NATIONAL OPEN UNIVERSITY OF NIGERIA

SCHOOL OF MANAGEMENT SCIENCES

COURSE CODE: COP 213

COURSE TITLE: COOPERATIVE ECONOMICS II

COURSE GUIDE

COP213
COOPERATIVE ECONOMICS II

Course Team Dr. Dimis I. Mai-Lafia (Developer/Programme Leader) - NOUN
Dr. I. Ogboru (Editor) - UNIMAID
Mrs. O. Inua (Coordinator) - NOUN

NATIONAL OPEN UNIVERSITY OF NIGERIA

National Open University of Nigeria
Headquarters
14/16 Ahmadu Bello Way
Victoria Island
Lagos

Abuja Office
No. 5 Dar es Salaam Street
Off Aminu Kano Crescent
Wuse II, Abuja

e-mail: centralinfo@nou.edu.ng
URL: www.nou.edu.ng

Published By:
National Open University of Nigeria

First Printed 2012

ISBN: 978-058-731-4

CONTENTS **PAGE**

Introduction

Cop213: Cooperative Economics II is a semester course for students pursuing B.Sc. Cooperative Management programme. This course will also be available to students who want to do a post – graduate course in Cooperative Management. It is assumed that these students do not have cooperative background.

This course guide tells you the nature of the course, the materials you are going to use and how you are going to use the materials for meaningful benefits. It is expected that, at least 2 hours should be devoted to the study of every course unit. For each course unit, there are exercises. You are encouraged to attempt these exercises. They obviously serve as points of reflections, which are necessary for proper understanding of the facts contained in the course.

At the end of each unit, there is a tutor –marked assignment which you are expected to answer. It serves as revision and continuous assessment. Tutorial lectures will be provided, which is an opportunity for you to have a face-to-face contact with your facilitator. Any area you do not understand will be explained during the tutorial classes at your study center.

Course Aims

The course aims at further exposing you to the nature and economics of cooperative business enterprise as well as to how cooperative organisations are organised.

The course aims at the following.

- Introducing you to the definition and differences between horizontal and vertical integration.
- Knowing the effects of horizontal and vertical integration as well as problems associated with both horizontal and vertical integration.
- Knowing the concept of pricing in cooperative enterprise, pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and the margins, as well as applying monopolist's short-run costs analysis to cooperative pricing policy and cooperative optimisation problems.
- Identifying and explaining various price policies of the cooperative business enterprise and how price policy relates to making of surplus (profits).
- Explaining the appropriation of net surplus in the cooperative business.

- Identifying non-member business in a cooperative.
- Describing organisational forms and structural types of cooperative.
- Explaining the nature of productive cooperative, characteristics of productive cooperatives and reasons for high mortality rate, high failure rate of productive cooperative.
- Identifying success of some productive cooperatives like kibbutzim and moshaw shitufi of Israel.
- Knowing the concepts of mergers and legal provision on cooperative mergers, the need for mergers in cooperatives and problems associated with mergers in cooperatives.

Course Objectives

At the end of this course, you should be able to:

- define and differentiate between horizontal and vertical integration.
- describe the effects of horizontal and vertical integration and problems associated with both horizontal and vertical integration.
- explain the concept of pricing in cooperative enterprise.
- describe pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and margins.
- apply monopolist's short-run costs analysis to the cooperative pricing, policy and solutions to cooperative optimisation problems.
- explain the various price policies of cooperative business enterprise and how price policy relates to making of surplus (profit).
- explain the appropriation of net surplus in the cooperative business, and non-member business in cooperative.
- classify cooperatives based on the organisational farms and structural types of cooperatives.
- describe the nature and, characteristics of productive cooperatives.
- give reasons for the high mortality rate, high failure rate of productive cooperatives as well as the success of some productive cooperatives.
- explain the concept of mergers and legal provision on cooperative mergers, the need for merger in cooperatives and problems associated with mergers in cooperatives.

Course Materials

i. Course Guide
ii. Study Units
iii. Textbooks
iv. Assignment File
v. Tutorials

Study Units

The study units are divided into two modules with a total of 15 units as listed below:

Module 1

Unit 1	Definition and Differences between Horizontal and Vertical Integration
Unit 2	Effects of Horizontal and Vertical Integration and Problems Associated with both Horizontal and Vertical Integration
Unit 3	The Concept of Pricing in Cooperative Enterprises
Unit 4	Pricing with Respect to Cost Concepts of Marginal Cost, Marginal Revenue, Average Total Cost and Margin
Unit 5	Monopoly Short-run Costs Analysis and Cooperative Optimisation Problem
Unit 6	Identification and Explanation of Various Price Policies of the Cooperative Business Enterprise and how Price Policy Relates to Making of Surplus (Profit)
Unit 7	Appropriation of Net Surplus in the Cooperative Business
Unit 8	Non-member Business in a Cooperative
Unit 9	Organisational Forms and Structural Types of Cooperatives

Module 2

Unit 1	The Nature of Productive Cooperative
Unit 2	Characteristic of Productive Cooperatives
Unit 3	Reasons for High Mortality Rate, High Failure Rate of Productive Cooperative
Unit 4	Success of some Productive Cooperatives
Unit 5	Concept of Mergers
Unit 6	Legal Provision on Cooperative Mergers, the Need for Mergers in Cooperatives and Problems Associated with Mergers in Cooperatives

All the units are important for proper understanding of cooperative economics.

For each study unit, you are to spare at least 2 hours, there are specific objectives. At the end of each unit, measure what you have learnt against the objectives. If there is any deviation, go back to the contents of that unit. There are textbooks, which you may go through for additional information. These textbooks are listed under "References/Further Reading" after each unit.

Please attempt all the self-assessment exercises in each unit. This will help to assess yourself and see if you have followed the ideas being presented. In addition, there are tutor-marked assignments. You are advised to attempt them, as some of them will be part of the continuous assessment.

Assignment File

There will be 5 assignments, which will cover the following areas.

i. Definition and differences between horizontal and vertical integration, effects of horizontal and vertical integration and problems associated with both horizontal and vertical integration. (units 1 and 2)

ii. The concept of pricing in cooperative enterprise, pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and margins, monopolist's short-run costs analysis, cooperative optimisation problems and identification and explanation of various price policies of the cooperative business enterprise and how price policy relates to making of surplus (profit) (units 3, 4, 5 and 6).

iii. Appropriation of net surplus in the cooperative business, non-member business in a cooperative and organisational forms and structural types of cooperatives. (Units 7, 8, and 9)

iv. The nature of productive cooperative, characteristics of productive cooperative and reasons for high mortality rate, high failure rate of productive cooperatives and success of some productive cooperatives (Units 10, 11, 12 and 13).

v. Concept of mergers and legal provision on cooperative mergers, the need for mergers in cooperatives and problems associated with mergers in cooperatives (Units 14 and 15).

Presentation Schedule

This is about dates for tutorials submission of assignments which will be sent to you in due course.

Assessment

This will be in 2 forms, namely:

i. The continuous assessment, which will be based on 30%.
ii. The final semester examination that you will write after you have completed the materials will be based on 70%.

Tutor-Marked Assignment

There are two of them in each unit of this course but you are to attempt only 5 out of a total of 30 as grouped under Assignment File. You are to submit 5 in which each of them carries 6%. As soon as you complete your assignment, send it immediately to the tutor.

Final Examination Grading

There will be a three hour examination covering the whole course. You are expected to answer 5 questions on the whole.

Unit	Titles of Work	Weeks' Activities	Assignment of unit
	Module 1		
1	Definition and Differences between Horizontal and Vertical Integration	1	
2	Effects of Horizontal and Vertical Integration and Problems Associated with both Horizontal and Vertical Integration		1st Assignment
3	The Concept of Pricing in Cooperative Enterprises		
4	Pricing with Respect to Cost Concepts of Marginal Cost, Marginal Revenue, Average Total Cost and Margin		
5	Monopoly Short-run Costs Analysis and Cooperative Optimisation Problem		
6	Identification and Explanation of Various Price Policies of the Cooperative Business Enterprise and		

	how Price Policy Relates to Making of Surplus (Profit)		2nd Assignment
7	Appropriation of Net Surplus in the Cooperative Business		
8	Non-member Business in a Cooperative		
9	Organisational Forms and Structural Types of Cooperatives		3rd Assignment
	Module 2		
1	The Nature of Productive Cooperative		
2	Characteristic of Productive Cooperatives		
3	Reasons for High Mortality Rate, High Failure Rate of Productive Cooperative		
4	Success of some Productive Cooperatives		4th Assignment
5	Concept of Mergers		
6	Legal Provision on Cooperative Mergers, the Need for Mergers in Cooperatives and Problems Associated with Mergers in Cooperatives		5th Assignment
Total			5 Assignments

How to Get the Most from This Course

i. As a diligent student, you are expected to devote at least 2 hours to go through each unit. You are going to play a dual role, that is, as a lecturer and a student. This means that some confidence has been reposed in you. Read the course carefully just as you will listen carefully to a lecturer.

ii. As you read each paragraph, try to interpret and evaluate so as to bring out the sense contained therein.

iii. After going through the instruction, read the objectives. As you read the main content, ask yourself whether or not what you are reading tallies with the objective.

iv. Make sure you take time to work through the self –assessment exercises. You may discuss these with other students studying the same programme.

v. If you know your tutor’s address, do not hesitate to contact him or her whenever you encounter any problem in your course.

vi. Always send your tutor –marked assignments on time. Also, note the tutor's comments against future assignments.
vii. Above all, never involve in examination malpractices.

Summary

Cooperative economics II gives you the basic knowledge that will put you steadily on B. Sc. Cooperative Management. Having completed the course, you would have known what a cooperative is and can separate it from other forms of business enterprises. You will also know how to manage a cooperative including how prices are fixed by a cooperative and how to manage them if you are a manager. If the need arises, you will know the procedure for the merger of two or more cooperatives. You will also be able to identify productive cooperative and the reasons behind their success and failures.

Course Code COP213
Course Title Cooperative Economics II

Course Team Dr. Dimis I. Mai-Lafia (Developer/Programme Leader) - NOUN
Dr. I. Ogboru (Editor) - UNIMAID
Mrs. O. Inua (Coordinator) - NOUN

NATIONAL OPEN UNIVERSITY OF NIGERIA

National Open University of Nigeria
Headquarters
14/16 Ahmadu Bello Way
Victoria Island
Lagos

Abuja Office
No. 5 Dar es Salaam Street
Off Aminu Kano Crescent
Wuse II, Abuja

e-mail: centralinfo@nou.edu.ng
URL: www.nou.edu.ng

Published By:
National Open University of Nigeria

First Printed 2012

ISBN: 978-058-731-4

CONTENTS **PAGE**

MODULE 1

UNIT 1 DEFINITION AND DIFFERENCES BETWEEN HORIZONTAL AND VERTICAL INTEGRATION

CONTENTS

1.0 INTRODUCTION

How time flies! You are now in the second semester of the 200 level of your B.Sc. in cooperative management programme and you are now going to take Cooperative Economics II, which is a continuation of Cooperative Economics I. Just as COP 212 was engaging and interesting, COP 213 will equally engage your attention. In this unit, which is the first in this course, you are going to define and differentiate between horizontal and vertical integration as well as give reasons for their adoption by some entities.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define horizontal and vertical integration
- differentiate between horizontal and vertical integration
- explain why some firms adopt horizontal and/or vertical integration.

3.0 MAIN CONTENT

3.1 Meaning of Horizontal Integration

In microeconomics, the term horizontal integration describes a type of ownership and control of an enterprise. It is a strategy used by a business that seeks to sell a type of product in numerous markets. This occurs when a company expands its business with different products that are similar to current lines.

Horizontal integration could also occur when a firm absorbs several firms involved in the same level of production and sharing resources at that level. It is like a company dominating a market at one stage of the production process by monopolising resources at that stage.

Consequently, horizontal integration occurs when a firm is being taken over by, or merged with, another firm which is in the same industry and in the same stage of production as the merged firm, e. g. a car manufacturer merging with another car manufacturer. In this case, both companies are in the same stage of production and also in the same industry.

Another good example is the idea of owning many media outlets, which run almost the same content like Daar Communications Plc, which owns both radio and television broadcasting stations.

3.2 Meaning of Vertical Integration

Microeconomics also describes vertical integration as a style of management control of an enterprise. Thus, vertical integrated companies are united through a hierarchy with a common owner. Usually, each member of the hierarchy produces a different product or (market-specific) service, and the products combine to satisfy a common need.

Consequently, vertical integration is the degree to which a firm owns its upstream suppliers and its downstream buyers. It is typified by one firm engaged in different parts of production (e. g. grouping raw materials manufacturing, transporting, marketing and/or retailing).

It was the nineteenth century steel tycoon, Andrew Carnegie who introduced the idea of vertical integration. This led other business people to use the system to promote better financial growth and efficiency in their companies and businesses.

One of the earliest, largest and most famous examples of vertical integration was the Carnegie Steel Company. The company controlled, not only the mills where the steel was manufactured, but also the mines where the iron ore was extracted, the coal mines that supplied the coal, the shops that transported the iron ore and the rail roads that transported the coal to the factory, the coke ovens where the coal was cooked, etc.
Local examples of vertical integration could be those of oil companies such as Exxon Mobil and Royal Dutch Shell. This means that they are active all the way along the supply chain from locating crude oil deposits, drilling and extracting crude, transporting it and refining it into petroleum products such as petrol/gasoline, to distributing the fuel to company-owned retail stations, where it is sold to consumers.

There are three types of vertical integration, namely:

- backward (upstream) vertical integration
- forward (downstream) vertical integration
- balanced (horizontal) vertical integration.

A company exhibits backward vertical integration when it controls subsidiaries that produce some of the inputs used in the production of its products. For example, an automobile company may own a tyre company, a glass company, and a metal company.

On the other hand, a company tends towards vertical integration when it controls distribution centers and retailers where its products are sold.
Balanced vertical integration means a firm controls all of these components, from raw materials to final delivery.

3.3 Differences between Horizontal and Vertical Integration

In horizontal integration, a company attempts to control a single stage of production or a single industry completely whereas in vertical integration a company tries to dominate a market by controlling all steps in the production process.

Horizontal integration is the expansion of a firm within an industry in which it is already active for the purpose of increasing its share of the market for a particular product or service.

On the other hand vertical integration is when a company expands its business into areas that are at different points of the same production path.

A monopoly created through horizontal integration is called a horizontal monopoly. In contrast, a monopoly produced through vertical integration is called a vertical monopoly, although it might be more appropriate to speak of this as some form of cartel.

Horizontal integration in marketing is much more common than what vertical integration is in production.

SELF-ASSESSMENT EXERCISE 1

Look around you and mention two companies that practise horizontal integration.

3.4 Reasons for Horizontal Integration

We may at this stage ask why some companies are interested in integrating horizontally. Why would a suya vendor, for instance, expand into selling meat-pie? Why would a book publisher acquire another publishing house? Why is it that media nowadays tend to be in the hands of those who are rich enough to buy the media such as Rupert Murdoch? The answers to all these questions are that horizontal integration allows:

- economies of scale
- economies of scope
- economies of stocks; and
- strong presence in the reference market.

3.5 Reasons for Vertical Integration

In contrast to horizontal integration, why would some firms be integrated vertically? Why would an automobile company diversify into tyre manufacturing? Why would Dangote Sugar Plc own its sugar plantation as well as its haulage fleet?

Obviously, vertical integration is one method of avoiding the hold-up problem. This is because it is typified by one firm engaged in different stages of production e.g. growing raw materials, manufacturing, transporting, marketing and/or retailing. The reasons for a firm to engage in vertical integration are as follows.

a) Internal gains such as:

i. lower transaction costs
ii. synchronisation of supply and demand along the chain of products.
iii. lower uncertainty and higher investment.
iv. ability to monopolise market throughout the chain by market foreclosure.

b) Benefits to society such as:

i. better opportunities for investment growth through reduced uncertainty.
ii. products availability due to non-disruption of production.

SELF-ASSESSMENT EXERCISE 2

Apart from Dangote Sugar Plc that practises vertical integration, which company in the Dangote Group practise vertical integration?

4.0 CONCLUSION

This is the first unit in COP 213: Cooperative Economics II. In this unit, you have learnt the meaning of horizontal and vertical integration as well as the differences between the two terms.
You are now conversant with the reasons why some firms engage in horizontal integration while others practise vertical integration.

5.0 SUMMARY

You have now learnt the definition, the differences between horizontal and vertical integration as well as the reasons for the need for horizontal and vertical integration. In unit 2, which is a continuation of the topic, you will learn about the effects of horizontal and vertical integration and problems associated them.

6.0 TUTOR-MARKED ASSIGNMENT

1. In your own words, what do you understand by expansion through integration?
2. Differentiate between vertical and horizontal integration giving local examples.

7.0 REFERENCES/FURTHER READING

Investor words (2009). *Integration***.** Retrieved on August 1, 2009 from http://www.investorwords.com/5977/vertical_integration.html

Joseph, R. C. (2007). *Vertical Integration.* Belmont, C. A.: Thompson Wadsworth.

Thorburn, David & Jenkins, Henry (Eds.) (2003). *Rethinking Media Change*. Cambridge, Massachusetts: MIT Press.

UNIT 2 EFFECTS OF HORIZONTAL AND VERTICAL INTEGRATION AND PROBLEMS ASSOCIATED WITH BOTH HORIZONTAL AND VERTICAL INTEGRATION

CONTENTS

1.0 INTRODUCTION

In the first unit, you defined and differentiated between horizontal and vertical integration. Unit 2 is going to be an extension of unit 1. This is because you are still going to closely look at the effects of horizontal and vertical integration and problems associated with both horizontal and vertical integration.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the effects of horizontal integration
- state the effects of vertical integration
- explain the problems associated with both horizontal and vertical Integration
- cite examples of local and foreign entities that practice horizontal and vertical integration.

3.0 MAIN CONTENT

3.1 Effects of Horizontal Integration

You may recall that horizontal integration is when a firm is being taken over by, or merged with, another firm which is in the same industry and in the same stage of production as the merged firm. You also learned about the examples of a car manufacturer merging with another car manufacturer, and a book publisher acquiring another publishing house to increase its stable of editors and authors or to otherwise enhance its competitiveness.

Horizontal integration can have so many consequences (effects) as we can see below.

(a) It enables a firm sell a type of product in numerous markets. This is possible when a company expands its business into different products that are similar to current lines.
(b) It increases the firm's share of the market for a particular product or service. For instance, the book publisher that acquires another publishing house takes over the market of the acquired publisher.
(c) It is productive. For example, owning many media outlets, which run almost the same content is very productive, since it requires only minor changes of format and information to use in multiple media forms. For instance, within a media conglomerate, the content used in broadcasting television would be used in broadcasting radio as well, or the content used in hard copy of the newspaper would also be used in online newspaper website.
(d) It leads to domination of the market at one stage of the production process.
(e) It leads to absorption into a single firm of several firms involved in the same level of production and sharing resources at that level.

3.2 Effects of Vertical Integration

In vertical integration, a company owns its upstream suppliers and its downstream buyers.

a. Vertically integrated companies are united through a hierarchy and share a common owner.
b. It avoids the "hold – up" problem.
c. It could lead to monopoly.
d. Vertical integration creates a stable supply of inputs as well as ensures a consistent quality in the final product.
e. It minimises cost by centralising the production processes.
f. It could lead to more efficient utilisation of resources and more profit.

