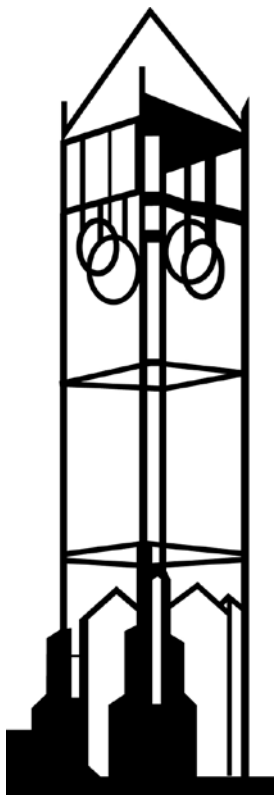


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Cooperatives: A Competitive Yardstick for Health Care

Mark A. Edelman and John R. Dunn *

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As the national debate over health care reform continues, consideration is increasingly being given to the use of consumer-focused health care cooperatives as a key strategy for providing access to affordable health care and insurance for the millions of consumers and small businesses not presently able to afford or obtain adequate health care. Historically in many other sectors, the cooperative form of business has been successfully adapted by farmers, consumers, businesses, and public bodies as an effective strategy for attaining scale, lowering costs, improving incomes, providing services, and creating a better functioning marketplace. Reasons for forming cooperatives and analysis of cooperative movements can typically be traced to presence of a market failure (Schrader). Thus, as this nation seeks to remedy the plight of millions of uninsured urban and rural residents, cooperative models are properly on the table.

Differences between Cooperatives and Other Firms

It is the cooperative's unique relationship with its customers...its members... that defines what a cooperative is and why the cooperative operates to serve the interests of its members. Cooperatives are businesses that are owned and controlled by their members for the sole purpose of producing benefits for their members. In contrast to investor-oriented-firms that typically have voting schemes based in proportion to investor ownership shares, cooperatives use a principle of one member-one vote. Therefore a few large investors cannot deliver a voting majority when a proposition is at odds with the interests of a majority of all members (customers). So in the final analysis, the benefits of cooperatives--including the returns to ownership--are received by the cooperative's members (customers) based on the nature of their use of the cooperatives.

This direct alignment with the interest and needs of its customers affects not only the way the cooperative operates as a business, but can also have impact on the conduct and performance of non-cooperative firms in the marketplace. In short, cooperative presence in a market place can help to assure that consumer needs are met with a more competitive marketplace. This theory of the cooperative firm is known within the academic community as the "competitive yardstick" characteristic of cooperatives. First identified by E.G Nourse in the 1920's this theory posits that the transparency and alignment of the cooperative's operations to its members interests means that cooperative members have a rational basis for understanding whether or not the deals they are being offered by non-cooperative firms are fair and reasonable. The cooperatives' offerings present a standard or yardstick by which all firms' offerings can be compared. This has direct effect on how all firms in a given industry establish the prices and terms they offer customers, driving the performance in that industry to a more competitive outcome.

To skeptics in the health care debate, this theory sounds good, but, they ask, where is the proof? The limited role, to date, of cooperatives in the health sector provides little evidence one way or the other.

However the impact of cooperatives on the performance of a marketplace does not grow out of the characteristics of the given market, but rather from the characteristics of the cooperative form of business, its participation in the market, and its focus on the needs of the member consumers. Thus, the best evidence of the competitive yardstick effect of cooperatives is seen in other industries and sectors where cooperatives have developed a more significant presence. This evidence takes the form of both rigorous academic research and well documented anecdotal materials on the market failures that were present at the time in which the cooperative movement occurred for each respective industry sector or marketplace.

A Synopsis of Three Studies and Anecdotal Contexts

Food and Agriculture. In a study published in 1994, Rogers and Petraglia examined how the presence of cooperatives in 134 distinct segments of the food industry has a direct effect on the performance outcomes and competitiveness within an industry. They found that when cooperatives had significant presence in an industry, the industry-wide margins between costs and prices were reduced, indicating industry performance more consistent with a competitive market outcome. Because of cooperative's presence, the ability of firms in an industry to extract extra-normal or monopoly profits was reduced. This study provides direct empirical support for the competitive yardstick theory.

Anecdotally, the food cooperative movement occurred during this time in part because many like-minded consumers desired natural, organic foods, or local foods that were not being offered by the major commercial food store chains of the day. Today, the natural, organic and local food industry has continued to grow and commercial grocery chains have also increased availability of these products.

