopoly. This strategy was successful among many agricultural cooperatives given the tendency for spatial monopolies to exist. Lowering transaction costs arising due to moral hazard or hold up also allowed the cooperative to pass additional savings back to their members. Patron-members were then able to maximize their returns at the farm-level.

Over time, successful cooperatives may ameliorate market failure issues or market contracting costs [21]. Future generations of producers no longer experience the same motivations that led their predecessors to organize for defensive purposes. Successful waves of defensive cooperation may, in fact, be one of the reasons we witness the development of new patron-driven strategies. Amelioration of market failure issues may allow producers to focus on market opportunities further up or down the value chain.

It is in organizing to exploit these market opportunities that producers begin to engage in collective entrepreneurship. In doing so, they seek avenues to generate Ricardian and entrepreneurial rents at multiple levels: the farm level and the firm level. Producers are able to access Ricardian rents by investing in further processing or marketing activities because, as suppliers, they have extensive ability to improve the quality of inputs or produce according to exact specifications. Thus, Ricardian rents are generated by the producers' collective ability to influence consumer price through the provision of quality products or to minimize marketing margins through the provision of raw material produced to specification [22]. By definition, producers seeking entrepreneurial rents contribute upfront risk capital to invest in new resource combinations, uncertain of the value of those new combinations [23].

Thus, if we are to develop a continuum to explain collective action, we suggest the method of rent generation as one of the defining criteria. Traditional cooperation would be dominated by the dissipation of monopoly rents. Hybrid forms may begin to shift their focus to Ricardian rent generation; while collective entrepreneurs are primarily focused on the generation of entrepreneurial rents.

III. THE BEARING OF UNCERTAINTY

Knight (1921) holds that the act of bearing uncertainty is a distinct characteristic of the entrepreneur [8]. Therefore, in attempting to distinguish between the traditional cooperative and emerging instances of collective entrepreneurship, we look to the bearing of uncertainty in order to identify additional distinguishing criteria and their resulting structural implications. We find joint bearing of uncertainty is a notable trait of collective entrepreneurship that results in significant changes to equity capitalization and membership requirements.

A. *Mitigating Farm-level Risk vs. Joint Bearing of Uncertainty*

When considering a patron-driven cooperative endeavor, we must analyze two primary levels of rent generation: the farm and the cooperative firm. Traditional cooperation seeks to mitigate uncertainty at the level of the farm by transferring risk to the cooperative. Several traditional functions of the cooperative embody this transfer of risk to the cooperatives including the use of pooling strategies, the use of a cooperative to ensure market access or service provision, and the Noursian ideal of the cooperative as a competitive yardstick. Thus, traditional cooperatives are an important mechanism for producers to reduce on-farm risk [22]. Valentinov characterizes this function of the traditional cooperative as “offering members a degree of revenue insurance” (2007) [24].

In agreement with the Knight’s assessment of large corporations, producers are able to mitigate the level of uncertainty they experience by pooling these uncertainties within a larger organization, the traditional cooperative [25]. Therefore, the traditional cooperative, although an efficient mechanism for mitigating risk, would not be considered an entrepreneurial organization in the Knightian sense. Traditional cooperation was therefore designed primarily as a means to mitigate farm-level uncertainty. The cooperative’s goal was to minimize costs at the firm-level while supporting a producer’s on-farm interests [26].

By contrast, those ventures assuming attributes of collective entrepreneurship call upon a producer to bear a greater degree of uncertainty at the farm-level and the firm-level. Producers engaged in collective entrepreneurship often invest upfront risk capital in the organization. In conjunction with their share purchase, they contract to provide the venture with raw inputs. Due to the contractual obligation of the supplier relationship, the producer now bears a greater share of the production risk. While in the traditional cooperative, a producer may choose not to deliver, emerging collective entrepreneurial ventures such as new generation cooperatives and patron-owned limited liability companies often strictly enforce delivery obligations.

In addition to the increase in production risk borne by producers, producer-investors are exposed to firm-level uncertainty experienced by the new cooperative entity through their risk capital contribution. Producers essentially agree to bear this uncertainty jointly. Often, on-farm risk may be amplified due to a closely-related or vertical investment strategy that lowers investment diversification. The advantage of investing in an organization that is dependent upon a producer’s raw inputs is often touted as enabling producers to realize dual profits: profits at the farm-level through increased prices paid for inputs and profits at the firm-level through rents generated in the processing of those inputs. However, if entrepreneurial profits are generated through the bearing of uncertainty as in the Knightian perspective, we recognize that dual profit potential could manifest as dual jeopardy in times of economic hardship. Among collective entrepreneurial ventures that failed, we observe instances of producers losing not only their initial investment, but also payments for their raw material inputs. This organizational structure, while allowing producers profit potential, is dramatically different from the traditional notion of cooperation with respect to its risk bearing attributes.

Joint bearing of uncertainty may afford producers a mechanism to diffuse the level of uncertainty that would have been borne by a single producer-investor in the entrepreneurial venture. However, due to the assumption of production, processing and marketing uncertainty born by individual producers through supply contracts and risk capital investments, collective entrepreneurial cooperative entities deviate from their traditional cooperative counterparts.

