Developing Cooperative Strategy to Create and Improve Member Value

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Today’s Game Plan

- Evaluate a strategic decision-making framework for cooperatives
- Discuss alternative types of cooperative strategies used to increase member value
- Consider specific examples of strategic choices and their implications
Warm-up

USDA estimated that the total number of agricultural (farmer) cooperatives in the U.S. in 2009, including marketing, supply and service cooperatives was:

A. 238 
B. 2,389 
C. 23,894 
D. 238,942 

Correct Answer: B
Warm-up

USDA estimated that the total number of agricultural (farmer) cooperative memberships in the U.S. in 2009, including marketing, supply and service cooperatives was (in thousands):

A. 224
B. 2,248
C. 22,484
D. 224,842

Correct Answer: B
The total number of agricultural (farmer) cooperatives in the Northeast U.S.* in 2009, including marketing, supply and service cooperatives was:

A. 61
B. 103
C. 162
D. 225
E. 458

*Includes ME, VT, MA, CT, NY, PA, NJ, MD, DE (NH & RI not rep. < 3)
Warm-up

The state with the highest number of agricultural (farmer) cooperatives in 2009, including marketing, supply and service cooperatives was:

A. Minnesota
B. Texas
C. North Dakota
D. California
E. Iowa

Source: USDA Cooperative Programs 2011
Warm-up

The state with the highest gross business volume for agricultural (farmer) cooperatives in 2009, including marketing, supply and service cooperatives was:

A. Minnesota
B. Texas
C. North Dakota
D. California
E. Iowa

Warm-up

The state with the highest gross business volume for agricultural (farmer) cooperatives in 2009, including marketing, supply and service cooperatives was:

A. Minnesota $17.6 billion (2nd)
B. Texas $5.0 billion (12th)
C. North Dakota $6.4 billion (9th)
D. California $10.0 billion (4th)
E. Iowa $18.1 billion (1st)
F. Illinois $12.7 billion (3rd)
G. Wisconsin $9.4 billion (5th)
H. New York $2.7 billion (18th)
I. Pennsylvania $2.0 billion (20th)

Source: USDA Cooperative Programs 2011
Defining *Cooperative Strategy*

- **Definition:** “Cooperative Strategy is the attempt by organizations to realize their objectives through cooperation with other organizations, rather than in competition with them.” (Child & Faulkner 1998)
  - **Strategic decisions** – making decisions in light of information on the expected actions and responses of others
  - Recognize *individual incentives* in making cooperation possible, e.g., receive *positive differential returns* over other options
  - Closely linked to attaining the *goals desired by cooperative* – maximizing value to its members

**Forms of *Cooperative Strategy***

- Cooperative
  - Farmers
  - Farmers
  - Farmers
  - Farmers

- CO-OPS
  - CO-OPS

- NON CO-OPS
  - NON CO-OPS

- NON CO-OPS
  - NON CO-OPS
Defining *Cooperative Strategy*

- **Advantages/Incentives of cooperative strategies?**
  - Pooling of competencies and resources, information exchange
  - Combining different perspectives & experience in making decisions
  - Can build new values and innovative ideas
  - Reduce risk exposure; e.g., pooling, diversification, market integration
  - Easier access to or securing member markets
  - Market power effects
  - Transaction cost economies

- **Obstacles to cooperative strategies?**
  - Constrained focus (+ or -)
  - Incomplete or inaccurate information
  - Balancing cooperative goals and member incentives
  - Business as usual trap, ability or ease of change
  - *Diverse member interests and needs*

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**Strategic Framework with Diverse Member Interests**

- **Goals of Indiv. Producers**
- **Incentives for Cooperation**
- **Member Consensus**
- **Consistency in Policies**
- **Achieving Goals**
- **Co-existent Pressures:**
  - **Diverse Member Interests**
  - **Competitors’ Indiv. Dealings**
  - **Conflicting Interests**
- **Rebuild Incentives for Cooperation**
- **Divisiveness & Decline**

*Source: Reynolds 1997*
Strategy Examples - Attracting Large Producers

- Hypothetical cooperative that operates more efficiently when it receives patronage from large members
- A competitor offers individualized deals to bid large members away from the cooperative.
- You are members of the BOD that must decide whether to accept various policies (strategies) proposed by management

Setting the Stage

- Initially, by being a larger coop, it receives a total payment of $7, distributed to members based on patronage implies SP receive $4 and LP receive $3.
- LP have the opportunity to defect (leave), since by acting individually, they could receive a payment of $4.
- The resulting lower volume in the coop reduce efficiencies and lower member returns to $1 (large scale economies)
Policy Proposal I
- Establish differential pricing in proportion to product volume delivered.
- Large producers will be penalized if they leave the coop by expropriating a portion of their equity (or retained for an extended period of time).
- With the expected outcomes of the alternative scenarios below (and known by both), how should you vote and what will the large producer do (optimally)?