3.3 Problems Associated with Horizontal Integration

Even though there are many benefits of horizontal integration such as economies of scale, economies of scope, economies of stocks and strong presence in the reference market, there are also several problems associated with it. Some of these problems are as follows.

(a) Unemployment or loss of jobs. This could occur when a firm is merged with another as happened during banking consolidation where weaker banks merged with stronger ones, led to loss of thousands of jobs.
(b) It could lead to unfair dominance of markets. For instance, media critics, such as Robert Machesney, have noted that the current trend within the entertainment industry has been toward the increased concentration of media ownership into the hands of a smaller number of transmedia and transnational conglomerates. Media nowadays tend to be in the hands of those who are rich enough to buy the media such as Rupert Murdoch, who own Sky News Television and several media houses.
(c) It could lead to monopoly.
(d) There is strict management control.
(e) It is highly regulated by antitrust laws (Acts).

3.4 Problems of Vertical Integration

(i) Vertical integration results in reduced competition.
(ii) It leads to static technology.
(iii) Some argue that it may also lead to dynamic technology. They said that vertical integration will eventually hurt a company because when new technologies are available, the company is forced to reinvest in its infrastructures in order to keep up with competition. Some say that today, when technologies evolve very quickly, this can cause a company to invest into new technologies only to reinvest in even newer technologies later, thus costing a company financially.
(iv) There could be internal losses such as higher monetary and organisational costs of switching to other suppliers/buyers.
(v) It could lead to monopolisation of markets.
(vi) It could lead to rigid organisational structure, having much the same shortcomings as the socialist economy.
(vii) It may result in monopoly on intermediate components.

SELF-ASSESSMENT EXERCISE 2

Mention two firms in Nigeria that practise horizontal integration and two foreign firms that practise vertical integration.

3.5 Examples of Local and Foreign Firms that Practise Horizontal and Vertical Integration

You must know from the onset that the varieties of integration being discussed are only abstractions; actual firms employ a wide variety of subtle variations. Suppliers are often contractors, not legally owed subsidiaries. In addition, a client may effectively control a supplier if their contract solely assures the supplier's profitability. Moreover, distribution and retail partnerships exhibit similarly wide range of complexity and interdependence. In relatively open capitalist contexts, pure vertical integration by explicit ownership is uncommon and distributing ownership is commonly a strategy for distributing risk.

Nevertheless, we can still point to some companies that practise a semblance of horizontal and vertical integration. In Nigeria, we have the Dangote Group, which is into cement manufacturing, sugar production, rice production as well as haulage. This is a good example of vertical integration.

Another good example of a Nigerian company that practises horizontal integration is Daar Communications Plc, with its radio and television outlets. Daar has also added multi-channels pay-per-view satellite television channels to enhance her market share in the entertainment industry.

At the international level, examples of vertically integrated firms are Carnegie Steel and oil companies such as Exxon Mobile, Royal Dutch Shell and Conoco- Phillips or Bp.

Foreign entities that are horizontally integrated are Daimlar-Chrysler and Murdoch Media Empire.

SELF-ASSESSMENT EXERCISE 3

Is Ajaokuta Steel Company Limited a vertically or a horizontally integrated company?

4.0 CONCLUSION

So far, you have seen the effects of horizontal and vertical integration as well as the problems associated with both terms. You have also noted that pure horizontal and pure vertical integrations are only abstractions because actual firms employ a wide variety of subtle variations.

5.0 SUMMARY

You are obviously progressing steadily in your journey through Cooperative Economics II. You have taken two important steps by studying the first unit of the course that is the definition and differences between horizontal and vertical integration. In the second step, you will examine the effects of horizontal and vertical integration and the problems associated with both.

6.0 TUTOR-MARKED ASSIGNMENT

1. Which Nigerian company practises horizontal integration and vertical integration?
2. Vertical expansion is also known as vertical acquisition. Discuss.

7.0 REFERENCES/FURTHER READING

Investorwords (2009). *Integration*. Retrieved on August 1, 2009 from http://www.investorwords.com/5977/vertical_integration.html

Joseph, R. C. (2007). *Vertical Integration*. Belmont, C. A.; Thompson Wadsworth.

Thorburn, David & Jenkins, Henry (Eds.) (2003). *Rethinking Media Change*. Cambridge, Massachusetts: MIT Press. Pp 283-284.

UNIT 3 THE CONCEPT OF PRICING IN COOPERATIVE ENTERPRISES

CONTENTS

1.0 INTRODUCTION

In this unit, you are going to examine the concept of pricing in cooperative enterprises having looked at the definition and differences between horizontal and vertical integration as well as the effects and problems associated with both horizontal and vertical integration.

In attempting to describe the concept of pricing in cooperative enterprises, you are going to follow some concepts developed by reputable scholars on the subject.

There are several concepts on cooperative enterprises developed by eminent scholars. You are going to interact with these concepts in the main content below.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the price policy of the cooperative societies
- describe the price of products and services to members
- explain the cooperative's pricing system
- describe the cooperative cost price principle
- state the cooperative financial policy.

3.0 MAIN CONTENT

3.1 The Price Policy of Cooperative Societies

In his publication titled, “The price policy of cooperative societies”, which was published in Economica by London School of Economics and Political Science, Yamey, B.S., developed a concept for cooperative pricing.

Yamey’s treatment of the price policy of cooperative societies takes the form of an attempted analysis of the “economics (theory) of the firm”. The firm in this case means a cooperative retail society.

His consideration of cooperative price policy was in situations where consumers regard the dividends they receive merely as price-reducing rebates.

Yamey states the consequence of the practice of “open membership” which is a feature of cooperative enterprise. He extends the analysis to include cooperative societies (not necessarily retail societies) in which the payment of dividends to consumers is an unimportant feature of cooperative business.

He examines various possible objectives of price policy. It is from his analysis and that of Jeffrey S. Royer and Holger Matthy that units 4, 5, 6, 8 and 11 will be developed. In unit 4, you are going to learn cooperative pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and margins using the example of a perfectly competitive firm while that of a monopoly will be treated in unit 5.

3.2 Price of Product of Service to Members

There is a question among scholars whether the members should be charged at the market price, thereby creating a large surplus or not.
The costs to the member can be reduced by taking a small amount of the surplus to cover unexpected expenses (margin of security). The second possibility results in the best possible service to the member, by offering the lowest feasible selling price.

Price of product or service to members

Purchase price	+	Direct operating costs	+	Margin of security surplus	=	Price to members

Fig. 3.2: Price of Product or service to members

You should note that the first alternative of selling to the members at the market price, and the allocation of the resulting high surplus will not benefit him in any way. The first point you will learn is the large surplus. The surplus is usually divided up after the end of the financial year. The treatment of surplus will be in unit 7, so watch out for it.

SELF- ASSESSMENT EXERCISE 1

Look around you for a cooperative. Compare the prices of the products and/or services sold to members at market price.

3.3 Cooperative Pricing System

Every cooperative's pricing system is based on the simple formula thus.
Purchase Price + Direct Operating Expenses + Surplus Fund = Sale Price.

You should note that the cooperative direct operating expenses include wages paid by the cooperative.

If wages are lowered, the size of the surplus fund (reserve) can be increased. If you decide that you only want a small surplus as a reserve against unexpected expenses ("security margin"), you can of course, increase the amount of remuneration to the members. The resulting equation used by the cooperative will, therefore, differ from that shown in figure 3.1.

Raw material purchase price

+

Direct operating expenses

+

Remuneration to members

+

Security margin surplus

=

Sale price of product or service to market

Fig. 3.2: Pricing in the Productive Cooperative

To reiterate, if we decrease wages, the surplus remaining will be increased, while if we ignore the surplus, members can be directly remunerated more generously for their work.

3.4 Cooperative Cost Price Principle

You should note that the cooperative usually deliver goods/services to its members at cost price. This means, for instance, a supply cooperative delivers supplies to farmers at cost price plus a so-called “mark – up” to cover operational costs of the cooperative and net surplus. The net surplus is used to cover unforeseen costs and risks, to build up financial reserves and to pay bonuses or interest to the members. Only part of net surplus should be considered as “profit”. The profit is often kept as reserve fund for future investments or used as so – called appropriation profit to replace borrowed capital by the cooperatives. This is important since many new cooperatives in developing countries have difficulty in finding sufficient capital of their own.

3.5 Cooperative Financial Policy

The cooperative financial policy may be simplified in the following manner, using an example of a farmer's cooperative society.

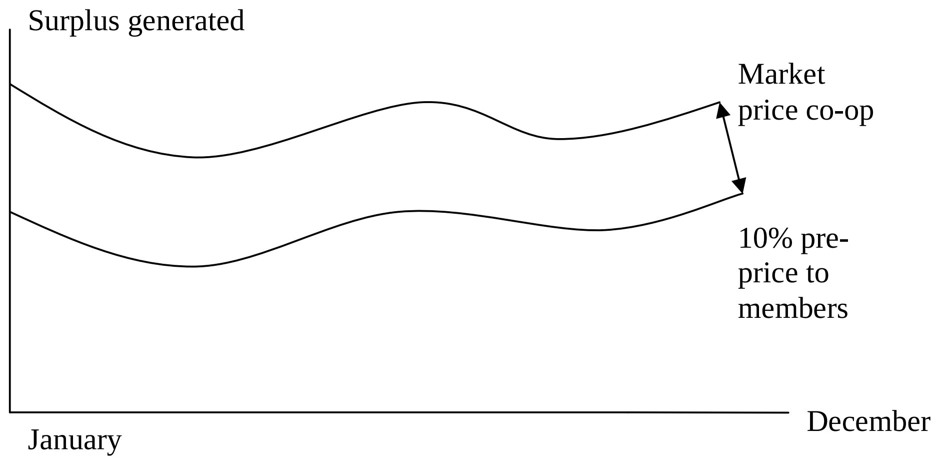


Fig. 3.3: Functioning of the Zero – loss policy

The cooperative has to offer secure price to its members in such a way that it succeeds in making "profits" (surplus).

Pre-payments may differ in the course of the year, but differences should be eliminated in post-payments. In order to avoid post harvest losses, production will be purchased immediately upon the harvest in a period of more or less two months.

The following diagram shows the allocation of revenues and reserves.

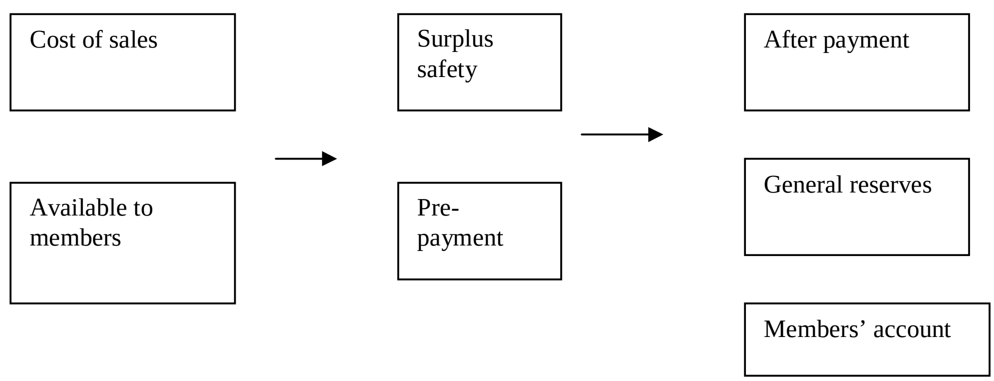


Fig. 3.4: Reservation Policy

SELF- ASSESSMENT EXERCISE 2

Look around you for a farmers' cooperative society and find out how the members are paid for their produce. Compare the price the farmers sell their produce with the prevailing market prices. Which is higher?

4.0 CONCLUSION

You have examined the concept of pricing in cooperative enterprises. You also learnt that the pricing policy of cooperative differs from that of the conventional business enterprises.

5.0 SUMMARY

Now that you have learned the concept of pricing in cooperative enterprises, you will now move on to look at pricing with respect to cost concepts of marginal costs, marginal revenue, average total cost and margins.

6.0 TUTOR-MARKED ASSIGNMENT

1. With the aid of appropriate diagram(s), explain how a cooperative will fix price of product or service to its members.
2. With the aid of appropriate diagram(s), explain the pricing policy in the productive cooperative.

7.0 REFERENCES/FURTHER READING

Yamey, B. S. (1951). *The Price Policy of Cooperative Societies*. Economica, London: Blackwell Publishing. New Series, Volume 17 number 65, pp 23-42.

UNIT 4 PRICING WITH *RESPECT TO COST CONCEPTS* OF *MARGINAL* COST, MARGINAL REVENUE, AVERAGE TOTAL COST AND MARGINS

CONTENTS

1.0 INTRODUCTION

The preceding unit looked into the concept of pricing in cooperative enterprises.

In this unit, you will continue with pricing with special reference to the cost concepts of marginal cost, manual revenue, average total cost and margins.

The treatment of this unit will, like the preceding one, take the form of an attempted analysis of the economics of the firm. In other words, you will be using the pricing and cost concepts of a perfectly competitive firm to drive home the points. The firm in this case is the cooperative.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain pricing with reference to cost concepts of marginal cost, marginal revenue, average total cost and margins
- explain price determination in a firm.

3.0 MAIN CONTENT

3.1 Concepts of Cost

Costs are being incurred in the production of goods and services. The traditional theory of cost differentiates between the long-run and the short-run.

(a) The short-run

A firm is operating in the short-run when it cannot vary at least one of the resources it uses in the production process. In the short-run, a firm employs a given (fixed) amount of some resources. The cost of these resources is called fixed cost (FC). Also, in the short-run, there are other resources that a firm can vary their utilisation. These types of resources that a firm can vary are called variable resources. The cost of these variable resources is called variable cost (VC). Therefore, in the short-run, total cost of production (TC) is equal to fixed cost and variable cost.

TC = FC + VC

(b) The long-run

The long-run represents a period within which the firm can vary its utilisation of all productive resources. Therefore, in the long-run, there are no fixed costs. All costs are variable. How long is the long-run? Or how short is the short-run?

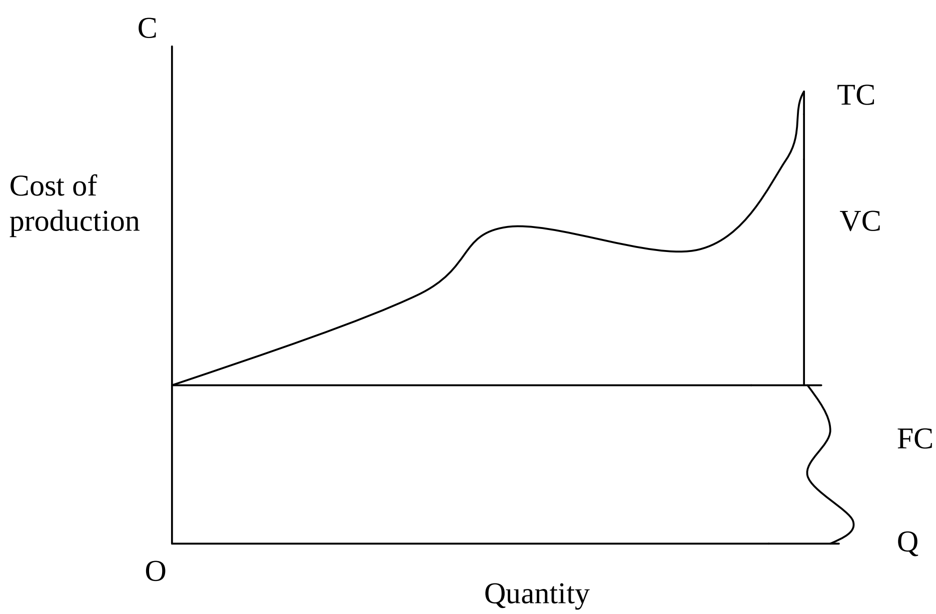


Fig. 4.1: Types of costs

Table 4.1: The relationship between costs

Q	FC	VC	TC	ATC	AVC	AFC	MC
1	10	100	110	110	100	10	100
2	10	180	190	95	90	5.0	80
3	10	311	321	107	103.7	3.3	131
4	10	450	460	115	112.5	2.5	139
5	10	600	610	122	120	2.0	150
6	10	902	912	152	150.3	1.57	302

The Relationship between Q, ATC, AVC, AFC and MC can be presented in a diagram like this

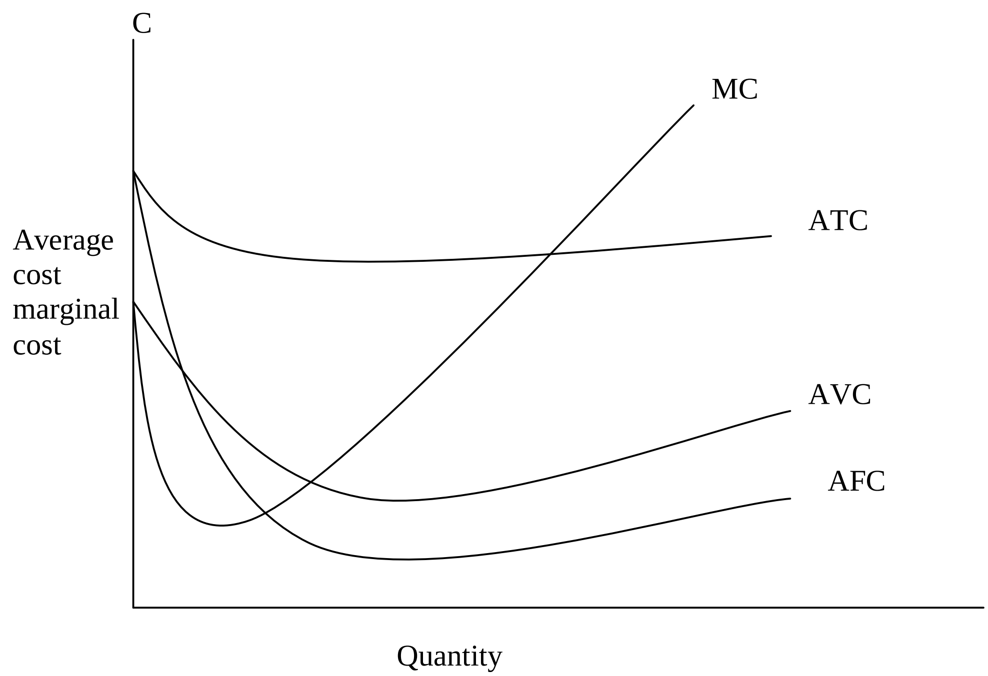


Fig. 4.2: Relationship between costs

From the above table and figure, you can now draw the following important conclusions:

- Both average total cost and average variable cost decline first, and rise with increase in quantity produced. Thus, both are u-shaped.
- When average total cost and average variable cost are declining, marginal cost is lower than both. However, when average total

cost and average variable cost are rising, marginal cost is greater than both.

3.2 Marginal Cost

Although total costs are important, economists are, however, more interested in marginal cost and average cost. This is because the marginal cost (MC) is a measure of cost as a result of an increase in a unit of output.