Banking. The competitive performance of the banking industry is clearly impacted by the presence of cooperatives. Credit unions, which provide banking services to millions of Americans, have been shown to have a direct benefit impact on the rates consumers pay for personal loans. A 1999 study by Robert Feinberg of American University examined the competitive effects of cooperatives presence or potential presence in 101 local banking markets in 33 metropolitan areas and 49 non-metropolitan areas provided clear empirical evidence that personal loan rates charged by banks decrease as the combined market share of credit unions rise. Further, rates charged to consumers by banks showed decreases with the possibility of future expansion in credit union market share, an effect even more pronounced in local markets with a high level of concentration in the for-profit banking sector.

Anecdotally, credit unions have recently emerged in underserved metropolitan neighborhoods that have experienced redlining by other commercial lending institutions. In one example, a traditional banking institution even formed a credit union to deploy a strategy for reducing risk in serving blighted areas while promoting local investment, entrepreneurial activity, and local ownership.

Anhydrous Ammonia. A 1981 study by the Federal Trade Commission points to a very specific instance that demonstrates how cooperatives' presence in the marketplace aligns market performance with cooperative members' economic interests. Disruptions in the world anhydrous ammonia industry led to a dramatic run up in the price of nitrogen fertilizer between 1973 and 1975. Typically, unstable price conditions that occurred at that time created tremendous incentives and opportunities for firms to price

gouge and otherwise enrich themselves at the expense of buyers. However, cooperatives, which held a 28 percent market share in U.S. nitrogen industry at the time, made an explicit decision to hold prices stable to protect their members. The result was, according to the FTC study, a saving of \$198 million to farmers. Study author Robert F. Liebenluft concluded that “the existence of this (cooperative) alternative in the marketplace is likely to discourage anticompetitive practices (p. 44).

This finding in fact underscores the rationale that spawned the last major agricultural cooperative movement in the U.S. during the early part of the 20 Century. Following the end of WWI, the rural conditions present during a decade long agricultural depression in the 1920s contributed to creating a coop movement that resulted in a doubling of agricultural marketing cooperatives to a peak of 12,000 by 1930. Farmers had trouble sourcing supplies for a “fair” price and marketing their commodities for a “fair” price. According to agricultural historians, the cooperative movement resulted from the presence of economic conditions in which farmers were unable to access critical supplies and markets through existing business concerns at competitive prices. Thus, local farmers worked together by pooling their capital to form coops and they received complementary support from national organizations and public policy (Ingalsbe and Groves).

Concluding Observations

Cooperatives tend to flourish in underserved markets that are sometimes avoided by investor oriented firms because the model represents an approach for potential members to pool resources and share risks to address the needs of the underserved market. The studies reviewed indicate that cooperative movements have developed in metro and nonmetropolitan areas when underserved markets are present.

In health care and insurance, one might envision the cooperative model could potentially be applied on a smaller scale in various communities and neighborhoods, on a larger regional scale, or on a multi-level basis. For example, preventative health increasingly appears to be related to community culture, individual motivation, nutrition, quality of food available in the local trade area, and opportunities for physical exercise and recreation. To the extent that market failures and cost effective remedies exist in local community or neighborhood markets, locally-owned community-based cooperatives might provide an effective model for deploying incentives and monitoring for preventative health strategies. Cooperative principles have traditionally stressed addressing community needs, sustaining culture, and education of coop members. In contrast, formation of larger regional cooperatives provides an opportunity for balancing health risks across larger pools, serving specialized health needs, and achieving economies of scale across larger geographic areas. Multi-level cooperative systems have also been designed, sometimes with direct members as well as indirect membership through local cooperatives. Decision-making at each level is driven by the interests of the respective member interests. As a result, an opportunity develops for creating competitive yardsticks in multiple levels of the marketplace.

If consumers could describe what they really want to see from their health care and insurance providers, access, affordability, reliability, user-friendliness, and competitiveness would likely be high on the list.

Cooperative members would likely expect and insist upon their cooperatives meeting these standards. In doing so, cooperatives would create a visible and transparent yardstick by which all consumers could see what is possible and how that compares to the rest of the industry. If the history in other sectors is a guide, cooperatives could move individual communities and the entire industry to become more responsive to consumers' needs as well.

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