Journal of Cooperatives

Articles

Democratic Control and Cooperative Decision Making: A Conceptual Framework

Bruce L. Anderson

What is the impact of democratic control on cooperative decision making? The purpose of this article is to present a conceptual framework for the analysis of democratic control. It suggests that democratic control does not guarantee optimal decisions for the cooperative. Suboptimal decisions result from simple majority rule, the activity of cooperative interest groups, members pursuing their interests to the detriment of the cooperative firm, and management pursuing its interests at the expense of the membership. This paper also outlines strategies cooperatives can adopt to correct the problems due to democratic control.

Democratic control by members is a fundamental characteristic of cooperative organizations.[1] However, only recently have cooperative researchers begun to recognize that the political aspects of cooperative decision making have an important impact on economic performance (Vitaliano; Ladd; Knoeber and Baumer; Staatz; Buccola and Subaei). Our understanding of the political economy of cooperatives still is in its formative stages. But for cooperative decision makers to arrive at the best decisions, it is imperative they have an appreciation of both the advantages and disadvantages of democratic control.

The purpose of this paper is to examine the impact of democratic control on cooperative decision making. It explores the dynamics between various groups of members as well as between the membership, the board of directors, and management. This is done through the presentation of two conceptual models that provide a general framework for analysis. In ad-

Bruce L. Anderson is associate professor, Department of Agricultural Economics, Cornell University.

The author gratefully acknowledges the support of the Institute of Economics and Statistics at the Swedish University of Agricultural Sciences and the Swedish Federation of Farmers for funding of this research.

dition, strategies to deal with the weaknesses of democratic control are identified and discussed.

Decision Making in Cooperative and Noncooperative Organizations[2]

The goal of a noncooperative firm is to enhance the economic well-being of the firm's owners by maximizing profits. In a noncooperative relationship, each party is concerned only with its own personal costs and benefits. No party is interested in the impact a proposal or decision has on the other parties involved. Both farmers and noncooperative firms would accept those proposals where the private benefits exceed the private costs and reject those where the reverse is true.[3]

How does decision making differ in cooperative organizations? The general goal of a cooperative organization is to improve or maximize the economic well-being of its members. Rather than consider the impact of a decision on any individual party, a cooperative organization should consider the total impact of a decision on the cooperative firm and its membership. Consequently, the appropriate decision rule for a cooperative organization would be to accept those proposals where the total benefits accruing to the cooperative firm and all its members exceed the total costs imposed on the firm and its members.[4] Conversely, the organization would reject proposals where the total costs are greater than the total benefits.[5]

At first glance, it does not seem troublesome that a cooperative organization should analyze the total impact of its decisions. Recognition of an interdependence between the firm and members is a major reason for the existence of cooperative organizations. However, this interdependence in decision making results in three unique situations for cooperative organizations. They are:

(a) Some types of issues impose different patterns of costs and benefits on different groups of members.
(b) With some types of issues, the cooperative firm bears a large share of the costs while its members receive a major portion of the benefits.
(c) With other types of issues, members bear a large share of the costs while the cooperative firm garners a major portion of the benefits. (Although the cooperative receives the benefits in the short run, members should benefit in the long run as patronage refunds are passed along to members.)

These three situations, it should be noted, do not arise in noncooperative business organizations. Parties looking out for their individual interests, as is the case in a noncooperative relationship, will never be faced with these three dilemmas. The consequences of each situation are analyzed in the following sections.

Different Patterns of Costs and Benefits Among Members

Throughout this analysis, it is assumed members are interested solely in their individual welfare and they can perfectly estimate the impact of a

proposal on their welfare. Decision rules for individual members are assumed to be the following:

Favor proposal if:
Member's Benefits > Member's Costs.
Oppose proposal if:
Member's Benefits < Member's Costs.

Further, suppose all members vote on all proposals or perfect representation prevails.[6] In addition, assume democratic control involves one-member/one-vote and a majority (i.e., 50+ percent of the membership) is required for any proposal to be adopted. Finally, for every issue, suppose there is a majority opinion (represented by more than 50 percent of the membership) and a minority opinion (represented by less than 50 percent of the membership). The primary difference between the majority and minority is the relative magnitude of the costs and benefits that would be experienced by each group.

