

Property Rights and Patronage

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The cooperative business model has many unique aspects. Even great business models have their imperfections. One of those imperfections is the “imperfect property rights” in an open membership cooperative. Cooperatives retain profits in the form of both allocated equity (stock patronage) and unallocated retained earnings. That reinvestment helps to create future profits and future patronage payments. In the case of allocated equity the member has a defined property right to the face value but cannot control the timing of the redemption. More importantly, the true value of the retained funds is returned through future patronage. Members with different time horizons will receive different benefits from retained profits. The imperfection is more dramatic when the cooperative retains profits as unallocated retained earnings. Members have a collective claim on that equity but the profits represented by retained earnings will never be returned to the member unless the cooperative is liquidated. In that case all of the member’s benefit come through future patronage.

The cooperative board of directors has the dual goals of providing immediate benefit to members and protecting and growing the cooperative. Imperfect property rights add to that challenge. Members have different time horizons and thus more or less interest in future profits and patronage. The tendency is for individual members to want to underinvest in the future of the cooperative even when reinvestment is collectively in the cooperative interest.