Marginal cost (MC) is thus, the extra cost of production resulting from the production of one more unit of the commodity. It measures the increment in total cost as production is increased by an additional unit. Average cost (AC) is the per unit cost of production at each output level. Marginal cost is obtained by subtracting the TC of producing the preceding quantity from the present quantity.

Any of the following gives the definition of MC.

$$MC = \Delta TC$$
$$MC_n = TC_n - TC_{n-1}$$
$$MC_n = TVC_n - TVC_{n-1}$$

The marginal cost is the rate of change in total cost (TC) as a result of a unit change in output (quantity, Q). It is obtained mathematically by taking the first derivatives of the TC function. It is the slope of the TC curve and corresponds with the slope of the total variable cost (TVC) at any point since the other component of the TC is fixed.

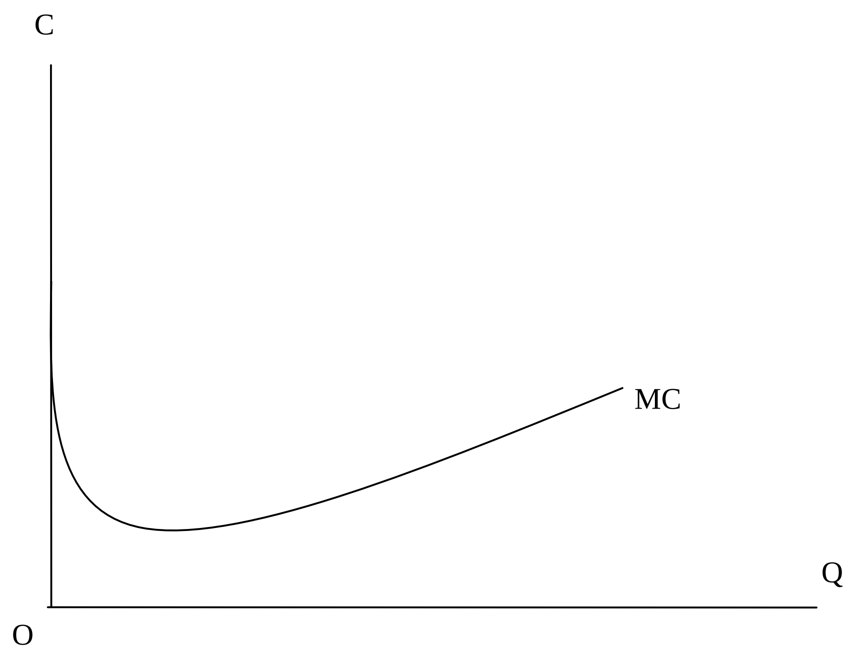


Fig. 4.3: Marginal Cost

3.3 Marginal Revenue

Marginal revenue is additional revenue accruing to a firm arising from production of an additional unit of output.

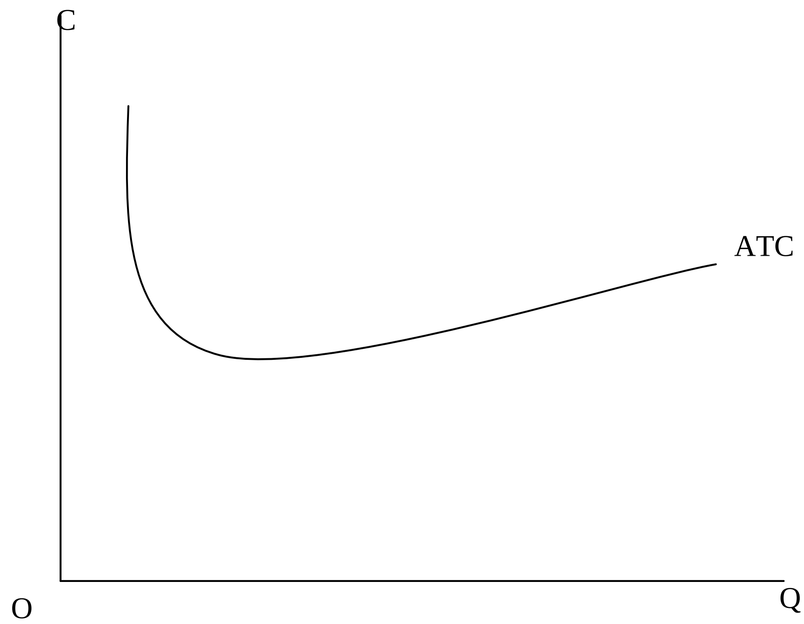
For instance, if a fertilizer manufacturing company produced 1000 tons of fertilizer in a week and earned 900 million naira as its total revenue and if in the preceding week it could only produce 800 tons, from which it earned ₦800 million, the marginal revenue will be the difference between ₦900 million and ₦800 million, which is, ₦100 million. $MR_n = TR_n - TR_{n-1}$.

3.4 Average Total Cost

Average total cost is obtained by dividing total cost by output (Q)

$$ATC = \frac{TC}{Q}$$

Graphically, ATC can be derived in the same way as short run average variable cost (SAVC)



3.4.1 Price Determination

You should not lose focus of the fact that all the above analyses on concept of costs are signposts to pricing in a firm. The cost concepts help a firm to determine prices that it would sell its goods and services. You should remember that the fixed costs include salaries, depreciation, cost of building and land maintenance, etc. On the other hand, the variable costs include the raw materials, the cost of direct labour, running expenses etc.

How a firm fixes the price of its product is influenced by these costs.
In the short-run, it is possible for a perfectly competitive firm to make abnormal profit or loss. But this tends to disappear in the long-run.

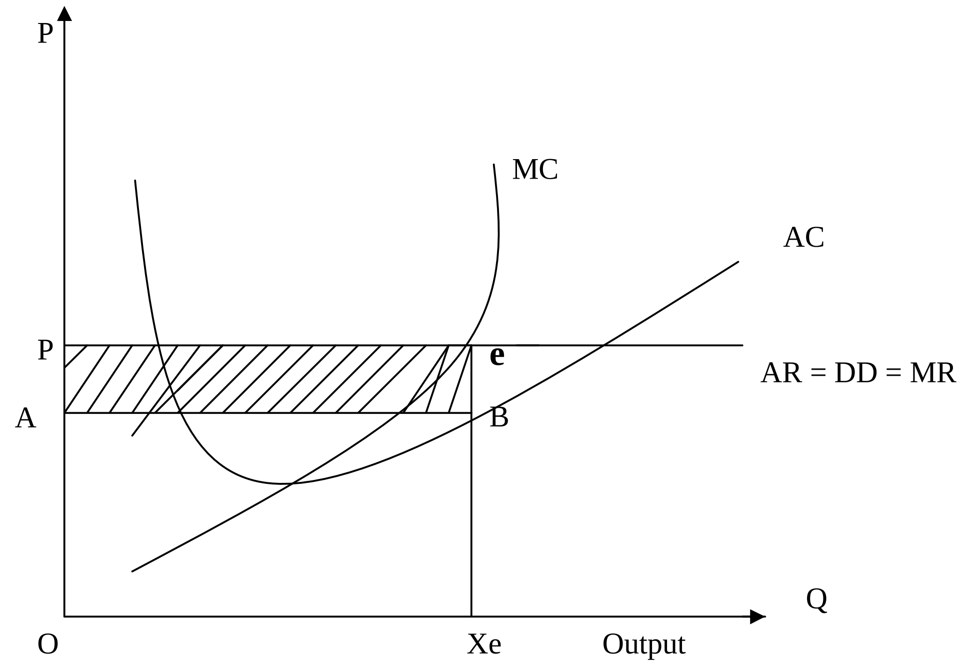


Fig. 4.5: A profit-maximising competitive firm

The equilibrium point is ‘e’. The condition for short-run equilibrium of a perfectly competitive firm is therefore, defined as MR =MC. We should also note that the marginal revenue (MR) of this firm is the average revenue (AR) and the demand (DD), which is also the price. Thus, AR = DD = MR, where DD (demand) stands for the unit price.

From the above diagram, we can conclude that;

“ABOXe” = the total cost incurred by the firm, “PeOXe” = the excess profit.
You should note that, in a cooperative, there is no excess profit. What you may have in cooperative set-up is the “surplus”. Consequently, our “excess profit” here represents the surplus.

SELF-ASSESSMENT EXERCISE 1

Discuss the possibility of a firm making an abnormal loss instead of a profit. Use a diagram similar to that of the excess profit.

3.5 Simple Cooperative Mode l

Before you go into the discussion of non-member business in unit 8, it is useful to review cooperative production and pricing decision using a simple model of marketing cooperative developed by Jeffrey S. Royer and Holger Matthy. In their model, the cooperative processes market a single raw product purchased from members. Although they use a set of specific functions to derive numerical solutions, the derived results are generally applicable to any set of well-behaved functions.

The price (P) the cooperative receives for the processed product is

$$P = a + bQ \qquad a > o, b \leq o \qquad (1)$$

Where Q is the quantity produced. The total cost (C) of processing the raw product is

$$C = c + dQ \qquad a > o, d > o \qquad (2)$$

For simplicity each unit of raw product is assumed to yield one unit of processed product. Alternative assumptions would complicate the analysis without enhancing the results.

The raw product (R) supplied by members is a function of the price (N) offered by the cooperative

$$R = e + fN \qquad e < o, fc < o \qquad (3)$$

Thus the supply function for the raw product can be written as follows.

$$N = {}^{1}/_{f}R - {}^{e}/_{f} \qquad (4)$$

Members are assumed to supply raw product at the level at which the price they receive equals the marginal cost of production. Thus equation (4) represents the marginal cost function. The total cost of production (F) can be expressed thus.

$$F = \int^{R}_{0} = [{}^{1}/_{f}R - {}^{e}/_{f}]\, dR = {}^{1}/_{2f}R^{2} - {}^{e}/_{f}R + g \qquad (5)$$

You are going to continue with the analysis of this model and its equation in units 6 and 8, which are respectively, identification and explanation of the various price policies of the cooperative, and non-member business in a cooperative.

4.0 CONCLUSION

You have learnt pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and the margins.

A price a firm fixes for its products depends on a combination of several factors. The best price is when the AR = MR = MC =DD.

For a cooperative, making profit is not the motive, although the mark-ups must be sufficient to cover costs of purchases and running of the cooperative.

5.0 SUMMARY

You have so far learnt pricing with reference to cost concepts of marginal cost, marginal revenue, average total cost and margins.

In unit 5, you will continue with pricing with reference to cost concepts of the marginal cost, marginal revenue, average total cost and margins, using a monopoly short-run costs analysis.

6.0 TUTOR-MARKED ASSIGNMENT

1. How a firm fixes the price of its products is influenced by the costs incurred. Discuss.
2. Although total costs are important, economists are, however, more interested in marginal cost and average cost. Why?

7.0 REFERENCES/FURTHER READING

Buccola, Stephen T. (1994). Agricultural Cooperatives: A Unified Theory of Pricing, Finance, and Investment. *In Cooperative Theory: New Approaches*, (ed.) Jeffrey S. Royer, pp.171-258. Washington D. C.: USDA ACS Serv. Rep. 18, July 1987.

Jeffrey, S. Royer & Holger, Matthey (1999). Optimal Strategies of Marketing Cooperatives: Regarding Non-member Business. *American Agricultural Economics Association Meetings,* Nashville. August 8-11, 1999.

Samuelson, P. A. (1980). *Economics* (11th Ed.). Tokyo: McGraw-Hill.

UNIT 5 A MONOPOLIST'S SHORT-RUN COSTS ANALYSIS AND THE COOPERATIVE OPTIMISATION PROBLEM

CONTENTS

1.0 INTRODUCTION

In the previous unit, you examined pricing with respect to the costs concepts of marginal cost, marginal revenue, average total cost and margins. You also used the short-run cost analysis of a perfectly cooperative firm and considered a firm in that instance to be a cooperative. Now, in this unit, you are continuing with the cost concepts of marginal cost, marginal revenue, average total cost and margins but using the short-run cost analysis of a monopoly instead of the perfect cooperative firm that was discussed in unit 4.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- define monopoly
- list the characteristics of a monopoly
- explain causes of monopoly
- explain effects of monopoly
- determine price and output under a monopoly
- discuss cooperative optimisation problem..

3.0 MAIN CONTENT

3.1 Definition and Characteristics of a Monopoly

Monopoly is a market situation where there is only one firm in an industry producing a product for which there are no close substitutes. A typical example of monopoly in Nigeria is the Nigerian Railway Corporation which produces rail services and no other firm produces such services.

A monopoly is, therefore, characterised as follows.

(a) A single seller, that is, one firm and the firm is the industry. Because the firm is the only one producing such services, it is a monopoly. Since no other firm produces such services, the firm is also the industry.
(b) There is no close substitute for the commodity produced under monopoly.
(c) There are barriers to entry. This means that other firms cannot produce the same commodity either because they are not allowed or because of the monopolistic conditions that make entry into the industry difficult.
(d) It is faced with a negatively down-ward slope demand curve. This means that the monopolist is a price setter- i.e. he sets the price but the quantity demanded is dictated by the buyers (consumers). Under the characteristics, we find that demand curve is not equal to the marginal revenue curve as is the case with perfect competition discussed in unit 4.

3.2 Causes of Monopoly

The followings are causes of monopoly.

(i) Ownership of strategic raw materials. It is possible for a firm to have control of raw materials and it can deny all other firms the use of the materials, thus, becoming a monopoly.
(ii) Exclusive knowledge of the production technique. If a firm is the only one that has access to the production technique of a product, it will become monopolistic in the production of that commodity.
(iii) Patent rights from the authority. This could be for a product or for the production process of a commodity. For example, the government may decide that a certain product should be limited to one source like Power Holding Company of Nigeria PHCN, producing and supplying electricity in Nigeria.
(iv) Government licensing or the imposition of foreign trade barriers to exclude foreign competitors. The government may issue

import license to only one firm for the importation of certain plants and machinery.

(v) The size of the market. This is a situation where the size of the market may be such as not to support more than one plant of optimal size.

(vi) The existing firm may adopt a pricing policy by deliberately selling at lower prices so as to discourage entry.

(vii) Declining cost industry where there is increasing return to scale. In this case, the most efficient firm will tend to increase production and scale of operation. The unit cost keeps declining and the economy of scale will also decline. The increase in output is lower than the increase in factors of production, and as a result, other firms may decide leaving the industry to the only firm and thus, monopoly sets in.

3.3 Price and Output Determination under Monopoly

The monopolist maximises his short-run profits if the following two conditions are fulfilled.

i. MC = MR
ii. The slope of MC is greater than the slope of the MR at the point of intersection.
The following figure explains it better.

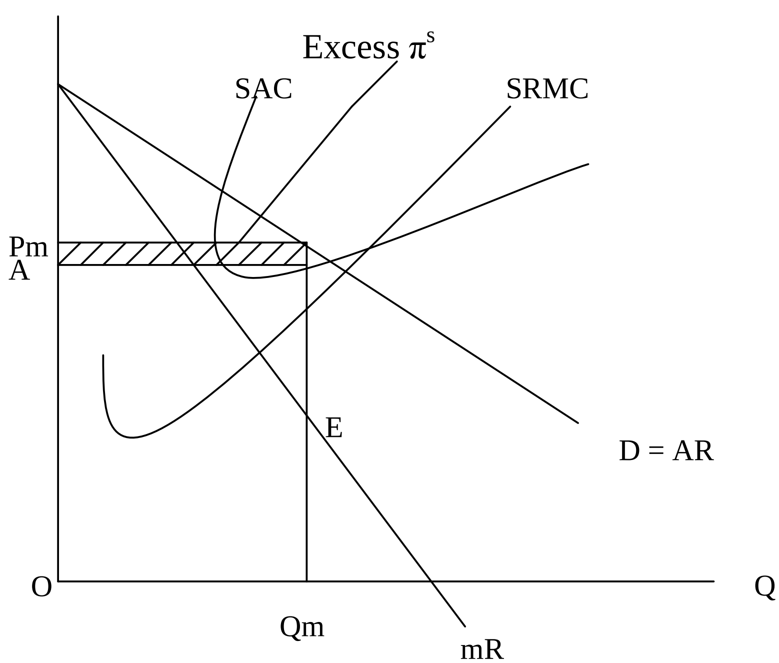


Fig. 5.1: A monopolist short-run profit maximisation

Where
Pm = monopoly price
Qm = monopoly quantity
Mc = marginal cost
Mr = marginal revenue
Smc = short-run marginal cost.

In the figure above, the equilibrium is defined by point E, at which MC = MR, and after the point E, MC > MR so both conditions are fulfilled.

Note the following observations from the diagram.

(1) The monopolist cannot set both price and quantity demanded in the market. The price set and the quantity demanded are determined by the situation in the market.
(2) The demand curve and MR-curves are downward sloping and negatively sloped, which means the higher the price, the lower the quantity demanded. This explains why the demand curve is higher than the MR-slope.
(3) The monopolists maximise profits both at the short-run and long-run situations. The profits are in excess, as long as entry into the industry is restricted.
(4) Production is not at the lowest point of average-cost curve. This is because with entry blocked, it is not necessary for the monopolist to reach an optimal scale i.e. to build up this plant until he reaches the optimum point of the LAC. Neither is there any guarantee that he will use his existing plant at optimum capacity.
(5) There is an advertisement only for public relations or goodwill or to show that the firm is doing good service to the public but not for competition.
(6) The monopolist cannot raise price indefinitely. Figure 5.2: below explains this point clearly.

Price	Quantity Sold	TR
5	100	500
10	80	800
15	50	750
20	35	700

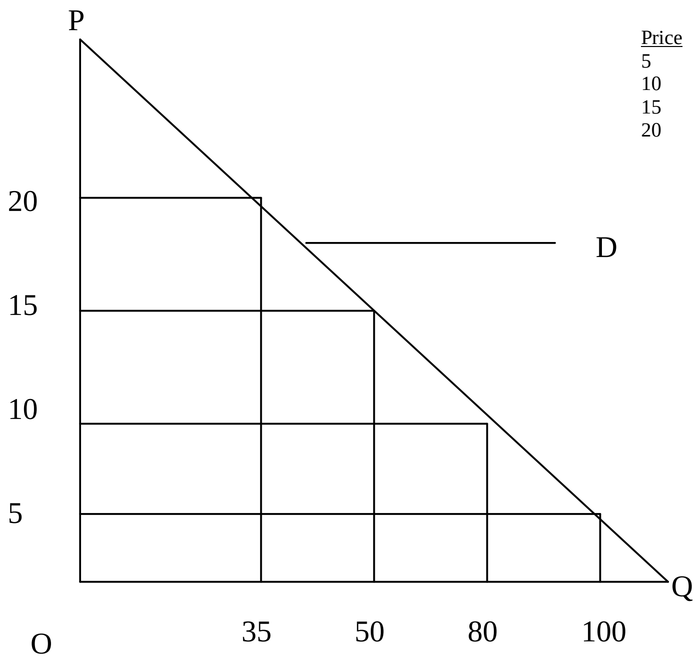


Fig. 5.2: A monopolist pricing policy

The diagram and the table above explain that, when the price is 5, the quantity sold is
100 units and total revenue (TR) is 500. The TR increases with increase in price but after a point, the total revenue will decrease. In this example, when the price rises from 10 to 15, TR declines from 800 to 750.

3.4 Effects of Monopoly

(a) Compared with perfect competition, monopolist produces less at higher prices. Consumers are forced to consume at such high prices because they have no choice e. g. Power Holding Company of Nigeria (PHCN) bills.

