ROYAL COMMISSION ON FARM MACHINERY

THE PRAIRIE FARM MACHINERY CO-OPERATIVE

Rubin Simkin

Study No 5

ROYAL COMMISSION ON FARM MACHINERY

THE PRAIRIE FARM MACHINERY CO-OPERATIVE:

"THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED"

By

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While this study was prepared independently for the Royal Commission on Farm Machinery and is being published under its auspices, the views expressed herein are those of the author and not necessarily those of the Commissioner.

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CONTENTS

1. INTRODUCTION

General Comments on Co-operatives

Initially, a significant portion of the co-operative movement, especially in Britain and to a lesser extent in Canada, consisted of persons who were opposed to capitalism. Anti-capitalist attitudes were expressed in such statements as "Production for use, not for profit", "Self-help and democracy", and "Masters of their own destiny". In short, the co-operative movement was concerned with building a better society. Many co-operators were interested in "the good society", and the co-operative enterprise was the main economic instrument of those who abhorred excessive emphasis on materialism and acquisitiveness to the exclusion of other human needs and aspirations. At one extreme there were co-operators who regarded the co-operative enterprise as a means of transforming society from a capitalist to a socialist economy. This position was held by E.A. Partridge, the man who played the most important single role in the organization of grain co-operatives in Western Canada.

> Cooperation provided a temporary remedy for existing abuses of the grain trade. It would provide out of its revenues a great educational fund which would finance a newspaper and a campaign which would culminate in the domination of the legislatures by the common man, and in the introduction of state ownership of public utilities and natural resources. Then would come true cooperation based on the ethics of Ruskin. The above is a slightly paraphrased summary of opinions expressed by Mr. Partridge in a personal interview with the writer.1/

> Cooperation was for him [E.A. Partridge] not an alternative but a stepping stone to government ownership.2/

1/ W.A. Mackintosh, Agricultural Cooperation in Western Canada, Toronto: The Ryerson Press, Queen's University, p. 34.

2/ Ibid., p. 34.

2 THE PRAIRIE FARM MACHINERY CO-OPERATIVE

A similar concern with the development of "the good society" is found in Mr. M.M. Coady's *Masters of Their Own Destiny*. The sub-title of the study clearly indicates his basic approach: "the story of the Antigonish movement of Adult Education through Economic Cooperation".

> The adult education movement described here involves the creation of economic institutions cooperatively owned. And that involves opposition, active opposition from the vested interests, passive resistance from the masses. The advocates of political democracy were and are faced with the same antagonism. Kings were not anxious to strengthen lords and nobles. Lords and nobles had no desire to grant a franchise to the masses of men. The masses in turn were slow to demand it and even slower to use it effectively. The fact is that they could not and cannot use what they never really possessed. Vested interests have merely displaced invested lords and nobles. We, the people, have the ball and chain removed from one foot only. And the dictators laugh while we hobble along in an unequal race, handicapped by their friends who live in our own camp - our own dictators, our men of money. And if we lag, democracy gets the blame...3/

> This enlightenment and education must take place on all fronts at the same time and over a wide area to achieve the best results. It must also be of a two-fold nature. It must apply to the whole man, body and soul. And insofar as it is possible to consider one phase of man to the exclusion of others, the economic side must be given first consideration. That is why we prescribe first of all cooperative education or education in the principles and techniques of economic group action. It is not all but it is the beginning.4/

The purpose of the Antigonish movement was always more than material. Like the idealists who saw the new Jerusalem in the 19th century extension of the franchise and education to all men, the co-operators saw men raising themselves spiritually while they were improving their physical lot.

> The kind of education just outlined is not enough. As we have said, it is only the beginning. We have no desire to remain at the beginning, to create a nation of mere shopkeepers, whose thoughts run only

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3/ M.M. Coady, Masters of Their Own Destiny, New York and London: Harper and Brothers, 1939, p. 154.

4/ Ibid., pp. 159-160.

> to groceries and to dividends. We want our men to look into the sun and into the depths of the sea. We want them to explore the hearts of flowers and the hearts of fellow-men. We want them to live, to love, to play and pray with all their being. We want them to be men, whole men, eager to explore all the avenues of life and to attain perfection in all their faculties. We want for them the capacity to enjoy all that a generous God and creative men have placed at their disposal. We desire above all that they will discover and develop their own capacities for creation. It is good to appreciate; it is godlike to create. Life for them shall not be in terms of merchandising but in terms of all that is good and beautiful, be it economic, political, social, cultural, or spiritual. They are the heirs of all the ages and of all the riches yet concealed. All the findings of science and philosophy are theirs. All the creations of art and literature are for them. If they are wise they will create the instruments to obtain them. They will usher in the new day by attending to the blessings of the old. They will use what they have to secure what they have not.5/

At the other extreme is the position held by a very large number of Unites States co-operators. Mr. Raymond W. Miller in *A Conservative Looks at Cooperatives* expresses the views of those who think in terms of 19th century liberal democrary.

> 'Cooperatives help to keep our free enterprise system competitive.' This statement by Dr. Joseph G. Knapp tersely sums up the basic reason why this author believes in cooperatives as a vital part of the private enterprise system.6/

The relationship between co-operative and free-enterprise ideology, as Miller understands it, is clearly stated in his reply to the common charge in the United States that co-operatives are socialistic.

> Nothing is more capitalistic than a corporation for service without entity-profit, but with profit to the members who use and own it - such as the Associated Press, Sunkist, Railway Express Agency, Land O'Lakes, Equitable Life Assurance Society, our credit union finance companies, and agricultural purchasing associations....7/

5/ Ibid., p. 163.

6/ Raymond W. Miller, A Conservative Looks at Cooperatives, Athens: Ohio University Press, 1964, p. 28.

7/ Ibid., p. 51.

> Capitalism is at its best when people participate in all types of capitalistic organizations.8/

The political and social views of the co-operative movement have shifted to the right during the last 30 years and the number of those with strong anti-capitalist sentiments appears to have declined drastically. Nevertheless, there is still considerable disagreement among co-operators concerning the ultimate objectives of a co-operative enterprise. To the Fabian Socialist or left wing it is a stepping-stone to a socialist commonwealth. To the conservative co-operator it is an integral and necessary part of the capitalist system. Finally, for others it is the means of mitigating the oppressive powers of big business by expanding the ideals of democratic control of industry.

> Both sides [supporters of socialism and free enterprise] insofar as they are sincere are in large measure arguing for the same thing - the fullest possible opportunity for individual development - but each neglects to consider a part of the facts: the socialist, that government ownership in the present stage of social development may easily involve restrictions on the liberty of the individual, over-centralization, bureaucracy, and some degree of authoritarianism; the free enterpriser, that the days of small-scale individual enterprise are gone, and that the economic system is dominated by big business. Furthermore, small-scale enterprise, in the 19th century sense of the term, can never be restored: the large-scale business unit, exemplified by the super-corporation, has developed in response to certain technological and economic factors which will persist in the future and require even larger business organizations. The problem of democracy is not to destroy these large business units, an impossible task anyway, but to restore them to the control of the people. That is the aim of the socialists; but I have already discussed the threat to liberty, under present conditions, involved in government administration of the economy. The alternative method of control is for the people to go into big business for themselves: and that is where co-operation comes in.
>
> For co-operation is the people's way into big business. The masses cannot hope to get into big business as individual producers; they have neither the resources nor the capacity for that; but by co-operating as consumers, they can on the one hand retain the advantages of free enterprise, and on the other hand they

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8/ Ibid., p. 69.

> can, by their competition, force the corporations into the service of the people. Consumers' co-operation is in fact the people's free enterprise: it is the democratic way of carrying on big business. And if socialism does come, to the extent that the people have been educated by economic co-operation, they will be able to exercise effective democratic control over their government.
>
> Co-operation, then, is the effective way to preserve the advantages of free enterprise. More than that, co-operation may provide the dynamic principle on which a better postwar world may be based. We cannot build a better world solely on a philosophy of social security and 'full employment'; such a philosophy is negative, lacking the power to motivate human development; and those who insist on 'security' as the only postwar aim are Quislings to social progress. Social and economic security are essential; but if our civilization is to advance, socially and economically, it must find some dynamic idea, some new principle to motivate men to action. 'Free enterprise' no longer commands the undivided loyalty of men: perhaps co-operation will provide the explosive idea for the new world of the common man.9/

All co-operators stress the difference between the power structure of the co-operative enterprise and that of the private firm. They argue that the one-man, one-vote rule (rather than the one-vote, one-share rule) constitutes a significant advance in democratic control. Although this argument is partly true, the claims are highly exaggerated. In both organizations power resides with the owners of the company.10/ The internal structure of the two organizations -- the relationships among workers, management and owners -- is substantially the same. It is true that all modern companies are authoritarian in structure, since it is not the employees who decide on policy. (This may well be the inevitable consequence of the highly specialized and technical nature of the modern firm.) The increase in democracy resulting from a broader base of ownership seems to be relatively minor except in "workers' co-operatives", i.e., co-operatives where the employees

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9/ Harry G. Johnson, The Antigonish Movement, Extension Department, St. Francis Xavier University, pp. 13-14 (apparently written in 1944-45).

10/ The alternative theory, that corporate power resides with management (see, e.g., John Kenneth Galbraith, The New Industrial State, Boston: Houghton Mifflin Company, 1967), in no way conflicts with the conclusions which follow.

are the owners. However, these workers' co-operatives have been remarkably unsuccessful and comprise a trivial part of co-operative enterprise. In the important areas of co-operative enterprise -- the consumer and producer co-ops -- although the democratic process is expanded, the essentially authoritarian structure remains unaltered. Co-operatives are more democratic but the difference is of minor importance. The co-operatives' claim of a significantly higher degree of economic democracy is surely incorrect, since it ignores one of the essential characteristics of modern capitalism, the employee-owner relationship.

The existence of groups with widely divergent ideologies is not usually a disruptive force during the initial stages in the development of a co-operative enterprise. The arduous immediate tasks of organizing the co-op, acquiring members, and creating an efficient economic unit, etc., are likely to push any ideological differences into the background. After the co-op is organized and becomes a viable economic unit, or fails to do so, the previously submerged ideological differences come to the surface and often lead to serious conflict. To a certain extent, the conflict is inevitable, since the role of the co-op is interpreted differently by different groups within the organization. Furthermore, the very existence of the co-op produces substantial changes in environment, and response to these changes depends, in part, on one's ideological position. Thus the initial organization of a co-operative is a unifying force which brings together diverse groups for the purpose of common action in the interest of the common man, whereas once established and viable, the co-op, paradoxically, can become a divisive force in the movement or community.

