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# AGRBUSINESS MANAGEMENT

## **YOUR COOPERATIVE -- WILL YOU LOSE IT THROUGH INEFFICIENCIES.**

In my own chosen field of agricultural economics, I can't think of a more misunderstood term than "efficiency" (or inefficiency). We use the term loosely, sometimes even frivolously. Efficiency is a powerful term, but one that has become even more potent in these times of budget deficits, resource shortages and an inflationary economy. To better illustrate the confusion surrounding the common usage of this term, consider the following incident:

One bright sunny day not long ago, a young 28-year-old man boarded an airplane and flew from France, across the English Channel to Canterbury, England. For all practical purposes, such a flight might appear routine and hardly worthy of historical note. Yet, this incident attracted much attention around the world as this young man had piloted an aircraft called the "Solar Challenger," a plane viewed by the scientific community as the most energy-efficient, solar-powered, propeller-driven aircraft ever invented. Indeed, the Challenger consumed no carbon-based fuels during the entire flight. Instead, it used sixteen 128-photo voltaic cells, each of which reacted chemically to the power of the sun. At first look, the economic efficiency of this 180-mile flight could be judged to be very high -- indeed, almost infinite -- as the variable costs of the journey were nonexistent. However, when this same feat is judged by other criteria, the claimed efficiency becomes much more dubious. Obviously, the flight was not very time-efficient, as it

took Stephen Ptacek 5 hours and 22 minutes to complete the short international transit. The level of practical efficiency is also doubtful as the pilot was forced to travel barefoot to lighten the plane's load. Also, while the variable costs were nil, the capital invested to construct the fragile 30-foot-long aircraft totaled a whopping \$680,000!

Cooperatives share with the Solar Challenger many of the same basic characteristics. At performing some of their tasks, cooperatives are very efficient. Yet, many of these organizations have highly specific functions which are not practical in all areas. Similarly, while the variable costs of operating a cooperative business may appear attractive, the capital investment required to construct and expand these organizations often reaches astronomical proportions. Had the Solar Challenger failed in its attempt to cross the English Channel, the failure would have appeared in national headlines. Nevertheless, unbeknownst to most Americans, many cooperatives fail to reach their goal every year as inefficiencies of one kind or another plague their operational bases. Indeed, each year many of our nation's cooperatives must "go barefoot" to reach and retain their economic viability for yet another season.

To lose a cooperative, for whatever reason, is a sad and serious matter. Given that each cooperative was formed to fill a perceived need of its patrons, the loss of that organization will create a void in the rural economy. Of course, neglect can destroy a cooperative as effectively as economic factors. We must note, however, that while neglect is an error of omission,

inefficiency is more often an error of commission.

To avoid these errors, management must be aware of those areas where inefficiencies most often arise.

### **Self-Induced Inefficiencies**

Self-induced problems generally originate within the organization's perceived need to perform functions or provide services for which it is ill prepared. Our earlier example of the Solar Challenger may again be used. This aircraft was unique. It was designed with a highly specific purpose in mind, and was ill suited for any other use. The aircraft designers and engineers were well aware that it had no commercial value as a practical vehicle. Many cooperatives also originate and operate from within a similar design constraint. When used properly within this constraint, they perform well and efficiently.

Before long, however, patrons and management want to expand the original organization. Little thought is given as to the firm's structural design capacity or the limits of managerial expertise. Worse, little consideration is given to the degree of compatibility between the desired expanded operation and that, which currently exists. A commodity-marketing cooperative expands into production supplies. A processing cooperative is attracted into distribution and retailing. Such expansions may be perfectly legitimate and may, in fact, reflect an existing patron need.

Cooperatives, however, must pursue these options with great caution and consideration. Too often, the problems and pitfalls of rapid expansion are overlooked or minimized in the midst of the enthusiasm for better serving the patron. We must never forget that to best serve our patrons, the cooperative must remain economically viable. If this viability is threatened by rushing into areas the firm is ill prepared for, gross inefficiencies will result and the cooperative itself could be lost.

### **Externally Imposed Inefficiencies**

While some inefficiencies are self-induced, others are imposed on cooperatives by external forces over which they have little control. Cooperatives do not operate in a vacuum, but within a highly competitive environment. Competitively induced decisions by cooperatives may also dramatically change the economic base of their operations. Over time, such adjustments are beneficial. Without these inducements, the agricultural economy would stagnate and all agribusiness firms would become so complacent that customer service would suffer, perhaps irreparably. The true dilemma, therefore, revolves around the cooperative's ability to judge accurately the competitive pressures. Patron benefit is, again, the best guideline. A competitively-induced adjustment which forces the cooperative organization into an untested environment will bring with it a package of operational inefficiencies the organization can ill afford.