(b) Monopoly results in misallocation of resources. Price is greater than MR, which means more would have been offered at the given price but less is offered to the consumers.

(c) The monopolist makes excessive profits in the long-run, and since profits go to the well-to-do capitalists, a monopoly tends to widen the gap between the rich and the poor.

(d) The monopolist spends part of society’s scarce resources in public relations and advertisement. Such expenditure does not contribute to society’s welfare.

(e) The plant size may not be optimal. The point where MC = MR may not coincide with the lowest point of the monopoly's average total cost-curve.

(f) Monopolist can practise price discrimination to raise profits.

SELF-ASSESSMENT EXERCISE 1

Go back carefully through the characteristics of monopoly and state whether or not a monopoly resembles a cooperative society.

3.4.1 Relating a Monopoly's Price Determination to the Cooperative Pricing Policy

You should remember that the cooperative delivers goods and services to its members at cost price. This means, for instance, a supply cooperative supplies to farmers at cost price plus a so-called "mark-up" to cover operational costs of the cooperative and a net surplus. The net surplus is used to cover unforeseen costs and risks, to build up financial reserves and to pay bonuses or interests to the members. Only part of the surplus should be considered as "profit". The profit is often kept as reserve fund for future investments or used as so-called appropriation profit to replace borrowed capital by the co-operatives own capital. This is important since many new cooperatives in developing countries like Nigeria, have difficulty in finding sufficient capital of their own.

Even though a cooperative may in a sense resemble a monopoly because members are "forced" to buy from it, it is quite different from a monopoly.

3.5 Cooperative's Optimisation Problem

You should remember that a cooperative is a business firm owned by the users of the firm's services (Buccola, 1994, pg 431). The net revenue of the cooperative is returned to the co-operative members on the basis of their use.

Let us take an example of a marketing cooperative that assembles, processes and sells farm products.

Figure 5.1, illustrates the cooperative's optimisation problem (Buccola, 1994, pg 438)

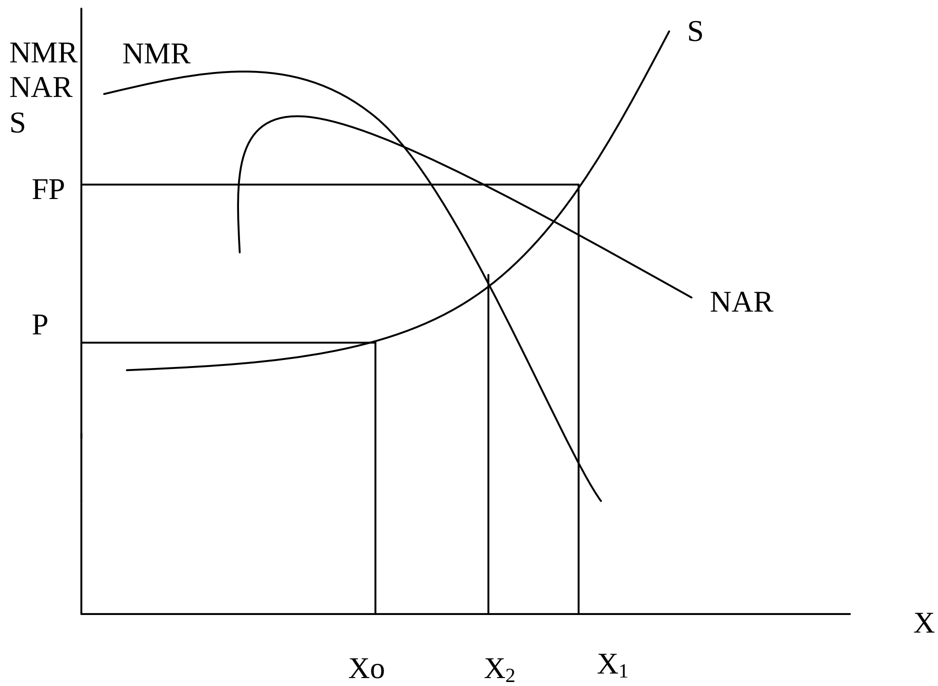


Fig. 5.1: Alternative Output Levels of a Cooperative

A cooperative that controls members' output reaches the optimal output at the point where the net marginal revenue (NMR) intersects the members' supply function S. The pay to the members is P. The difference between the price paid and the net average revenue *(*NAR*)* is the co-operatives surplus. The surplus is returned to the members, raising the price received to the full price (FP). Helmberger, (1969), argues that the cooperative is unable to set output at the income-maximising level. In this model, the patronage refund raises the price received by the members from P to FP, which induces members to increase their output to level X_1. Through a dynamic adaptation process, members' output converges at the equilibrium level $\boldsymbol{X_{2,}}$ where NAR and S intersect. From the perspective of members' welfare, this is the wrong signal, because it results in overproduction and lower total welfare. Pareto optimality is reached at the output level Xo, if the cooperative is a price taker in the processed product market.

SELF-ASSESSMENT EXERCISE 2

Is the pricing policy of monopoly the same as that of the cooperative?

4.0 CONCLUSION

The pricing policy of cooperative is different from that of a monopolist in many aspects. You have examined the characteristics of monopoly, its price and output determination and concluded that the monopolist is a price taker.

5.0 SUMMARY

You have learned about the price and output determination of a monopolist and related this to the pricing policy of a cooperative enterprise. Next, you are going to learn about the identification and explanation of the various price policies of the cooperative business enterprises in unit, 6.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the conditions to be met for a monopolist to maximise his short-run profits?
2. Explain the effects of a monopoly.

7.0 REFERENCES/FURTHER READING

Aboyade, O. (1983). *Integrated Economics.* London: Addison-Weslay.

Buccola, Stephen T. (1994). Agricultural Cooperatives: A Unified Theory of Pricing, Finance, and Investment. *In Cooperative Theory: New Approaches.* Jeffrey S. Royer, (Ed.) pp.171-258. Washington D. C.: USDA ACS Serv. Rep. 18, July 1987.

Jeffrey S. Royer & Holger, Mathey (1999). Optimal Strategies of Marketing Cooperatives Regarding Non-member Business. Selected paper, *American Agricultural Economics Association Meetings*, Nashville, T. E. August 8-11, 1999.

UNIT 6 IDENTIFICATION AND EXPLANATION OF VARIOUS PRICE POLICIES OF THE COOPERATIVE BUSINESS ENTERPRISE AND HOW PRICE POLICY RELATES TO MAKING OF SURPLUS (PROFIT)

CONTENTS

1.0 INTRODUCTION

In the last unit, you examined pricing with respect to cost concepts of marginal cost, marginal revenue, average total cost and margins using the example of a monopolistic enterprise. The essence was to find out how these costs influence the pricing policy of a firm, in that instance, a monopoly. We borrowed this idea from Yamey, B. S., who in his highly acclaimed publication titled "the price policy of cooperative societies", treats the price policy of cooperative enterprise in the form of an attempted analysis of the "economics of the firm", in a cooperative society. Now, you are going to learn how to identify and explain the various price policies of the cooperative business enterprise as well as relate price policy to making of surplus (profit) in the cooperative business enterprise.

There are various price policies of the cooperative business enterprise.

The common trend (enacted in different ways, and subject to constraints of various systems of national law) is the principle that an enterprise or association or society should be owned and controlled by the people it serves, and share any surplus on the basis of members' cooperative contributions (as a producer, labourer or consumer) rather than their capacity to invest financial capital. In other words, the defining point of a cooperative is that the members have a close association with the enterprises as producers or consumers of its products or services, or as its employees. Cooperative which is expressed today, as “profit-sharing” and “surplus-sharing” arrangement has distinct pricing policies different from that of conventional business enterprise.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the conventional price theory
- explain cooperative price policies
- describe price determination in cooperative
- describe how surplus is made in a cooperative
- explain the remuneration of a share in cooperative business enterprise.

3.0 MAIN CONTENT

3.1 The Conventional Price Theory

Price, according to Esogwa, C. O., is the amount of money a customer must pay for a product. The most obvious goal of pricing is to earn a profit. To do so, the price must be high enough to cover all the costs of making the product and all the costs of other parts of the marketing mix.

Esogwa further argues that, “…although no firm can ignore the need to make a profit, other goals often play a role in pricing. The second most common goal of pricing is growth of sales”. This means that the goal of growth of sales could influence a firms pricing policy. This goal may be expressed in terms of a percentage rate of growth. It can also be expressed in terms of growth of the firm’s share of the market for the product. Consequently, the price of the product is set low enough to achieve the target rate of growth.

SELF-ASSESSMENT EXERCISE 1

Go back through subsection 3.1 again and state whether cooperative pricing system resembles the conventional price theory.

3.2 The Cooperative Price Policies

The first Rochdale principle, which is followed by cooperatives throughout the world today, is that, "goods are to be sold at prevailing prices".

The second cooperative price policy is that the society delivers goods/services to its members at cost price. For instance, a supply cooperative delivers supplies to members at cost price plus the so-called "mark-up" to cover operational costs of the cooperative and a net surplus.
In simple diagrammatic terms, it can be represented thus:

Cost price	+	Mark-up	+	Net surplus	=	Price

Fig. 6.1: Pricing Policy of Cooperative

Remember that the net surplus is used to cover unforeseen costs and risks, to build up financial reserves and to pay bonuses or interests to the members. A third cooperative price policy is the consideration of price in situations where consumers regard the dividend they receive merely as price-reducing rebates.

Another point is that money is saved through direct channeling of goods from producer to consumer. This eliminates the middlemen as obtains in capitalist business enterprise. The elimination of the middlemen means reduction in the final goods sold to members (in the case of consumer cooperatives). But in the case of productive cooperatives, direct sale to the end users, for instance, a flour mill means increased price for the products and/or services offered by the productive cooperative.

The fifth pricing policy of the cooperative is that, the society has to offer secure prices to its members in such a way that it succeeds in making surplus (profit). In the case of productive cooperative, for instance, a pre-payment of say, 10 percent could be made to members (farmers, in this case). Then, the post-payment of the remaining 90 percent could be made after final price is determined and the products sold.
We should note that pre-payments may differ in the course of the year but differences should be eliminated in post payments.

3.3 Price Determination in Cooperative Business Enterprise

The question is how to determine the price of the product or service provided by the cooperative to its members. Let us take the example of the production co-operation in order to understand how price is determined in a cooperative enterprise.

The calculation will initially involve purchase price, or the price to the cooperative of supplying the product which it wishes to sell. We must add to this price the cooperatives direct operating expenses. These expenses always include transport costs, rent, electricity, water, wages costs, insurance and financing the cooperative's operating expenses. It is also customary to add indirect expenses, such as interest payments and the repayment of principal on member's cash investment and on loans taken from outside sources in order to finance the establishment of the cooperative. This calculation can be diagrammatically represented thus:

Purchase	+	Direct Operating Costs	=	Sale Price

Fig. 6.2: Price Determinations in Cooperative Business Enterprise

If we now subtract purchase price from the sale price and operating expenses we then have the surplus or "profit" as follows:

Surplus = Sale Price – (Purchase Price + Direct Operating Costs).

3.4 The Making of Surplus (Profit) in Cooperative Business Enterprise

In a cooperative enterprise, goods are sold to the public as well as to members, usually at prevailing market prices; any surplus above expenses is turned back to the members. The net surplus is also used to cover unforeseen costs and risks, to build up financial reserves and to pay bonuses or interests to the members. Only part of the net surplus should be considered as "profit". The profit is often kept as reserves fund for future investments or used as the so-called appropriation profit to replace borrowed capital by the cooperative.

3.4.1 How Surplus is created

The income of the cooperative is created in the following ways

1. In cooperatives, where members are not the users, the income is generated out of selling the products or services to the market, at the highest possible price.
2. In cooperatives, where members are the users, the income is generated out of selling of services of the cooperative to members. The cooperative will seek to minimise as much as possible its net income.

The surplus is created in a cooperative, when there is the difference between the total income of the cooperative and the total outgoing, including the total operating expenses and any payments to employees. The difference between the two is the surplus.
The following diagram simplifies how a surplus is made.

Sale Price – Purchase Price + Direct Operating Costs = Surplus Profit)

Fig. 6.3: The Making of Cooperative Surplus

3.4.2 Cooperative Objectives

You are now going to identify three different objectives a cooperative pursue. To illustrate these outcomes, you will continue with the model equation you learned in unit 5.

a) Cooperative maximises profits

In this case, the cooperative behaves like a profit-maximising firm. It takes only the cooperative surplus into account. The objective function of the co-operative is;

$$\pi = PQ - C - NR \qquad (6)$$

This function is maximised with respect to the raw product price. The decision criterion to determine the price paid to members is:

$$NMR = MIC \qquad (7)$$

Where NMR is the net marginal revenue and MIC is the marginal input cost. The cost is the sum of the marginal processing cost and the marginal cost of purchasing the input from the members. The cooperative maximises its profits, which are redistributed to the members. Members will then receive a patronage refund in addition to the price of the raw product.

b) Cooperative maximises joint welfare

Enke introduced a consumer cooperative objective function, which was applied to marketing cooperatives by Royer, (1978, 1982), and argued by Ladd, (1982***)***. This objective function aggregates the profits (surpluses) of the cooperative and its members into a joint objective function:

$$L = PQ - C - F \tag{8}$$

Therefore, we differentiate equations (8) with respect to the quantity of processed product which yields the following first-order condition:

$$NMR = N \tag{9}$$

Or net marginal revenue equals raw product price. In this case the cooperative acts like a fully integrated firm. The on-farm cost of the members is internalised. Members receive a lower patronage refunds compared to the one they receive when the cooperatives objective is profit maximisation. These patronage refunds raise the total price received by members. The cooperative has to restrict members' output to the optimal level, by dissociating the raw product price from the patronage.

c) Cooperative maximises price paid members

Eminent scholars, Helmberget and Hoos**,** in their classic article, argued that a cooperative does not have direct control over members' output quantity. Such a cooperative finds its equilibrium quantity where the member supply function interests the NAR function of the cooperative. You can go back to the sub-topic "The cooperative optimisation problems**"** in unit 5 to refresh your memory. This type of cooperative does not have a distinct objective function. Instead, it processes whatever quantities of the raw product members choose to deliver. The price of the raw product is derived from the behavioural condition that members react to the sum of raw product price and patronage refund. Thus, the price paid to members is:

$$N = \frac{PQ - C}{R_1} \tag{10}$$

Equation (10) can alternatively be expressed as:

$$N = NAR \qquad (11)$$

The behavioural condition drives cooperative profit to zero. No patronage refund is paid in this set-up. Members overproduce, compared to the previous case.

You are going to use more of this model and its equations in unit 8, where you are going to learn about non-member business in a cooperative.

SELF-ASSESSMENT EXERCISE 2

Look around you and select a cooperative society. Find out how their net surplus (profit) is called. Do the cooperative follow the format in figure 6.3 in calculating its surplus?

3.5 The Remuneration of a Share in Cooperative Business Enterprise

What remuneration should be provided on the cooperative's share capital? We may recall that the third international cooperative principle maintains that the cooperative should pay a limited rate of interest on the funds invested by a member in return for a share. In many countries, the maximum rate is usually very low. As a result, the interest rate is often negative in real terms, and may be much lower than the local rate of inflation.

We may at this juncture ask why only a limited rate of interest is paid on a share. The most common answer is that the limitation is aimed at preventing a situation where the cooperative member will prosper solely from the interest on his investment, a situation which leads to the economic destruction of cooperatives.

4.0 CONCLUSION

In a cooperative enterprise, the members need to obtain the benefit (profits). This is also one of the reasons why those responsible for formulating cooperative policy have restricted the amount of benefit which the member may obtain from the capital he has invested on the society in order to make it distinct from the capitalist enterprise. Because those who are served by a cooperative are members and owners as well as customers, the cooperative must keep careful account of members' transactions so that savings can be properly returned to them in proportion to their patronage.

The pricing policy of the cooperative should not lead to excessive accumulation of surplus (profit) otherwise; the society will deviate from its primary objective of serving its members.

5.0 SUMMARY

In this unit, you learnt the various price policies of the cooperative business enterprise as well as how the price policy relates to making of surplus (profit). You are now moving to unit 7, which examines the appropriation of net surplus in the cooperative business enterprise.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain 5 cooperative price policies.
2. With an aid of a diagram, explain how surplus (profit) is made in a cooperative business enterprise.

7.0 REFERENCES/FURTHER READING

Buccola, Stephen T. (1994). Agricultural Cooperatives: A Unified Theory of Pricing, Finance, and Investment. *In Cooperative Theory: New Approaches.* Jeffrey, S. Royer. (Ed.) pp.171-258. Washington D. C.: USDA ACS Serv. Rep. 18, July 1987.

Enikanselu, S. A.; et. al. (2005). *Principles and Economics of Cooperative.* Lagos: Dart Trade Limited.

Jeffrey S. Royer & Holger, Mathey. (1999). Optimal Strategies of Marketing Cooperatives: Regarding Non-member Business. Selected paper, *American Agricultural Economics Association Meetings,* Nashville, T. E. August 8-11, 1999.

Redmond, W. A. (2008). *Cooperatives.* Microsoft [(2)] Student DVD: Microsoft Corporation, 2007.

Yamey, B. S. (1951). *The Price Policy of Cooperative Societies. Economica,* London: New series, vol. 17, No 65, page 23-42, Blackwell Publishing.

UNIT 7 APPROPRIATION OF NET SURPLUS IN THE COOPERATIVE BUSINESS

CONTENTS

1.0 INTRODUCTION

The focus of this unit is the appropriation of net surplus in the cooperative business. You are going to examine the purposes and the criteria used for the appropriation of the net surplus.

You should note that a person usually joins a cooperative because he expects some kind of remuneration. This remuneration may take the form of services provided, with the services in question being of the highest possible quality and at the lowest possible price.

You may at this stage recall the different forms of cooperative involvement mentioned earlier in Cooperative Economics I, that is COP 211. They are stated as follows.

1. There is the group of cooperatives whose members are its users, as in the case of consumer, saving and credit, insurance and housing cooperatives. The members of this type of cooperative expect to receive remuneration in the form of the particular services which are required.
2. There is the group of cooperatives whose members are not its users, but its workers. These include production, building and transport cooperatives. The member earns his living from his employment in the cooperative. Here we come to the question of exactly what remuneration the member should receive for working in the cooperative.

Another question to be asked is how the cooperative appropriates these surpluses.

The question will be answered in the main content.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the cooperative surplus and patronage refund
- describe basic principles relating to cooperative surplus
- explain how surplus should be distributed
- describe problems associated with distributing patronage refund and rebate.

3.0 MAIN CONTENT

3.1 What is Cooperative Surplus?

The surplus is the difference between a co-operative total income and total expenditure (Galor, 1988). We may ask why the cooperative should try to make a surplus, that is, a “profit”. By its very nature, the aim of the cooperative is to serve members in various ways. When the cooperative sets out to make a surplus (profit), it is detracting from the quality of service provided to its members. This is an absurd point which hardly anyone involved in cooperative theory bothers to discuss. What is more, this absurdity is perpetuated by legislation throughout the world.