Ideological differences are not the only causes of conflict within co-operatives. Other equally important factors arise once a co-op is established. Often the co-op cannot eliminate some of the complaints which gave rise to the enterprise. Some problems cannot be solved by a single firm in the industry, or even by the industry itself. Such has been the case, and still is, in the agricultural industry. The classic problems of inelastic demand cannot be solved by the co-operative enterprise. Hence, even after the co-op is established, many basic problems remain unsolved. But one can no longer simply blame big business or an oligopolistic market structure for these difficulties. The co-op has become an

integral part of the industry. Somehow one must come to terms with its role in the industry and its potential power to eliminate problems in the industry. Some co-operators will argue in favour of using the power of government to organize a monopoly through nationalization or by creating a marketing board, thus eliminating the co-op as well as the other firms in the industry. Others will argue that co-op management is, for one reason or another, incompetent, since it has failed to eliminate many of the basic complaints of the industry. Management and those closely associated with management will naturally defend the co-op. These differences tend to split the co-op movement or closely associated movements.[11/] It will be shown below that such a situation arose after a farm machinery co-operative was established in Western Canada.

History of Co-op Experience in the Farm Machinery Industry

Before discussing the organization and development of Canadian Co-operative Implements Ltd., it will be useful at this point to review briefly the history of co-operative experience in the farm machinery industry.

One of the first attempts by a farmers' enterprise to enter the farm machinery industry in Western Canada was made in approximately 1914. United Grain Growers, after their spectacular success in the grain trade, expanded into a number of new areas, including farm supplies and machinery. The experience of the company's purchasing department with respect to supplies and machinery is briefly summarized by W.A. Mackintosh as follows:

> It was at first designed to act as a purchasing agent for farmers. Goods were purchased on commission and in car-load lots. Stocks of goods were not carried and costs were kept at a minimum. Regular and satisfactory service of that type, however, depends upon two factors--the forethought of the purchaser in gauging correctly his demands and the ability of the manufacturer to guarantee delivery. Over neither of these factors did the company have control, and with rising markets and increased demands, contracts had to be made so far in advance of sales that the company was forced to relinquish the commission basis and carry stocks of goods. This was particularly necessary in the cases of binder twine and machinery. That policy has gradually developed until at present the company

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11/ Further comments on these problems may be found in Appendix 3.

> carries a heavy inventory in its Supplies Department. At another point, modification has been made in the original plans. The necessity of being able to supply standard parts for agricultural machinery and to give expert service in setting up, led to the establishment of a retail agency system to handle these lines. Fifty-seven of these agencies carried stocks of machinery and repairs....
>
> From the financial point of view this department of the United Grain Growers has frequently resulted in a loss, particularly on its machinery lines. From 1919 to 1922, losses of $59,000, $52,000, $282,000 and $219,000 resulted. Following the discontinuance of the Machinery Department a slight profit was shown.12/

In the early 1940s, 12 large regional co-operative wholesales in the United States organized a National Farm Machinery Co-operative. Although the wholesales distributed farm machinery and some of them had small manufacturing plants, National was presumably established for the purpose of entering the manufacture and distribution of farm machinery on a large scale. A factory was purchased, the production of tractors began in 1946, and an agreement was reached with Cockshutt to purchase combines and other machinery. National entered the farm machinery industry at a most opportune time. There was an extremely large backlog of demand, the market was buoyant, and prices increased substantially between 1946 and 1950. Nevertheless, in October 1952 the co-operative went bankrupt.

One interesting feature of co-operative experience in farm machinery is the remarkable lack of analysis of the failures in this area. W.A. Mackintosh devotes little more than the page quoted above to an analysis of the dramatic failure of United Grain Growers in the farm machinery business. R.D. Colquetter, in his history of the UGG -- *The First Fifty Years* -- devotes even less space to a description and analysis of UGG's experience, despite the loss of approximately $500,000.13/ The bankruptcy of National 30 years later in 1952 did not, so far as this writer is able to

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12/ Mackintosh, op. cit., pp. 128-30.

13/ The loss of $500,000 in the years 1919-1922 is, in terms of purchasing power, equivalent to a loss of approximately $900,000 in 1967.

determine, produce an analysis of the causes of National's disaster. The response of co-operators or the co-operative movement is somewhat incomprehensible. The farm machinery industry has been of great importance to farmers for many years and its importance has continued to grow. Co-operatives have suffered spectacular setbacks in the industry on this continent and can point to very few successes. Nevertheless, there has been virtually no attempt to systematically analyze the causes of failure. This neglect certainly cannot be explained by a lack of co-operative literature in general! Furthermore, co-operatives claim to be highly democratic, open, and self-critical organizations in which all issues are fully and freely discussed. Unfortunately, they did not live up to their claims on these occasions, and criticism of their failure to do so is perhaps justified.

2. THE INITIAL ORGANIZATION AND DEVELOPMENT OF C.C.I.L.[1]

In 1936 and 1937, an investigation of farm machinery prices was carried out by the House of Commons Standing Committee on Agriculture and Colonization. The Committee made a very lengthy and detailed examination of many aspects of the industry. The final section of the study consisted of a number of "Conclusions and Recommendations". Two of the important conclusions were "that in the farm implement industry there is competition in the matter of sales with little effective competition in the matter of prices" and "that the Committee is of the opinion that the cost of distribution of farm implements is unnecessarily high and constitutes an important factor in the price to the consumer". The Committee then recommended "that the companies themselves should make every effort to reduce these costs or farmers should be encouraged to organize for the co-operative distribution and servicing of farm implements".[2]

Two years later a Committee of the Saskatchewan Legislature questioned whether anything had been done to implement the recommendation. This Committee recommended that a co-operative be formed to sell farm machinery. It suggested that the Dominion Government and the three Prairie Provinces help organize a co-operative and provide financial support. On this occasion the recommendations were implemented. A co-operative was incorporated in 1940, but production and sales distribution did not begin until 1946. The difficulties of the war years partly explain the length of time required to organize the co-operative.

1/ This section is based primarily on John B. Brown, Memorandum on Farm Machines, Their Manufacture, Distribution, and Prices, Based Upon the Experience of The Canadian Co-operative Implements Limited, a paper presented to a meeting of representatives of the Prairie governments, major co-operatives, and other farm bodies in Regina in October 1957.

2/ Ibid., pp. 2-3.

The first annual meeting of The Canadian Co-operative Implements Limited (C.C.I.L.) was held in February 1941. The campaign for funds during the previous fall aroused a great deal of interest in the machine co-operative but failed to raise adequate capital. Less than $50,000 was obtained and a considerable portion of this amount was required to cover the expenses of the fund-raising campaign. Subsequently, loans and grants were obtained from the Manitoba and Saskatchewan governments and from the Wheat Pools in these provinces. However, it was not until April, 1945 that the minimum objective of $750,000 was reached. Three-quarters of this amount was raised through the purchase of co-operative shares by individual farmers. The difficulties encountered in raising the money indicate clearly how arduous a task it is to organize a co-operative in this area, even with assistance from government and large, established co-operatives.3/

It was generally believed that the main source of inefficiency in the farm machinery industry was in distribution; most recommendations for the establishment of a co-operative had referred to distribution rather than to manufacturing. However, the National Farm Machinery Company was organized in the United States to manufacture machinery and C.C.I.L. decided to join National. The main supporters of National were 12 large regional co-operative wholesales in the United States. National planned to purchase a factory to assemble tractors and manufacture other farm equipment. In 1942 the Board of Directors of C.C.I.L. decided that "complete co-operation with National in the manufacture of machines was basic policy for C.C.I.L.".4/

Apparently, during the period 1942-1943 the directors of C.C.I.L. realized that the goods which National planned to produce would not satisfy the needs of Western Canadian farmers. National proposed to manufacture goods that were needed primarily in the corn belt, since most of the regional wholesales were located in this area. In 1944, C.C.I.L. decided to revert to the plan that had received attention earlier, i.e., to attempt to reach an

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3/ Some general comments on the problems of organizing a co-operative will be found in Appendix E.

4/ Brown, op.cit., p. 6.

agreement with Cockshutt Plow Company Limited, the only major all-Canadian implement company. The specific proposals made to Cockshutt at this time were:

(1) that Cockshutt build a specific line of machines for C.C.I.L.;

(2) that C.C.I.L. take over the western division of Cockshutt;

(3) that C.C.I.L. buy Cockshutt lock, stock, and barrel.

Cockshutt rejected all of these proposals. Shortly after these negotiations broke down, C.C.I.L. purchased a small factory in Winnipeg for $370,000. The factory was engaged in making harrows, wagons and sleighs. Despite this purchase, once again C.C.I.L. decided to concentrate on distribution and to attempt to renegotiate with Cockshutt. In 1944, a conference attended by the Board of C.C.I.L., representatives of major co-operatives, and representatives of the Saskatchewan and Manitoba governments, reached the following decision. It was agreed that C.C.I.L.:

(a) should secure wider farm support by increasing its membership to 50,000 and its share capital to a minimum of $750,000;

(b) should concern itself primarily with distribution rather than manufacture of machines, with the distribution as free as possible from unnecessary sales expense;

(c) should try to come to an agreement with Cockshutt.

Another membership drive was undertaken and was highly successful. This time $562,000 was raised, twice the amount raised in the previous four years. Although C.C.I.L. was now in a moderately strong financial position, Cockshutt was still reluctant to enter into an agreement with a co-operative. Such an agreement would mean a break with the trade. Probably more important, it would raise difficult organizational problems for Cockshutt, since it had its own dealerships in Western Canada. The latter problem appeared to disturb the Cockshutt organization for the entire duration of its agreements with C.C.I.L.

Cockshutt finally did decide to supply C.C.I.L. with farm machinery. The decision to do so arose from considerations unrelated to C.C.I.L.'s desire to purchase supplies from Cockshutt. Cockshutt was considering the possibility of manufacturing tractors

and self-propelled combines at this time. It wished to enter the United States market but had no distribution system in the United States. Agreement with National would enable Cockshutt to enter the U.S. market without incurring the large cost of organizing a distribution system in this market. National, although reluctant to do so, reached an agreement with Cockshutt, and apparently Cockshutt felt obliged to negotiate with C.C.I.L. as well. When agreement between Cockshutt and C.C.I.L. was reached, the latter found itself in both the manufacturing sector (through the purchase of the Winnipeg factory) and the distribution sector. Since the factory had a small and very limited line of implements, no serious conflict arose between Cockshutt and C.C.I.L. as a result of C.C.I.L.'s manufacturing activities.

Thus during its initial period of organization, 1940-45, C.C.I.L. made a number of major shifts in policy. The original plan was to organize a distribution agency and to negotiate with Cockshutt for the supply of machinery. When this plan failed to materialize, C.C.I.L. joined with National for the purpose of manufacturing farm machinery. Then this policy was abandoned and once again it was decided to concentrate on distribution and to re-open negotiations with Cockshutt. After Cockshutt rejected C.C.I.L.'s proposals, C.C.I.L. decided to go into production on its own and purchased the small factory. Following the purchase, C.C.I.L. again decided to concentrate on distribution. Finally, due to fortuitous circumstances, an agreement was reached with Cockshutt and C.C.I.L. engaged in both manufacturing and distribution. These rather strange and rapid reversals of policy may be explained in several ways, and the causes of the original vacillations in policy have, to some extent, persisted and continue to plague C.C.I.L.

The changes in C.C.I.L. policy can be traced partly to differences in opinion among members of the Board of Directors. Perhaps the views of those favouring distribution prevailed at certain times, and those favouring both manufacturing and distribution prevailed at other times. However, even if such is the case, an analysis in terms of shifts in power between these groups will provide only a superficial explanation of the vacillations which occurred. A more fundamental explanation will be found in the awkward situation facing the new co-operative.