Before proceeding, two points concerning cooperative majorities and minorities are worth noting. First, the issue being considered determines whether a member is in the majority or minority. A common division in many cooperatives is for small-volume producers to constitute the majority and large-volume producers to make up the minority. But, depending on the issue, other divisions also are possible: younger versus older members, diversified versus specialized producers, members located close to major markets versus those located some distance from markets, farmers interested in the highest possible market prices and no cooperative services versus those interested in a multitude of services and lower prices, etc. Second, the composition of the majority and minority will change as issues change. Any individual can be a member of the majority on one issue and a member of the minority on the next issue.

Table 1 illustrates six different types of membership issues faced by cooperatives. The issues are identified by capital letters in column 1. Column 2 indicates the relationship between the benefits and costs that would be experienced by members of the majority on each issue. Column 3 illustrates the benefit and cost relationship for members of the minority. The impact of each proposal on the total membership is shown in column 4.[7] Proposals A through C have a positive net effect on the organization while proposals D through F have a negative impact.[8] Column 5 indicates the optimal decision for the organization as a whole. It is based on the decision rule, previously outlined, that a cooperative accept those proposals where there are positive net benefits for the organization as a whole and reject those where the total costs outweigh the total benefits.

The Impact of Simple Majority Rule

With simple majority rule, only those proposals where the benefits exceed the costs for the majority will pass. Conversely, if the costs exceed the benefits for the majority, the proposal will fail. The results of applying simple majority rule to each policy proposal is illustrated in column 6 of table 1.

Table 1.—Impact of Majority Rule, Vote Trading, and Interest Groups on Cooperative's Economic Performance

Type of Issue (1)	Net Impact on: Majority (2)	Minority (3)	Total Membership (4)	Optimal Decision (5)	Simple Majority Rule (6)	Majority Rule + Vote Trading (7)	Majority Rule + Vote Trading + Interest Groups (8)
A	B > C	B > C	B > C	Pass	Pass	Pass	Pass
B	B > C	C > B	B > C	Pass	Pass	Pass	**Fail**
C	C > B	B > C	B > C	Pass	**Fail**	Pass	Pass
D	B > C	C > B	C > B	Fail	**Pass**	Fail	Fail
E	C > B	B > C	C > B	Fail	Fail	Fail	**Pass**
F	C > B	C > B	C > B	Fail	Fail	Fail	Fail

With simple majority rule, all decisions will correspond to the optimal decisions, except Type C and D issues. Simple majority rule will result in suboptimal decisions for Type C and D issues.

Although the proposals are of net benefit to the cooperative organization as a whole, Type C proposals are rejected because the costs experienced by the majority are greater than the benefits they receive. An example of a Type C issue is a proposal to change a cooperative fee structure from a per-unit basis to a structure with a fixed rate for each member and a lower per-unit charge. This type of proposal will likely fail because the total fee for small-volume producers, which are in the majority, will likely increase. Differential pricing schemes that decrease the cost to large-volume producers and increase the cost to small-volume producers are another example of this type of proposal.

Because Type C proposals fail when simple majority rule prevails, they are not adopted as cooperative policy. Nonetheless, while being considered by membership, these issues usually provide for lively discussion at cooperative meetings.

With simple majority rule, Type D proposals pass because the benefits exceed the costs for the majority. But these proposals are a detriment to the cooperative organization as a whole because the net costs imposed on the minority exceed the net benefits accruing to the majority.

In general, it is difficult to identify Type D proposals because they often are assumed to be a part of the cooperative's normal operations. In fact, many Type D issues may have been decided when an organization was founded. The per-unit fee structures of many cooperatives probably are Type D decisions and were adopted when the organization was formed. Free or subsidized services also may fall into this category by consuming cooperative resources and reducing the earnings of the organization. These decisions are suboptimal in that they are detrimental to a minority of current members and they most likely discourage some potential members from joining the organization.

