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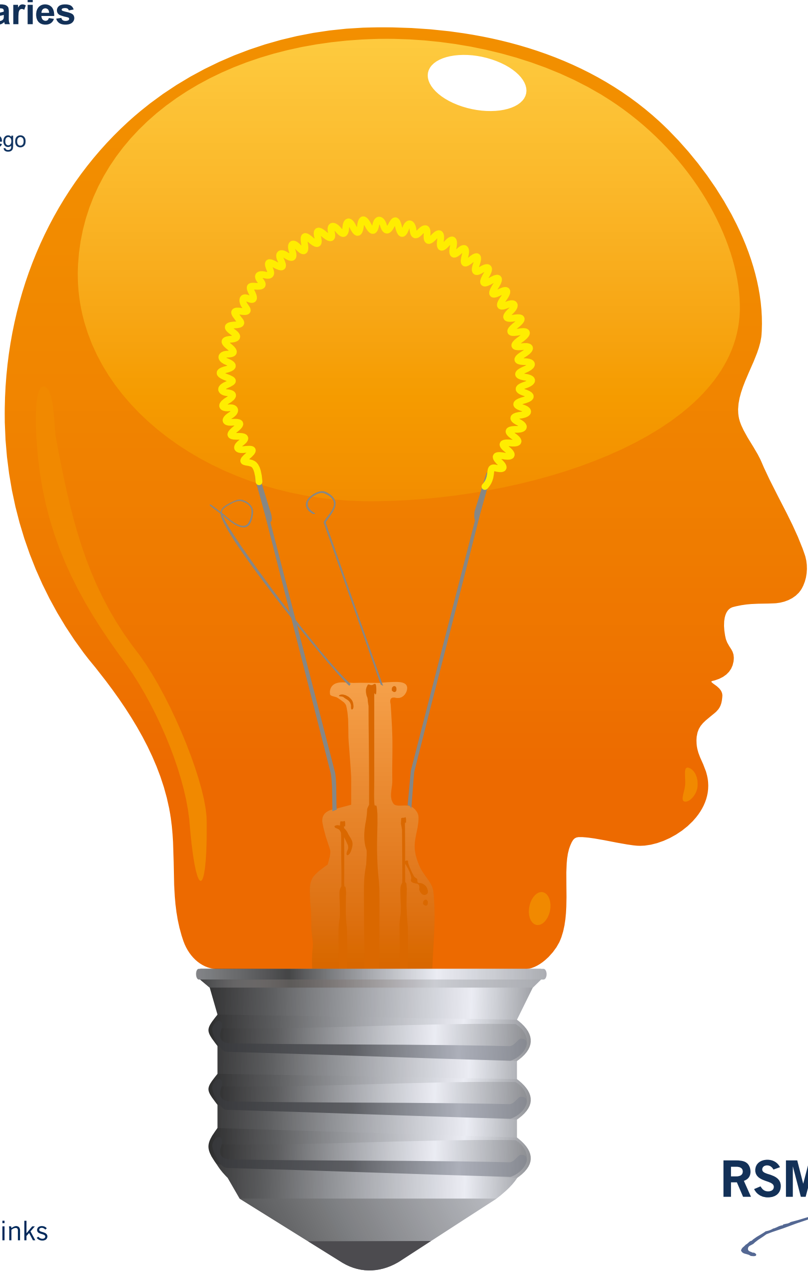

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Co-operatives and channel governance

by George Hendrikse

The inference behind the economic principle known as Gresham's Law is that 'bad money drives out good money'. The Greenery, a €1bn-plus annual turnover fruit and vegetable processing co-operative in the Netherlands, found this to be almost literally true.

In my recent paper, *Pooling, Access, and Countervailing Power in Channel Governance*, I review how a longstanding traditional policy of paying its producer members by quantity rather than quality, threatened not only the image of The Greenery, but also its very existence.

I also consider how a willingness to change its by-laws and policies on payment in reaction to that threat saved the business. The change in emphasis that shifted the distribution of surpluses, rewarding higher quality producers more than lower quality ones, means The Greenery's pie is today larger, delivering a win-win scenario.

"Many co-operatives nowadays spend considerable effort in redesigning their income rights in terms of developing member benefit programmes."

