Differential Pricing and Diverse Memberships

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The cooperative business model is unique in that members are both customers and owners. For that reason pricing strategies in a cooperative can become controversial. As owners, members should want pricing that allows the cooperative to effectively compete and be financially stable. That allows the cooperative to be profitable and distribute benefits through patronage. As customers, each individual member wants favorable prices that create immediate benefit. Differential pricing, charging different prices in different situations becomes particularly controversial. When most agricultural cooperatives were established, differential pricing was not an issue because the membership was homogeneous. When all members purchase the same goods and services in the same volumes or deliver similar amounts of the same commodities pricing boils down to charging an appropriate margin. As the cooperative membership becomes diverse it becomes clear that equal pricing is not equitable. Cooperatives also find that they face competitors with less restrictions on their pricing options.

There are two obvious rationales for differential pricing. The first is that there are cost differences across customers. While once controversial, price differences reflecting handling methods or transportation distances have been adopted by most cooperatives. Members typically concur that, when there are different costs for serving different customers, equal pricing is not equitable. The second rationale for differential pricing is that attracting additional volume to the cooperative spreads the fixed costs over more units and benefits the existing users. It is this category of differential pricing that has the potential to become controversial in a cooperative. As owners, members might understand the rationale for spreading fixed costs. As customers they are upset that they aren't the ones getting the more favorable price.

I used my grain handling cost calculator to examine a hypothetical differential pricing situation. According to my calculator approximately two thirds of a grain elevator's costs are fixed. If a typical elevator with 1.5M volume gained an additional 150,000 bushels the fixed costs per bushel would decline by around 5¢/bu. The cooperative's profits and potential patronage would rise by the same amount. Incentivizing that extra 150,000 bushels is clearly beneficial. The question becomes whether it is equitable and whether we should care. I continue that discussion in my next newsletter.

The problem is not that life is not fair. It's that life isn't unfair in my favor!