The farm machinery industry is, to an important extent, highly integrated.[5/] Each manufacturer has its own wholesale organization and distribution system. Furthermore, the cost of entering the manufacturing sector in an effective way is enormously high. Although it is easy enough to enter distribution as a single franchise dealer, to enter -- as C.C.I.L. hoped to -- by building a complete distribution system is quite another matter. This can be done by competing with a manufacturer's own distribution system or by replacing it. Alternatively, on rare occasions a co-op may find a supplier who has no distribution system in a given area either because the supplier is not in a particular market or because it is too small to have developed an independent distribution system. Under most circumstances, however, it is impossible to enter the distribution sector as a national or regional enterprise. C.C.I.L. tried to enter the farm machinery industry without the capital requirement to manufacture a full line of machinery and without suppliers who were willing to complement its proposed distribution system. The C.C.I.L. policy vacillations arose from efforts to find ways over or around the barriers that prevented the co-op from functioning in the industry.

Manufacturing

The factory purchased by C.C.I.L. was of modest size and the equipment manufactured had to be restricted to relatively simple implements; the factory could not produce highly complex equipment like tractors and combines. Within the limits imposed by the size of the plant, C.C.I.L. did succeed in modifying and improving a number of implements.

A new "harrower" was quickly developed in 1945 and put on the market in 1946. Subsequently, improvements were made and the "harrower" was considered to be greatly superior to the draw harrow in common use at the time. A more important innovation was the development of a "disker". This implement proved to be highly successful and shortly after its introduction many large manufacturers produced a similar product. Although C.C.I.L. developed

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5/ The industry, of course, is not completely integrated. But the North American market is highly integrated and it was not feasible to purchase from European manufacturers immediately after the Second World War.

the "disker", the large manufacturers succeeded in capturing a large share of the market within a few years. In other attempts to develop new implements or improve existing ones C.C.I.L. encountered both successes and failures.

The high cost of research and development placed a severe restriction on the resources C.C.I.L. could afford to allocate to experimental work and the modest size of the plant limited the types of equipment it could manufacture. Therefore, C.C.I.L. has played a relatively minor role in the manufacturing sector of the farm machinery industry. Nevertheless, its accomplishments are noteworthy. In 1966, C.C.I.L. sold $10,084,317 of its own manufactured equipment.

Sales Policy

The initial sales policy adopted by C.C.I.L. followed logically from criticism by co-operators and farm leaders of the methods and practices of distribution in the industry. These criticisms were directed mainly at wasteful expenditures on advertising, too many inefficient dealers as a result of competition for sales, and salesmen who pressured farmers into buying machinery against their better judgment. The general point was that wasteful competition and emphasis on useless frills led to high distribution costs and in turn to the high cost of farm machinery.

The sales or distribution policy adopted by C.C.I.L. in October 1945 was as follows:

(1) The distribution of all supplies to members in the most direct, efficient and economical manner free as possible of all unnecessary sales and service expense.

(2) No dickering on trade-in machines.

(3) Repair and field service designed to give the most useful service at the lowest cost.

(4) Business for cash only.[6/]

What was the most efficient way of distributing machinery (point (1) above)? Three methods were considered:

(a) Sales direct to the farmer by mail order.

6/ Brown, op. cit., p. 21.

(b) Sales through Local Co-ops which would act in the same capacity as agents for profit-making machine companies and receive the same sort of commissions.

(c) Sales through order takers in the persons of Local Co-op Managers, Pool and UGG agents who would receive commissions of 2 1/2% of retail for their services.7/

Method (c) was selected and, given the general attitudes of co-operators to costs and problems involved in distribution, their decision to pay a 2.5 per cent commission to local co-ops was not too surprising. Also of significance was C.C.I.L.'s attitude toward trade-ins and the policy adopted with respect to them.

> With regard to No. (2) above, no dickering on trades, it was agreed that if and when trades were taken they would be handled on the basis of selling them to the best advantage and crediting the member with the price obtained in settling for his purchase of a new machine. In no event, it was made clear, should there be any chance of loss to C.C.I.L. or any penalizing of others, through dickering and paying more for a used machine than it could be sold for.8/

Trade-ins were not important until 1953-54 and therefore the immediate effects were of little consequence. However, since 1954 they have been a very important element in the total configuration of the market, and the preferred policy of C.C.I.L. in this regard took on a new significance.

The above policy, strangely enough, lasted only two years.9/ In the fall of 1947 an experienced executive from the "trade" was hired and a new sales policy introduced. As a result, C.C.I.L. hired 24 salesmen. The new policy was based on the argument that sales volume is of crucial importance if the enterprise is to succeed and that volume can be obtained only by "selling" machines. The view that farmers had to be "sold" machines was, of course,

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7/ Brown, ibid.

8/ Brown, op. cit., p. 22.

9/ Strangely, because it was very consistent with co-operative thinking in general and there was no apparent reason for regarding the policy as a failure at the time it was changed. Perhaps some co-operators expected the same spectacular success from C.C.I.L. as had been experienced in other co-ops and felt the performance of the new co-op was disappointing.

precisely the view held by all private firms in the industry. The new policy must have led to considerable dissension and conflict within C.C.I.L. management since it represented repudiation of one of the most fundamental and cherished tenets of the co-operative philosophy. Opponents of the new approach presented four arguments in favour of the original policy adopted by C.C.I.L.:

(a) that C.C.I.L. could never beat the machine companies at their own game, could never successfully compete with the thousands of machine company dealers located in every hamlet on the prairie and that consequently the chase after volume was about as promising as going after a pot of gold at the foot of the rainbow;

(b) that whatever volume was secured once the market returned to normal would never produce after all the sales expense was met, a worthwhile reduction in the price of machinery;

(c) that C.C.I.L. had no warrant to give up the attempt to carry through the basic proposition upon which it was founded until that proposition had been demonstrated by practical experience to be invalid;

(d) that at worst, it was better for C.C.I.L. to die in the course of an attempt to break a new path in distribution than to live a little better than another machine company.

It was argued further that in the long run the economic method would win out over the uneconomic method and that if men were put on the road to sell machines C.C.I.L. would nullify its appeal to co-operative loyalty; that in short, exhortation and appeals to men to support C.C.I.L. because it was a co-operative was a waste of time anyway and that the only way to get anywhere was to show them how they could save money acting as their own salesmen.10/

In addition to the introduction of salesmen, several other changes in sales policy were made subsequently. The policy of selling through local co-operatives at a very low commission proved unsatisfactory. C.C.I.L. introduced the idea of having a small number of depots strategically located throughout the western provinces. The decision to establish 60 depots was made in 1951, and by 1952, 25 depots were established. The depots were used for three purposes:

(1) to sell machinery;

(2) to provide service with respect to spare parts;

(3) to provide service with respect to maintenance.

10/ Brown, op. cit., p. 22.

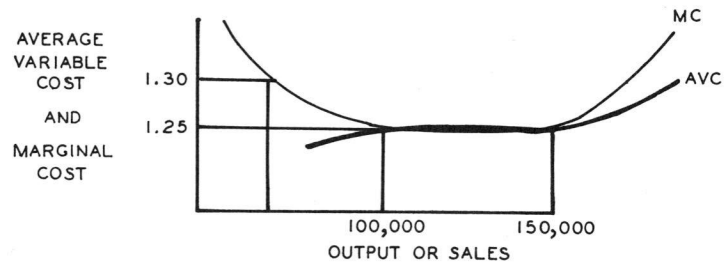
This system was also a radical departure from the traditional approach to distribution used in the trade -- 60 retail outlets as contrasted with thousands of independent franchise dealers. The introduction of depots did not represent (as in the case of salesmen) a fundamental departure from co-operative policy, but it did represent a fundamental change in attitude towards the distribution of farm machinery. It was now recognized that distribution of farm machinery was a full-time job and a difficult one.

Another departure from the original four-point policy, enunciated in 1945, was made with respect to the practice of selling trade-ins on consignment; i.e., the initial policy was to sell second-hand machinery for farmers who purchased their new machines from C.C.I.L. In 1952, C.C.I.L. adopted the practice of the trade. The sale of second-hand machinery now constitutes an important part of total C.C.I.L. sales -- $8 million out of $26 million in 1966 -- and the book losses from trade-ins in 1966 were over $4 million.

3. DISTRIBUTION IN THE FARM MACHINERY INDUSTRY

Everyone -- the trade, the farmers, the co-operatives, research consultants, and the government -- has suggested that the system of distribution in the implement industry is highly inefficient from several points of view. It was felt that excessively high costs of distribution could be cut significantly by reducing the number of dealerships. With fewer dealers, each would handle a larger volume and thus could operate more efficiently. Each dealer could stock a more complete line of repair parts, thereby improving service to the farmer. The following comments will be confined to an analysis of costs.

Why should a large dealer be able to produce or sell at a lower cost than a small dealer? The most common argument is that dealers are able to handle a large additional volume of sales at very little additional cost. It is believed that the average cost per unit sold will decline as volume of sales increase. This argument, which has been applied to many firms or industries, is valid for farm implements manufacturing. There are large fixed or overhead costs in manufacturing and average costs will continue to fall until a high level of output is reached. This is so because the technology used in producing tractors, combines, etc., is such that a very large, expensive plant is required, regardless of the level of output. As output increases, the fixed plant cost can be spread over an increasing number of units. More important, even after the minimum cost per unit is reached, the additional cost of producing an additional unit of output may be the same as the initial minimum value -- i.e. the marginal and average cost may be constant over a wide range of output or sales. This analysis is represented in the standard textbook cost-output diagram below.



Average costs continue to fall until the large output of 100,000 units is reached. Although costs do not continue to fall after 100,000 units, they do not begin to rise until 150,000 units is reached. Suppose the minimum point is $1.00 per unit. If the selling price is $1.25 the firm can make substantial profits by selling 150,000 units. If it could sell only 50,000 units at $1.25 it would be losing money, since the cost per unit would be larger than the selling price per unit. Volume is essential for profits, and when volume is high costs are low; therefore, even at low prices reasonable profits can be made. This situation arises because of large overhead costs and because of the nature of the technology used in producing the product in question.

Is this argument equally applicable to retail dealers? Obviously it is, to a certain extent. A retail dealer must have a "plant" and therefore "overhead". He certainly can sell two units at a lower cost than he could sell one. But is the average cost curve fairly flat for a wide range of sales at the minimum point? Are most dealers operating at a lower volume than at the minimum point on the cost curve? Expressions such as "it's volume that counts, not the mark-up" reflect the view that cost curves, both in manufacturing and in distribution, are of the general shape described above and that output is normally to the left of the minimum point. If such is the case, larger output and fewer firms, other things being equal, would result in a decline in costs. If there is sufficient competition to keep prices down to the level of costs (including normal return on investment) the purchaser will gain from the decline in the number of establishments. The above argument provides a rationalization for the contention that the distribution industry is highly inefficient.

