

Potential Roles for Marketing and Bargaining Cooperatives in the Pollock Fishery

Steven T. Buccola
Oregon State University

Draft membership agreements for pollock fishery cooperatives pay particular attention to the allocation of quota among cooperative members. Since the impetus for cooperative organization among pollock fishing boats derives largely from the opportunity provided by transferable quotas, this emphasis is not surprising. However, a cooperative structure requires attention to other important issues as well. Below, we review the following issues, with particular attention to the lessons from agricultural marketing and bargaining cooperatives:

- (a) features of a marketing/bargaining cooperative
- (b) control of a marketing/bargaining cooperative
- (c) functions of a bargaining cooperative in particular
- (d) combinations of marketing and bargaining functions
- (e) the bargaining process
- (f) possible pricing structures
- (g) prospects for success and ideas for the future

The terms “cooperative member,” “producer,” and “raw product supplier” will be used here interchangeably.

Features of a Marketing/Bargaining Cooperative

A cooperative is a firm that is owned by those who use its services, as distinguished from an investor-owned firm, namely one whose owners are not necessarily its users. Cooperatives which market their members' products are further divided into those which take title to their members' products in order to handle or process them, and those which do not take title but instead provide other services. Agricultural bargaining cooperatives normally fall into the latter category, although some bargaining cooperatives do take title to their members' products.

It is helpful to look briefly at the manner in which cooperatives which do take title allocate their net returns among members. Return allocation procedures fall into two alternative categories: allocation by individual account, and allocation by pool. In the individual account method, the cooperative segregates each member's product (in the fisheries case, the member's catch), sells it separately, and returns the revenue to the member less the variable and overhead costs of the cooperative's services. (Procedures for covering fixed or capital costs are discussed three paragraphs below.)

In the pooling method, the cooperative instead adds the revenue from the sale of all (or of a given

subset) of its members' products, deducts the cooperative's variable and overhead costs, then allocates this pooled net revenue to each member according to a prearranged rule. A typical rule is that each member's share of the net revenue is determined by the proportion of the total value of raw product that the member contributed to the pool that year. That is, the member's share of the pooled net revenue equals the share of the raw product value he contributed to the pool. Computing such a share requires estimating the “prices” of the raw products delivered by each member. These prices are often known in agricultural marketing cooperatives as “established” or transfer values and play a critical role in a cooperative's organization. A cooperative may conduct one or more pools at a given time. Members' products need not be physically commingled in order to sell them on a pool basis. However, once products are commingled, member incomes must be allocated through a pool because payment by individual account is no longer feasible.

Cooperatives that do not take title to members' goods instead provide services to members, such as bargaining for contract terms with processors and providing member information. These coops have no revenues from which to deduct their costs, so must finance themselves in another way. Most typically, agricultural bargaining cooperatives charge members a fixed rate either per unit of product or per dollar of raw

product value the member sells. If the charge is on a per-dollar-of-raw-product-value basis, "established values" must again be used.

Whether or not the cooperative takes title to product, it must subscribe equity capital from its members in order to cover fixed or capital costs. Cooperatives do so in one or more of three ways: membership application fees, withheld patronage dividends, and capital retains. Typically, little capital is raised through application fees. The second or withheld patronage dividend approach involves holding back a percentage of each member's net return allocation each year. That is, part of the cooperative's payment to a member is made in the form of an equity certificate, which is recorded in the cooperative's books in the member's name. The third or capital retains approach is to charge each member a fixed fee per unit or per unit value of the raw product that the member delivers to the cooperative. As with the withheld patronage dividend approach, an equity certificate is exchanged for this fee, which is recorded in the cooperative's books in the member's name.

The capital retains approach is used heavily by bargaining cooperatives because these cooperatives typically do not have any revenues as such and so have no patronage dividends to distribute to members. Even cooperatives that do earn revenues often draw part or all of their capital through capital retains. Most cooperatives revolve members' capital back to them after a certain period, either as determined annually by the board of directors or according to a fixed time interval as stated in the bye-laws. Interest may or may not be paid on the member's withheld capital, but usually is not paid. Nonpayment of interest creates no efficiency or fairness problem as long as each member's share of the cooperative's total equity capital stays roughly in proportion to that member's share of the value of product delivered.

Control of a Marketing/Bargaining Cooperative

The cooperative's constitution and byelaws distribute decision-making power among the board of directors, members, and hired employees. Some cooperatives choose to become members of a cooperative federation, which is a cooperative whose members are individual cooperatives. In that case, the constitution both of the cooperative federation and of the member cooperative determine the distribution of decision-making power between the federation and the member cooperative. Cooperative federations perform such

functions as exporting or further-processing members' goods, purchasing supplies, serving as information clearing houses, and representing members to the public and to policy makers. Cooperative federations are run democratically by the member cooperatives, just as member cooperatives are run democratically by the individual raw product suppliers.