Cooperatives must accept the fact that they are often obligated to react differently to competitive pressures. For the corporate entity, competitive inducements evolve from the desire to maximize stockholder benefit. Within this context, the corporate entity can experiment more freely with customer-oriented variations in products, services and functions. Conversely, cooperatives are patron-oriented. As such, the desire to gain a competitive edge through experimentation is not a clear option. Variations in products, services and functions are directly and immediately imposed upon patrons -- the very same persons whose long-term benefit the cooperative is seeking to enhance.

Technology has improved operational efficiency in all sectors of the agricultural economy, including cooperatives. However, along with this increased technological dependence has come a greater need for competence in our cooperative management and employees. Just as well-adapted and properly managed technology can greatly improve efficiency, so can ill-

adapted and improperly managed technology produce massive headaches and inefficiencies.

The major question facing many cooperatives, therefore, is not whether to adopt these new technologies, but rather what kind of technologies to acquire and how to implement and use them effectively. Because our industry is so subject to seasonal changes and price variability, it becomes ever more critical that the operational characteristics of technology be thoroughly evaluated. Technology must be judged not only on the basis of its dependability, but also on its ability to serve the cooperative well in a wide variety of market and economic conditions.

The fruit industry in the state of Washington has experienced an ever-changing array of packaging, processing, handling, and storage technology. Over just two decades, the packing equipment used by our apple cooperatives has changed completely, and the end is not yet in sight. Experience has proven to these organizations that technology alone will not salvage their cooperatives. To use technology's true efficiencies, this industry must extend its packing season, change its marketing strategy, and secure debt capital in rapidly growing amounts. Commensurate with these changes, we find a general deterioration in membership equity and control, and acceleration in the trend toward cooperative mergers, and a lessening of the industry's flexibility as it becomes more highly leveraged.

It can always be argued, of course, that had this technology not been adopted, competitive pressures and high labor costs most surely would have killed the industry by now. Quite possibly this is true. Unfortunately, our cooperatives are ill prepared to deal with the full impact of technology. Managers, directors, and patrons assess the technology only on the basis of its physical or engineering merits. In the future this will no longer suffice as many technologies used at less than their design capacity become a major, and

perhaps a permanent, contributor to inefficiency and the ultimate loss of the cooperative.

### **Institutionally-Induced Inefficiencies**

As we review the legal, governmental or institutional constraints placed upon the agribusiness industry in recent years, we would be hard pressed to find many areas where efficiencies resulted. Conversely, most institutional inducements tend to make the conduct of a business a little more tenuous. We have found that most legislation written in the areas of labor, transportation, environment, food standards, etc., have been restrictive in nature rather than permissive in intent. In addition, regardless of any shift in major political philosophy, it is doubtful that this will change significantly in the near future.

Cooperative enterprise should not expect to be exempted from legislation. Does this mean that further inefficiencies must be anticipated and accepted? Institutional actions are difficult, if not impossible to predict. As cooperatives become more deeply involved with labor unions, management will surely experience reduced flexibility. Forced labor-related inefficiencies, similar to those now imposed on the nation's transportation sector, may begin to affect cooperatives. Environmental and health-related constraints are likely to remain, suggesting future conflicts between that which is judged efficient and that which is judged legal. Operational constraints may ease slightly, particularly in the areas of mergers, consolidations and acquisitions, thus enabling some cooperatives to seek greater efficiencies in this manner. Yet overall, cooperatives would be best advised to continue searching for enhanced efficiencies from within the existing bundle of constraints, rather than out of fear or hope for what the future might bring.

### **Growth-Induced Inefficiencies**

During the past five years, I have witnessed the demise, or near death, of three large regional cooperative organizations and

numerous smaller ones. To suggest that these losses have all resulted from inefficiencies would be a gross oversimplification. Yet, some factors are common to all these troubled cooperatives and warrant attention.

Most of these organizations entered the 1970's as dynamic, viable entities. As could have been anticipated, each cooperative responded positively to the brief, but prosperous period for agriculture during 1973-1974. The agricultural abnormalities which persisted during that period were perceived by many as the necessary incentives for rapid growth and expansion. By the mid-1970's, these organizations were in the midst of a major growth mode, expanding both horizontally and vertically.