In order to understand the nature of the surplus, we will take the example of the production cooperative. The question is how to determine the price of the product or service provided by the cooperative to its members. This calculation initially involves purchase price, or the price to the cooperative of supplying the product which it wishes to sell. We must add to this price the cooperative’s direct operating expenses. These expenses include transport costs, wages costs, rent, electricity, water, insurance and financing the cooperative’s operating expenses. It is also customary to add indirect expenses, such as interest payments and the repayment of principal on member’s cash investment and on loans taken from outside sources in order to finance the establishment of the cooperative.

Although most cooperatives do so, we believe these expenses should not form part of our calculation. Financing expenses for the establishment of a cooperative should be included in a separate account, which is quite separate from the cooperative's operating expense account. We have here two types of account.

1) Finance for the establishment of the cooperative, which is entirely at the members' responsibility, with each member being responsible for his relative share of the money raised for the purpose by the cooperative.
2) Finance for the cooperative's operating costs. The latter is also provided by the members, although never on an equal basis, but according to the extent of each member's purchase of services from the cooperative. A member who buys more from his consumer cooperative participates to a large extent in its operating expenses. Now the surplus must be added to the purchase price and the second component which is the direct operating costs.

3.2 Basic Principles Relating to the Surplus

You recall that the surplus is the difference between a co-operative's total income and total expenses. The surplus, or "profit", should not be the cooperative's final objectives, but only a means to an end. The surplus represents a "security margin" component of its accounting policy which should be applied with respect to the members or the market to prevent the cooperative from losing money. When the co-operative's business results are certain, and there is no need to wait until the end of the year, we must repay the entire surplus to the members, relative to the extent of their participation in the cooperative. This rule should apply to all cooperatives.

In the productive cooperative, the surplus should be repaid according to each member's contribution to the cooperative's production system.

The surplus is a temporary fund paid by the members until a price is determined, at which stage the surplus can be repaid and all surpluses must be repaid to the members.

We must remember that investment; the reserve fund, community development, cooperative education and interest on share capital should be financed by the members on an equal basis.

SELF-ASSESSMENT EXERCISE 1

What is the difference between surplus and net surplus in a cooperative enterprise?

3.3 How Surplus should be distributed

On two occasions Daniel (1986 & 1989) tried to deal with the question of wages and the use of surpluses.

With respect to cooperative's surplus, Daniel claims that the members' wages should be based on the average for the branch in question. If the cooperative is run properly, it will be profitable, and the surpluses which can be distributed at the end of the year will be larger. Daniel suggests that these surpluses should be distributed to the members at the end of the financial year.

Daniel suggests that the surplus should be divided into a number of components:

1. **10** percent for a cultural fund
2. **30** percent for a reserve fund
3. **30** percent for remunerating members for their investment in the cooperative.
4. **30** percent for remunerating members according to the amount of work they perform for the cooperative.

However, some scholars are of the opinion that, none of these allocations should be made from the surplus. Daniel, according to them, repeats a "mistake" which is very common among cooperative specialists.

3.4 Uses of Surplus

The fourth point to be discussed is the way in which the surplus is used. Cooperatives use surpluses in many ways, but one of their last priorities is to allocate it to the members at the end of the financial year.

We should note that surpluses are used in accordance with international cooperative principles or local cooperative laws.

Surpluses are used for:

- additional investment in the cooperative
- financing cultural and educational activities
- social and community development
- financing interest payments on members' shares; and
- the creation of reserve fund.

3.5 Patronage Refund Payments

A patronage refund is not a return of profits in the ordinary sense of the word. It is nothing more than an adjustment made in charges for service so that the price paid will be the true cost of service. In the case of a consumer or purchasing cooperative, the patronage refund may be looked upon as the return of an overpayment for service, since the gross margin taken usually turns out at the end of the business period to be more than the actual cost of the service. In the case of a marketing association, a patronage refund payment corrects an underpayment because the association is able to get more for the product after deducting proper costs than it paid to the members.

Now, consider a practical example to make the picture clearer.

Suppose that a group wishes to market corn co-operatively. They form a local cooperative association for the purpose. They must, of course, get an elevator (a produce merchant) and employ a manager.

When a member wishes to sell his grain, he brings it to the elevator where he is paid in cash the “going” price for corn in his community. The cooperative elevator then tries to sell the grain- perhaps to a flour mill for a somewhat higher price. Since it is a co-operative venture, the elevator pays back to the farmer his part of any income made from the sale, or it may credit him on his share of ownership in the society. In either case, his return is measured not by the number of shares he may own in the co-operative but by the proportion of grain he sold through it.

If there was a way by which members could be paid at the time of delivery or when the elevator could sell the corn for less costs, there would be no need for patronage refund payments. But this cannot be done, since the local elevator must assemble wheat and sell it in wholesale over a period when the market price goes up and down.

3.5.1 Problems Associated with Distributing Patronage Refund and Rebate

In co-operative economic, benefits are distributed proportionally according to each member’s level of participation in the co-operative. For instance, by a dividend on sale or purchases, rather than dividend according to capital invested.

In production cooperatives, for instance, the creation and allocation of surpluses are usually regarded as a positive development because the allocation of surpluses fulfils several functions.

(1) Income – an addition to a member's income.
(2) Withdrawal – an incentive to participation in and fidelity to the cooperative.
(3) Saving –allows the member to increase his share capital
(4) Remuneration – for the effort invested by the member.

Despite all these positive functions of the allocation of surpluses, there are lots of problems associated with such allocation. But first, let us consider the terms rebate and patronage.

(a) Rebate is the sum of money by which a debt, tax, etc may be reduced. For instance there may be a rebate of ₦100 if the account is settled before a certain date.
(b) Patronage means the level of participation by a member in a cooperative activity by way of purchases (in terms of consumer cooperative) and the quantity of goods and/ or services provided by members (in the case of productive cooperative).

The problems associated with the distribution of surpluses are as follows.

- Limited portion of the surplus is usually distributed to members
- It is very difficult to find a suitable medium between the labour invested by each member, the surplus achieved and that part of it which is to be allocated to the members.
- Most of the surplus goes to the state, the cooperative movement, debt repayments, and various funds only as a last priority to the members.
- The criterion by which the surplus is apportioned among members of a productive cooperative is defective. These criteria are; the length of time for which they have worked in the cooperative, the type of work involved and the level of vocational skill required.
- In most cases, surplus funds are used to repay the principals on the members' shares, and the members enjoy no direct benefit from the surplus.
- The problem of equal or differential remuneration.

SELF-ASSESSMENT EXERCISE 2

List the criteria by which the surplus of a productive cooperative is apportioned among members.

4.0 CONCLUSION

You have examined appropriation of net surplus in the cooperative businesses. Note that most scholars hardly make distinction between surplus and net surplus, but it is assumed that the latter is obtained after provision for operating costs have been made before the figure is arrived at.

5.0 SUMMARY

Having examined the appropriation of net surplus in the cooperative business in this unit, you are going to learn about the non-member business in cooperative in unit, 8.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are cooperative surpluses used for?
2. Daniel, A. suggests that the surplus should be divided into a number of components and assigns percentages to each component. List and explain these components.

7.0 REFERENCE/FURTHER READING

Daniel, A. (1986). A New Model for Producer Cooperatives in Israel. *In Cooperative Today*. Geneva: ***I. C. A.***,1986, pp 113-129.

UNIT 8 NON-MEMBER BUSINESS IN COOPERATIVE

CONTENTS

1.0 INTRODUCTION

The spirit of cooperative has been in the heart and mind of every Nigerian. This spirit is almost instinctive; it is something that swells up in us whenever the occasion to lend a helping hand to our neighbour arises. This saw the beginning of various self-help projects that dotted every community in Nigeria. Note that formal cooperatives took off from the self-help spirit. It is the discussion on involvement of non-members in the business of cooperative that will occupy your attention in this unit.

You will learn the various reasons why non-members are encouraged in cooperative enterprises, the problems created by non-members and how the net surplus attributable to non-members business is treated under patronage rebate. You will also learn the models of cooperative with non-member business as well as the role of promoters in a cooperative setting.

You recalled that a cooperative society under the law is a group of individuals who have specific needs. These are to consume, to save, to obtain credit, to produce, to market, to be insured, to transport , to build, to be housed, have a pension etc. Cooperatives freely enter into partnership in order to attain these common needs by setting up an economic enterprise which is managed by the members themselves, in a democratic manner, and to which they are bound.

In such economic enterprise and in the course of carrying out these activities, the cooperative is likely to be involved with non-member business. For instance, marketing cooperative may buy agricultural raw products from both members and non-members producers.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the encouragement of non-member business in cooperatives
- explain problems created by non-member business
- explain how the net surplus attributable to non-member business is treated under patronage rebate
- analyse models of cooperative with non-member business
- explain the role of promoters in cooperative.

3.0 MAIN CONTENT

3.1 Encouragement of Non-member Business in Cooperatives

Since members may not be able to carry out the activities of the cooperatives alone, there is the need to involve non-member business. You should remember that the business operation of modern cooperatives is becoming linked together. For example, many marketing cooperatives do business both as wholesale and retail and in addition prepare the raw product for the consumer. Many purchasing associations combine retail, wholesale, and manufacturing. This means that saving from wholesale marketing, transportation, processing, and manufacturing are added to those of local marketing or retail purchasing. Savings from these combined operations greatly increase the benefits attributable to both members and non-members that patronise the cooperatives.

You may at this juncture ask what the nature of non-member business in cooperatives is. These are:

- as external financiers
- suppliers
- buyers
- marketers
- hired workers (in productive cooperative)
- promoters, etc.

Remember, that, in many cases, those wishing to establish cooperative lack the necessary resources. All they can do is finance a small part of the value of a share. Other capital has to come from loans or grants or assistance from promoters.

SELF-ASSESSMENT EXERCISE 1

Why should a non-member business be allowed in a cooperative?

3.2 Problems Created by Non-member Business

The first noticeable problem created by non-member business in a cooperative enterprise is the problem of "hold–up". By this, we mean when a cooperative depends on a non-member business for its daily operations, if such a non-member business is unable to meet its contractual obligations with the cooperative, the activities of the cooperative may be adversely affected. Let us discuss a practical example for a clearer picture of the term "hold –up".

Suppose a marketing cooperative has entered into a contractual agreement with a flour mill to supply a 500, 000 tons of corn every year. It is assumed that members of these marketing cooperatives, who are also farmers, could only supply about 300, 000 tons of corn annually. The marketing cooperative then entered into agreement with some farmers who are not members of the marketing cooperatives, to supply the remaining 200, 000 tons of grains. If, due to unforeseen circumstances, such as poor harvest, or the diversion of the grains to alternative markets, the non-members may not be able to supply this quantity to the marketing company thus leading to its inability to meet its contractual obligation to the flour mill. Thus the marketing cooperative is "held – up" by the inability of non-member suppliers to fulfill their contracts.

Other problems created by non-member business in a cooperative are as follows.

- Poor services/goods delivery
- Lack of commitment
- Lack of patronage
- Fraud
- Higher interest on loans
- Higher charges on credit facilities.

3.3 How the Net Surplus Attributable to Non-member is treated under Patronage Rebate

Now, remember that a rebate is a sum of money by which a debt, tax, etc may be reduced. For instance, one may enjoy a discount, which has a rebate of ₦100 if the account is settled before December 2009. And in the case of patronage rebate, it is a rate of surplus refund to those who patronise the activities of a cooperative.

From the surplus, the interest on external sources of finance, payment of trade creditors and suppliers are also made. I will like you to recall the different forms of cooperative involvement earlier discussed in this course and also that there is the group of cooperatives whose members are its users, as in the case of consumer, saving and credit, in service and housing cooperatives. The members of this type of cooperative expect to receive remuneration in the form of the particular service they require. Similarly, a non-member business dealing with the cooperative that falls under this group is also expected to receive remuneration in the form of the particular service he requires. And just as patronage refund is made to members, usually at the end of the year, non-member business can also lay claims to a portion of the surplus.

Secondly, there is the group of cooperatives whose members are not its users, but its workers. These include production, building and transport cooperatives. In this second example, the member earns his living from his employment in the cooperative. Here we come to the question of exactly what remuneration the member should receive for working in the cooperative.

Similarly, productive cooperatives sometimes hire workers as non-members involved in the operations of these cooperatives. The hired workers also expected remuneration just as the members who are also workers. Any discussion of the surplus and patronage rebate must include the subject of financial remuneration for the members and non-members involved in the cooperatives.

3.4 Models of Cooperative with Non-member Business

Eminent professors of Agricultural Economics Jeffrey S Royer and H Matthey cited in units 4, 5 and 6 also extend their models to a cooperative with non-member business. They stated that, if the cooperative is assumed to purchase raw product from both members and non-members, the raw product supply function represent by equation 3 (please, see unit 4 as a reminder) is replaced by two examples

$R_1 = e - fN_1 \qquad e < 0, f > 0 \qquad (12)$

And

$R_2 = h - lN_2 \qquad h < 0, l > 0 \qquad (13)$

Where R_1 and R_2 respectively represent the quantity of raw product supplied by members and non members, and $\boldsymbol{N_1}$ and $\boldsymbol{N_2}$ are the prices offered members and non members by the cooperative.

Like in unit 6, where we identified three different objectives a cooperative can pursue, Jeffrey and Holger also extend same to the present models where a cooperative deals with both members and non members.

(a) Cooperative maximises profit

In this case, they argue that, the cooperative treats members and non-members alike. The objective function of the cooperative reflects this:

$$\pi = PQ - c - N_1 R_1 - N_2R_2 \qquad (14)$$

The cooperative maximises its profits with respect to the two raw product prices. It exercises its monopsony power in the member and non member market. The decision criteria to determine the prices paid to the suppliers of the raw product are

$$NMR = MFC_1 \qquad (15)$$

and

$$NMR = MFC_2 \qquad (16)$$

Remember that NMR stands for Net Marginal Revenue while MFC stands for Marginal Factor Cost.

Non members receive only the raw product price. On the other hand, members receive the rents that the cooperative earn as patronage. They get an additional amount in patronage refunds. A numerical solution can be obtained using the formulae above if we have the parameters.

(b) Cooperative maximises joint welfare

The objective function of the cooperative is

$$L = PQ - C - N_2R_2 - F \qquad (17)$$

The cooperative has two control variables $\boldsymbol{N_1}$ and $\boldsymbol{N_2}$. The decision criteria are derived by differentiating the objective function with respect to the two raw product prices that are offered to members and non-members. This differentiation produces two first-order conditions. From the conditions placed on equations (12) and (13) we see that neither $\partial R_1/\partial N_1$ is assumed to be zero. Thus, the first-order conditions can be written as thus.

$$NMR = N_1 \tag{18}$$

and

$$NMR = MFC_2 \tag{19}$$

MFC_2 represents the Marginal Factor Cost of the raw product supplied by the non members. This is equivalent to stating that for a maximum value of the objective function, the cooperative will produce the quantity of the processed product at which the marginal net revenue equals the price that it offers members for the raw product and the marginal factor cost of the raw product supplied by non-members. Equations (18) and (19) can be solved for the optimal values of the prices offered members and non-members given the relationship presented by equations (1), (2) (in unit4), and module 2(unit 3 and 4) . When there are parameters, the optimal solutions for the prices offered members and non-members for the raw products can be determined. It will also show that non-members receive only the raw product price, while cooperative members get additional amount on each unit of raw product plus their price. The internalisation of the on-farm cost of the members allows the cooperative to act like a partially integrated firm. Only non-member output is restricted to the monopsony level, while members produce at the competitive level.

(c) Cooperative maximises price paid to members

The cooperative cannot maximise members welfare directly, because it does not control members raw product output. The non-member business is used as an instrument to improve members' welfare. The objective function cannot be maximised with respect to the member price. The first-order condition represented by equation (15) is replaced by the behavioural constraint.

$$N_1 = \frac{PQ - C - R_2N_2}{R_1} \tag{20}$$

In this case, the member price $\boldsymbol{N_1}$ is no longer a decision variable as it can be defined as a function of the parameters and $\mathbf{N_2}$. The only control variable in this model is the non-member price $\boldsymbol{N_2}$. Differentiating the objective function with respect to the non-member price gives the following first-order condition.

$$NMR = MFC_2 \tag{21}$$

Equation (21) states that the cooperative will set the member price such that the net marginal revenue from the total processed product equals the marginal factor cost of the non-member raw product. The behavioural constraint and the first-order condition define the optimal behaviour of a cooperative that is unable to control members' raw product quantity directly.

We can find the solutions to numerical example using the equations if we have the parameters. We will then discover that cooperative profit will be driven to zero in this set-up. Also, no patronage is distributed. Members and non-members receive only their respective raw product prices.

3.5 The Role of Promoters in Cooperative

It does happen that it is not in all cases that members of a profession or trade will organise others of the same profession to form a cooperative. For example, a bricklayer may organise the bricklayers to establish a cooperative.

An outside person can be so motivated to bring others together to form a cooperative. This outside person may not even belong to the same social or economic class. Such an individual is called a promoter.
This means that members of the cooperatives did not just get up and act on their own without outside influence. They were prompted and prodded. The pressure and activities of promoters are important here.

3.5.1 Types of Promoters

In developing countries such as Nigeria, the promoters include the following.

- Philanthropists
- Religious bodies
- Trade unions
- Existing cooperative institution
- The government.

4.0 CONCLUSION

Having looked at the activities of the non-member business in a cooperative, you have to realise that their involvement in cooperative is necessary. It is not in all cases that the non-member business in a cooperative creates problems for the society. Most of the non-member business in the cooperative had contributed to the success of many cooperative enterprises.

SELF-ASSESSMENT EXERCISE 2

List various promoters for cooperatives.

5.0 SUMMARY

In conclusion you have learnt the role of non-member business in cooperative. In the next unit, which is the last unit of module I of this course, you are going to learn the classification of cooperatives in terms of the organisational forms and structural types.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the type of business non-member business in cooperative may undertake.
2. Define the following terms

- "Hold–up"
- Rebate
- Patronage
- Promoter

7.0 REFERENCES/FURTHER READING

Chukwu, S. C. (1990). *Economics of the Cooperative Business Enterprise*. Germany: Marburg consulting for self-help promotion

Jeffrey, S. Royer & Holger, Mathey (1999). Optimal Strategies of Marketing Cooperatives, Regarding Non-member Business. Nashville: *American Agricultural Economics Association Meetings*, T. E. August 8-11, 1999.

UNIT 9 ORGANISATIONAL FORM AND STRUCTURAL TYPES OF COOPERATIVES

CONTENTS

1.0 INTRODUCTION

In units 7 and 8, you examined the appropriation of net surplus in the cooperative business and the non-member business in a cooperative. You also learnt the purposes and criteria used for the appropriation of the net surplus. More so, you learnt about the problems associated with the different methods used in the distribution of patronage refund and rebate.

Now you are going to classify cooperatives in terms of the organisation forms and structures as well as apply this classification to identifiable cooperatives.

You can recall that a cooperative is a form of business ownership that consists of a group of people who have joined together to perform a business function more efficiently than each individual could do alone. You also remember that the purpose of a cooperative is not to make a profit for itself, but to improve each member's situation. However, members of certain types of cooperatives do make a profit by selling their product and/or service to customers who are not cooperative members.

Note that cooperatives can take many forms. The classifications of cooperatives in terms of organisation forms and structures types are as follows.

i. Primary cooperatives
ii. Secondary cooperatives; and
iii. Tertiary cooperatives.

