Patronage and Pricing

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One of the original Rochdale cooperative principles was “Goods Sold at Market Prices”. Many students assume that the goal was to discourage cooperatives from setting prices too high. In fact, the rationale for the principle was just the opposite. The Rochdale Pioneers were cautioning cooperatives not to provide benefits up front through favorable prices. Instead, the cooperative was encouraged to price at market levels and distribute the resulting profits through patronage.

Ever since the first published set of cooperative principles, cooperative firms have been cautioned about favorable pricing. The disadvantages are easy to see. The cooperative can under estimate costs and end up experiencing a loss. Members are typically not anxious to make end of year payments to cover their share of an operating loss. When a cooperative offers favorable prices it has low net income and low return on assets and equity. That leads members to conclude that the cooperative is not performing. Market based pricing and the resulting creation and distribution of profits helps members appreciate the performance and benefit of the cooperative. Traditional cooperatives also create equity out of the profit stream. The cooperative needs to create a profit so that equity can be retained and it is through retained patronage that individual members build their ownership stakes.

In an ideal world, market prices would be constant and observable. Cooperatives could price at market levels and cooperative profits would reflect the efficiency of the firm. Unfortunately, price and patronage are inherently linked. The simplest example would be the true pooling cooperatives that are prevalent on the West Coast. In those cooperatives, the members simple receive their share of the total market value of the crops delivered. The distribution is in a sense both price and patronage but there is no observable boundary because there is no observable market price. Members can describe their distribution as all patronage, all commodity payment or any combination. Pricing strategies and patronage are not completely independent in any cooperative.

In today’s competitive environment, there are also producer segments that are willing to forego patronage and cooperative ownership for a more favorable price transaction. This creates a slippery slope for cooperative leaders. Cooperative members are owners and have the responsibility to provide equity capital. That equity has historically been created through retained patronage. A cooperative would not be viable if members received their patronage up-front through the pricing strategy. That why “Goods Sold at Market Prices” was an original cooperative principle. The Rochdale Pioneers might have been smarter than we thought!

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