Horizontal expansion proved less bothersome as cooperative management was familiar with the industry, its needs, and its particular idiosyncrasies. Vertical expansion, however, proved more demanding, as cooperatives entered fields and confronted problems never before experienced. Regardless of which of the two directions a particular cooperative pursued, it went in search of such efficiency-related goals as economies of size, market share expansion, the elimination of middlemen services, and control over resource supplies. Most firms following either a vertical or a horizontal expansion plan survived.

Unfortunately, a few cooperatives elected to pursue a vertical and horizontal growth plan simultaneously. Few survived to tell of their troubles. In this instance, their search for efficiency through growth had superseded their concern for managerial controls, financial capacity, and common sense. The very goal they sought was destroyed in their over enthusiastic attempt to find a shortcut toward achieving it. Expansion plans were aborted as their sources of capital dried up and management could no longer cope with rapidly broadening responsibilities.

A second factor affected those cooperatives attempting to gain operational efficiency through vertical integration. It became obvious early in the 1970's that if supply cooperatives were to meet the needs of their patrons, they would have to gain some foothold over their basic resources. The concept behind this realization was both real and accurate. Unfortunately, many smaller organizations soon discovered that the capital required to gain this foothold was much greater than anticipated and far exceeded their individual abilities. They also discovered that economies of size within this nation's basic resource industry could not be secured at the expense of those many other functions traditionally performed by the cooperatives. Competition with the corporate giants grew intense.

Worst of all, it soon became apparent that expansion into the manufacturing and refinery industry was hampered when the cooperative couldn't control the raw product itself. As supplies dwindled, their acquisition price rose to record levels and the facilities were forced to operate below their break-even design capacities. Obviously, inefficiencies developed. In many cases, a similar situation was experienced by those firms which sought to vertically expand forward into the food chain. Financial resources were stretched, competitive pressures increased and unanticipated inefficiencies arose.

### **Inefficiencies as a Cost of Organizational Autonomy**

The concept of patron control over the cooperative organization is a deeply ingrained practice. In the absence of this concept, the true cooperative would cease to be. It is perfectly understandable, therefore, that any patron would be reluctant to sacrifice some of this direct control through merger, acquisition, or consolidation. Cooperative autonomy has a true value to patrons; but it also has a cost.

Smaller organizations, in particular, are beginning to realize that they are simply

not able to achieve that level of operational efficiency necessary to effectively serve their patron. The patron may incur the penalty now in the form of reduced service, higher costs, and non-revolving equity; or he may incur the penalty gradually over a longer period as his cooperative struggles year after year, existing mostly on a diminishing depreciation allowance. The end result is usually the same.

In this case, the cost of autonomy will exceed its value. A cooperative's patrons, directors and management, therefore, must deal with their desire to gain efficiencies through reorganization. This is not to say mergers or consolidations always produce the hoped for results. Such actions require thorough study and must be judged on how the organizations complement each other, their market structure, and a shared nucleus of membership interest.

### **Internal Inefficiencies**

No doubt the most pervasive inefficiencies are those indigenous to the cooperative itself. They can be found in any, or all, cooperative operations. They may be well hidden or openly visible. They may be linked inseparably to the firm's functions, or only loosely tied to its structure.

Cooperatives should first search for inefficiencies through a logistical appraisal. Product handling, storage, and distribution must be viewed with a critical eye. Because cooperatives are so susceptible to seasonal variations in volume handled, inventory practices need to be carefully examined. For those organizations with heavy investments in facilities and

equipment, extending the period of usage must be considered. Balancing higher storage costs against reductions in per unit costs of processing, manufacturing, or packaging provides a convenient means for uncovering internal inefficiencies.

Labor use should be continually reviewed. While such a review may not always suggest ways to cut labor usage, it often reveals a better use for the present labor force. Within this context, the cooperative should not limit its search for inefficiencies to the wage-earning labor force. Among salaried employees and management staff, inefficiencies may be more subtle. They may appear in the form of employees who neither understand nor have great sympathies towards the cooperative form of organization. They might be found to exist as ineffective leadership, or the failure to communicate with member patrons. They could appear as apathy, lack of foresight or a general inability to act decisively in times of need.

No doubt cooperatives will continue to fail because of one or more of these inefficiencies, neglect, and other causes. Solutions do not readily emerge. However, as we understand better the origins of inefficiencies, our search for an appropriate solution will be more productive. Awareness will develop a better understanding, thereby equipping cooperatives to avoid or at least minimize the causes of inefficiencies.

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