These form the subsections 3.1 to 3.3 of the unit.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- classify cooperative in terms of organisation forms and structures
- apply this classification to identifiable cooperatives
- explain the meanings of the terms union, federation and apex cooperative.

3.0 MAIN CONTENT

3.1 Primary Cooperatives

According to Enikanselu, S .A. et al, "primary cooperative is made up of natural person as members. By law, a primary cooperative should be made up of at least 10 members while industrial primary cooperative is 6 members (Adeoye 1996). There is no upper ceiling on membership of any primary cooperative. Primary cooperatives are, therefore, smallest individuals units in the set up. They cover limited area of operation. They also have in most cases individuals as members and may link up with other cooperatives for improved services. They may sometimes be called local cooperatives.

The basis for making the above mentioned categorisation is the membership of the cooperative and the activities of the cooperatives.

3.2 Secondary Cooperative

Enikanselu, S. A. et al, state that a secondary cooperative is made up of at least two or more primary cooperative societies. It is a union of cooperative societies and they are usually referred to as mother union. One feature of the secondary cooperative is that individual members cannot become a member.

Obviously, secondary cooperatives are cooperatives occupying the second layer with the primary cooperative below. They are mostly formed by a number of primary cooperatives. Secondary cooperatives cover wider areas of operation. They are sometimes called regional cooperatives.

3.3 Tertiary Cooperatives

They are cooperatives occupying the third layer with the secondary and primary cooperatives below.

Tertiary cooperatives are formed mostly by secondary cooperatives. The areas of operation in this set up cover the areas of the operations of the secondary cooperatives that formed them. Sometimes, they are called national cooperatives if they cover the whole country.

We are going to apply the classification of cooperative in terms of organisation forms and structures to identifiable cooperatives in the next section.

SELF-ASSESSMENT EXERCISE 1

What are the 3 main types of organisational classification of cooperatives?

3.4 Application of the Classification to Identifiable Cooperatives

Having examined the classification of cooperatives according to organisation forms and structures, we now proceed to apply this classification to identifiable cooperatives.

i. Primary cooperatives – as pointed out above, these are cooperatives with individuals as members. They cover limited areas of operation. Primary cooperatives could be consumer cooperative or productive cooperative. Good examples of primary cooperative are as follows.
ii. Lagos State University (LASU) staff multipurpose cooperative society limited.
iii. Lagos State Polytechnic (LASPOTECH) staff multipurpose cooperative society limited
iv. LUTH/CMUL Idi–Araba cooperative multi-purpose society limited

Taking the example of the LUTH cooperative, we can analyse it as follows.

LUTH/CMUL Idi–Araba, cooperative multipurpose society limited

This society primarily caters for staff members of Lagos University Teaching Hospital (LUTH). Its mission is "to be a dynamic cooperative society that would be both proactive and responsive to the hopes and aspirations of co-operators". The society has over the years been able to grant loans to its members for productive and provident purposes. It has acquired lands and allocated same to members to enable them build their own houses. The society also assisted members to buy shares.

The bylaw of the society states that "the primary objective of a thrift and credit society shall be granting of loans to members". The society added additional functions to its primary objectives, which necessitated a change of status and name. The society then applied for re-registration as a multipurpose cooperative society. This implies that, even though the thrift and credit society stood to grant loans to members as its main objective, the multipurpose, as the name suggests, is allowed to venture into other businesses such as land/estate, investments (buying of shares, house-hold equipment, etc) as well as sales of consumer goods and food stuffs at moderate rates.

2) **Secondary cooperative –** you recall that this type of cooperative is made up of at least two or more primary cooperative societies.

A good example is state or region cooperatives such as Akwa Ibom cooperative federation limited representing the interest of cooperative movements in that state.

3) **Tertiary cooperative –** remember that these are formed mostly by secondary cooperatives. A good example of tertiary cooperative is at the national level where cooperatives are formed to cover the entire country, for instance, National Cooperative Federation of Nigeria Limited. This caters for all cooperatives in the country.

Examples of tertiary cooperatives can be found at international level. These international cooperative are world cooperative bodies representing cooperative interest and welfare on a global level.
Examples are as follows.

a) International Cooperative Alliance (ICA), which was established in 1895 with membership from over 65 countries.
b) International Federation of Agricultural Producers (IFAP).

SELF-ASSESSMENT EXERCISE 2

Look around you and list three examples of primary cooperatives.

3.5 Meanings of the Terms Union, Federation and an Apex Cooperative

It is imperative for us to at this stage, look at terms commonly used for classification but sometimes confusing. These terms are as follows.

a) Union

As the name implies, a union can be referred to as any coming together of primary cooperatives to form another common body. It is identical with a federation in that sense.

b) Federation

A federation is a result of joint action by a number of independent primaries and/or secondary and/or tertiary cooperatives. In some cases, a union can also be seen as a primary cooperative society in Nigeria.

c) An Apex Cooperative

This is functionally specialised for instance, the National Cooperatives Federation of Nigeria Limited.

4.0 CONCLUSION

You have gone through the organisational forms and structural types of cooperatives. The journey took you to the classification of cooperatives in terms of organisation forms and structures types. You also examined the meanings of the terms union, federation and an apex cooperative.

5.0 SUMMARY

In this unit, you have learnt the classification of cooperative in terms of organisation, forms and structures. You were able to identify three categories of cooperatives and also identify where a cooperative will belong based on some criteria. Next to consider is the nature of productive cooperative in unit 10, which is the first unit of Module 2.

6.0 TUTOR-MARKED ASSIGNMENT

1. Briefly describe the three main types of cooperatives according to organisational forms and structural types of classification.
2. Explain the terms 1) Union 2) Federation 3) An apex cooperative.

7.0 REFERENCE/FURTHER READING

Enikanselu, S. A.; et al. (2005). *Principles and Economics of Cooperative.* Lagos: Dart Trade Limited.

Owojuyigbe, S. (1988). *Cooperatives Administration and Fieldwork in Nigeria*. Ibadan: Anu Olu Publishers.

MODULE 2

UNIT 1 THE NATURE OF PRODUCTIVE COOPERATIVES

CONTENTS

1.0 INTRODUCTION

In unit 9, you were taught the organisation and classification of the forms and structures of cooperative as well as the application of the classification to identifiable cooperatives.

In this unit, you are going to look into the nature of productive cooperative, their historical antecedents, especially their spread in the modern world.

During the 1980s, trade union organisations, non-governmental organisations and even governments themselves began to regard industrial production cooperatives as potential vehicles for the creation of employment. In both developed nations and third world countries, which suffer from rampant and often concealed unemployment, full employment, particularly employment in production sectors of the economy, is an overriding national objective.

The capitalist method of providing full employment has proved a failure. Before the collapse of communism (which prided itself on the attainment of full employment, albeit at the cost of disguised unemployment), the communist method was extremely unattractive. An alternative method of providing full employment, therefore, needs to be found, and it is here that the productive cooperatives have an important role to play.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the nature of productive cooperatives
- trace the historical antecedents of the productive cooperatives and their spread in the modern world
- give examples of productive cooperatives
- explain the productive cooperative as a tool for development.

3.0 MAIN CONTENT

3.1 What is Productive Cooperative?

As the productive cooperative originated in France, it is worthwhile to examine how the French define this type of cooperative. Here, we will refer to the definitions introduced by Antoine Antoni, the general secretary of the French Confederation of Production Cooperatives. The first definition used by Antoni was taken from the French Cooperative Law of 1937. "Workers" production cooperative societies are established by the workers or employees for the purpose of jointly practising their occupation for their employment, or public or private services resulting from the practice of the said occupation including the sale of products manufactured, processed, converted or extracted by them, and the execution of auxiliary replacement and installation work". The second definition, which is taken from the Cooperative Law of 1947, states as follows.

The essential aims of cooperative societies are as follows.

1) To reduce, for their members' benefit and by the members' joint effort, costs and, where relevant, the sale price of certain goods and services, while fulfilling the functions of entrepreneurs or

intermediaries, whose remuneration would have the effect of increasing these costs.

2) To improve the commercial quality of the products supplied to their members, or of those supplied by the latter or delivered to the consumers. Cooperatives are active in all fields of human endeavours.

Antoni found these definitions lacking and felt they ignored the main function of the production cooperative. A group of definitions relating to productive cooperatives, which were published in the 1970s, beginning with what was the standard definition in Poland will now be examined. According to this definition:

A labour cooperative is an enterprise which develops its activities on the basis of cooperative principles and which is engaged in various types of industrial productions or the supply of various services. This actively is based on the practical work of the co-operatives members and on joint ownership of the means of production.

Another definition, also dating back to 1979 and worded in labour cooperative terms, comes from the French school of thought.

Any industrial enterprise, all activities by workshop owners, building enterprises, public works or service enterprises can be described as labour cooperatives, if they are based on the International Cooperative Alliance’s (ICA) cooperative principles. These enterprises recruit workers who elect their leaders, make joint use of the enterprise’s equipment and services and are jointly responsible for the common enterprise.

The principles contained in the above definitions can be analysed as follows.

(1) The productive cooperative is based on the ICA’s cooperative principles.
(2) The enterprise in question manufactures and sells products and supplies and sells various services.
(3) The workers are members of the cooperative and also owners and managers of the enterprises.
(4) The latter component refers to enterprises which belong to their workers.

3.2 Historical Antecedents of Productive Cooperatives

As pointed out in section 3.1, productive cooperative originated in France.

You should remember that, back in early colonial days, and later, neighbours used to help one another on many kinds of jobs – building their houses, raising the roofs of their barns, harvesting their crops, storing their crops and all kinds of things that needed many hands. These kinds of informal co-operation were part of life in the olden days, and it continues to this day in so many aspects of our lives.

Historically, when faced with limited access to institutional financing, most oppressed ethnic groups, including Nigerians, have devised ways to finance their projects from within their own groups. Often, small groups organise and pool their resources together. This is because no group can truly prosper without a strong economic base that creates jobs for its members. This led groups to build and maintain their own businesses.

A productive cooperative, that is owned and democratically controlled by its “worker-owners”, is an answer to this problem. The impact of political ideology restrains the development of productive cooperative in different countries.

3.3 The Spread of Productive Cooperatives in the Modern World

In the 19th century, a cooperative movement began to grow in Europe and the United States. Individuals banded together in economic, financial, and other ventures, sharing labour and profits.

Since the establishment of the first productive cooperative in France in the 1830s (Antoni**,** 1957), they had spread all over the world, including Nigeria. These productive cooperatives were living proof that economic success does not necessarily entail the exploitation of hired workers by their bosses. In 1848, over 300 production cooperatives were formed in France, 100 of them in Paris alone. Most of them were established at the instigation of Phillippe Buchez and Louis Blanc. (Buchez 1795 – 1865), said that workers must create production cooperatives and become self reliant, supplying the necessary capital for the cooperative members of the same cooperative which must have the same occupation and will choose managers from among themselves. Members were to receive wages according to the ability and in accordance with the norms adopted for their occupation.

At the end of every year, surpluses were to be distributed as follows, 80 percent were to be allocated to members according to the amount of labour which they have invested. The remainder was intended to increase the enterprise's capital. The capital was not to be owned by any individual, and was not to be divided up among the members. Hired workers had to become members after one year.

Most of the basic principles laid down by Buchez are still applied in many productive cooperatives today.

Louis Blanc (1812 – 1882), however, presented a different approach to the capital formation of the production cooperative, claiming that the cooperative should be financed by the state. Each member is to be paid according to his needs, while the member will contribute according to his ability. Production is to be directed and regulated by the state.

In Germany, Ferdinand Lassalle (1825 – 1864), promoted the same approach as Louis Blanc, that the state should provide finance for establishing the cooperative. But he did not believe that the state should be responsible for organising and marketing the co-operatives production.

We are confronted here with two schools of thought. One prefers a cooperative where there is an identity between the co-operatives capital and its members. The other school of thought regards the members only as those who supply labour and management but not as owners of the enterprise, since they do not supply the capital required to finance it.

From Germany, it spread to England, Poland, Mondragon, Israel and Nigeria. It is a fact that productive cooperatives exist throughout the world in a number of countries with varying degrees of success.

3.4 Examples of Productive Cooperative

The most successful productive cooperatives are Kibbutzim and Moshave Shitufim of Israel. Another example of a successful productive cooperative is the Ramgarhia Production Cooperative in India. In France, a productive cooperative that manufactured card boards was very successful.

In Nigeria, a good example is the Nigeria artisan cooperative, which is in Anambra in the eastern part of the country. It produces sculptures and woodwork. The cooperative was established after World War II, during the colonial period (Ijere**,** 1976). Every member of the cooperative works in his own home. The cooperative deals with credit, the supply of raw materials and, particularly, marketing. The price which the member

obtains for his work is determined according to the size of the sculpture, the sophistication of the work involved and the amount of work necessary to produce the finished object. The manager of the cooperative, who is responsible for sales, obtains a percentage of the sale price, instead of a salary. The cooperative, therefore, has a manager who has an interest in increasing the sale of sculptures, since he will earn more as a result, while also increasing the members' earnings.
This successful productive cooperative in Nigeria is located in Amawbia, Awka, which is on the main highway between two cities where it also markets its produce by its members who are the sculptors.

3.5 The Productive Cooperative as a Tool for Development

When we set up a productive cooperative, we begin naturally with its members.

Production in the cooperative factory is based not only on education and appropriate training programmes, but also on a proper production plan.

You can see that productive cooperative contributes to the development of any nation through the followings:

- provision of employment
- provision of goods and services
- education and training of members
- development of entrepreneurial skill; etc.

SELF-ASSESSMENT EXERCISE

List five examples of productive cooperative in Nigeria?

4.0 CONCLUSION

Unit 1 has examined the nature of productive cooperative. The productive cooperative is a possible solution for development problems of most of the third world countries, including Nigeria.

5.0 SUMMARY

In this unit, you have learnt the nature of productive cooperative. You will now move on to unit 2 to examine the characteristics of productive cooperative, which is especially distinct from service cooperatives.

6.0 TUTOR-MARKED ASSIGNMENT

1. In your own words, define productive cooperatives? What are the two schools of thought on productive cooperative?
2. Trace the historical antecedents of productive cooperatives and their spread in the modern world?

7.0 REFERENCE/FURTHER READING

Wright, D. J. (1971). *Cooperative and Community: the Theory and Practice of Producer Cooperatives*. London: Bedford Square Press.

UNIT 2 CHARACTERISTICS OF PRODUCTIVE COOPERATIVES

CONTENTS

1.0 INTRODUCTION

In unit 1, you interacted with the nature of productive cooperatives. In this unit, you are going to study the characteristics of productive cooperatives.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the characteristics of productive cooperatives
- list the main divisions of productive cooperatives
- list different types of productive cooperative
- classify productive cooperative according to activity.

3.0 MAIN CONTENT

3.1 The Main Characteristics of Production Cooperatives

Given the large number of definitions of the nature of production cooperative several researchers have attempted to outline the production cooperatives main characteristics.

For instance, Jones, D. C., describes these characteristics in the following terms.

1) The cooperative enterprise is independent
2) The cooperatives workers can become members, usually by purchasing part or all of the cooperatives capital
3) The cooperatives regulations contain provisions allowing for the direct or indirect participation of members in supervisory and managerial functions, at every level
4) Workers' employment in the enterprise confers on them the right to share in monetary proceeds after payment of expenses.
5) Application of the cooperative principle of one member, one vote, and a limited rate of interest on capital.

Another authority worth considering is Rozolio, D., who describes the cooperative economy as follows.

1. Joint ownership and labour
2. Democratic management via direct democracy
3. Equal distribution of the fruits of the members' labour
4. Quality of work and job satisfaction as an objective in its own right
5. Involvement in the surrounding community
6. Achievement of objectives over and above the cooperatives economic functioning.

Rozolio claims that as the production cooperative's members are also its owner, they are the ones to benefit from the results of its activity. The members are responsible for the cooperative enterprise, whether it succeeds or fails.

Louis, R. however, presents a different point of view, by declaring that there is no need for a member of a production cooperative to be an owner as well. Proof of this statement can be found in various types of production cooperative, especially those established in Britain during the 1970s.

Louis maintains that cooperative related legislation should allow a production cooperative to borrow money from any source, like any other economic enterprise. He equally believes that the productive cooperative should recompense its members and financiers in a normal (commercial) manner. This view by Louis is obviously opposed to traditional cooperative practice. The main argument advocated by Louis is that, it should be possible to establish a productive cooperative without "shareholders". He believes that productive cooperative should be based on equality, purely on the basis of its members' technical knowledge and vocational expertise.

Another characteristic is the possibility of the cooperatives surplus being directed to a special fund for guarantees and reserves.

3.2 Main Groups of Productive Cooperative

Zvi, Galor (1991), in his book titled "The production cooperatives- a tool for national development" introduced a completely different way of classifying production cooperatives and understanding their nature.

Cooperatives can be divided into two main groups (Galors, 1989).

(1) The first group consists of cooperatives whose members use its facilities, but do not work in it. This group includes the consumer cooperative, the saving and credit cooperative, the insurance cooperative and the housing cooperative. These cooperatives usually set no limit on the number of members and the value of their shares tends to be relatively low.

(2) The second group consists of cooperatives whose goods and services are used by the general public, and not by its members who actually work in it. This group includes cooperatives engaged in manufacturing and the provision of services, construction cooperatives and transport cooperatives.

All of these cooperatives have a relatively small number of members, while the value of their members' shares is relatively high.

3. 3 Types of Productive Cooperatives

Production cooperatives have been called by many different names. As a result, in order to provide some kind of ordered classification, the International Cooperative Alliance (ICA) decided in 1978 to adopt the following nomenclature: workers production cooperatives, industrial cooperatives, artisan cooperatives, and service cooperatives. All of these are names for what is essentially the same phenomenon. Munkner, (1979), in this context claims that all cooperatives consist of manufacturers who are united in a democratic manner in order to achieve economic, cultural and social objectives, via the organisation to which they belong. The convergence of technology and the plethora of names have led to unnecessary confusion and a lack of basic understanding of the nature of the production cooperative.

Munkner, therefore, suggests that production cooperatives be grouped into three main categories.

a) Service cooperatives

Members of these cooperatives remain independent, whether they are grouped together as enterprises or households, and make their living as self-employed manufacturing or service workers. Each member earns according to the extent of his participation in the production or the provision of a service. The cooperative supplies its members with production services and facilities at cost price, or at the lowest possible price.

b) Workers' productive cooperatives

Members of these cooperatives are joint owners of the enterprise where they work as self-employed individuals, for their own profits and at their own financial risk. Members' participation in the enterprise takes the form of capital investment, labour and decision making. Their livelihood depends on the enterprise's revenue and profit. This type of cooperatives main objective is production, although it is also involved in marketing, in order to attain the maximum price possible for the goods or services which it provides.

c) Labour contracting cooperative

This is a production cooperative in which a group of workers organises to sell their labour. The workers are not owners of any enterprise; they hire their labour and are paid for it by the cooperative, which concludes agreements with contractors and employers.

Mukner claims that the Kibbutz and the Moshav Shitufi are examples of agricultural productive cooperatives, which is s sub-category of workers' productive cooperative.

SELF-ASSESSMENT EXERCISE 1

List and explain the International Cooperative Alliances (ICA) classification of productive cooperative.