Ways to Correct the Problems with Simple Majority Rule

Because simple majority rule can result in suboptimal decisions, it is essential for cooperatives to have a set of strategies to correct potential problems. Although cooperators will not find the list surprising, because many cooperatives already use these measures, there are several strategies that can be adopted to deal with the problems associated with majority rule.

The first and most important strategy is for the cooperative to carry out a thorough and objective analysis of the issues being considered. The analysis should include an examination of the impact of the proposal on different groups of members as well as the cooperative organization as a whole. For decisions with a minor impact, it may be sufficient only to compute the economic impact of the issue on the cooperative firm and express the results on a per-member basis or as a percentage of projected patronage refunds.[9]

Do cooperatives currently evaluate the impact of various decisions on the membership as a whole as well as on different groups of members, or do they merely evaluate the impact of proposals on the cooperative firm? This author is unaware of any research on the topic. However, casual observation suggests that most cooperatives only study the impact of a proposal on the cooperative firm and do not carry out a quantitative analysis of the distributional impact of a proposal. Although an analysis of the impact of policies on the membership does not guarantee decision makers will arrive at the optimal decision, it will provide an estimate of the costs and benefits that currently may not be available. Moreover, it may make decision makers more aware of the financial trade-offs involved.

An aggressive member education program is a second strategy. For members, perceived costs and benefits are more important than the real costs and benefits. When data are lacking, there may be a tendency for members to underestimate the costs and overestimate the benefits associated with decisions they favor. The reverse is true for proposals they oppose.

A third strategy is to keep reintroducing proposals that initially fail but are expected to improve cooperative performance. A fourth strategy is to accompany the preceding activities with pleas for solidarity and loyalty. Calls for solidarity and loyalty often are made when a particular action will adversely affect a large number of members personally but is likely to be in the interest of the cooperative as a whole and should benefit all members in the long run. For members to respect these requests, the predicted results of prior calls generally must be realized.

Continually reviewing a cooperative's existing policies is a fifth strategy. Because simple majority rule has a major impact on decision making, many Type D proposals already may have been adopted. Consequently, it may be necessary for the cooperative to have a built-in mechanism to review established operations and services.

The final strategy to correct problems associated with simple majority rule is to transfer decision-making responsibilities from members and delegates to the board of directors. One important reason for this strategy is to increase the speed of decision making. A second reason is that members have a tendency to look out after their own individual interests while the board has the legal responsibility to safeguard the long-run interests of the cooperative. Because vote trading requires a small number of decision makers, a final reason for moving major decisions to the board is to increase the potential for vote trading. The concept and impact of vote trading are analyzed in the next section.

Vote Trading and Simple Majority Rule

Vote trading involves members of a group exchanging votes on different issues to arrive at a decision different from, but preferred to, the one that would have been made with simple majority rule. Optimal vote trading can correct the problems associated with simple majority rule. In the public choice literature, vote trading is synonymous with logrolling and hypothetical compensation (Buchanan and Tullock).

Vote trading is most easily explained in the context of hypothetical compensation. Hypothetical compensation operates in the following manner: If net benefits can be derived from a proposal, the members who benefit should be willing to completely compensate the members who experience increased costs because, if the proposal is approved, those who benefit still would be better off by the amount of the net benefit. Conversely, if a net cost is involved, the members who would experience the loss from a proposal should be willing to completely compensate the members who would benefit. By rejecting the proposal, the members who would lose from it still would be better off by the net cost of the proposal.

Naturally, money never really changes hands. That is why one of the names of this concept is "*hypothetical* compensation." In practice, votes are traded. Vote trading works best in small groups. It can work at the board level but would be difficult, if not impossible, to implement at the delegate or membership level. In large cooperatives with delegate and membership meetings, there often are too many individuals involved for vote trading to operate effectively.

A few comments are in order. The idea of vote trading usually conjures negative connotations, and most cooperative directors will deny they or their boards engage in vote trading. In reality, vote trading is a very subtle, implicit, and personal process. Rarely are votes explicitly traded. Vote trading is the act of compromise, and most directors freely admit they often must compromise their original positions for the good of the cooperative.

If vote trading operates according to the rules of hypothetical compensation, all Type C proposals will be approved and all Type D proposals will fail. In other words, ideal vote trading has the potential to completely correct the problems associated with simple majority rule. This is illustrated in column 7 of table 1.