There are approximately 1,900 full- and part-time dealers in Saskatchewan. A large percentage of these undoubtedly do a very low volume of business. These dealers are likely operating at a point to the left of the minimum point on the average cost curve. By reducing the number of dealers and increasing the volume for the remaining dealers, the cost of distributing farm machinery at the retail level will decline.

Will the costs of the larger dealers continue to decline as output is increased? Does the average cost continue to fall until

sales reach a very large figure before inefficiencies arise and the cost curve turns upward? Alternatively, will the cost curve turn up or remain stationary after a moderate volume of sales is reached? If the latter is the case, a large number of medium-sized firms could operate as efficiently as a small number of large ones.

It is possible to obtain some insight into the shape of the cost curves for retail outlets from a study carried out by the National Farm Power Equipment Dealers of the United States.[1/] This study of the cost of doing business by farm power equipment dealers provides estimates of sales margins, a detailed breakdown of expenses, and a summary of the assets and liabilities of these firms. The data are classified by regions, size of sales, and degree of profits. A summary of the data on sales and expenses is presented in the table below.

	Average All Dealers		To $250,000		$250,000-500,000		Over $500,000	
	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales	Amount	% of Sales
Sales	$576,432		$171,975		$370,338		$859,473	
Total Salaries	33,238	5.74	9,511	5.50	22,159	5.96	49,139	5.69
Total Expenses	73,467	12.74	24,005	13.95	48,561	13.11	107,874	12.55
Expenses Excluding Salaries	40,229	6.98	14,494	8.42	26,402	7.13	58,735	6.83

The figures show that the total expenses as a percentage of sales is remarkably constant for the three sales groups. There is a slight fall in expenses: 13.95 per cent for the up-to-$250,000 group, 13.01 per cent for the $250,000-$500,000 group, 12.55 per cent for the $500,000-and-over group. Sales in the third group are approximately five times as high as they are in the first group but expenses as a percentage of sales decline by just 1.4 percentage points. If salaries are excluded, the decline is

1/ 1965 Farm and Power Equipment Dealer's Cost of Doing Business Study, National Farm and Power Equipment Dealers Association, St. Louis, Missouri.

from 8.4 per cent to 6.8 per cent -- a 1.6 decline. A fivefold increase in sales (and in output) from the initial amount of approximately $172,000 has led to a very small change in the percentage cost of retailing farm machinery. There is apparently very little in the way of economies of scale. On *a priori* grounds, one ought not to expect such economies. There is no change in the technology of retailing. Labour costs are approximately half the total expense and a doubling of sales probably requires a doubling of the number of salesmen, servicemen, repairmen, etc. A doubling of sales might require a doubling of showroom space or of the plant generally. This seems to be the case for the sales range in question. However, one cannot assume a similar conclusion is justified in the case of dealers whose sales are below $170,000, as is true of the majority of Western Canadian dealers.

Data on sales and number of dealers in Saskatchewan indicate that average sales per dealer are a very small fraction of average sales per dealer in the study referred to above. In 1967, there were 1,866 licensed dealers in Saskatchewan -- 921 major or long-line dealers and 815 short-line dealers. Sales of farm machinery in Saskatchewan in 1965 were approximately $221 million (at list price). Average sales per dealer were approximately $118,000.[2/] If we assume the long-line dealers had the major portion of the market -- assume that 921 dealers did 80 per cent of the business -- then average sales per long-line dealer would still be less than $200,000 at retail prices. There may, therefore, be considerable economies for the industry in reducing the number of dealers in Saskatchewan or in Western Canada.

The data suggest that reducing the number of dealers to 900 would result in insignificant economies of scale or reductions in cost.[3/] If there were 900 dealers their sales would average approximately $250,000 and costs per unit of sales would presumably decline very little up to sales of $500,000. Alternatively, even if sales per dealer increased substantially, average costs would

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2/ Submission of Saskatchewan Implement Dealers' Association to the Royal Commission on Farm Machinery, March 1967, p.3.

3/ The figure of 900 was obtained by dividing $250,000 (sales per dealer) into $221,000,000 (total sales in Saskatchewan).

not decline.[4/] However, in reaching this conclusion a number of very important factors have been neglected. These are reductions in the cost of wholesaling (inventory, transportation, handling, etc.) which would result from a drastic decline in the number of retail outlets, i.e., economies that are external to retailing as such should arise in the industry as a whole. Probably, significant economies of this kind would arise only if the number of retail outlets were radically reduced. Therefore one might speculate that a 50 per cent reduction in the number of outlets would not substantially reduce the costs of retailing as such and might have little effect on "external" economies (external to retailing). Perhaps significant economies in distribution are contingent upon a reduction in the number of outlets to approximately 10 per cent of their present number.

In the case of C.C.I.L., sales of new machinery in 1966 were $20 million and there were approximately 60 depots. The average sales were approximately $300,000. If it is correct that there are no significant economies of scale above approximately $200,000, then C.C.I.L.'s decision to restrict their number of depots to 60 may have been a serious mistake. More depots would not increase costs per dollar volume of sales to any significant extent, and it is generally believed that more outlets would lead to greater sales. This is certainly the view held by the trade and explains in part why there is such a large number of dealers in the industry.

4/ Substantially the same conclusion was reached by Mr. John Brown, President of C.C.I.L., on the basis of his analysis of C.C.I.L.'s data on depot costs. "We, of course, have very detailed information with respect to every depot operation, as you can understand. I would say that a depot getting $150,000.00 worth of business can be economic, not quite as economic as one getting a quarter of a million, I would say a quarter of a million would be better and above that the savings are of no account." Hearing of the Royal Commission Farm Machinery, vol. No. 34, p. 3750.

4. BUYING HABITS OF FARMERS

One of the crucial considerations in determining the costs of distribution is the buying habits or methods of purchase of the consumer. At one extreme, and obviously the least expensive method, is direct factory purchase and direct shipment to the consumer. At the other extreme is the highly personalized service provided in expensive establishments such as boutiques and other sophisticated retail outlets. Distribution costs may vary from 10 to 15 per cent to over 100 per cent of the cost of manufacturing.

The system of distribution in an industry will depend not merely on purchase habits or preferences. The market structure, degree of integration in the industry, the type of commodity and its cost, and the past methods of distribution, are all factors that affect the prevailing system of distribution. Buying habits may simply be a consequence of choices or the lack of them faced by consumers in the past. Nevertheless, present habits tend to sustain the existing system. It takes time for habits to change and if they change slowly the costs and risks to an individual firm that attempts to introduce a new and less expensive system may be prohibitively high. In the farm machinery industry, the distribution system has traditionally been a fairly expensive one.

The purchasing attitudes of farmers can be analyzed by temporarily ignoring the other factors and the mutual interdependence between these factors and buying habits. From time to time, surveys have been carried out in order to determine farmers' preferences in selecting their manufacturers and dealers. The resulting data are subject to many severe limitations and skeptics may regard the studies and their conclusions as virtually useless. The writer will, however, present a brief summary of some survey results on the grounds that these data in conjunction with data collected from other sources may provide some insight into the purchasing habits of farmers.

Distance to Dealers

A small survey of farmers who purchase from a co-op showed that the average distance from the farm to the major source of supply is

only eight miles and the distance is approximately the same for each product line surveyed. The results are shown in the table below.[1/]

DISTANCE FROM THE FARM TO THE MAJOR SOURCE OF SUPPLY FOR 99 COOPERATIVE MEMBERS, 1962

Product	Distance in miles					Average Distance (miles)
	0-3	4-7	8-11	12 or over	Total	
	(percent of members)					
Fertilizer	28	33	22	17	100	7.29
Feed	23	27	24	26	100	8.43
Petroleum	17	25	32	26	100	8.53
Average	24	29	26	23	100	8.08

Loyalty to the Co-op

It has often been suggested that farmers' attitudes with respect to the purchase of farm machinery are different than their attitudes towards purchase of farm supplies in general. It is usually recognized that an appeal to the farmer's sense of loyalty to his co-op will not be effective in the area of machinery, whereas it might be (by implication) effective in the case of supplies. However, one study shows that 20 per cent of co-op members have strong loyalty while the remaining 80 per cent purchase only part or none of their major supplies from their co-op.[2/]

PATRONAGE LOYALTY OF 99 COOPERATIVE MEMBERS TO THEIR COOPERATIVE, 1962

Degree of loyalty	% of members
Loyal (purchased all major supplies from the cooperative)	20
Medium loyal (purchased some major supplies from the cooperative)	67
Unloyal (purchased no major supplies from the cooperative)	13
Total	100

1/ "Purchase Behaviour", Purdue University, Research Bulletin No. 797, May 1965, Table 5, p. 5.

2/ Ibid., Table 9, p. 8.

Brand Loyalty and Shopping

The conclusions drawn from surveys on the extent to which farmers practise brand loyalty and the extent to which they shop before making a purchase vary considerably. One survey report concludes:

> Past studies have indicated that the individual farmer does not seem to "shop around" either due to brand or dealer loyalty. Our study supports these findings. For example, we found that more than half our respondents (56 per cent) considered no other brands before making their last machinery purchase. About 60 per cent purchased the same brand as their previous machine. Over half of our respondents did not visit any other dealers than their place of purchase.3/

Another study leads to a contrary conclusion. This study of the buying habits of co-operators indicates a high degree of "disloyalty" which in turn implies that farmers do shop around and purchase from different dealers. This statement applies to the purchase of supplies. One would expect the farmer to do considerably more shopping in the case of an infrequent and very expensive purchase, such as farm equipment.4/

Contact with Dealers

A third study suggests that farmers generally take the initiative in contacting a dealer.5/

> The farmers surveyed were asked, "When you were in the process of making your most recent farm machinery purchase, which of the following statements best describes the role played by the dealer or salesman from whom you made the purchase?"
>
> And here are the answers:
>
> The respondents were asked to check one of three answers provided them and which are shown in the following table.

3/ Glen H. Mitchell, E.M. Rogers and J.G. Kendrick, "Suggestions for Strategy", Reprinted from Implement & Tractor, Kansas City 5, Mo.

4/ "Purchase Behaviour", Purdue University, Research Bulletin No. 797, May 1965, p. 8.

5/ "Farmers' Buying Habits - a complete study", a condensation of a series of articles based on data from a national research project conducted by The National Farm & Power Equipment Dealers Association under the supervision of Drs. George M. Beal and Joe M. Bohlen, Rural Sociologists, Iowa State University.

	Percent
Dealer found out that I was interested in the machine and actively followed up until I made the decision to purchase	9
Both the dealer and I initiated some of the contacts and discussion before I finally agreed to purchase	51
Almost all of the contacts between the dealer and me were initiated by me	40

While there is no self-evident conclusion that can be drawn from this, it does appear that the initiative is mainly on the part of the farmer rather than the dealer.6/

How much contact does the machinery dealer have with the farmer?

> ... each of the farmers in the sample was asked this, "How long has it been since a farm equipment dealer or salesman called on you at your farm?" The farmers answered as follows:7/

Most Recent Call	Percent
One month or less	17
2 to 6 months	26
7 months to 1 year	11
More than a year	46

Both with respect to "distance" and "loyalty" farmers' buying habits may be similar for supplies and machinery.