3. 4 The Different Classification of Productive Cooperatives

A notable authority on this subject, Abraham, Daniel, (1986), introduces a different classification of production cooperatives, using Pation's research conducted in 1978 as a basis, and divides them into five groups.

a) Endowed Cooperatives

In this case, private firms, whose ownership has been transferred to their workers for a variety of reasons including philanthropy, in the case of christian socialists, and pragmatic reasons, when the owners of an enterprise have no heirs.

b) Workers' Buy-Out Cooperatives

This is about private firms which have been purchased by a cooperative development authority and handed over to the workers for the purpose of establishing a cooperative.

c) Defensive Cooperatives

In this set-up, the cooperatives are established by workers whose place of employment is threatened with closure, during periods of economic recession when unemployment is high. These cooperatives naturally have to cope with many economic problems, including a low level of industrialisation, competitive inputs, poor management and lack of investment. Additional problems are a limited market for goods manufactured by a cooperative, insufficient managerial expertise and lack of capital.

d) Alternative Cooperatives

These are established by ideological minded members of the middle classes who are eager for a change. Their main features are: production directed at the achievement of social goals, a belief that the product manufactured is essential and a commitment to democratic control. Examples of these cooperatives in practice are language schools, print shops and publishing houses.

e) Job Creation Cooperatives

These are established in order to create sources of employment. Some have been established by the workers themselves, and others have been founded by philanthropic investors.

3. 5 Classification According to Areas of Activities

A survey conducted in a large number of developed countries (Moore, 1979), identified the following types of production cooperatives.

1. Processing of fruits, vegetables, fish, honey, coffee, tea, prepared foods, spices and sugar.

2. Food production marketing, bakery products, meats, preserves and soft drinks.
3. Processing of raw materials, silk, cotton, jute, rubber, tobacco, and raffia.
4. Traditional handicrafts, leather processing, ceramics and pottery, wood sculpture, weaving, carpet weaving, jewelry and metal work.
5. Light industry: furniture, textiles, sewing, embroidery, painting, shoe repairing, printing, bookbinding, farming implements, building tools.

Another important point made by the survey is that production cooperatives, based on individual production, were more common and more successful than those based on collective ownership.

3. 6 Different Types of Holding Exercised in Cooperative Enterprises

There are different types of holding exercised in cooperative enterprises, or in companies where worker ownership exists. These can be summarised as follows.

1. A company owned by its workers.
2. Direct ownership of shares by wage earning employees.
3. Indirect ownership of shares by employee trusts.
4. Additional production cooperative.
5. Firms owned by the community, as in the case of independently run enterprises in some parts of Nigeria.
6. Firms based on democratic principles.

SELF-ASSESSMENT EXERCISE 2

What are the different types of holding exercise in cooperative enterprises?

4.0 CONCLUSION

You have seen the characteristic and the different classification of productive cooperatives. Productive cooperatives have been called different names by many. That was why the ICA decided in 1978 to adopt a uniform nomenclature in order to provide some kind of ordered classification. It is hoped that ICA’s classification of productive cooperatives will help to minimise this confusion.

5.0 SUMMARY

Having looked at the various characteristics and classifications of productive cooperatives in unit 2, you are going to examine, in unit 3, the reasons for high mortality rate of productive cooperative.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the characteristics of productive cooperative.
2. List 5 classifications of productive cooperatives according to areas of activities.

7.0 REFERENCES/FURTHER READING

Abel, P. & Mahoney, N. (1981). *The Social and Economic Potential of Small-scale Industrial Productive Cooperatives in Developing Countries*. London: I.C.A., Conference 1981,pp.2-5.

Derrick, P. (1982). The Mondragon Way. *Review of International Co-Operation:* Volume 75, No 1, 1982, pp 17-24.

UNIT 3 REASONS FOR HIGH MORTALITY RATE, HIGH FAILURE RATE OF PRODUCTIVE COOPERATIVES

CONTENTS

1.0 INTRODUCTION

In units 1 and 2, you learnt the nature of productive cooperatives and the characteristics of productive cooperatives. You saw the historical antecedents of productive cooperatives. You also learnt that productive cooperatives started in France and how it spread to the modern world. Characteristics of productive cooperatives, especially as distinct from service cooperatives, were equally examined. There are unsuccessful productive cooperatives in many countries of the world, including Nigeria. Several reasons have been advanced by researchers for the high mortality rate of productive cooperatives both in the developed and developing countries.

Now, you are going to learn the reasons for high mortality and failure rate of productive cooperatives.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state reasons for the high mortality rate of productive cooperatives
- enumerate problems encountered in the establishment of productive cooperatives

- state the three main aspects of ownership of productive cooperatives
- explain the state-ownership of productive cooperative
- explain the management of productive cooperative.

3.0 MAIN CONTENT

3.1 Problems Encountered in the Establishment of Productive Cooperatives

There are many problems encountered by a group of people who wish to establish a productive cooperative.

1. The main problem is lack of capital or own resources. This is because production cooperatives have larger capital requirements than other cooperatives. Accordingly many financial risks are associated with them.
2. There is the problem of finding suitable staff to run the enterprise, and finding who will be capable of handling the complex tasks facing them.
3. There is also the problem arising from the network of relationships existing between members of the cooperative and its management. Production cooperatives have to deal with the problem of giving due expression to the principles of democracy, and the relations between members working at different levels of the organisational hierarchy and the management levels.
4. The problem encountered with those types of cooperative with members who are shareholders but who do not actually work in the cooperative. In my humble opinion, this situation should not have been allowed in the first place. But neither is the opposite situation desirable, where those working in the cooperative are not members.
5. Another problem is that of distributing earnings or surpluses to members. For instance, if a large proportion of earnings is allocated to the members, the cooperatives will be left with relatively little investment or working capital.
6. Another problem is that of a hostile community and trade unions opposing the proper development of the industrial cooperatives. This state of affairs is most commonly encountered in cooperatives which employ a large number of workers.

Note that the six problems discussed above are the outcome of the studies conducted by Derrick, P. in 1982 and published in the review of *International Cooperative* as the Mondragon Way.

SELF-ASSESSMENT EXERCISE 1

Go through sub-section 3.1 again. Look for any productive cooperative in your area and find out the problems encountered in their establishment. Do these problems resemble those compiled by Derrick, P.?

3.2 Reasons for the High Failure Rate of Productive Cooperatives

The main reasons are as follows.

1) Lack of capital is the main reason for high mortality rate of productive cooperative, Abel, (1981). Abel claims that production cooperatives suffer from under-investment. That is to say that their members are unable to raise all the capital required for the smooth operation of the cooperative. This problem is compounded by the fact that the members are not altogether willing to raise the necessary capital from their own sources, because as far as they are concerned, this capital is not liquid and, therefore, cannot be withdrawn on demand.

   Another reason cited by Abel for capital insufficiency is the low interest paid on capital. The low rate of interest (in line with the third international cooperative principle) is a disincentive to members raising capital from their own sources. As a result, production cooperatives tend to suffer from lack of investment, and most of their capital derives from outside sources.
2) Members' lack of confidence in their own abilities.
3) An unsuitable marketing apparatus and lack of commercial expertise.
4) Very poor management.
5) Almost constant lack of cooperative education and training among members.
6) Lack of technical and managerial training, among both the members as a whole and their leaders.
7) Hired labour.
8) Members undergoing a transition from ideological commitment to a calculating economic orientation, measuring everything in terms of economic success and profit and loss.
9) The tendency of production cooperatives to change from multi-purpose cooperatives to single-purpose cooperatives.
10) With respect to members' participation, there is a transition from direct to representation democracy away from equality of remuneration to inequality. The cumulative effect of all these is a

situation of internal solidarity between members to a state of conflict between management and workers.

3.3 The Three Main Aspects of Ownership of Productive Cooperatives

You may at this juncture ask; what is the optimum model for a productive cooperative as regards its ownership structure?

It is incontestable that the nature of the cooperative member's ownership is poorly understood not only by the members themselves, but also by researchers. This brings us to the question of ownership**.** Wright (1079) listed three main aspects of ownership of cooperatives as:

1) control
2) benefit, and
3) transfer.

(1) The right of control

First, let us examine the right of control. This consists of the right to use or to direct the use of the property. In a capitalist enterprise, all rights of control lie with those who have invested capital in the enterprise, and the employees have no right of control whatsoever.

But in a cooperative, the employees are the owners and also consequently have the right of control; clearly therefore, it is in the workers' interest that they have the right of control, and that they provide the capital which will give them the rights of ownership and control.

(2) The right of benefit

Benefit is the right to receive all the income derived from the use of the property. In a capitalist enterprise, the sole aim of utilising the factors of production is to create benefit and profits for those who invested their money in the enterprise.

The investors hire workers and pay them for their work. The remuneration from the enterprise for the work performed is limited, while there is no limit to the remuneration for the capital invested by the capitalist entrepreneur. The remuneration on capital takes the form of a dividend on share and a rise in the value of the shares.

However, in a cooperative enterprise, it is the workers who need to obtain the benefit (profits). This is also one of the reasons why those responsible for formulating cooperative policy, have restricted the amount of benefit, which the member may obtain from the capital he has invested in a cooperative enterprise, in order to make it distinct from a capitalist enterprise.

(3) Right of transfer

This is the owners' right to sell, rent, lease, transfer or bequeath their assets.

3.4 State Ownership

When an enterprise is under cooperative ownership, the members enjoy all three of the above-mentioned ownership rights (sub-section 3.3.). State ownership, by contrast, exists in two forms as listed below.

1) Ownership as in the now defunct "socialist" republics of the USSR.
2) Trade union ownership. In this case, the state keeps the right of transfer to itself while preserving, to some extent, the right of control and benefit to the workers, as is the case in Yugoslavia.

3.5 Management of Productive Cooperative

Some researchers outline a number of principles relating to the management of the production cooperative. These are stated below.

- Each member who works in the enterprise is also a manager. This suggests that the workers actually hire the managers. The cooperative thereby institutionalises the control of the workers over management activity.
- The management of the productive cooperative is based on democratic principles, and the delegation of authority.
- The highest authority is the members' general meeting, which delegates authority to the management committee, who are members of the cooperative. This committee in turn delegates its authority to the manager of the cooperative who is engaged in the day–to–day management activity. This system of delegating authority leads to problems, especially when the managers accumulate authority in their own right and weaken the authority of the general meeting.
- Two types of management can be identified. One is the cooperative democracy model, and the other is the autogestion (own management) model, where an enterprise is run by its workers or their appointees.

4.0 CONCLUSION

Having looked at the various reasons for high mortality rate of productive cooperatives, you have to realise that these reasons do not exist in isolation. See them as a checklist. It is not in all cases that all the reasons will occur. You must, therefore, assess whether the failure of a particular productive cooperative is as a result of a certain factor or some other factors.

5.0 SUMMARY

You now know the reasons for the high failure rate of some productive cooperatives. You are also aware that these reasons vary. If a decision is taken to establish a productive cooperative, such business decision must take note of the failure factors treated in this unit.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain the main reasons for the high mortality rate of productive cooperatives.
2. What are the three main aspects of ownership of productive cooperatives?

7.0 REFERENCES/FURTHER READING

Abel, P. & Mahoney, N. (1981). The Social and Economic Potential of Small – scale Industrial Productive Cooperatives in Developing Countries. London: I.C.A., Conference 1981, PP. 2-5.

Derrick, P. (1982). The Mondragon Way, *Review of International Co-operation.* Vol.75, No 1, 1982, PP. 17-24.

UNIT 4 SUCCESS OF SOME PRODUCTIVE COOPERATIVES

CONTENTS

1.0 INTRODUCTION

In Unit 3, you learnt the nature of productive cooperatives and you traced the historical antecedents as well as their spread in the modern world. You also learnt that there are many successful productive cooperatives in the world.

In Unit 4, you are going to learn about Kibbutz and Moshav Shitufi of Israel, together with a Nigerian artisan cooperative for wood- sculpture in Amawbia - Awka in Anambra State.

The reasons for the success of some productive cooperatives are varied. Some of the reasons are as follows.

- Presence of an open market, without competition from inputs and good marketing skills
- All of the cooperatives' supply was taken up by the local market.
- Cooperatives were labour intensive and therefore, did not require major capital investment
- A constant look out for new products and suitable sources of raw materials.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- state the first Kibbutzim
- list types of Kibbutzim
- explain the communal and economic life in Kibbutzim
- explain the Moshav Shitufi
- explain a Nigerian artisan cooperative for wood-sculpture based in Amawbia–Awka in Anambra State.

3.0 MAIN CONTENT

3.1 The First Kibbutzim of Israel

The first Kibbutz called Deganya, near the Sea of Galilee in Israel was founded in 1910. There were also two largest Kibbutz federations, HaKibbutz Hameuhad (the United Kibbutz Movement) and HaKibbutz Haartzi (the Kibbutz of the land). In 1988, a number of small movements including the agricultural collective settlements of the religious HaKibbutz Hadati, affiliated with the labour wing of the national religious party. In 1986, there were 125, 700 residents of about 265 Kibbutzim, divided among five Kibbutz federations.

The Kibbutz is a collective settlement originally devoted solely to agriculture, but since the late 1960s, it has included industrial concerns, too. Founded by social democrats, Kibbutzim are characterised by the collectivisation of labour and capital: the means of production, consumption and control, with considerable emphasis on participatory democracy in the operation of Kibbutzim. Education and, in some federations, the rearing of children in age-graded dormitories, are communal as well.

3.2 The Communal and Economics Life in Kibbutzim

a) The communal life

The principle of equality was taken extremely seriously up until the 1970s. Kibbutzniks did not individually own tools, or even clothing. Gifts and income received from outside were turned over to the common treasury. If a member received a gift in service- like a visit to a relative who was a dentist or a trip abroad paid for by a parent- there could be arguments at members' meetings about the propriety of accepting such a gift.

In the 1920s Kibbutzim began a practice of raising children communally away from their parents in special communities called “children’s societies” (Mossad Hinuchi).

Social lives were held in common, not only property. As an example, most dining halls exclusively used benches, not as an issue of cost or convenience, but because benches were construed as another way of expressing communal values.
In Kibbutzim, women performed the same role as men, including armed guard.

b) The Kibbutzim’s economics

Kibbutzim in the early days tried to be self-sufficient in all agricultural goods, from eggs to dairy to fruits to meats. However, through experimentation, Kibbutzniks discovered that self-sufficiency was impossible. Kibbutzniks were also not self-sufficient when it comes to capital investment. At the founding of a Kibbutz, when it would be opened on land owned by the Jewish national fund: for expansion, most Kibbutzim were dependent on subsidies from charity or the state of Israel. Most of the subsidies took the form of low-interest loans or discounted water. In Israel, when interest rates were running over 30 percent until the 1990s and where water is expensive, these gifts came to a very great amount indeed.

Even prior to the establishment of the state of Israel, Kibbutzim had begun to branch out from agriculture into manufacturing. Kibbutz Degania, for instance, set up a factory to fabricate diamond cutting tools; it now grosses several million dollars a year.

Kibbutzim industrialised at a time when agricultural jobs were not enough to absorb everyone on the Kibbutz. Kibbutzim also industrialised due to pressure from the state of Israel. Throughout the 1950s and 1960s, Israel had one of the world’s highest trade deficits, the state was desperate to increase exports and Kibbutzims were asked to play a role.

As Kibbutzim branched out into manufacturing in the 1960s, they are branching out into tourism and services today. Kibbutz Hatzerim even has a law firm, as well as Nahsholim. Virtually every Kibbutz has guest rooms for rent. Some of these rooms are intended for traveling students, but Kiryat Anavim has a luxury hotel. Several Kibbutzim, such as Kibbutz Lotan and Kfar Ruppin, operate bird-watching vacations. They say that a European visitor can see more birds in one week in Israel than he or she would in a year at home. It is not lost on the modern Kibbutz movement that Kibbutzniks today are working in occupations which the first Kibbutz generation condemned.

Many Kibbutzim aggressively put money into building new enterprises even playing the stock market. This borrowing spree caught up to the Kibbutz movement in the 1980s, forcing Kibbutzim to retreat from collective ideas. Today, most Kibbutzim are at the economic break-even point, a dozen or so are very healthy, and several score lose money. Many people who live on Kibbutzim have to work outside the Kibbutz. They are expected to return a percentage of their earnings to the collective.

3.3 Types of Kibbutzim

The Kibbutzim have three different movements.

1) The joint movement, aka the "Kibbutz Movement", which constitutes as a roof-organisation of two separate movements, and ideologies: the "United Kibbutz Movement" founded in 1979 as a merger of two older movements: "The United Kibbutz" and "Union of the Kivutzot and the Kibbutzim", and "Kibbutz Artzi Hashomer Hatzair"
2) "Religions Kibbutz movement Hapoel Hamizrachi".
3) "Agudat Israel Workers"

We wish to point out that, more than 80 percent of the total number of Kibbutzim belongs to the Kibbutz movement.

Following many changes which the Kibbutzim over went through the years and following the appeal made to Israel High Court by the Mizrahi Democratic Rainbow Coalition in 2001 in which the state was required to redefine the exact definition of a Kibbutz in order to define the rightful benefit which the Kibbutzim members should be granted by law. The reactivated legal definition was given to the industry, trade and labour minister of Israel on December15th, 2005. According to this classification there are three types of Kibbutzim.

1) **Kibbutz Shitufi:** a Kibbutz which still preserves a cooperative system.
2) **Kibbutz Mitchadesh:** a community which has a number of cooperative systems in its intentions (guaranteed minimal income within the coming partnership in the ownership of the production means, partnership in the ownership of the lands, etc).
3) **Urban Kibbutz:** a community which exists within an existing settlement (city). Since the 1970s, about 100 urban Kibbutzim have been founded within existing Israeli cities. They have no

enterprises of their own and all of their members work in the non-Kibbutz sector. Examples include Tamuz in Jerusalem or Migvan in Sderot.

SELF-ASSESSMENT EXERCISE 1

Look around you and mention any cooperative activity that resembles the Kibbutzim.

3.4 The Moshav Shitufi of Israel

The first Moshav was established in Jezreel Valley (Emeq Yizreel is also seen as the valley of Esdraelon in England) in 1921. In 1986, about 156,700 Israelis lived and worked on 448 Moshavim, the great majority divided among eight federations. There are two types of Moshavim, the more numerous (405) Moshavim Ovdim, and the Moshavim Shitufim. The former relies on cooperative purchasing of supplies and marketing of produce; the family or household is, however, the basic unit of production and consumption. The Moshav Shitufi form is closer to the collectivity of the Kibbutz although consumption is family-or household-based, production and marketing are collective. Unlike the Moshavin Ovdim land is not allotted to household, or individuals, but is collectively worked.

Because the Moshav form retained the family as the center of social life and eschewed bold experiments with communal child-rearing or equality of the sexes, it was much more attractive to traditional oriental immigrants in the 1950s and early 1960s than was the more communally radical Kibbutz. For this reason, the Kibbutz has remained basically an Ashkenazi institution, whereas the Moshav has not. In the country, the so-called immigrants' Moshav (Moshav Olim) was one of the most-used and successful form of absorption and integration of oriental immigrants, and it allowed them a much steadier ascent into the middle class than those who live in some developed towns.