This conclusion applies only if *ideal* vote trading prevails. There are several reasons vote trading may not operate perfectly. Members and directors may not correctly estimate the impact (i.e., the true costs and benefits) of a proposal. Appropriate information may not be available because it is costly and time-consuming to carry out an accurate and thorough analysis. Directors may not elect to or be able to accurately represent the aggregate opinions of their constituents. One or more parties may try to capture all the benefits of vote trading and prevent compromise. Different issues may involve different magnitudes of net costs and benefits. Coalitions change, and it may be difficult for the various parties to "repay" their obligations and achieve political equilibrium. Finally, interest groups may arise. Interest groups can cause serious problems and are discussed in the next section.

The Impact of Cooperative Interest Groups

An interest group is a small minority of the membership that experiences relatively large and concentrated benefits or costs from a decision (Olson). As a result, an interest group has a strong incentive to ensure proposals of net benefit to it are passed and those that are of net detriment fail. Consequently, interest groups are willing to invest considerable time, effort, and resources ensuring their proposals are acted on appropriately.

In the presence of interest groups, the majority is docile. It is docile because the costs and benefits experienced by the majority are relatively small and dispersed. In cooperatives, the majority usually consists of the entire membership excluding members of the interest group in question.[10] Members of the majority have little or no incentive to fight aggressively for beneficial issues and oppose detrimental proposals because the per-member costs or benefits are spread over the entire membership.

The effect of powerful interest groups may be *minority* rule rather than majority rule. Column 8 in table 1 indicates the potential impact of interest groups. Note that Type B and E issues deviate from the optimal outcome. Type B proposals fail although they are of net benefit to the organization as a whole. On the other hand, Type E proposals pass although they are detrimental to the cooperative.

A proposal to close a local outlet operating at a loss is an example of a Type B issue. Many Type E proposals take the form of subsidized services utilized by only a small proportion of members.

Strategies Used by Interest Groups

It is necessary to recognize the strategies of interest groups to effectively deal with them. There are several short-run and long-run strategies commonly used by cooperative interest groups.

When an issue of concern arises, an interest group will likely be overrepresented at cooperative meetings. The group will vigorously present its case and may attempt to dominate the discussion. In its presentations, the group may appeal to emotional arguments as well as cooperative ideology and principles. An interest group also may present cases showing the extreme negative consequences of not accepting its proposal. If resources are available, it even may attempt to present its own estimates of the impact of the proposal, which will likely support the group's position. Finally, interest groups may exert considerable effort lobbying cooperative officials (delegates, directors, and management) individually and as a group.

Those involved with cooperatives probably recognize these strategies. In fact, cooperators are likely to consider these activities as essential characteristics of vibrant democratic control and something to be nurtured rather than a cynical ploy by interest groups and to be avoided. The point is: It is difficult to distinguish Type B issues from Type D issues and Type C issues from Type E issues. In all four cases, the minority attempts to promote its positions by lobbying directors and management as well as trying to recruit the majority to its point of view. The only difference between the issues is their impact on the total organization. Type B and C proposals will have a positive impact while Type D and E proposals will have a negative effect. The only way to distinguish between the proposals is through objective analysis. Moreover, given their tactics, it often is difficult to determine whether an interest group represents the interests of the majority or the minority.

Interest groups also use long-term strategies to achieve their objectives. One is to nominate and attempt to elect their candidates to cooperative decision-making bodies, especially the board of directors. Other long-run strategies include trying to change the attitudes of the majority and recruiting new members who share their point of view.

The short- and long-run strategies of interest groups are a legitimate element of democratic control. Moreover, it is important to keep in mind that interest groups do not always have a negative impact on the cooperative. They may be necessary for Type C proposals to pass and Type D proposals to fail. Consequently, it is essential to know whether the issues they support are beneficial or detrimental to the cooperative as a whole.