The evidence concerning the "shopping" a farmer does before purchasing equipment appears to be contradictory and inconclusive. If in fact farmers do consider the available choices and purchases are not predominantly influenced by habit, then the introduction of low-cost methods of distribution might be highly feasible. On the other hand, if habit is the predominant consideration (present purchases depend on past purchases), then a new method of distribution, even if it proves feasible in the long run, may result in large short-run losses. Because of doubt concerning the extent to

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6/ Ibid.

7/ Ibid.

which farmers would support a low-cost distribution system (if one were available) firms in the industry have been extremely reluctant to offer alternatives to the present method. As W.G. Phillips noted:

> . . . unless some outside agency or competition forces them to do so, it is unlikely that the companies themselves will initiate a more economical policy as each fears the loss of identity of its own organization.8/

8/ W.G. Phillips, The Agricultural Implement Industry in Canada, Toronto: University of Toronto Press, 1956, p. 137.

5. C.C.I.L. AND THE FARM MOVEMENT

A number of conditions in rural Western Canada favoured the growth of protest movements in general and co-operatives in particular. Many farmers' supplies are manufactured by large Eastern firms under oligopolistic conditions and farmers felt that the profits of these firms were excessive and were directed to and used for the benefit of Eastern Canada. Until recently, Western Canada was geographically isolated and this intensified the feeling of being exploited. The National Policy further aggravated these feelings. In addition, Western Canada has had a substantial number of highly intelligent and articulate farm leaders, many of whom believed in a co-operative commonwealth or socialism. These conditions led to the development of many protest movements and co-operatives.

The establishment of a co-operative may have important economic effects as well as important political and social implications. The existence of a co-op changes the choices available to the purchaser and therefore alters, or appears to alter, the basic arguments available to those who oppose the policies of the established firms in the trade. This has certainly been the case in the farm machinery industry and in a number of other industries.

Once a co-op is established it is no longer possible to argue with equal effectiveness that a small group of capitalists is exploiting the farm community, since farmers now have the option of buying from their own company. For this reason alone, the force of the protest movement is weakened even if the co-operative has failed to eliminate any of the grievances that originally gave rise to the co-operative enterprise. Some farm leaders will press for various government regulatory devices or, in the extreme, nationalization. Others will exhort farmers to support their co-operative. Many farm leaders are faced with the awkward problem of attacking the trade and, at the same time, defending the co-operative which is part of the trade.

The Commissioner of the Royal Commission on Farm Machinery questioned a number of farm leaders concerning the slow growth of

C.C.I.L. His questions and their replies are as follows:

1. The Commissioner:

   On page 18, you discuss in general the role of cooperatives. I was wondering, if you had any views as to why the Canadian Cooperative Implements Company hasn't played a larger role in the distribution of farm machinery in western Canada?

   Mr. Platt:

   No, Mr. Commissioner, I haven't.1/

2. The Commissioner:

   On page 15, you refer, under item 8, to the desirability of farmers making more use of their own facilities through C.C.I.L. Do you have any views why farmers don't make greater use of the Canadian Cooperative Implements Limited?

   Mr. Malm:

   The views expressed there, I suppose, could be some from a personal viewpoint and some from conversations that I have had with farmers. I think, first of all, that C.C.I.L. probably haven't as wide a dealership and service arrangement as they might have. And the other question is that they have never had a full line of machinery. They have had a limited line and also they have been at somewhat of a disadvantage in having to change the machinery for the kind of machinery that they have been able to sell. This has worked against them. I think there is another item there that is worth mentioning. Farmers are peculiar people too, like some others. Quite often a farmer will insist that he will only buy a certain manufacturer's machine. He has had what he considers good service from that particular dealer in many cases, or the company, and he wants to stick with one of the larger companies. I think these are some of the reasons. Now, some of the reasons why C.C.I.L. hasn't progressed more than they have, I don't think, well, I just can't explain it, I don't know why. I just don't know why.2/

3. The Commissioner:

   Have you any idea why more farmers don't buy from C.C.I.L.? I understand they do about 5 per cent of the total business in western Canada.

1/ Royal Commission on Farm Machinery, vol. 6, p. 543. Hearings held in Calgary, March 16, 1967. Mr. Platt is Executive Secretary of the United Farmers of Alberta Co-operative Limited.

2/ Ibid., p. 597.

Mr. Knelsen:

> I am not too sure. Some of them claim they don't like the equipment and I claim it is the excessive advertising on the part of some of the others. Another thing that is very lucrative, or seems to be until it is thoroughly understood, is the high prices that the others are allowing for used equipment. Farmers don't seem to take into consideration that the cost at C.C.I.L., to begin with, is much lower.3/

In its brief to the Royal Commission, the Manitoba Farmers' Union, which said it represented 30 per cent of the farmers in the province, had this to say about the machinery co-op:

> Lack of leadership and effective recognition of the continuing trends in the technological revolution that was taking place in farming operations, failed to develop C.C.I.L. as a continuing innovator of new ideas and designs in farm machinery.
>
> The concept of contracting for the supply of major farm machinery with either a manufacturer in Canada or abroad did not provide for the stability of service and acceptance of machines that farmers generally desired. This condition is borne out by the fact that several changes have taken place in this regard.
>
> There is no question in our minds that the manufacture and distribution of farm machinery on a Co-operative basis, has and will continue to serve the agricultural community of western Canada, and we are looking forward to some objective and realistic developments regarding the expansion of the organization towards an effective operation, that will meet the needs of the farmers at large.

There are two reasons for the rather awkward off-the-cuff statements made by these and many other farm leaders with respect to C.C.I.L. in general and C.C.I.L. growth in particular. First, they were attempting to provide a short answer to a highly complex problem. Second, in this writer's opinion, they were trying to criticize the trade for what they feel are its shortcomings, while at the same time trying to avoid criticizing C.C.I.L. On rare occasions some farm organizations will attack the co-op and in so doing make explicit the rift that exists in the farm movement.

3/ Royal Commission on Farm Machinery, vol. 10, p. 925. Hearings held at Regina, Saskatchewan, March 28, 1967.

Similarly, the co-op often finds itself in a delicate position. It is evident on common-sense grounds that C.C.I.L. must temper its criticism of the trade. A major share of its sales are products manufactured by other firms in the industry. C.C.I.L. could not make agreements with a manufacturer (Cockshutt, for example), carry on day-to-day business on a manageable basis for five days a week, and on the sixth vilify the manufacturer for charging excessive prices and earning abnormal profits -- for producing goods with built-in obsolescence and unnecessary frills, and for degrading the community by false and absurd advertising. Even if C.C.I.L. had enormous countervailing power -- it actually has very little -- it could not maintain a tenable relationship with its suppliers and defend the standard complaints levelled against the industry by many farm groups.

The pricing policy of C.C.I.L. is either similar to or identical with that of the trade. It manufactures or sells products similar to or identical with those of its competitors. It has salesmen and provides service of approximately the same quality as its competitors. There are differences between the "package" provided by C.C.I.L. and that of its competitors (see below) but they seem to shrink in significance relative to the awesome charges laid against the industry. For all practical purposes, criticism of the trade is tantamount to criticism of C.C.I.L. C.C.I.L. walks its own tightrope between apologizing for and accepting the criticism of the industry and itself. Despite this dilemma, C.C.I.L. management has been remarkably candid in stating its position.

On a number of occasions, C.C.I.L. has stated that manufacturers in the industry produce the best machine they can. This view is based partly on management's experience with its suppliers and partly on the standard competitive argument:

> In any case, although we are no apologists for the old machine companies, we have no hesitation in saying that all manufacturers of farm machines do their best to avoid mechanical troubles. Every one means an immediate heavy loss in money and above all, in goodwill to the manufacturer; the very things he must avoid if he is to succeed in his business.4/

4/ C.C.I.L. Annual Report, 1966, p. 4.

Of greater significance is the position held by C.C.I.L. with respect to farmers' or farm leaders' complaints and demands for government inquiries.

> Let us summarize all this by saying that there is nothing wrong with the farm machine business that the farmers can't cure by co-operative action. It is not only foolish but it is, in our opinion, weak and childish to cry for Inquiries, for Government or any other kind of help, when all that is needed is for us to do the job ourselves.
>
> No person, no inquiry, no farm organization, has ever been able to suggest any other kind of action than co-operative action to reduce prices and correct other matters in the industry that require correction. We are convinced that none ever will.
>
> Western organizations don't need to worry about those who prefer to buy from profit making machine companies. They have made their choice as they have every right to do and, in so doing, have prescribed their own medicine.5/

C.C.I.L. notes that all government inquiries are the result of pressure exerted on the government by farm organizations, but feels that an inquiry is not only useless, but possibly harmful.

> All the previous inquiries and also the present one came about as the result of pressure from farm organizations and particularly from their western sections. We believe that, instead of asking for still another Inquiry, the interests of western farmers would be better served by all farm bodies declaring that the previous Inquiries were right in their conclusions and that farmer co-operation provided the answer to high prices and other related problems. To ask for an Inquiry tends, we fear, to discredit C.C.I.L. and to weaken instead of strengthen confidence in what farmers can do for themselves through co-operative action. Farmers have the whole market for farm machines in their own hands, and having this, they have all power. All they need to do to achieve the main objective of lower prices is to use this power sensibly.6/

It is interesting to note that the position taken by C.C.I.L. and many other co-operatives with respect to political or government action is virtually the same as that held by the other firms in the trade. In 1966, there was a small grass-roots protest movement against the high and rising cost of food. The response of the

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5/ C.C.I.L. Annual Report, 1966, p. 3.

6/ Ibid.

Winnipeg Red River Co-op was simple and direct. The co-op management argued that there was no need to protest. The consumer could solve the problem of high food costs by patronizing a co-operative food store. Whatever the merits of the arguments presented by the leaders of the protest movement, surely the claims of the co-op were highly exaggerated in this instance. It is this writer's view that co-operatives tend to overestimate, even under highly favourable circumstances, the power of a co-op to alter market conditions. Meyer Brownstone's comments on producer co-ops is, to some extent, also applicable to purchasing and manufacturing co-ops.

> But as bargaining agencies in the market place co-operatives have, almost without exception, been quite unsuccessful. At no time has the co-operative form developed enough member support to be able to command enough product consistently to obtain real market power.7/

The following is a newspaper report of a statement made by Mr. Walter C. Newman before the Manitoba legislature's special committee investigating the high cost of farm implements.

> Noting that he was representing 12 firms, he said that farmers have ample opportunity to seek competitive prices from various companies or, failing that, could go to the farmer-operated Canadian Co-operative Implements Limited.8/

Obviously, there is a group of farmers who are dissatisfied with many aspects of the industry and who do not believe C.C.I.L. can eliminate the conditions which have given rise to their complaints. On the other hand, as noted above, C.C.I.L. argues that the only practical approach to improving the industry is to give massive support to C.C.I.L. In failing to do so, the farmers have "prescribed their own medicine". There is evidently a profound split in the farm movement on this issue.9/

Of course, the establishment of an agricultural co-operative does not invariably lead to a rift in the farm movement, and if one

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7/ Meyer Brownstone, "Agriculture", in Social Purpose for Canada, Michael Oliver ed., University of Toronto Press, 1961, p. 326.