Despite the compelling reasons raw product suppliers often have for forming a cooperative, a potential always exists for some members to free-ride on others. For example, if the cooperative's per-unit costs decline as its volume grows (increasing returns to size), larger members can argue reasonably that they contribute more to the coop's economic success than do smaller members. If, then, all members receive equal benefits per unit from patronizing the cooperative, smaller members free-ride on larger ones. On the other hand, larger members free-ride on smaller ones if the cooperative faces decreasing returns to size. Other sources of free-riding may also be present.

Claims that some members free-ride on others are a major source of cooperative failure. Why, then, do many cooperatives succeed? The academic literature suggests that cooperatives whose members are relatively homogeneous -- especially with regard to their size and to the type of product they harvest -- are more likely to be successful than are cooperatives whose members are relatively heterogeneous. The principal reason is that the greater the homogeneity, the less likely it is that some members can point to others as free-riding.

Coops whose members are very heterogeneous must do the best they can to limit the circumstances in which some members think that others are free-riding. One way of doing so is to use sliding scales when charging members for the cooperative's services. Another way of doing so is to give some members more votes than others have. In our own survey of forty-three agricultural marketing cooperatives, 63% allocated one vote to each member regardless of size, 9% allocated votes in proportion to a member's dollar volume of business with the cooperative, 7% allocated one vote to each member plus additional votes according to volume of business, and 14% allocated votes in proportion to each member's stock ownership in the cooperative. (Seven percent of the respondents did not answer the question.)

Functions of a Bargaining Cooperative in Particular

The subset of marketing cooperatives known as bargaining cooperatives see their chief service as

negotiating with processor/buyers over prices and terms of trade. Numerous agricultural bargaining cooperatives are organized under the Capper-Volstead Act, that is are exempt from certain anti-trust provisions by virtue of that Act. Although bargaining coops are registered under incorporation laws in their own states, only a few states, such as Michigan and California, have laws regulating their activities as specifically bargaining cooperatives.

Through the membership document, each member agrees that the bargaining cooperative will be the member's sole agent in negotiating contractual terms with processors. In agricultural cooperatives, membership usually is specified for a given quantity of the farmer's acreage rather than for a given quantity of the goods produced from it, since the quantity produced typically isn't known at the time of contract negotiations. Membership may or may not be closed; that is, the cooperative may or may not reserve the right to restrict the entry of given individuals or of given acreage to the cooperative. Although a cooperative normally wants as many members as possible, the demand for its product may sometimes be such that restricting entry of new members or of new acreage is in the best interest of the incumbent members.

Agricultural bargaining cooperatives normally distinguish between bargaining for "price" and bargaining for "terms of sale." "Price" refers to the base price corresponding to a reference product specification, which often is the lowest or highest grade of product available from members, or a grade that members commonly deliver. Anti-trust law, and perhaps the cooperative's self-interest, prohibits agricultural bargaining cooperatives from agreeing with processors on a particular price. Rather, agreement is reached on a minimum price that processors will pay for the reference product specification. Processors are free during the season to pay prices higher than this.

Agricultural bargaining cooperatives sometimes negotiate different base prices with different processors. However, they do so only to account for such cost factors as the differing locations of these processors. The reason is that bargaining cooperatives have a strong incentive to equalize the price paid to all members for a given quality of product. The literature of virtually every bargaining cooperative refers specifically to this equalization goal. In the absence of equalization, farmer dissension grows, sub-coalitions form among them, processors move to take advantage of the division, and members drop out.

In contrast to the base price, "terms of sale" refer to any combination of: (a) discounts and premia for

selected grade standards, for selected varieties or species of product, or for alternative dates and places of delivery; (b) conditions under which the processor can refuse an entire lot; (c) division of responsibility for containers and for off-loading of product; (d) changes in the base price according to the portion of the season in which the product is delivered; (e) members' delivery schedules and permissible adjustments to these schedules to account for unforeseen events; and (f) means of redress of grievances between cooperative and processor. Terms of sale typically are included in a document, often called the "Master Document," separate from that stipulating the base price. In many cases, the Master Document is renegotiated only every two or three years, whereas base price is renegotiated every year. Terms of sale are nearly always the same for every member except for allowances regarding the plant or processor to which the product is shipped.

Besides negotiating over price and terms of sale, agricultural bargaining cooperatives offer other member services. The most important is regular dissemination of information about supply and demand conditions in the industry. Economic information of this sort not only helps members estimate the value of the bargaining cooperative's services, but also assists them in making short-term management and long-term investment decisions. Cooperative managers agree that the principal key to a bargaining cooperative's success is full and frequent communication among the manager, board, and members.