Strategies for Cooperatives

There are several strategies cooperative directors, management, and members can use to deal with the short-run efforts of interest groups. The first is to try to ensure a high degree of attendance at cooperative meetings. Second, the leadership should make sure the majority, as well as the minority, is well-informed about the issue. Although the majority typically behaves in a docile manner in the presence of interest groups, it should be prepared and willing to argue its position. Third, management, directors, and members of the majority should not hesitate to also use appropriate cooperative ideology and principles in making their case. Fourth, because the extreme examples used by interest groups often are the result of unrelated external factors (e.g., climatic conditions, changes in agricultural policy, poor farm management, etc.), the leadership should try to determine the external factors involved, if any, and discount the example appropriately. Fifth, cooperative officials should keep thoroughly informed and be prepared to defend the position that is in the best interest of the organization as a whole. Finally, the cooperative leadership should take the offensive and not be forced into taking a defensive position when dealing with interest groups.

There also are long-run strategies cooperatives can adopt. One is for the cooperative to have a well-structured nominating system. If interest groups are based on geographical factors, then a district or delegate system of nominating candidates may be desirable. Although minorities have the right to be represented, the system should ensure interest groups do not become overrepresented. Second, the cooperative should develop a workable two-way communication system that serves as a feedback and early warning system for member attitudes as well as a method to communicate information to members. Third, members should be continually reminded that the purpose of a cooperative is to improve the long-run economic well-being of all members and that, in the short run, democratic decision making means any given member will win on some issues and lose on others. Finally, the preceding discussion suggests that it is essential for modern-day cooperatives to develop a data base and analytical techniques that can assist in analyzing the impact of various decisions on different groups of cooperative members.

Up to this point, we have merely examined how different groups of members react to different types of proposals. It was assumed the issues considered had no impact or only an indirect impact on the cooperative firm. In the next section, we examine what happens when costs and benefits are unevenly distributed between the membership and the cooperative firm.

Conflicts Between Cooperative Members and Management

In cooperatives, there are issues where the cooperative firm bears the costs and members receive the benefits. There are other decisions where the membership bears the costs and the cooperative receives the short-term benefits. In the latter case, members should eventually receive the benefits accruing to the cooperative firm through higher patronage refunds.

In exploring the impact of the uneven distribution of costs and benefits between the membership and the cooperative firm, it is necessary to make a few additional assumptions. Assume the membership is a homogeneous entity and the problems of majorities and minorities previously discussed do not arise. Also, suppose members are concerned only with the impact of a proposal on their individual operations and they ignore its effect on the cooperative firm. Consequently, the membership will:

Favor proposal if:
  Total Membership Benefits > Total Membership Costs.
Oppose proposal if:
  Total Membership Benefits < Total Membership Costs.

Further suppose the primary goal of management is to promote only the economic interests of the cooperative firm. In other words, management ignores the impact of issues on the membership. Consequently, assume management adheres to the following decision-making rules:

Favor proposal if:
  Benefits to Cooperative Firm > Costs to Cooperative Firm.
Oppose proposal if:
  Benefits to Cooperative Firm < Costs to Cooperative Firm.

Table 2 presents six alternative relationships between cooperative members and management. The alternatives are identified in column 1 by roman numerals. The reader will note table 2 is similar to table 1 except the

Table 2.—Impact of Member-Dominated, Management-Dominated, and Balanced Cooperative on Organization's Economic Performance

Type of Issue (1)	Net Impact on: Total Membership (2)	Cooperative Firm (3)	Total Organization (4)	Optimal Decision (5)	Cooperative Dominated by: Members (6)	Management (7)	Balanced Approach (8)
I	B > C	B > C	B > C	Pass	Pass	Pass	Pass
II	B > C	C > B	B > C	Pass	Pass	**Fail**	Pass
III	C > B	B > C	B > C	Pass	**Fail**	Pass	Pass
IV	B > C	C > B	C > B	Fail	**Pass**	Fail	Fail
V	C > B	B > C	C > B	Fail	Fail	**Pass**	Fail
VI	C > B	C > B	C > B	Fail	Fail	Fail	Fail

headings have been changed. Column 2 indicates the relative costs and benefits experienced by the membership for the six proposals. The cost and benefit relationships experienced by the cooperative firm (i.e., management) are presented in column 3. Column 4 shows the net impact of each proposal on the total organization (i.e., the total costs and benefits of both the membership *and* the cooperative firm). The optimal decision for each issue, based on the preceding decision rules is presented in column 5.