8/ Winnipeg Free Press, Friday, October 13, 1967.

9/ The validity of the farm organizations' and C.C.I.L.'s arguments is not the point under discussion. The issue is the disagreement.

takes place it need not last long. A great deal depends on the extent to which grievances are eliminated by the co-op and the trade as new techniques and procedures are developed. Furthermore, the introduction of regulatory devices by the government may greatly reduce or eliminate areas of conflict -- the hot issues of one decade are often the dead issues of the succeeding decade.

6. THE SUCCESSES AND FAILURES OF C.C.I.L.

Co-operatives have been successful in many industries or sectors of the economy. This is especially true in Western Canada where farmers' co-operatives have been strong and influential. The frequent and occasionally spectacular success of co-ops in the West has led many to presume that a farm machinery co-operative would be equally successful.[1/] Such has not been the case. In this chapter an attempt is made to explain the failure of C.C.I.L. to play a significant role in the farm machinery industry. However, before presenting and analyzing some of the explanations given for this failure, a short comment will be made on the criteria used to measure success.

The degree to which a firm has been successful can be judged from several points of view -- total sales, profits, percentage of the total market, value added, number of employees, and impact on market price. Obviously, a firm can be successful from some points of view and unsuccessful from others. These differences in criteria partially explain the disagreement among various groups about the success of C.C.I.L.

Had C.C.I.L. been a private profit firm rather than a co-operative, there is little doubt that most observers would have considered its growth rate extremely satisfactory. Since its inception in 1945 as a distributor and manufacturer of farm machinery, its sales have expanded to $20 million (1966) and, aside from fluctuations experienced by the industry, have been steady and substantial. The record of the company with respect to the surplus earned and percentage of savings or patronage dividend is nothing short of superb. The surplus and percentage dividend are the main criteria used by the directors of the company in assessing its performance. They are not, however, the criteria used by its critics who are concerned with the total impact C.C.I.L. has had on the price, quality, and service in the farm machinery industry.

1/ Co-operators have a strong inclination to ignore their spectacular failures. As noted in Chapter 3, this has been the case in farm machinery.

These critics point out that the co-op has failed to capture an important share of the farm machinery market and that it has had an insignificant effect on the market price. They argue that since C.C.I.L. has not improved the bargaining power of farmers in their struggle with the old-line companies, it has failed in the objectives for which it was originally organized. In this very special and very harsh sense, C.C.I.L. has been unsuccessful. Some of the explanations given for the slow growth of C.C.I.L. are discussed below.

Savings or Inability to Compete

Savings, in the present context, refer to the difference in the retail price charged by two firms. If Company A sells a product for $1.00 less than Company B, then the savings per unit are $1.00 and the total savings are $1.00 times the number of units sold, assuming the commodity was purchased at the lower price. However, there are usually differences in quality and service and these must also be taken into account in estimating savings. If the latter two factors are the same and the prices charged are known, then savings can be calculated very simply. In the farm machinery market it is usually difficult to determine the market price, differences in quality and service, and therefore the savings. Additional problems arise when one of the two firms is a co-operative.

Co-ops often charge the market or going price (initially) and this is the avowed policy of C.C.I.L. In these circumstances, savings in the first instance are zero -- that is, there is no difference between the prices charged by C.C.I.L. and the private firm. But savings arise later when the surplus or patronage dividend is calculated. The dividend is a residual or surplus calculated by subtracting revenue or value of sales from cost. It is therefore necessary to determine both revenue and cost before the surplus or savings can be calculated. Estimates of cost, especially when there are large inventories and capital items to depreciate, can be difficult and can vary considerably depending on the estimating techniques used. These are additional difficulties that do not arise when comparing the "savings" obtained by buying from Company A rather than Company B; a comparison of the prices charged by the two firms is all that is required.

C.C.I.L. estimates the savings of its customers by two methods that yield substantially different amounts and percentages.

> There are two ways of calculating the savings for the member-customers of C.C.I.L. One is on the basis of allotted dividends. The other is on the basis of dividends plus the reductions from list prices effected through discounts for cash, in the case of cash deals, and through prices allowed for trade-in machines in excess of what it is possible to sell these for.2/

Both of these estimates of savings are useful, as will be shown below. However, the second estimate, based on reductions from list price plus dividends, is misleading from one very important point of view, namely, as a basis for comparing the savings received by a farmer who purchases from C.C.I.L. rather than from a private profit firm.

> But, as you are all aware, co-operative practice is to sell at the going price and the going price for farm machines is a lot less than the list price,...3/

Purchases from any company involve savings from list because there is a discrepancy between the list price and the going or market price. Therefore, the market price has to be used as a reference point in calculating the "true savings" gained from dealing with C.C.I.L. However,

> ...with almost all sales involving trades, it is impossible to determine with any degree of accuracy just what the going price is.4/

It follows that the true savings farmers make by purchasing from C.C.I.L. are also difficult to estimate. Fortunately, in the present case there are special circumstances which greatly reduce the difficulty of making rough estimates of savings.

C.C.I.L. manufactures some machinery and also, until recently, purchased a large portion of their machines from Cockshutt. Since C.C.I.L. was selling the same machinery as franchised Cockshutt dealers, this eliminates, in part, the problem of comparing quality. Furthermore, C.C.I.L.'s list price was the same as that of the independent Cockshutt dealers. The difference between final or market price and list price can be calculated by subtracting cash

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2/ C.C.I.L. Report of the Directors to the Annual Meeting of Delegates, Winnipeg, Manitoba, March 1961, p. 10.

3/ Ibid., p. 11.

4/ Ibid., p. 11.

discounts and trade-in losses from list. From 1945 to 1953 the difference between market and list price was small since there was a seller's market, and from 1953 to 1963 C.C.I.L. sustained very heavy trade-in and cash discount losses, especially in the latter years. These losses are far greater than any franchised dealer could possibly incur and remain in business; e.g., in 1966,[5] they were 23 per cent of sales at list price. Furthermore, in 1966 the patronage dividend was 12 per cent of the list price. Given the standard dealer discount of 20 to 25 per cent,[6] it is evident that C.C.I.L.'s prices have either been below or at least as low as the market price.

The third factor to be considered is service. It is more difficult to quantify this factor and one can only judge the relative value of C.C.I.L.'s service compared with that of the franchised dealer. There are, however, several reasons for believing that C.C.I.L.'s service was at least as good as that of its retail competitors. Whatever empirical evidence is available (unfortunately there is little) suggests that C.C.I.L.'s service has been, by and large, satisfactory; in the case of the franchised dealer the evidence is harder to interpret. C.C.I.L. has larger depots (dealer outlets) and probably is better equipped to provide parts and service than most independent dealers. Many franchised dealers have gone bankrupt and no doubt the elimination of these dealers has created special problems for their customers. For these reasons, it seems reasonable to conclude that C.C.I.L.'s service has probably been at least on a par with that of its competitors.

There can be little doubt that C.C.I.L. is competitive in price. The quality for a large part of its sales is identical with that of its competitors (other Cockshutt dealers) since they were buying from the same supplier. There is no reason for believing that service would be in any way inferior to that of its competitors. Hence, there is reason to believe that C.C.I.L. offered better prices and provided at least as good a service for the same quality of machine. Moreover, the co-op also declared a fairly high

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5/ The last year in which C.C.I.L. handled Cockshutt machinery.

6/ Dealers will often receive another 5 to 7 per cent in volume discounts. These dealers will be in a position to increase their discount-off list. This consideration weakens the argument but does not invalidate the analysis above.

patronage dividend. We therefore can state that C.C.I.L. did effect "true savings" to its customers and that the co-op is highly competitive.

The savings made by owner-customers of C.C.I.L., assuming initial price, quality, and service are approximately the same for all firms in the industry, are equivalent to the surplus less income tax. The savings as calculated by C.C.I.L. for the period 1945-66 are as shown in Chart 1 on the following page.

Co-op savings as a percentage of sales have been high. However, only a small portion of the savings or patronage dividend is paid out in cash and the present value of non-cash dividends is substantially lower than the cash dividend. A rough estimate of the difference can be made as follows: assume a farmer spends 40 years at farming and purchases from a co-op roughly equal amounts throughout this period. A dollar equity would remain with the co-op for approximately 20 years (the geometric average is approximately 15 years). Since the equity is in a higher risk firm, we will assume it should yield a 10 per cent return. The present value of an expected return 15 years from now, discounted at 10 per cent, is approximately 25 per cent of the future value; i.e., the current value of a dollar dividend is 25 cents.[7/] Therefore, the effective savings to the co-operator is only one-quarter of the apparent savings; the difference arises because interest is not paid on equity held by the co-op. The above objective estimate or its intuitive equivalent will be made by some customers. Others will use a subjective discount rate so that the present value of the dividend is virtually reduced to zero. Such statements as "I'm not interested in what I'll get in 20 years, what will I get now?" implies this kind of discount rate. In other words, the failure to pay out dividends in cash is viewed by some as equivalent to receiving no dividend. Some take an antagonistic attitude toward the non-cash dividend, even though they can get as good a deal from

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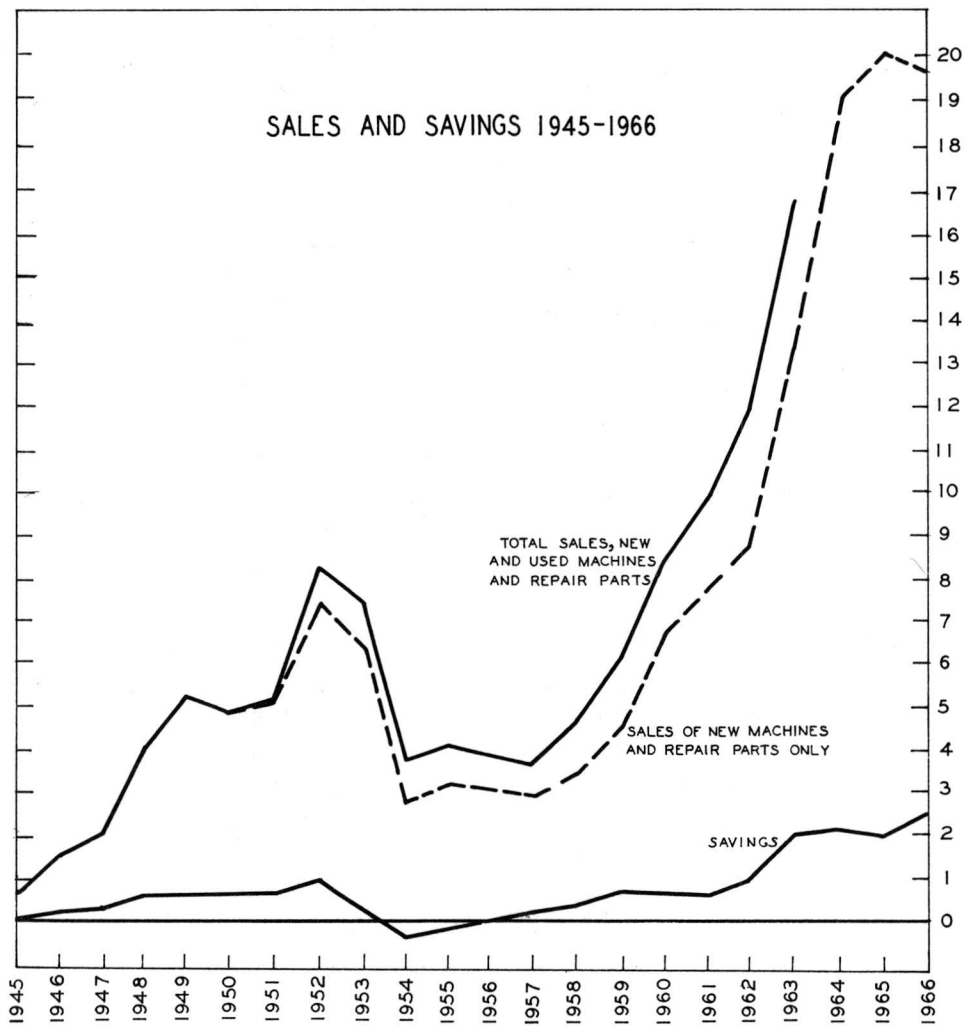
7/ The estimate of 25 cents is too low, since C.C.I.L. has declared some cash dividends and has also allowed part of the dividends to be used in part payment for new equipment. On the other hand, an estimate of a present value of 50 cents is probably too high. The example indicates how large a difference there can be between cash and non-cash dividends, given reasonably realistic assumptions with respect to the rate of interest and the time periods for which the money is held.

