Corporate Governance and Co-operatives: Peer Review Workshop

Session 3: “Renewal of co-operatives” – ‘traditional’ to ‘new generation’

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Key co-op features

- Aim is commonly to enable members to continue their social and economic activity – as producers or suppliers. Multiple objectives
- No separation between interests of capital providers and co-op's users. Two interests are fused within membership
- Strong focus on exclusive control by members (exclude 'capitalists' or 'intermediaries')
- Competition is viewed as adverse
- "Co-operative goals require a the absence of opportunism" *[Drs Bremmers and Zuurbier]*
- Commitment to "spirit of co-operation" – somwhat undefined *[Bekkum, van Dijk, Gorcum]*

Historical aims

- Countervailing market power
  - increase members' selling price (not tenable in competitive global markets)
- Market access
  - increase members' access to markets
- Economies of scale
  - reduce members' costs
- Political influence
  - obtain protections (tax, subsidies, anti-trust exemptions)
  - social policy objectives
- Preserve employment or life-style

Taxonomy

- Traditional
- Cartel
- Yardstick
- Second generation
- Third generation
- Hybrid or combination

"…precise legal definitions [of cooperatives] with universal applicability, do no exist" – *A M Hind*

Traditional co-operatives

"…an aggregate of economic units (members) and are not themselves acquisitive economic units – in other words, a cooperative is a pure agency with members as principals" – *Torgenson, Reynolds + Gray*

Types

- Consumer (retail) co-ops – buy and sell to members
- Producer (agricultural) co-ops – buy from members
- Manufacturing (supply) co-ops – make and sell to members
- Service co-ops – supply to members (credit)
- Labour co-ops – members supply to others
- Supply co-ops – members purchase inputs and use to supply services to others

Traditional characteristics

- Open, direct membership
- Long term affiliation
- Member’s obligation to use co-op
- Co-op’s obligation to serve member
- $1 in, $1 out
- Low capital input
- No return on capital
- One person, one vote (not proportional to inputs)
- Equal pricing across all members’ (not related to volume or distance)
- Cost averaging in serving members

Success requirements for producer co-operatives

- Members share common objectives
- Homogenous inputs and outputs
- Outputs closely related to inputs (limited other production or service inputs)
- High membership commitment
- Low costs of entry
- Low management (agency) complexity
- Withdrawal relatively difficulty
- Members accept implicit cross-subsidies

Environmental changes

- More competitive international markets
- Limited ability for seller groups to influence market prices
  - Especially given increased power of global wholesale and retail businesses
- Vertical integration (to capture down-stream value) requires diverse and specialised inputs – goods, capital, and skill
- Producers and consumers have greater choice
  - control of governance not required if suppliers/producers able to access competitive alternatives
  - notion of ‘exclusive member control’ tends to be illusory in large co-ops

Challenges

- Disparate member goals – ‘horizon problems’
- Distorted price signals to members, causing over or under production
- Producer co-ops focus on serving members, not customers
- Inflexible or slow decision-making
- Agency problems – disconnect between members, directors and managers
- Weak monitoring
- No return on capital
- Multiple objectives – confusion on how to make trade-offs

Challenges *(cont'd)*

- Limited access to equity capital
- Weak disciplines on investment decisions, particularly given restrictions on capital withdrawal
- Narrow talent pool for governance (acute for more complex businesses)
- Pool of unallocated capital – inequity between new and existing members
- Lack of diversification for members – all eggs in one basket
- Weak commitment to *co-operative spirit*

Producer co-ops struggle in competitive consumer end markets

The future

- Some argue that traditional cooperative principles “are the result of historical facts that have developed into ideological and cultural convictions” – *Nilsson*

- Fundamental that choice of governance structure should fit the objectives of the venture – *“structure enables strategy”*

- Better to be ‘agnostic’ on choice of structure – aim is to meet members’ needs

- Is a ‘shared spirit of co-operation’ durable to bind over time divergent and more complex members’ interests, and business challenges?

New generation co-ops

- Allow tradability of shares – often separate class of share
- Bring in outside equity – limited voting power
- Allow external directors
- Separate price for goods supplied from return on capital
- Value shares at ‘fair value’ (market value)
- Allow withdrawal of share capital

New generation co-ops *(cont'd)*

- Create separate 'value add' subsidiary
- List co-op with controlling shares held by suppliers
- Remove cross-subsidies, and pay value-based prices – differential among members

Starts to look like investor-owned company

Companies

- Company form is also a form of co-operation
- In NZ, most widely used form – most businesses are very small – ordinary people
- Company is simple, standard form – ‘off the shelf’ – standard rules, low transaction costs to set up, run and dissolve. Familiar body of well developed rules – well known to banks, regulators, investors, and ordinary shareholders
- Very useable and malleable
- Co-op form should seek to achieve the same

Conclusions

- Need diversity of business forms – co-ops part of the mix
- But aim is not to protect and promote co-operatives as an organisational form
- Aim is to achieve participants' shared goals
- Design governance to achieve group's goals
- Agnostic as to which form works best