Combinations of Marketing and Bargaining Functions

The distinction between a bargaining cooperative and one that takes title to or processes members' product is not straightforward. Some bargaining cooperatives, the California Canning Peach Bargaining Association in particular, take title to their members' products even though their principal goal is only to bargain for prices. The advantage of taking title is that members cannot drop out during the bargaining process; knowledge of this fact probably gives the cooperative greater bargaining leverage with processors. In addition, the cooperative can use its ownership of the product to perform marketing services for members, for example coordinating sales with individual processors and commingling the products of a group of members prior to a particular sale.

Most of the product which the Canning Peach Bargaining Association sells to processors is segregated by member. That is, payments to individual members are determined mostly by individual account rather than

through a pool. However, the Association's ownership of the member's product permits it to pool product across members if market conditions warrant. In particular, product which does not move readily at prices the Association has negotiated is often commingled together and held in a pool, to be sold later. Returns from this pool are allocated according to the principles outlined above.

Obtaining title to members' products gives the bargaining cooperative another advantage: if the coop considers that prices and trade terms negotiated with processors are inadequate, it may seek a co-packing arrangement with one of the processors. In a co-packing arrangement, the cooperative and processor agree to share the proceeds of the pack in some manner. Such arrangements include profit-sharing or an agreement under which the processor is paid a fixed fee for its services and the cooperative bears the full profit risk. Pollock cooperatives now forming in the Alaska fishery largely envisage themselves as bargaining with a single processor over prices and trade terms. However, they should bear in mind that pooling and/or co-packing generally remain as alternatives in the event that negotiations prove unfruitful.

The Bargaining Process

Before negotiating with processors each year, an agricultural bargaining cooperative must ensure that it has sufficient support from farmers in the industry. Normally, support is reckoned in terms of the percentage of the acreage in that industry which is signed up with the cooperative in the form of a membership agreement. Some bargaining cooperatives say they need as little as 40% of the acreage in their industry in order to bargain effectively with processors. Other cooperatives say they need a minimum of 70%. An informal survey of agricultural bargaining cooperatives suggests that they represent between 45% and 80% of the acreage in their industries. Often, much of the remaining acreage is committed to another cooperative which takes title to and processes the members' goods. This, for example, is the case in the California raisin industry, where much of the acreage not represented by the Raisin Bargaining Association (RBA) is sold through a processing/marketing cooperative. The RBA and the latter cooperative have close informal ties with one another.

Because processors are forbidden by anti-trust law from colluding in the establishment of prices or terms of trade, a bargaining cooperative must negotiate individually with each processor. Some cooperatives

seek first to bargain with the smaller or weaker processors, then move to the larger ones. However, the most frequent strategy seems to be to begin negotiating first with the larger processing firms. Only in California and in several other states are processors required to bargain. In any event, processors are free to offer different terms to different farmers, and in general to find various ways to encourage individual farmers to break from their cooperative organization. For example, processors are free to pay to cooperative nonmembers prices different than those that they pay to members.

Many bargaining cooperatives feel it is important to agree with processors first concerning terms of trade and only then concerning base price. Such a sequence helps assure farmer-members of a home for their product because, unlike base price, terms of trade are negotiated on a multi-year basis. In addition, agreeing first about trade terms helps processor and cooperative become familiar with one another's bargaining strengths and attitudes before they begin negotiations over the price level itself. Furthermore, trade term negotiations allow the cooperative to reveal the interests that it holds in common with the processor, such as the establishment of a price premium/discount schedule best suited to maintaining high product standards and timely raw product deliveries. Overall, agricultural bargaining managers seem to agree that it is usually better to discuss first the issues on which producer and processor are likely to agree.

Some agricultural bargaining cooperatives authorize a single negotiating team to bargain with all processors. Others establish a separate negotiating committee to work with each processor or plant. These processor-level committees come under the central direction of the cooperative manager and board. In any event, if agreement cannot be reached with a processor before the onset of the harvest season, the cooperative and processor may turn to a mediator, and if that is not successful, to an arbitration board. However, cooperatives usually try to avoid arbitration because it tends to undermine members' estimation of the cooperative's value.

Possible Pricing Structures

Most agricultural bargaining cooperatives confine themselves to negotiating a base price (and associated terms of trade) to be paid in cash during that harvest season to the coop's members. Many coops in earlier years tried instead to utilize a price formula in which the price which processors would pay would depend upon such industry aggregate data as cold-storage

inventories at time of delivery. However, these formulae proved too simplistic to capture all the factors that affect supply and demand, and hence value, of raw product.