CHART 1


SALES AND SAVINGS 1945-1966
TOTAL SALES, NEW AND USED MACHINES AND REPAIR PARTS
SALES OF NEW MACHINES AND REPAIR PARTS ONLY
SAVINGS
20
19
18
17
16
15
14
13
12
11
10
9
8
7
6
5
4
3
2
1
0
1945
1946
1947
1948
1949
1950
1951
1952
1953
1954
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1959
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1961
1962
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1965
1966

a co-op as they can from anyone else. They feel that there is a pretense or hoax involved. At best, the continuous failure to pay cash dividends generates an attitude of indifference in some co-operators despite the substantial amount of cash they will ultimately receive. Thus both the objective and subjective savings of farmers are substantially below the figures quoted by C.C.I.L.

The Integrated Nature of the Industry

The farm machinery industry is highly integrated; the large manufacturer is his own wholesaler and either has his own retail outlets or, more commonly, has a number of independent franchised dealers. Therefore, a firm entering the industry at the manufacturing level is faced with the problem of finding retail outlets for its products. If the firm has enormous financial resources and is producing a moderately wide range of goods it can set up its own distribution organization. On the other hand, a firm can enter the industry at the distribution level. But most firms that do so are small independent dealers who are an integral part of the manufacturer's distribution system.

It is difficult for a co-op to restrict its operations to the distribution sector. A co-op will attempt to organize on a large scale in order to serve the entire farm community. That is, it will wish to enter the industry as a chain, not as a small independent dealer. As most manufacturers have established outlets, they can sell to the co-op only at the risk of disturbing their traditional organization. The only remaining alternative -- to enter at both the manufacturing and distribution level -- requires enormous capital and entails very large risks. Nevertheless, C.C.I.L. decided to do precisely this, and to do so, moreover, with a small amount of initial capital. It had to pay a high price for attempting so much with so few resources. The manufacturing operation had to be confined to a limited number of relatively inexpensive implements and to producing too few of these. This limited operation was inadequate to provide a solid basis for a retail outlet. Therefore, C.C.I.L. had to distribute goods manufactured by other firms. As noted, most private firms with a reasonably full line had their own distribution agencies. It was remarkably difficult for C.C.I.L. to induce a firm to sell to it, since a manufacturer could do so only at the risk of jeopardizing his traditional outlets.

This point is of considerable importance in assessing the role of C.C.I.L. The management of C.C.I.L. has consistently claimed that the main savings in the farm machinery industry are made in distribution rather than in manufacturing. If, in fact, one organization must have control over an integrated operation, the traditional distinction between the two sectors of the industry and the traditional allocation of costs between manufacturing and retailing are, to an important extent, untenable. The manufacturer may allow large discounts or commissions and incur various distribution costs in order to insure a configuration of favourable conditions in his total organization. To analyze the "cost of distribution" separately without examining the impact of alternative distributions on the cost of manufacturing, and vice versa by implicitly assuming other things equal, may lead to fallacious results.

The experience of C.C.I.L. shows clearly the difficulties that arise at the distribution level if the sources of supply are controlled by others. First, C.C.I.L. had great difficulty in negotiating its initial contract with Cockshutt. Even after the first agreement was reached, disputes arose between the two parties since Cockshutt had its own outlets to consider. The contract had to be renegotiated from time to time, and there was always the possibility that Cockshutt would not wish to renew the contract or would renew it only under less favourable conditions. Obviously, C.C.I.L. was in an inferior bargaining position. Furthermore, there was the danger that Cockshutt might merge with another firm that had its own distribution organization and which would not wish to distribute its product through C.C.I.L. or any other co-operative. And this, in fact, is what happened. C.C.I.L. was then forced to negotiate a contract with the new company. Again the new company merged; again C.C.I.L. was without a source of supply. Each change in supplier disturbed the flow of continuous services with respect to trained personnel and repair parts and thus undermined confidence in and the competitive position of C.C.I.L. Most large manufacturers find they need their own distribution system. It may be equally true that a distribution organization needs its own sources of supply. C.C.I.L. did not have the resources to enter both the manufacturing sector as a full-line producer and the distribution sector. Its limited resources seriously restricted its manoeuverability. This partially explains its failure to grow more rapidly than it did.

An Estimate of C.C.I.L.'s Savings from Manufacturing and Distribution -- The C.C.I.L. Annual Report to the Directors contains, in addition to a summary of the year's operation and a balance sheet statement, a great deal of other important information. The supplementary information on sales policy, breakdown of sales between C.C.I.L. and other manufactured goods and machinery purchased for resale, inventories, savings or patronage dividends, and various other items, are not, however, presented on a continuous basis each year. One problem may be regarded as important in a given year, discussed at length and then not referred to again. The lack of continuity in many important figures makes it impossible to provide a reasonably complete analysis of many problems. One such problem, an analysis of the returns and costs of distribution and manufacturing, suffers from both the discontinuity of published data and the complete absence of other data. It is therefore possible to make only a partial analysis of this question.

The 1966 Report provides a breakdown of total sales into four groups: sale of new machinery manufactured by C.C.I.L., sale of new machinery manufactured by others, sale of repair parts, and sale of second-hand machinery. (These data are available only in the 1965 and 1966 Reports.) There are also figures on cost of goods purchased, factory costs, and other items. However, the cost-of-goods-purchased data are not separated into manufacturing materials used by C.C.I.L. and machinery purchased for resale. Nor is there published data (naturally) on the discount received from the manufacturer by C.C.I.L. In order to estimate returns from manufacturing and distribution, it is necessary to estimate either the discount received by C.C.I.L. or the cost of goods used by C.C.I.L. in manufacturing its own machines.

Let us assume that C.C.I.L. receives a 40 per cent discount off list from the manufacturer. It is now possible to calculate the cost of machinery purchased for distribution and the balance represents the cost of goods used by C.C.I.L. for manufacturing purposes.

The data following indicate that $1,720,736 was earned from manufacturing and $938,389 from distribution. These results are somewhat surprising.[8/] They suggest that C.C.I.L. is making most

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8/ Not too surprising when one considers the trade-in losses incurred by C.C.I.L. See Appendix I, C.C.I.L. Annual Report, 1966, p. 15.

SURPLUS FROM MANUFACTURING AND DISTRIBUTION [a]

Value of sales of machines purchased from other manufacturers		$ 8,942,010 [b]	
Cost of machinery purchased from other manufacturers .6 x $8,942,010		$ 5,365,206 [c]	
Cost of goods of C.C.I.L. manufacture $9,963,870 - $5,365,206			$ 4,598,664
Additional manufacturing expenses			
1. Factory	$ 83,914		
2. Administration in general	188,423		
3. Parts Expenses [d]	87,000		
4. Interest [e]	90,000		
Total			449,337
Total cost of manufacture			$ 5,048,001
The wholesale value of goods produced by C.C.I.L. is assumed to be 60% off list price			
Machine of own manufacture and repair parts (assumed to be of own manufacture) at list ($10,084,317 plus $1,196,912)		$11,281,229	
60% of list .6 x $11,281,229			$ 6,768,737
Total cost of manufacturing			5,048,001
Surplus from manufacturing			$ 1,720,736
Surplus for the year (before taxes)		$ 2,659,125	
Surplus from manufacturing		1,720,736	
Surplus before taxes from wholesale and retail			$ 938,389

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[a] See C.C.I.L. Annual Report, 1966, Appendix 1.

[b] P. 8, col. 2.

[c] See text assumption.

[d] In 1962, Head Office expenses were $38,902 and sales were $8,739,293. The ratio of expenses to sales for 1962 applied to 1966 yields a figure of approximately $87,000.

[e] The interest charge was arbitrarily divided equally between manufacturing and distribution.

of its surplus in manufacturing rather than in distribution, although most farm leaders have usually stressed the inefficiency of and potential savings from distribution. The relatively large surplus from manufacturing suggests that further expansion should take place in this sector. Significant expansion in manufacturing would require the production of tractors and combines, and the production of either would entail a completely new and expensive plant. Expansion would require millions and involve large risks. It would not take place by investing small amounts over a period of years, as has been the case in the distribution sector. This analysis provides another explanation for the slow growth of C.C.I.L. Management must have found[9/] -- assuming the analysis above is correct -- that the largest part of the surplus was made in manufacturing, but felt the company was not in a strong enough position to make a major expansion or a breakthrough in this area.

This conclusion is subject to a number of severe qualifications. Firstly, the analysis assumes that it is possible to separate manufacturing and distribution costs, and the questionable nature of this assumption has been discussed above. Secondly, the data cover only one year and the proportion of profit might vary considerably from year to year. Finally, the relevant consideration is the rate of profit (the return per dollar invested in each sector) not the amount of profit. At best the analysis provides a very rough estimate of the relative amount of profit made in manufacturing and distribution.[10/]

Insufficient Support from the Co-operative Movement

When C.C.I.L. was originally organized a few large co-operatives provided financial assistance to the new co-op. Subsequently, however, there was apparently little effort by many of the large established co-operatives to encourage its members to support

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9/ Although the writer has no way of determining the accuracy of his analysis, he is quite certain that management has made similar analyses and does know where the main source of surplus arises.

10/ Further comment on the earnings and costs of distribution are made in Appendix 3.

C.C.I.L. and to purchase most of their farm machinery from their own co-operative. C.C.I.L. might have grown far more rapidly had other co-ops exhorted their members to support the new co-op. There are, however, a number of reasons for doubting the importance of this factor.