B. *Capital Generation*

Traditional cooperatives utilize retained earnings as their primary mechanism for capital generation. This structural trait is a reflection of the transference of risk to the cooperative. Minimal capital contributions are made in a passive or quasi-passive manner by patrons. Thus, the cooperative operates on generated savings or earnings. In addition, contributed capital is often redeemable which serves to lower the financial commitment and, therefore, level of uncertainty borne by the producer. Traditionally, cooperatives were not focused on generating equity capital, nor building strong asset bases. Limited equity capital has been a structural consequence for many traditional cooperatives [27], [28]. Their primary function was, again, to support the producer's on-farm production. Therefore, savings or earnings were primarily intended to be passed back to the member, not to be utilized to capitalize the cooperative. This structural characteristic leads Cortopassi to refer to equity capital generated from retained earnings as "an accounting misnomer for junior, subordinated revolving debt' (qtd in Staatz).

Among collective entrepreneurial ventures, members often commit substantial, upfront, equity capital. This proactive risk capital investment is utilized to capitalize the cooperative and provide working capital prior to the commencement of the cooperative's business activities. This structural characteristic sets collective entrepreneurial organizations apart from traditional cooperatives. In addition, to the bearing of uncertainty through initial capital contributions, these equity capital shares are often transferrable and appreciable, but not redeemable. Therefore, producer-shareholders are committing permanent equity capital to the cooperative, a characteristic "rarely" seen in the traditional cooperative setting [27]. Examples of patron-driven organizations relying on upfront equity capital contributions include Southern Minnesota Beet Sugar Cooperative, Fonterra, and the majority of producer-owned ethanol companies formed in United States in the last few decades.

C. *Membership*

Traditionally, cooperatives allow open membership. Members are not required to perform specific duties nor are they obligated to deliver certain products. Thus, cooperative members choose when to do business with the cooperative and at what level, depending upon their individual preferences during the production season. In this way, uncertainty with respect to agricultural marketing is largely transferred to the cooperative.

In collective entrepreneurial ventures, membership is often closed. In addition, stringent production requirements or delivery obligations may be present. In this manner, the member assumes a greater level of production uncertainty. Supply contracts and marketing agreements are examples of structural mechanisms that may signify the emergence of a more entrepreneurial or hybrid organization developing. These structural elements transfer a larger portion of the risk in the supply relationship to the producer than within the traditional cooperative structure.

D. *Patron vs. Investor Focus*

Traditional cooperatives primarily focus on cost minimization or returns to members per unit of raw input supplied [26]. Thus, the cooperative exists to return benefits of membership to patrons on the basis of their patronage. This is commonly referred to as the user-benefits principle[29]. Residual claim and residual control rights are distributed solely among patrons. In addition, patrons are not required to bear uncertainty individually. The cooperative entity is constructed to pool uncertainties arising from production or marketing of raw material inputs.

By contrast, collective entrepreneurial organizations demonstrate a greater reliance on distributing residual claims to investors contributing risk capital. Investors elect to proactively contribute risk capital without knowing the probability of residual claim outcomes associated with this decision. Although investors may enter into a supply relationship with the organization in proportion to their capital investment, additional raw materials potentially supplied outside the initial marketing contract would not be eligible for a benefits distribution at the same level of compensation as those supplied under the auspices of the marketing contract. Thus, the distribution of benefits is structured to primarily reward investors' capital contributions. This type of cooperation lies in stark contrast to more traditional cooperation organized under Rochdale principles [30].

E. *Cooperative Performance Measures*

While multiple measures of cooperative performance are available, patrons of traditional cooperatives often rely on prices paid for raw material inputs to gauge the performance of the cooperative [31, 32]. Collective entrepreneurial organizations, however, are able to utilize share price or return on investment shares as an additional measure of cooperative performance. This additional level of performance evaluation may also represent another mechanism for the cooperative to influence a producer's loyalty in addition to raw input pricing and contractual delivery obligations.

Fluctuating share prices constitute a distinct deviation from many original cooperative structures. Early American cooperative organizers elected to fix share prices at the value at which they were issued in an attempt to reduce speculation and deter inflation [18]. No unusual risk was to be assumed by the cooperative. By contrast, fluctuating share prices or measures of return on share price are structural traits of collective entrepreneurial organizations allowing producers to attempt to value the level of entrepreneurial rents generated in the bearing of uncertainty at the level of the cooperative firm.

F. *Collective Decision-making*

Traditional cooperative structures are governed under the one-member, one-vote principle. This governance structure enhances the democratic capacity of its producer-members. It is important to note, however, that the defensive cooperative structure may be more susceptible to collective-decision making costs because of ill defined property rights [15]. These costs arise from the misalignment of residual control and residual claimant rights. Therefore, the one-member, one-vote structure may exacerbate collective decision-making costs. The resulting free-rider, horizon, portfolio, influence and control problems also act to limit producers' willingness to invest as individuals bearing uncertainty jointly.