Despite the failure of price formulae based on industry aggregate data, other alternatives to a simple annual cash price remain. One set of possibilities pertains to multi-year contracts. The California Tomato Growers Association presently is proposing to sign a two-year contract with canners in which a price would be set for each of the succeeding two years. The contract would state that, at the end of the first year of the contract, the second-year price would be renegotiated. Simultaneously, the price for the following (i.e. third) year would be determined. That is, contracts would be "rolling two-year-term" ones in which the second-year price would be renegotiated even as the following-year price is *originally* negotiated. Such an arrangement might help producer and processor plan for the future because, even though second-year prices could be changed through negotiation, they likely would not be changed appreciably unless both parties saw it in their interest to do so.

Along the same lines, the California Canning Peach Bargaining Association frequently utilizes rolling-ten-year contracts with processors. The Master Document in these instances allocates a given member's acreage to a given processor for the ten-year period, but states in only a general way how the price per ton will be determined each year.

In addition to multi-year contracts, the cooperative might negotiate price formulae in which raw product price is tied to the processor's performance. "Sales-minus" or revenue-share contracts are a case in point. In these contracts, the producer is paid a fixed percentage of the processor's resale price. If some of the processor's per-unit costs are deducted first from this resale price before the producer's share is computed, the contract instead is called a net-revenue-share or profit-share one. The latter contracts essentially treat the cooperative as if it were a full-fledged marketing cooperative, that is, as if it owned equity in the processing firm. The advantage of doing so is that producers are encouraged to act in accordance with the processor's interests, so that both producer and processor work to maximize the joint profit of the production and processing operation.

Except in cases in which the cooperative owns equity in the processor, agricultural bargaining cooperatives have not for the most part succeeded in negotiating revenue-share or net-revenue-share contracts with processors. One reason is that the processors'

owners have been unwilling to share processing profit or revenue with those, like bargaining cooperative members, who do not bear the risk associated with equity ownership. Even bargaining cooperatives perceive that profit- or revenue-share contracts can be injurious to cooperative members. In the first place, processors can, in one cooperative leader's words, engage in "creative accounting" when computing the processor's revenues or costs. For example, prices to some of the processor's customers may be subject to adjustment because of discounts offered to these customers or because of special services provided to them. Costs may be subject to similar adjustment. In the second place, agricultural bargaining cooperatives acknowledge that when a processor must pay a portion of its revenues to cooperative members, the processor becomes ill-inclined to obtain the maximum price possible for its product. This hurts coop members because the processor then has less net revenue from which to pay for raw product supplies. As the manager of the California Canning Peach Bargaining Association said, revenue-share contracts for raw product can be similar to raw product sales by consignment, because as the revenue share payable to the producer rises, the processor becomes simply a sales agent for the cooperative.

Nevertheless, profit- and revenue-share contracts have been used in a number of instances. Profit-share contracts between bargaining cooperatives and processors have been employed from time to time in the Florida citrus industry. And the Oregon Hazelnut Growers' Bargaining Association has, since 1983, obtained revenue shares from processors in the following way: If the processor's resale price (minus a discount if the processor adds much value through dicing, say, or adding chocolate) exceeds or falls short of the raw product price originally negotiated between cooperative and processor, producer and processor share the difference on a 50-50 basis. Recently, this arrangement has been amended as follows: If the resale price (possibly as discounted for costs as described above) drops *below* the originally negotiated raw product price, the raw product price is not reduced; but if the resale price rises *above* the originally negotiated raw product price, processors get the first three cents per pound of increase and producers get anything above that. In order for a revenue-share formula to be implemented, the processor's sales books must be audited by an independent auditor. The Hazelnut Bargaining Association acknowledges that, despite the overall success of its formula, processors are never happy about the auditing process.

Prospects for Success and Ideas for the Future

Managers of agricultural bargaining cooperatives say it is unrealistic to expect cooperative bargaining to bring dramatic gains to members. Processor-cooperative bargaining is part of the process of discovery of the raw product price. The process requires both parties to take into account current information about the supply and demand for the processed product as well as about the cost of raw product production. When raw product suppliers conduct their bargaining process as a group, they probably enhance price "a little bit" relative to what the price would be if suppliers each negotiated prices independently of one another. This may be enough justification for the bargaining cooperative's existence.

As we have mentioned, cooperatives offer other valuable services as well, principally in supplying

information to their members. Indeed, a bargaining cooperative is primarily in the information business. Effective information provision requires that the cooperative maintain wide contacts in its own industry and in related ones. For this and other reasons, a pollock fishery bargaining cooperative tied to a particular processor may well want to explore the possibility of joining with other Alaska pollock cooperatives in a cooperative union or federation. One role of the federation would be to gather and disseminate, to each member coop, information obtained from the other member coops and from the industry and general economy. Centralized information processing reduces fixed costs and enables the member coops to benefit in a timely manner from the other cooperatives' experiences. A pollock fisheries cooperative federation likely would also serve as the cooperatives' spokesman to individuals and groups outside the industry.