A Member-Dominated Cooperative

Let us first examine the performance of a "member-dominated" cooperative. A member-dominated cooperative is defined as one in which the desires of the membership always prevail. This is most likely to occur in cooperatives with a strong board of directors and a weak team of top executives. Although the board is sincerely interested in the welfare of members, it goes to extremes advocating member interests.

Column 6 of table 2 illustrates the decisions that would be made by a member-dominated cooperative. There are two deviations from the ideal: Type III and Type IV issues.

Type III proposals should pass, but in a member-dominated cooperative they fail. For the organization as a whole, the total net benefits outweigh the total net costs. Because the cooperative firm derives the benefits and members bear the majority of the costs, the proposal is defeated.

The history of marketing cooperatives is rich with examples of organizations that could not convince their members of the need for high-quality products and a supply in line with market demand. The cooperatives were victims of Type III decisions. The need for strong equity financing and aggressive marketing programs is well-recognized in the cooperative community. However, many cooperatives have an extremely high degree of leverage, and probably few cooperatives have marketing programs as aggressive as those of their noncooperative counterparts. One explanation is that members are too concerned with the immediate costs these issues imply. In other words, one possible explanation for membership-management conflicts is that members focus on the short run and have difficulty appreciating the positive impact sound management strategies will have in the long run.[11] The cooperative may be member-dominated and the need for financing and marketing programs may become Type III issues.

In a member-dominated cooperative, Type IV proposals pass although they should fail because they have a negative impact on the organization as a whole. The reason they are approved is that members derive the benefits and the cooperative firm bears the costs. Subsidized supply departments of marketing cooperatives and excess membership services are possible examples of Type IV issues.

The preceding discussion suggests that cooperative members do not instinctively know what is best for the cooperative as a whole. It is ironic that democratic control in a member-dominated cooperative will not always result in decisions that are in the membership's long-run best interests. However, many cooperators recognize this possibility and realize that to improve the long-run economic well-being of members cooperatives must be operated in a business-like manner. In fact, often one will even hear someone suggest cooperatives should operate in the same manner as noncooperative firms. We now turn to an examination of this alternative.

Management-Dominated Cooperatives

A management-dominated cooperative is defined as one where proposals that benefit the cooperative firm always prevail. Management-dominated cooperatives probably will arise when an organization has a strong team of top executives and a weak board of directors. One possible sign of a management-dominated cooperative is when one hears: "This cooperative is run just like Corporation X." This does not imply cynical motives on the part of management. Such management often is sincerely interested in the welfare of the association and focuses on improving the financial performance of the cooperative firm. A management-dominated cooperative does this by adhering to the management decision rules previously outlined and ignoring the impact proposals have on the membership.[12]

The type of proposals approved and rejected in a management-dominated cooperative are illustrated in column 7 of table 2. The results indicate that all decisions correspond to the ideal outcome except for Type II and V issues.

Type II proposals fail although they should be approved. These proposals are of net benefit to the organization as a whole, with the majority of the benefits accruing to the membership. But management vetoes the proposals because they impose a net cost on the cooperative firm.

The number and level of member services may be more limited in management-dominated cooperatives than in other cooperatives. In fact, this type of cooperative may not offer services that are of major benefit to members. Such services could include member education, technical production advice, or a reasonable assortment of products. Moreover, management-dominated cooperatives may put so much emphasis on the firm's financial performance that members sense an antagonistic attitude from management. These are examples of Type II issues in a management-dominated cooperative.

Lack of cooperative strategies to improve long-term planning, increase member equity, and strengthen marketing programs are other possible examples of Type II issues. Although contemporary cooperative management should be aware of the advantages of these strategies, management may not feel the personal rewards are worth the enormous effort required to implement them. Consequently, they fail to adopt such strategies.[13]

Although they should fail, Type V proposals are approved in management-dominated cooperatives. They are of net detriment to the organization but of net benefit to management or the cooperative firm. Management ignores the fact that a major proportion of the costs are borne by the membership.