As the popularity of new generation cooperatives rose in the early 1990's, one-member, one-vote governance structures continued to dominate these cooperative forms. However, new generation cooperatives often attempted to limit the number of shares any one member could purchase. This was an attempt to reduce heterogeneity of member preferences as producer-investors with substantially different risk capital contributions often exhibited different preferences when voting. Newly emerging collective entrepreneurial ventures increasingly adopt weighted voting schemes or voting proportional to investment in order to minimize ill defined property right problems. Governance structures that distribute voting rights in proportion to capital investments minimize free-riding and, therefore, are a more efficient structure for the joint bearing of uncertainty.

IV. DISCUSSION AND CONCLUSIONS

This paper discusses a dynamic that is occurring in patron-owned firms, an entrepreneurial form of organization which attempts to capture benefits from both patron-oriented and investor-oriented models. We attempt to inform the interface of the ownership literature with the entrepreneurship field – particularly the emerging study of collective entrepreneurship. Using rent generation, risk and uncertainty bearing, capital acquisition techniques, residual claim and residual control rights, collective decision-making costs, and performance measure elements to frame our discussion, we attempt to inform the uniqueness of an organizational design that is becoming increasingly common in the agriculture and food sectors.

Put into historical perspective, we see the traditional patron-owned design maintaining its favor as a single rent level, defensive form of producer cooperation employed for reducing the negative consequences of market failures. Nevertheless, producers are increasingly organizing offensive cooperatives – multiple level mechanisms for enhancing the vertical economic options of their agricultural production units. Thus, we conclude that all cooperatives are not created equal.

Public policy makers may be interested in the economic growth externalities, decision-making processes and qualities, democratic practice implications, collective decision-making skills and leadership training that evolve from collective entrepreneurship initiatives – all considered to be public goods. Additionally, agricultural producers, rural development specialists, and local government leaders may be interested in understanding the differences between traditional collective action and patron-investor collective entrepreneurship activities. In numerous countries, we witness emerging changes to cooperative law that seek to foster the development of collective entrepreneurial ventures with the structural characteristics described in this piece. Lenders and other input suppliers would be well advised to understand the risks and rewards of patron-owned entrepreneurial ventures. Although often viewed as similar in organizational architecture, the economic and decision-making differences between these emerging collective entrepreneurial ventures and traditional forms of collective action are important and merit scholarly exploration. The objective of this paper is to foster further discussion of this important collective action phenomenon.

Table 1. Comparison of Forms of Cooperation

	Traditional Cooperation	Hybrid Example	Collective Entrepreneurship
Original Purpose of Cooperative	- Defensive origins, often supplementing primary goals through multiple services	- Defensive origins, evolving as a cooperative to incorporate multiple offensive characteristics including the introduction of non-member business	- Offensive origins
Type of Rent Generation	- Founding purpose to dissipate monopoly/ monopsony rents	- Shifted from monopoly rent dissipation to Ricardian rent generation primarily due to competitive pressure	- Founding purpose to access Ricardian, and entrepreneurial rents, secondary goals could include the generation of temporary monopoly rents
Expectations Regarding the Bearing of Uncertainty	- Farm-level uncertainty transferred to cooperative firm	- Cooperative develops contractual arrangements and proportional capital mechanisms in an attempt to redistribute the bearing of uncertainty over the life of the cooperative	- Patron-Investors bear a greater proportion of their farm-level risk by assuming contractual delivery obligations. Patron-Investors engaged in joint uncertainty bearing with respect to non-redeemable risk capital contributions.
Primary Source of Equity Capital	- Allocated Earnings (Rochdale-Nourse, Passive), Retains (Sapiro, Quasi-Passive)	- Allocated Earnings, Retains, and Non-member Business	- Upfront Risk Capital Contributions, Allocated Earning, Retains, and Non-member Business.
Membership	- Open membership, voluntary supply	- Open membership subject to minimal business volume membership requirements, incentives developed to reward members for entering into supply contracts	- Membership closed to shareholders, shareholders contract to assume the delivery obligations
Distribution of Residual Claims	- To patrons in proportion to use	- To patron-users subject to minimum volume or equity capital levels. Distribution of fixed dividends to patron-investors may be introduced through preferred equity stock programs.	- To patron-investors, often including contractual arrangements that govern supply. Patron-investors own transferrable, appreciable shares.
Cooperative Performance Measures	- Primary focus is on prices paid per unit of raw inputs or cost per unit of purchased input	- Primary focus on prices paid per unit of raw inputs, with secondary emphasis on equity revolvement period	- Dual focus on (1) share price or return to shares and (2) price paid for raw input materials
Collective Decision-Making	- Most organizations rely on one-member, one-vote governance structure	- Weighted equity voting and mulit-tiered systems in an attempt to align residual control rights with residual claimants rights	- Increasingly utilizing legal structures that allow for the alignment of residual control rights with residual claimant rights. However, organizations that continue to rely on one-member, one-vote often cap the number of shares that can be owned by each individual in an effort to align investors' interests.

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