

MEMBER LOYALTY IN CO-OPERATIVES: THE EQUITY PARADOX

EXTENDED ABSTRACT

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MEMBER LOYALTY IN CO-OPERATIVES: THE EQUITY PARADOX

The importance of member loyalty for co-operative success has been studied extensively. The unique relationship of co-operatives with their members as customers and owners of the organization is a competitive advantage and major attributor to their resilience (Briscoe and Ward, 2000; Jussila et al., 2012); it can however also introduce significant challenges. A key advancement in the economics literature over the last two decades has been the identification and study of challenges facing co-operatives due to the nature and dynamics of their relationship with their members. Cook (1995) brought together the “free rider”, “horizon”, “portfolio”, “control” and “influence cost” problems, elements of which had been advanced in previous works of Vitaliano (1983), Porter and Scully (1987), Staatz (1987), Milgrom and Roberts (1990), LeVay (1983) and in the wider economic literature of public goods. These challenges have been attributed to the nature of residual claims in traditional co-operatives (poorly defined, restricted to members, non-appreciable and not traded, with common property aspects), and increased member heterogeneity as the co-operative evolves through its life-cycle (Vitaliano, 1983; Cook, 1995).

At the heart of these challenges lies a distribution equity problem, how can one decide what is “fair” or “equitable” when different stakeholders hold different views with potentially conflicting equity norms? A second question emerges, how can one then enforce this “fair and equitable” distribution while minimising the free-rider, horizon and portfolio problems? Research has primarily focused on addressing the second question, with the evolution of a body of literature that has studied co-operative ownership and control structures as they enable the delivery of member value while alleviating the ‘generic’ problems of the co-operative business model. This includes the advancement of ownership, control and governance classifications (Chaddad and Cook, 2004; Chaddad and Iliopoulos, 2013; Cook and Chaddad, 2004), their impact on organizational efficiency, economic performance and access to financing (Bijman and van Bekkum, 2005; Hendrikse and Bijman, 2002; Plunkett et al., 2010; Rebelo et al., 2002), as well as classifications of effective market, community and organisational responses to some of the above problems, the latter taking the form of “contracts or hierarchy solutions” (Iliopoulos, 2009).

Significantly less work has taken place in exploring the first question, shedding more light in the varying equity norms of a co-operative’s members. Of significance is Nilsson’s argument that the degree of challenge faced by co-operatives varies and is dependent on the importance placed by members on each one of their roles as patrons and investors (Nilsson, 2001). Equal economic participation is one of the founding principles of co-operatives, common derivatives of which are the establishment of transparent and equitable pricing, and the distribution of residual claims in proportion to patronage. These practices are engrained in the co-operative movement, evidence of which is found early in the history of the movement (Fairbairn, 1994; Hall and Watkins, 1937; Gide et al., 1915; Gide, 1922). Considerations of morality, fairness, and mutual obligation are in the core of cooperative behaviour (Jervis, 1988) and contribute to the evolution of trust and member loyalty within co-operatives. Whilst people exploit free-riding opportunities in voluntary co-operation games, when people care more about equity, and have a better sense of “distributive justice”, stable co-operation is maintained (Fehr and Schmidt, 1999; Ostrom, 1998). This is in line with equity theory which suggests that relational satisfaction depends on perceptions of fairness in distribution of resources; individuals value fair treatment and are motivated when fairness is maintained. In contrast to this widespread view, our work reveals that equality and transparency, in particular in

relation to the applied pricing rule, can paradoxically have minimal or even indirectly the reverse effect on co-operative members' loyalties, depending on environmental and other conditions. This work provides preliminary evidence that a transparent pricing scheme, by which members know in advance the pricing rules which are the same for everyone, can be both a strength, but at times also a weakness of the co-operative business model.

The argument evolves through exploratory case study research of two 'pacemaker' Australian co-operatives, Murray Goulburn Co-operative Co Limited (MGC) and Geraldton Fishermen's Co-operative Ltd (GFC). The concept of a 'pacemaker' co-operative originates from the work of Le Vay (1983) who identified such firms as those that set the benchmarks for prices and service standards in their markets. However, as Le Vay's theory suggests, the challenge of the 'pacemaker' is that once the co-operative becomes the benchmark its members may seek to obtain better 'value' by going outside to other suppliers or buyers. This sense of 'fairness and equity', in how the co-operative offers perceived value to its members, becomes a potential source of internal tension.