Excess management emoluments (such as corporate aircraft, country club memberships, luxury automobiles, and excessive staff) are examples of Type V proposals. It is interesting to note that cooperative managers probably have fewer perquisites then their noncooperative counterparts. Perhaps the career paths of cooperative managers have taught them not to expect or ask for such management perks. However, Type V issues also can take other forms. Managers of management-dominated cooperatives may pursue strategies and operational alternatives that enhance management income, prestige, and power at the expense of membership. For example, cooperative growth or diversification for its own sake may be Type V issues. Moreover, management-dominated cooperatives may be more likely to use unallocated equity (i.e., tax-paid retained earnings) as a major source of capital. The use of unallocated equity rather than allocated member equity may reduce member interest in the activities and performance of the cooperative and thereby give managers greater decision-making freedom (Royer, p. 27).

It is now possible to conclude that not even a management-dominated cooperative always will adopt those policies that maximize the net benefits of the organization as a whole.

The Need for a Balanced Approach to Cooperative Decision Making

Cooperative corporation law gives the board of directors ultimate responsibility for the survival and well-being of the organization. However, the board cannot merely represent the interests of the membership. At the same time, management cannot automatically apply the same decision-making rules it would in a noncooperative firm. In cooperatives, the board of directors and top management must consider the welfare of the total organization. They must balance the interests of different groups of members as well as the interests of the total membership and the cooperative firm. Because it has been assumed that the primary goal of cooperative leadership should be to maximize the net benefits of the total organization, the appropriate balance depends on the relative magnitude of costs and

benefits experienced by the various parties. Consequently, the board and management must make every attempt to accurately estimate the impact of various proposals on the membership as well as on the cooperative firm. Column 8 of table 2 indicates the ideal results of a balanced approach to cooperative decision making. It coincides with the optimal decisions in column 5.

The key to an effective cooperative is a balanced approach to decision making. A balanced approach requires an independent and analytical board of directors and a top management team that is sensitive to the impact of decisions on the cooperative firm *and* membership. The preceding discussion suggests the role of the board and top management may be even more important than previously suggested. In addition to the normal responsibilities in any business organization, the board and top management of a cooperative must balance the interests of members and the cooperative firm as well as the interests of different majorities and minorities within the membership. The conceptual framework outlined in this article assists in identifying general factors the board and top management should consider when making cooperative decisions, the type of studies that should be requested, and the problems that can arise in establishing cooperative policies.

Summary and Conclusions

Democratic control is a unique characteristic of cooperative organizations. The purpose of this paper has been to present a framework to investigate the strengths and weaknesses of democratic control.

This paper suggests that democratic control does not ensure cooperatives always will make decisions that are in the long-run interests of the total organization. Poor decisions can result from simple majority rule, the activities of interest groups within the cooperative, members pursuing their interests at the expense of the cooperative firm, and management pursuing its interests at the expense of the membership.

No individual organization is likely to be dominated entirely by the majority, the minority, the membership, or management. In fact, over time, any given organization is likely to experience some combination of all the problems described here.

This paper also outlines several strategies cooperatives can adopt to correct the problems that arise from democratic control. One important step cooperatives can take is to thoroughly analyze the impact of proposals on the entire organization. The implementation of this strategy requires cooperatives to increase their understanding of the impact of democratic decisions on members, the cooperative firm, and the organization as a whole as well as to develop methods to analyze this interdependence. However, the most important strategy probably is for cooperatives to continually educate their directors, management, members, and employees about the advantages and disadvantages of democratic control.

Notes

1. Throughout this paper, the cooperative principle will be referred to as "democratic control" rather than "one-member/one-vote." The former is broader than

the latter and includes such forms of decision making as voting based on patronage, voting based on equity, and mixed forms of voting.

2. The term "noncooperative firm" is used throughout this paper to distinguish all other types of firms from cooperative associations. Noncooperative firms include public corporations and partnerships as well as individual proprietorships.

3. When the time dimension is incorporated, the decision-making rule becomes: Accept all independent alternatives where the net present value of the private cash inflows and outflows is positive. For mutually exclusive alternatives, members and firms should select the alternative with the highest net present value based on their private cash inflows and outflows.