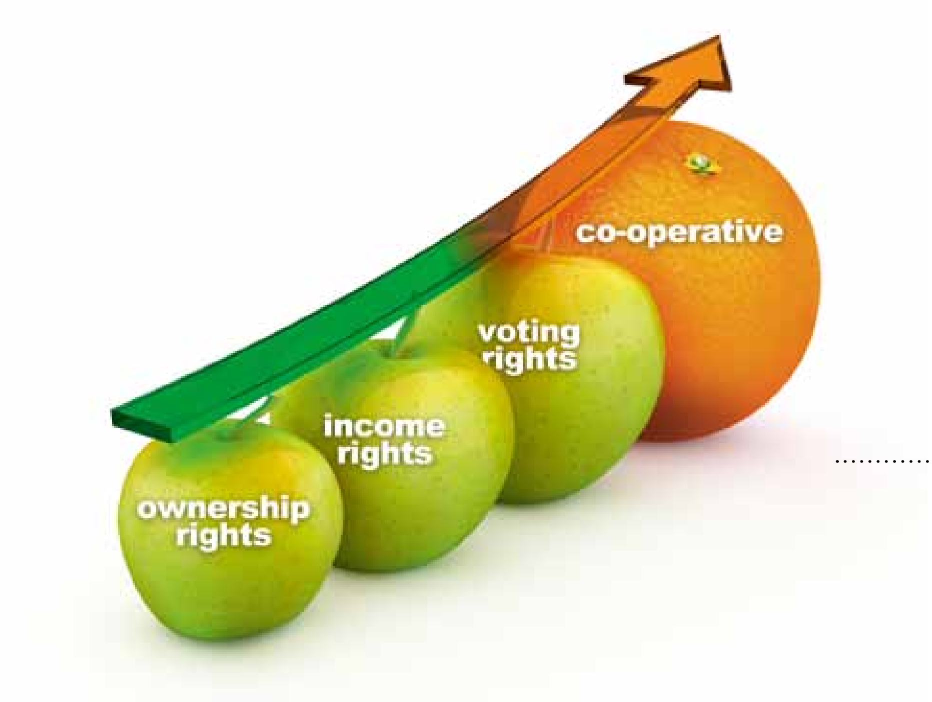
Economics of organisations

The economics of organisations is a fascinating field. Main topics are the ownership of the enterprise, hiring the right people, paying for A while hoping for B, task and job design, and alignment in organisations. When considering the question of supply chain governance, a key question is: which party should own which part of the chain? Candidates are farmers, intermediaries, retailers and consumers.

The best-known structure is the publicly owned stock market company, but most organisations are not publicly listed or owned by external shareholders. Family-owned entrepreneurial companies, for instance, fall into this category. Many organisations, such as hospitals and universities, have no owners in the conventional sense. They are foundations. My own longstanding special interest is in organisations owned by suppliers, especially agricultural co-operatives.

The Greenery B.V. is one of the leading companies in Europe in the fruit and vegetable sector. Its main activity is to provide a complete range of fruits and vegetables to supermarket chains in Europe, North America and the Far East throughout the year. Other major target groups are wholesale businesses, catering companies and industrial processing companies. The company has some 2,500 employees, while 1,500 producers own its shares. They are members of the horticultural co-operative Coforta U.A. and they market all their products via The Greenery.

The Greenery has gone through various governance structure changes. It started as a merger between nine regional fruit and vegetable auction co-operatives in December 1996. They combined all their assets and activities into Voedingstuinbouw Nederland (VTN). VTN is the 100 per cent shareholder of The Greenery. The organisation integrated forward by acquiring the fresh produce wholesalers Dutch Van Dijk Delft Group and the Fresh Produce Division of Perkins Food plc, a UK-based wholesaler in 1998.



It is possible to cite a number of good reasons for co-ops to form. If small-scale farmers join forces to deal with retailers, it increases their joint bargaining power with those retailers. This is an important consideration in the case of perishable goods. Ownership of a processing company gives access to the processing state of the cycle, further increasing bargaining power. Some co-ops have become very large organisations in their own right, turning over billions of dollars.

The basics of ownership

Ownership is a crude instrument to align interests. There is more to enterprises than their ownership structure. Nowadays enterprises are characterised in terms of their governance structure, specifying the structure of ownership, decision, and income rights. The ownership rights specify who formally owns the enterprise. For example, farmers are the owners of an agricultural co-operative.