Like the Kibbutzim, Moshavim, since 1967, have relied increasingly on outside-particularly Arab-labour. Financial instabilities in the early 1980s have hit many Moshavim hard, as has the problem of absorbing all the children who might wish to remain in the community. By the late 1980s, more and more Moshav members were employed in non-agricultural sectors outside the community, so that some Moshavim were coming to resemble suburban villages whose residents commute to work. In general, Moshavim never enjoyed the elite status accorded to Kibbutzim; correspondingly they have not suffered a decline in prestige in the 1970s and 1980s.

3.5 A Nigerian Artisan Cooperative

In the third world countries like Nigeria, there are a number of success stories of productive cooperatives.

You know that in Nigeria, there is a story of cooperative for wood-sculpture in Amawbia-Awka, in Anambra State. The cooperative was founded as far back as the colonial period. It is to be found on the main highway between two distinct cities where it also markets its produce by its members who are the sculptors.

This Nigerian Artisan Cooperative, is in the Eastern part of the country and produces sculptures and woodwork. The cooperative was established after World War II, during the colonial period.

Every member of the cooperative deals with credit, the supply of raw materials and, particularly, marketing. The price which the member obtains for his work is determined according to the size of the sculpture, the sophistication of the work involved and the amount of work necessary to produce the finished object. The manager of the cooperative, who is responsible for sales, obtains a percentage of the sale price, instead of a salary. The cooperative, therefore, has a manager who has an interest in increasing the sale of sculptures, since he will earn more as a result, while also increased the members' earnings.

4.0 CONCLUSION

This unit addresses the success of some productive cooperatives such as the Kibbutzim and Moshav Shitufi of Israel as well as a Nigerian cooperative for wood-sculptures in Anambra state. There is need to establish more productive cooperatives in Nigeria.

You have learnt and identified the various types of Kibbutzim Cooperative including the discussion on communal and economic life in the Kibbutzim. You also saw the Moshav Shitufi and its various types. A local flavour was added to the success story of the productive cooperatives, that is, a cooperative for wood sculpture in Anambra state.

5.0 SUMMARY

In this unit, you have learnt of the success stories of productive cooperatives and the examples of such success stories were examined. You are moving to the next unit which is the concept of mergers.

6.0 TUTOR-MARKED ASSIGNMENT

1. Give reasons for the success of some productive cooperatives.
2. Give reasons why Moshav Shitufi of Israel was preferred to the Kibbutzim by the oriental immigrants to Israel.

7.0 REFERENCES/FURTHER READING

Wikipedia. (2009). *Kibbutz.* Retrieved August 21, 2009 from http://en.wikipedia.org/wiki/Kibbutz .

UNIT 5 CONCEPT OF MERGERS

CONTENTS

1.0 INTRODUCTION

In this unit, you will learn the concept of mergers, as well as the differences between the various types of mergers, such as amalgamation, take–over, transfer and acquisition. In this unit, you will be examining the legal provision of cooperative mergers, the need for mergers in cooperatives and the problems associated with mergers in cooperatives.
The term mergers refer to the aspect of corporate strategy, corporate finance and management dealing with the buying, selling and combining of different companies that can aid finance, or help a company in a given industry grow rapidly without having to create another business entity.

In business or economics, the term merger refers to a combination of two companies into one larger company. Such actions are commonly voluntary and may involve stock swap or cash payment to the target.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain the concept of mergers
- differentiate between the various types of mergers
- list examples of local firms that have merged
- list reasons for mergers
- outline the disadvantages of mergers.

3.0 MAIN CONTENT

3.1 Types of Mergers

There are two groups of mergers that are distinguished by how the merger is financed. Each has certain implications for the companies involved.

(a) Purchase mergers

As the name suggests, this kind of merger occurs when one company purchases another. The purchase is made with either cash or through the issue of some kind of debt instrument.

Most acquiring companies often prefer this type of merger because it can provide them with a tax benefit. This is possible because acquired assets can be written-off to the actual purchase price, and the difference between the book value and the purchase price of the assets can depreciate annually, reducing taxes payable by the acquiring company.

(b) Consolidation mergers

With this merger, a brand new company is formed and both companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger.

You are now going to learn and differentiate between the various types of mergers. They are as follows.

3.1.1 Amalgamation

In the pure sense of the term, amalgamation happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned and operated. This kind of action is more precisely referred to as a "merger of equals". Both companies stocks are surrendered and new company stock is issued in its place. For example, in the 1999 merger of Glaxo Wellcome and Smithkline Beecham**,** both firms ceased to exist when they merged, and a new company, GlaxoSmithkline, was created.

3.1.2 Takeover

This is similar to acquisition and it is the buying of one company (the target) by another.

3.1.3 Transfer

This is common where the management of a company may be transferred to another entity for better management and profitability.

3.1.4 Acquisition

An acquisition, also known as a takeover or a buyout, is buying of one company (the target) by another. We should note that, an acquisition may be friendly or hostile. In the former case, the companies involved co-operate in negotiations while in the latter case, the takeover target is unwilling to be bought or the target's board has no prior knowledge of the offer.

Acquisition usually refers to a purchase of smaller firm by a larger one. Sometimes, however, a smaller firm will acquire management control of a larger or longer established company and keep its name for the combined entity. This is known as reversed takeover. Another type of acquisition is reverse merger- a deal that enables a private company to get publicly listed in a short term period.

SELF-ASSESSMENT EXERCISE 1

Look around and name three companies that have merged with others.

3.2 Classification of Mergers

Mergers can be classified as

(i) Horizontal mergers

This occur when two companies that are in direct competition and share similar product line markets decide to merge

(ii) Vertical mergers

A customer and the company or a supplier and the company may merge. You can here think of a newsprint supplier merging with a publishing house.

(iii) Market-extension mergers

In this instance, two companies that sell the same products at different markets may merge.

(iv) Product-extension mergers

This is when two companies selling different but related products in the same market may consider it profitable to come together.

(v) Conglomeration

Two companies that have no common business areas may decide to merge.

3.3 Motives behind Mergers

We may now at this juncture, ask why do businesses hitherto operating separately will decide to merge. In other words what are the motives behind mergers? We will then discover that, the dominant reason used to explain mergers' activity is that, acquiring firms seek improved financial performance. The following motives are considered to improve financial performance.

a) Economies of scale. This is possible because the combined (merged) companies reduce fixed costs by removing duplicated departments or operations, lowered costs of the company relative to the same revenue stream, thus increasing profit margins.
b) Increased revenue or market share.
c) Cross selling**,** for example, a bank buying a stock broker could then sell its banking product to the stock brokers' customers
d) Synergy. For example, managerial economies, purchasing economies, etc. are the likely benefits from mergers.
e) Taxation. As pointed out in sub-section 3.1 (a), most acquiring companies preferred mergers because it can provide them with a tax benefit (relief).
f) Geographical or other diversification**.** A company operating in the south of Nigeria, say, Lagos may consider it profitable to merge with a similar one up north, say Kano.
g) Resource transfer.
h) Vertical integration.
i) Diversification, etc.

3.4 Are there Distinctions between Mergers and Acquisition?

Since acquisition is part of mergers, does it make sense to distinguish between the two? Curiously, there are several literatures on this topic that made such distinctions.

Although they are often uttered in the same breath and used as though they were synonymous, the terms merger and acquisition mean slightly different things.

When one company takes over another and clearly established itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist; the buyer "swallows" the business and the buyer's stock continuous to be traded.

A merger in its pure sense happens when two firms, often of about the same size, agree to go forward as a single new company rather than remain separately owned. This is termed "merger of equals".

In practice, however, actual mergers of equals do not happen very often. The reality is that, one company will buy another and, as part of the deal terms, simply allow the acquired firm to proclaim that the action is a merger of equals, even if it is technically an acquisition.

Being bought out often carries negative connotations, therefore, by describing the deal euphemistically as a merger, deal makers and top managers try to make the takeover more palatable. An example of this would be the takeover of Chrysler by Daimler–Benz in 1999 which was widely referred to in that time, and is still now, as a merger of the two companies.

A purchase deal will also be called a merger when both chief executive officers agreed that joining together is in the best interest of both their companies. But when the deal is unfriendly, that is, when the target company does not want to be purchased- it is always regarded as an acquisition.

You can now see that, whether a purchase is considered a merger or an acquisition really depends on whether the purchase is friendly or hostile and how it is announced. In other words, the real difference lies in how the purchase is communicated to and received by the target company's board of directors, employees and shareholders.

3.5 Disadvantages of Mergers

Sadly, the completion of a merger does not ensure the success of the resulting organisation. Indeed, studies show that many mergers (in some industries, the majority) result in net loss of value due to problems such as:

- incompatibility (technology, equipment and corporate culture)
- diversion of resources away from new investment

- inadequate research
- concealment of losses or liabilities by one of the partners before merging
- overlapping subsidiaries
- redundant staff
- losing expertise
- disrupting employee culture

SELF-ASSESSMENT EXERCISE 2

List the disadvantages of merger.

4.0 CONCLUSION

In this unit, you have learnt the concept of mergers and the differences between the various types of mergers such as amalgamation, take–over, transfer and acquisition.

You were also able to identify several motives behind mergers and the problems resulting from mergers.

5.0 SUMMARY

In this unit, the concept of mergers had been explained to you. The various types of mergers, as well as the disadvantages of mergers, had also been described to you vividly. You are now moving to the next unit which is about the legal provision on cooperative mergers.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the motives behind the 1999 merging of Glaxo Wellcome and Smithkline Beecham, which led to a new company called GlaxoSmithkline?
2. List and explain the disadvantages of mergers.

7.0 REFERENCES/FURTHER READING

King, D. R.; Slotegraaf, & Kesner, R. I. (2008). Performance Implications of Firm Resource Interactions in the Acquisition of R&D. *Intensive Firms Organisation Science* 327-340.

UNIT 6 LEGAL PROVISION ON COOPERATIVE MERGERS, THE NEED FOR MERGERS IN COOPERATIVE AND PROBLEMS ASSOCIATED WITH MERGERS IN COOPERATIVE

CONTENTS

1.0 INTRODUCTION

In unit 5, you learnt the concept of mergers and how to differentiate between the various types of mergers like amalgamation, take–over, transfer and acquisition.

In this unit, which incidentally is the last unit of module 2 and the entire course, you will examine the legal provision on cooperative. mergers, the need for mergers as well as the problems associated with mergers in cooperatives.

You should note that the legal framework for non-governmental organisations (NGOs) in Nigeria is defined by provisions of the Constitution of the Federal Republic of Nigeria 1999 as well as federal and state laws. Prominent among the federal enactments are Companies and Allied Matters Act 1990 whose part C has repealed the Lands (perpetual succession) Act (1924) and Companies Income Tax Act 1961. These are general enactments. Specific laws also exist to regulate specialised organisations such as trade unions, cooperative societies and political parties. Apart from enforcing laws that recognise and regulate these organisations, government departments in some instances, require NGOs to register with them for the purpose of collaborating with or working for such departments in some programme areas.

It is in the light of the above that cooperatives are governed and amenable to cooperative laws of a local government or state government in which they are located. You should also bear in mind that cooperatives are limited by guarantee not by shares as in the case with limited liability companies.

2.0 OBJECTIVES

At the end of this unit, you should be able to:

- explain how a cooperative is formed
- explain the legal provision on cooperative mergers
- deduce reasons for mergers in cooperatives
- describe the problems associated with mergers in cooperatives.

3.0 MAIN CONTENT

3.1 Cooperative Formation

In their publication titled "*Principles and Economics of Cooperative*"**,** Enikanselu, S. A. and others, gave basic guidelines which the promoters must observe. Among these guidelines are the following.

- The minimum number of persons that can form a primary cooperative is 10 while that of an industrial cooperative society is 6.
- As for a new society, all the promoters or foundation members must have agreed to form the society. In the case of an on-going cooperative society, any person that is interested in joining the society must apply for a membership form, fill it and be recommended by an older member of the society.
- Any cooperative can be organised along a particular economic interest like cocoa producers cooperative society. This implies that only cocoa producers can be members of the society. However, in the case of consumer cooperative society, any member of the community can be a member subject to his admission to be a member and observing all the bylaws of the society.
- There is a possibility for the establishment of a single or a multi-purpose cooperative.
- Lastly, the formation of cooperatives has legal basis. For instance, in Nigeria, the instrument for the formation of a legally constituted cooperative society is the Cooperative Ordinance of 1935 along with the subsequent amendments.

3.1.1 Provisions of the Cooperative Ordinance of 1935

According to Enikanselu, and others, the law spells the requirements, which the cooperatives must meet. Among these requirements are the followings.

i) The societies that can be registered are only those which have the object of promoting the economic interests of members in accordance with the bylaws of such a society with or without limited liability as the director may decide.
ii) No farmer primary society that does not have up to 10 individual members shall be registered. The minimum for industrial cooperative is 6 members.
iii) A society that is registered shall be a body corporate having its own name. The name will be the one in which it is registered. It shall enjoy all the powers and privileges of all corporate bodies. That is, it can own movable and immovable properties; it can sue and be sued. It can award and be awarded contracts, etc,
iv) A primary cooperative society can decide to form a union with another cooperative society so as to protect the interest of the unionising cooperatives. Such unions of cooperative societies are referred to as secondary cooperative societies.
v) The minimum member of secondary society is two registered societies.

3.2 Steps in the Formation of Cooperative Societies

Enikanselu and others listed steps in the formation of cooperative societies. These are as follows.

1) The existence of a problem- this problem must be clear and the aims must be well conceived and humanly realisable.
2) There must be an inaugural meeting in which the agenda should be as listed.

i. Cooperative education to be given to potential cooperators by a cooperative officer.
ii. Passing a motion by the potential cooperators that they want to form a cooperative society
iii. Entrance fees should be determined and paid in addition to minimum share capital, thrift savings and other dues.
iv. The type of business they want to pursue must be stated.
v. The management committee to run the affairs should be elected.
vi. Adoption of the proposed name of the cooperative and business address.

vii) They should discuss about the type of persons they want to bring into the society

viii) They should select a survey committee to determine the economic feasibility of the project.

3) The preliminary report should be submitted to the director of cooperative services by a cooperative officer in the state in which the business will be located.
4) A formal application should be given to the director of cooperatives to permit the association to use the word cooperative tentatively before the society is legally registered.
5) It is imperative that a monthly managerial/inspection report be submitted to the director of cooperative, since the organisation would be closely monitored and inspected for upward of six months after the inaugural meeting till the date of the formal application for registration.
6) It is after this that the cooperative can now apply for formal registration of the society. The application must be followed by a feasibility study of its projects.
7) Finally, the proposals contained in the feasibility report should be implanted to make its registration purposeful.

SELF-ASSESSMENT EXERCISE 1

Find out from any cooperative within your area the steps it took before it was finally registered.

3.3 Legal Provision on Cooperative Mergers

You should recall that in the previous unit, you examined the concept of mergers. We need not repeat the meaning of merger here. Rather, you are going to learn about the legal provision on cooperative mergers.

Many types of organisations are allowed under Nigerian law. These include community based organisations (CBOs), non-government organisations (NGOs) and cooperative societies. Under the Companies and Allied Matters Act (CAMA) 1990, companies are recognised by law as juridical entities. “Companies” in this sense include trading companies usually limited by shares, and not-for-profit organisations which choose to and are incorporated as companies limited by guarantee. Remember that cooperative societies are limited by guarantee, that is, to the amount members subscribed to at the time of incorporation. In contrast, limited companies are limited by shares.

3.3.1 Mergers and Split-ups

There is no specific statutory provision regulating mergers and split-ups of cooperatives. But it appears that if the members of a society decide to pursue a merger or split up, they can indeed creatively utilise the existing provisions. In respect of a society which incorporation is limited by guarantee, the members can, with a merger or split-up in view, vote to dissolve the organisation on the ground that ("it is just and equitable in all the circumstances") to do so. This is a section in CAMA 1990 which is applicable to mergers and split-ups.

The members can then (as allowed by s. 691(4) of CAMA 1990 vote to transfer the property, or an agreed part of the property, of the organisation to the new organisation-which must obtain a fresh incorporation- representing a fusion or merger of two or more former societies (organisations). The same process can be used to facilitate a split-up. What is clear, however, is that the existing law does not contemplate the phenomenon of cooperative mergers and split-ups.

3.4 The Need for Mergers in Cooperative

We may ask at this juncture, why should cooperatives contemplate merging together? The following are the reasons why cooperatives seek mergers.

1) To seek improved financial performance.
2) To benefit from economies of scale. This is because combined cooperatives reducefixed costs by removing duplicate departments or operations, lowering the costs of the society relative to the same revenue stream, thus increasing profit (surplus) margins.
3) Increased revenue or market share.
4) Crossed selling-e.g. a saving and thrift society buying a farmers' cooperative could then sell its saving products to the farmers
5) There could be synergy such as managerial economies, purchasing economies, etc.
6) Geographical or other diversification.
7) Resource transfer between the two merging cooperatives.

SELF-ASSESSMENT EXERCISE 2

Look around you and find out if cooperatives have merged. Find out the reasons behind their merger.

3.5 Problems Associated with Mergers in Cooperatives

Remember that a merger happens when two cooperatives often of the same size, agree to go forward as a single new society rather than remain separately owned and operated. You should note that this kind of action is more precisely referred to as a “merger of equals”. In practice however, actual mergers of equals do not happen very often. Usually, one society will buy another and, as part of the terms, simply allow the acquired cooperative to proclaim that the action is a merger of equals, even if it is technically an acquisition.

Being bought out often carries negative connotations, therefore, by describing the deal euphemistically as a merger, deal makers and managers of the merging cooperatives try to make the takeover more palatable. Merging of cooperatives, therefore, have some disadvantages (problems associated with mergers). Some of these problems are as follows.

1. The completion of a merger does not ensure the success of the resulting cooperative.
2. It could lead to net loss of value, due to problems.
3. There is problem of incompatibility- whether of technology, equipment, or corporate culture.
4. It diverts resources away from new investment in trying to correct the problem at number 3 above.
5. The problems may be exacerbated by inadequate research or by concealment of losses or liabilities by one of the partners (i.e. one of the merging cooperatives may not give full disclosures of its activities).
6. Overlapping subsidiaries or redundant staff may be allowed to continue, creating inefficiency.
7. Conversely, the new management may cut too many operations or personnel, losing expertise and disrupting employees.

4.0 CONCLUSION

In this unit, you had learnt the legal provision on cooperative mergers and the problems associated with them. For the merger not to be considered a failure, the merging cooperatives must give full disclosures of all their activities, including assets and liabilities. You have been exposed to the various legal provisions on cooperative mergers.

5.0 SUMMARY

In this last unit, the legal provision on cooperative mergers had been fully explained to you. You have now completed the last unit of COP 213 which is Cooperative Economics II.

6.0 TUTOR-MARKED ASSIGNMENT

1. Which sections of the Companies and Allied Matters Act (CAMA) 1990 are applicable to mergers and split-ups of cooperative societies?
2. List seven problems associated with mergers in cooperatives.

7.0 REFERENCES/FURTHER READING

Companies and Allied Matters Act (*CAMA)* 1990.

Constitution of the Federal Republic of Nigeria 1999.

Enikanselu, S. A.; et al. (2005). *Principles and Economics of Cooperative*. Lagos: Dart Trade Limited.