In 2011 MGC was the second largest co-operative in Australia, with an annual turnover of 2.24 billion (Co-operatives Australia, 2011) and is the only dairy co-operative remaining in the State of Victoria. GFC has an annual turnover of \$145 million (Co-operatives Australia, 2011) and is the only remaining fishermen's co-operative in Western Australia. As a result both co-operatives are 'pacemakers' and in the case of MGC, the company essentially sets the benchmark farm gate price for whole milk in the south eastern part of Australia.

The data collection and analysis was informed by the work of Yin (1989) and involved developing a detailed case study protocol that guided all case data collection. A historical case analysis technique was applied, using multiple secondary data sources to develop a critical incident timeline in the history of each co-operative, which then guided in-depth interviews with current and past board members and executives (Flanagan, 1954; Gremler, 2004). Findings in relation to members' perception of equity and the impact of transparency and equal pricing on member loyalty were part of a larger set of research questions that were examined through this work. Emerging from this analysis was a series of narratives and themes. Further analysis of this data is underway using structured coding and a qualitative data analysis software.

Interpreting the findings of this work one can view member loyalty as a function of: a) perceived individual benefits and costs (including risks considered as costs); b) perceived equity/fairness of the distribution of benefits, and c) the distribution of risk perceptions among members. The benefits or value that members derive can be financial or functional (quality of service) (Söderlund, 2002). Emotional value (e.g. how members feel about their relationship) also plays a role, consistent with what is already known about customer perceived value (Sweeney and Soutar, 2001). This is supported by recent research evidence that illustrates the significance of the latter and especially the impact of affective commitment (member's emotional attachment to, identification with, and involvement in the co-operative) on member loyalty (Jussila et al., 2012; Mazzarol et al., 2012). The case study evidence suggests that in market conditions contributing to higher prices for agricultural output and/or climatic conditions result in agricultural supply that meets market demand, well-run pacemaker co-operatives can thrive. Supply levels are enough to enable processing plants to run at or close to maximum efficiency, production and processing costs are low, expected financial benefits are high and risks are low throughout the industry (for co-operatives and private processors alike). In

these conditions and assuming equal functional value provided by the co-operative and its competitors, the perceived fairness of the distribution of benefits is a key catalyst to member loyalty. The co-operative usually offers transparent and equal pricing for every additional unit, commonly committed to “growing with members”, as opposed to private processors that aim to maximise their own profits and even out their capacity utilization, at times even penalising their suppliers for supply above the agreed quantity.

In a season when supply or price of agricultural output drops dramatically, the situation is reversed and the whole industry is facing higher overheads, higher production costs and lower prices to producers. Pacemaker co-operatives typically have large size and volume requirements in order to ensure the efficiency of operations and economies of scale and scope. They also have to apply transparency of pricing and an equality of pricing for members that is usually based on volume. This can create rigidity in their pricing structure and make them vulnerable to investor-owned competitor firms that can negotiate pricing with suppliers individually to get the marginal number to switch to ensure they operate above break-even. Under these conditions of low expected benefits and higher risk in expected benefits the perceived fairness of distribution has minimal impact on member loyalty. Co-operative business models that are locked into offering equal and transparent pricing have been seen to gradually lose members to the competition in a low market. They run the risk of getting trapped in a vicious cycle of even less throughput and higher overheads which can destroy a co-operative or lead to its privatisation. Hence the title of this paper “equity paradox”, as fairness, a key element of the co-operative member value proposition can increase the vulnerability of this type of business under certain conditions.

This work suggests the need for a clear understanding of equity norms of members under different environmental conditions, including market conditions (e.g. expected benefits, costs and perceived risk of benefits), as well as demographic and other parameters that differentiate members from one another (i.e. distribution of perceived risk). This can enable co-operatives to develop better resolutions to the equity distribution problem, including methods for influencing risk perceptions, distributions of benefits and distributions of risks to enhance member loyalty. An example could be ways of extending the expected benefits and their perceived risk across a longer period of time that is less dependent on market fluctuation.

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