4. Although there seems to be agreement about the general objective of cooperative organizations, there is considerable disagreement about the appropriate operational objective for cooperatives. Ladd has discussed alternative cooperative objectives and suggests the preferred objective be one that maximizes members' net revenues. That is the assumed objective used throughout this paper.

5. To incorporate the time dimension, the decision rule is to accept all independent alternatives where the present value of the total benefits of all parties exceeds the present value of the total costs imposed on all parties. For mutually exclusive alternatives, the organization should accept the alternative with the largest net present value based on the costs and benefits of all parties. (Although the cooperative receives the benefits in the short run, members should benefit in the long run as patronage refunds are passed along to members.)

6. Perfect representation implies cooperative delegates and directors can perfectly analyze, aggregate, and summarize the impact of an issue on the membership and elected representatives vote in the same proportions as the members would have if they had voted.

7. For the time being, assume the proposals are only concerned with the distributional impact of costs and benefits on different groups of members and they have no direct impact on the cooperative firm. The effect of decisions on the cooperative firm is discussed later.

8. It is possible for a proposal to have a positive net impact on the organization when the costs exceed the benefits for the majority (i.e., Type B proposals) if the total net benefits accruing to the minority outweigh the total net costs imposed on the majority.

9. Cooperatives should be cautioned against expressing the impact only on a per-unit basis (e.g., per bushel, per hundredweight, per ton, etc.) or as a percentage of producer prices. In these cases, there is a tendency to make the impact of a proposal seem inconsequential.

10. When using parliamentary procedures, only one issue is decided at a time and the decision is either "Yes" or "No." Although different members on both sides are likely to have different and even conflicting reasons for their positions on any given issue, there is likely to be only one majority and one minority.

11. This suggests that cooperative members may have two discount rates: one for their own operations and a higher one for their cooperative.

12. In this section, it is assumed managers are interested only in the financial performance of the cooperative firm. Consequently, they ignore the impact of their decisions on the membership.

13. One reviewer correctly noted that both member-dominated and management-dominated cooperatives may lack the incentive to adopt programs that are likely to be to the long-run benefit of the organization as a whole (e.g., a solid equity program, a strong marketing program, etc.). The reviewer went on to suggest, and the author concurs, that a potential area of study would be analyzing the trade-offs among decisions in terms of short-run and long-run costs and benefits. In other words, one reason that Type III proposals fail in member-dominated cooperatives is that members have a very short payback period vis-à-vis their

cooperatives. They may not appreciate the potential long-run benefits of sound management strategies.

References

Buccola, Steven T., and Abdelbagi Subaei. "Optimal Market Pools for Agricultural Cooperatives." *American Journal of Agricultural Economics* 67(Feb. 1980):70–80.

Buchanan, James M., and Gordon Tullock. *The Calculus of Consent*. Ann Arbor: University of Michigan Press, 1962.

Knoeber, Charles R., and David L. Baumer. "Understanding Retained Patronage Refunds in Agricultural Cooperatives." *American Journal of Agricultural Economics* 65(Feb. 1983):30–37.

Ladd, George W. "The Objective of the Cooperative Association." In *Development and Application of Cooperative Theory and Measurement of Cooperative Performance*, pp. 1–23. Washington, D.C.: USDA ACS Staff Rep., Feb. 1982.

Olson, Mancur, Jr. *The Logic of Collective Choice*. Boston: Harvard University Press, 1965.

Royer, Jeffrey S. "Distributing Cooperative Benefits to Patrons." *Cooperative Accountant*, Summer 1982, pp. 17–30.

Staatz, John M. "The Cooperative as a Coalition: A Game-Theoretic Approach." *American Journal of Agricultural Economics* 65(Dec. 1983):1084–89.

Vitaliano, Peter. "The Theory of Cooperative Enterprise: Its Development and Present Status." In *Agricultural Cooperatives and the Public Interest*, ed. Bruce W. Marion, pp. 21–42. North Central Regional Res. Pub. 256, Research Division, College of Agricultural and Life Sciences, University of Wisconsin-Madison, Sept. 1978.