Decision rights specify who may take decisions on the strategies and policies of the organisation, as well as on the use of assets and thereby on the employment of people working with these assets.

Decision rights include the allocation of authority (delegation, centralisation), decision control (ratification, monitoring), decision management (initiation, implementation), task design, conflict resolution, and choosing enforcement mechanisms.

Income rights are rights to the (monetary) benefits and costs resulting from the activities of the organisation. Income rights are reflected in the composition of cost and payment schemes, thereby creating the incentive system. Examples of income rights in co-operatives are direct and indirect benefits of patronage, cost and benefit allocation schemes like pooling arrangements, and the compensation package of the members of the management team.

Many co-operatives nowadays spend considerable effort in redesigning their income rights in terms of developing member benefit programmes. Examples are quantity discounts, quality premiums, service at cost, offering favourable possibilities to supply financial funds for specific members, and supplying services tailored to the broader interests of specific members. It is in line with the normative implication of the increasing heterogeneity for the efficiency of traditional cooperatives that the impact of the collective features has to be reduced.

Income rights

Even the best-laid plans of mice and man, however, are subject to change, and change came to affect The Greenery, adversely, when the inadequacies of its payment pooling structure began to become clear. Various large growers left The Greenery to launch their own product-specific bargaining associations over the next few years. Finally, various bargaining associations merged again with The Greenery after the introduction of member benefit programmes.

As I note in my paper, pooling is an important aspect in many organisations. In his 1998 paper, researcher J. Nilsson observes that the principle of equal treatment within agricultural co-operatives is traditionally strong. For example, prices are not always differentiated based on quality and quantity, and member control, eg, the general rule is that all members have equal voting rights. The economic impact of equal treatment is that revenues and

Co-operatives and channel governance (continued)

by George Hendrikse

costs are allocated to a certain extent independent of quantity and/or quality.

The increasing grower heterogeneity poses also a challenge for traditional grower organisations because various aspects of these governance structures are tailored towards homogeneous members. Heterogeneous co-operatives have difficulties in keeping highly innovative growers. In the case of The Greenery, a number of large growers left due to the cross-subsidisation of small growers.

Innovative growers started product-specific bargaining associations. There were also some innovative growers leaving the co-operative in order to form bargaining associations and marketing co-operatives to advance their specific interests. They felt that marketing efforts could be improved to highlight their products.

Organisations can change internal policies to keep high quality members. Adjusting the pooling scheme brought farmers back. The Greenery moved away from its pooling practice to tailor services to different member groups as far as possible. To bring the better producers back, The Greenery changed its policy to one based on quality as well as quantity. If you pay the producers of bad cucumbers the same as you pay the producers of good cucumbers, producers will leave. This is the fruit and veg version of Gresham's Law, referred to earlier.

Positive image

Co-operatives emerge as a response to market failure. That is, the market does not provide certain products and services. Once co-ops came into existence, they largely enjoyed a positive image because of their communitarian philosophy, rooted in the determination to maximise price and profit for the ultimate suppliers of the goods being sold, rather than for intermediaries such as wholesale buyers and retail sellers.

Was that image damaged by the events that unfolded at The Greenery? It certainly came under threat. The management took action to rectify the situation and keep the growers inside The Greenery to maintain bargaining power. They changed the remuneration policy to place more emphasis on quality than on quantity.

Today, co-op payment policies are such that sometimes only high quality producers tend to be members. They tend to be too demanding for low quality producers. In this scenario, the distribution of any surplus rewards the higher quality producers more than lower quality producers. The pie is larger and the division of the pie has changed. Various questions surrounding the optimum form of ownership structure and channel governance remain unanswered, however.

Around one-third of world production today goes through co-ops. Which means two-thirds does not. Which is best? Ownership and income rights have been addressed, but decision rights have not. Bijman *et al.* (2012) address decision rights by distinguishing various board models in co-operatives. Successful co-operatives accommodate the diverging interests of their membership and the co-operative enterprise in one organisation. This is done by doing justice to the specific interests of the stakeholders in the design of coherent ownership, decision, and income rights. ■

This article draws its inspiration from the paper *Pooling, Access, and Countervailing Power in Channel Governance*, which was written by George W.J. Hendrikse and published in *Management Science*, 2011, 57(9), 1692-2002.

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