<table>
<thead>
<tr>
<th>Cooperative</th>
<th>New Policy</th>
<th>Current Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large Producer</td>
<td>(3,4)</td>
<td>(2,3)</td>
</tr>
<tr>
<td></td>
<td>(4,3)</td>
<td>(1,4)</td>
</tr>
</tbody>
</table>

Policy Vote and Outcome
How would you vote and how will the large producers respond?
A. Coop rejects new policy, LP defects
B. Coop rejects new policy, LP cooperates
C. Coop accepts new policy, LP cooperates
D. Coop accepts new policy, LP defects.
**Policy Vote and Outcome**

How would you vote and how will the large producers respond?

A. Coop rejects new policy, LP defects
B. Coop rejects new policy, LP cooperates
C. **Coop accepts new policy, LP cooperates**
D. Coop accepts new policy, LP defects.

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<tr>
<td>Large Producer</td>
<td>(3,4)</td>
</tr>
<tr>
<td>Cooperation</td>
<td>(4,3)</td>
</tr>
<tr>
<td>Defection</td>
<td></td>
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**Policy Result**

- The equilibrium solution is the upper-left cell (option C).
- Smaller producers are willing to transfer a portion of their value to large producers and large producers rejoin the co-op in this sequential game.
- Can also think about the defection choice under new policy, as if the LP hasn’t left yet.
Example 2 – Changing Market Conditions

- Overall market conditions have worsened and there is less opportunity to use the policy as before; in this case, the co-op receives a lower payment of $6 that now is allocated evenly to small and large producers at $3 each.
- The large producer still has the opportunity to defect and get a higher payoff of $4, but now this payoff depends on the continued existence of the coop (yardstick effect).
- Given that further benefits of scale economies have disappeared, the co-op is considering reducing scope of its operations.

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Policy Proposal II

- Reduce the scope of operations by terminating independent marketing program and contract with our former competitor for marketing services.
- Coop will still provide storage, product assembly, and will negotiate the marketing services contract.
- The expected payments are estimated to be (2,2) with LP and (2,1) without.
- The existence of the option is under discussion and known by all.
- Now what will you do?

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</thead>
<tbody>
<tr>
<td>Current Policy</td>
<td>(3,3)</td>
</tr>
<tr>
<td>Marketing Services Contract</td>
<td>(2,2)</td>
</tr>
</tbody>
</table>
Policy Vote and Outcome?

What will the players do now?
A. Coop approves proposal, LP cooperates
B. Coop approves proposal, LP defects
C. Coop rejects proposal, LP cooperates
D. Coop rejects proposal, LP defects

Policy Results – What will the players do now?

What will the players do now? It Depends!
A. Coop approves proposal, LP cooperates … perhaps
B. Coop approves proposal, LP defects
C. Coop rejects proposal, LP cooperates … perhaps
D. Coop rejects proposal, LP defects

Does LP think this is a credible threat?
**Policy Results**

What will the players do now? It Depends!

A. Coop approves proposal, LP cooperates … perhaps
B. Coop approves proposal, LP defects
C. Coop rejects proposal, LP cooperates … perhaps
D. Coop rejects proposal, LP defects

OR, is there sufficient communication and trust to REBUILD THE INCENTIVES FOR COOPERATION?

**Current Policy**

<table>
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<tbody>
<tr>
<td>(2,2)</td>
<td>(3,3)</td>
</tr>
<tr>
<td>(2,1)</td>
<td>(1,4)</td>
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Trust Communication Timing

Policy Results

Case 1: If LP thinks the threat is not credible…
- LP will defect
- But if policy subsequently implemented, LP is much worse by staying defected
- LP switches to cooperation (Answer A)
Case 2: If LP thinks the threat is credible…
- **Opportunity to achieve the original outcome**
- Answer C (but, in essence, w/o the BOD actually acting on the proposal)
- It is not the LP’s preferred selection at the start, before the threat was perceived as credible, but it’s better than the alternative

**Policy Results**

- Evaluating strategic options can be complicated as you need to consider your own and others (inter-dependent) choices, as well as impacts to overall market structures (e.g., yardstick effect)
- Even simple examples can show alternative solutions
- **Process and communication** of alternative strategies to members vital to rebuilding incentives for cooperation.
Conclusions

• Most cooperatives follow a rich mix of strategies that happen simultaneously and address multiple goals.
• Most situations are more subtle and generally unfold as a gradual process of adjustment.
• Our examples assume complete information that is adequately communicated, including the consequences of various actions. Lack of this can lead to lower-value joint outcomes.
• There are many cooperative strategy examples we can think of that look to strike the balance between the needs of the members and the cooperative; e.g., building cooperative liquidity versus paying patronage, short run versus long run effects, etc.
• Hopefully today’s discussion wetted your appetite to learn (and do) more!