1. C.C.I.L. advertises in many co-operative farm newspapers and magazines; it is difficult to believe that farmers are not fully aware of its existence.
2. The U.S. National was an offspring of a number of large and powerful United States farm co-operatives and although it did receive full support from these organizations, the machinery co-op failed.
3. It is doubtful that co-operative leaders could have exerted sufficient influence on the rank and file to significantly alter their purchasing patterns.

Therefore, the reason for the slow growth of C.C.I.L. must be found elsewhere.

C.C.I.L.'s Analysis of its Growth Rate

C.C.I.L. has been criticized frequently and severely for not expanding more rapidly, and the directors have answered their critics on a number of occasions. The latest defence of their growth policy is presented in their 1966 Annual Report.

> ...but we also realize that many want us to provide them with similar dividends on a wider range of machines than we presently have available and that they want us to manufacture those we cannot procure elsewhere. But, as we have said before many times, we do not consider it advisable to expand manufacturing operations any faster than we have been doing. Every machine has, in accordance with its complexity, a pretty definite minimum of yearly production of manufacture if this is to be economic and competitive. Even if we had abundance of money to build additional factory space and to design and manufacture additional lines, we would still face the job of persuading farmers to buy in the quantity necessary to avoid loss. The hard fact must be accepted that farmers have not, except in numbers too few to be significant in the business operations, bought any more readily from C.C.I.L. than they have from any other farm machinery company. Prices paid for trades demonstrate this fact.11/

11/ C.C.I.L. Annual Report, 1966, p. 10.

C.C.I.L. in short, argues that it has expanded as quickly as its financial and human resources have allowed, given the demand conditions. The problems of human resources or trained personnel and financial restraints will be dealt with first, although they are of lesser importance than the problem of demand.

Lack of Trained Personnel -- Every expanding organization faces the problem of finding and training new personnel. The task is difficult, expensive and time-consuming. Nevertheless, it is a problem that many organizations in the farm machinery industry have faced and solved. C.C.I.L. has been in business for 27 years, and with the exception of three poor years has earned substantial surpluses. Therefore, funds were and are available to pay the going rates for managers and technical personnel. It has also had ample time to train personnel for its present and any anticipated future expansion.

Lack of Financial Resources -- The second argument presented against more rapid growth is that C.C.I.L. has, throughout its history, grown as quickly as its financial resources have allowed. But what are the actual and potential resources or assets of C.C.I.L.? The actual resources are shown by the annual balance sheet of the company. The balance sheet and other accounting data indicate that C.C.I.L. is using all available resources for production and distribution. In fact, its short-run indebtedness to the bank is fairly high, and its interest payments have on a number of occasions been as high as $200,000 per year. However, given the nature of the industry and the sales of the firm, these costs are probably normal. The firm may still be able to borrow large amounts of money for an expansion programme. However, C.C.I.L. management has been concerned with finance in a much broader sense, that is, with the financial strength of the company to survive under adverse conditions which often arise in this high-risk industry.

These broader financial problems can be discussed most propitiously by contrasting C.C.I.L. with its competitors, the full-line companies, both with respect to their financial structure and their markets. The financial structure of C.C.I.L. is vastly different from that of their full-line competitors. As noted above, C.C.I.L. started with assets of $750,000 and expanded these to $15.8 million, and of these $13 million is held in inventories.

By comparison, the full-line companies are all giants; they are not only giants in their own right, they are subsidiaries of some of the largest and most powerful industrial complexes in the world. This puts C.C.I.L. at an overwhelming disadvantage in comparison with other companies.

The large corporations have another distinct advantage: they are multinational or worldwide in scope. The world, or a significant portion of it, is their market. The advantage of a very extensive market is of special importance in agriculture. Agricultural output of grain is still largely determined by acts of God. The demand for agricultural machinery is a derived demand, indirectly determined by agricultural output. As a consequence, the demand for farm machinery is highly uncertain and highly variable in a given region. Demand often doubles or is reduced by half within the short time span of a few years. Firms in a depressed area will inevitably suffer losses, and if a firm operates in this area only, it may go under, whereas firms operating in many regions can offset the losses incurred in one area with the profits earned in other more prosperous regions. The full-line companies who do operate in many regions can spread their risk and, in most cases, survive temporary setbacks. Firms that are essentially regional in character have no such cushion against local setbacks.

Most of the full-line companies are protected against adverse local or regional conditions by another and equally important characteristic -- they are highly diversified. A high percentage of the earnings of these super-giants is in other industries. Earnings from diversified activities, in most conceivable situations, will be sufficient to carry these firms through even a widespread agricultural depression.

The basic fact of agriculture -- so well known and so often repeated -- is that output and revenue are highly fluctuating. The super-giants have evolved techniques for protecting themselves against uncertainty and risk. Small regional firms have to survive as best they can, if they can. There is ample evidence that often they cannot. It is within this framework of extreme risk that one must assess the growth rate of C.C.I.L.

The existence of inherently large risks in this industry and the dangers of ignoring them have been the dominant consideration in C.C.I.L. policy. In Annual Reports, memoranda and submissions, etc., C.C.I.L. has stressed the potential vulnerability of its

position, given the extent and nature of its market, its financial resources and those of the full-line companies. Thus the extremely conservative growth policy adopted by C.C.I.L. provides a partial explanation for the slow growth of the company.

Lack of Demand -- In addition to limited financial and human resources, lack of demand is offered as an explanation for C.C.I.L.'s slow growth. C.C.I.L., it is argued, has an adequate number of distribution outlets (60 depots). If they wished, farmers could patronize C.C.I.L. without any significant inconvenience to themselves. Therefore, given the present level of demand, expanding the number of depots beyond 60 is pointless, and expanding production to new commodities, i.e., tractors and combines, etc. would be disastrous. Disaster would follow expansion because the demand would be insufficient to sustain an efficient and economic level of production. This argument assumes that depot expansion would not result in sales expansion. That is, the argument assumes that C.C.I.L. has saturated its market and that expansion of depots would merely result in splitting a given volume of trade among more depots. This view is certainly open to question. It is precisely because new outlets mean more sales that there is a ridiculously large number of dealers in the industry. One hundred and twenty depots might lead to a substantial increase in sales, and if so, the assumption of constant demand becomes invalid.12/

12/ "...farmers who purchase most of their farm supplies from co-ops, but most of their farm machinery from private companies, were asked to explain briefly the major reason for this behaviour.

. . .Although a wide range of reasons was cited by the farm operators, to explain why they are not willing to buy machinery from C.C.I.L., there appear to be two major inter-related reasons for this behaviour. Basically the farmers object to the line of machinery handled by the C.C.I.L. Sixty-one per cent of the farmers expressed dissatisfaction with the C.C.I.L. line. They said co-op machinery (primarily tractors and combines) is too small to handle the job adequately, and since the machines are foreign made, there is likely to be a problem in obtaining repair parts. It is important to note that the farmers are not opposed to the structure of the organization, and many said they would be willing to buy from C.C.I.L. if it handled a "desirable" line of farm machinery. A variety of the reasons offered by the farm operators with respect to this question are worthy of further investigation, including the fact that 11 per cent of the farmers simply do not buy farm machinery from C.C.I.L. because there is no co-op implement dealer in their immediate area."
Alexander Segall, Farmers' Attitudes to Farm Machinery Purchases, Royal Commission on Farm Machinery, Ottawa: Queen's Printer, 1970, p. 12.

Price Policy, Distribution Methods, and Demand

By the end of 1960, C.C.I.L. had been in business for 15 years. During the five years after 1960 -- from 1961 to 1966 -- sales increased from $7.7 million to $20 million, an increase of approximately 160 per cent. The expansion of sales in Western Canada was from $160 million[13/] to $352 million, approximately 120%. In 1961, C.C.I.L.'s sales were 4.8 per cent of the sales in Western Canada, and the corresponding figure for 1966 was 5.7 per cent. C.C.I.L.'s penetration into the market has hardly been startling and there are no special factors to indicate that it will make better progress in the immediate future. Therefore, it seems worth while to explore some of the alternatives C.C.I.L. has considered in the past in order to judge whether they might provide better alternatives to their present methods and practices.

C.C.I.L. began operating with a radically new distribution system. Gradually they shifted closer and closer to the traditional methods of the trade. In doing so, their costs increased and their surplus declined. They charged the market price and provided very little in the way of cash dividends. As trade-ins grew in importance they entered the second-hand machinery market and have consistently incurred large losses in this area. Gradually C.C.I.L. abandoned policies for which the co-op form of enterprise is uniquely suited and acquired policies that are uniquely difficult for co-ops to carry out.

By virtue of an identity of interests between the co-operative enterprise and its members, a co-operative possesses one powerful weapon not available to private profit firms. The co-op can elect to charge the market price and obtain a surplus, or reduce its price and deliberately eliminate its surplus.[14/] The co-operative and its members can, in theory, consider alternative combinations of "surplus" and "price" as points on an indifference curve. The private profit firm is motivated by the desire to make a profit or surplus and therefore cannot trade off "price" against "surplus". In practice, however, co-ops have very little flexibility or

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13/ The wholesale series inflated by 25 per cent to provide estimates of the value of sales at the retail level.

14/ For a more detailed discussion of this point and some comments on the economic theory of co-operatives, see Appendix 4.

manoeuverability. If, for example, the co-op charges the market price and its surplus is only a small percentage of sales then the trade-off range is too small to be of much relevance. However, in many cases, co-ops do earn large surpluses and lowering the price is a meaningful alternative which may have a significant impact on subsequent sales. C.C.I.L. has been earning substantial surpluses and has had to choose between charging the market price and maintaining the surplus or lowering the price and eliminating the surplus. C.C.I.L. chose to maintain the surplus and keep it in the co-op by issuing non-cash dividends.

Co-ops are often organized for the explicit purpose of lowering price and eliminating inefficiency in the industry. However, once the co-op is organized and established, it often adopts virtually the same sales and price policy as the trade. The success of the co-op then depends upon the quality of management. Despite some important innovations in distribution, C.C.I.L. has followed this pattern of behaviour, although it has done so with obvious reluctance.

C.C.I.L. has been concerned with the shift from the fundamental policy of reducing distribution cost to an absolute minimum to the present relatively high-cost situation. It has, for example, considered giving the customer a choice of minimum service or regular service. (From a technical point of view, the service would be the same in both cases; minimum service would involve direct purchase from the factory rather than through a salesman.) Those who purchased through the minimum service plan would receive a higher dividend. Plans of this kind -- the basic idea is that the customer is charged for extra service or rewarded for less expensive service -- were apparently tried unsuccessfully by private profit firms.[15/] There would probably be many cases where it was difficult to classify the customer. More important, the customer might demand the lower price or other reward as well as the better service and be resentful if he did not get both. The direct factory order would appear to provide a clear-cut criterion for classifying the customer. It would, however, undercut the position of the sales force. This is the crux of the problem of trying to operate two essentially different distribution systems in one

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15/ W.G. Phillips, The Agricultural Implement Industry in Canada, Toronto: University of Toronto Press, 1956, pp. 138 and 192.

organization. The customer who buys through a salesman will not pay more than he previously did, but since a direct order would lead to a lower price, he would now feel that he is being overcharged.

The co-op would presumably prefer to see customers shift to the direct factory order method. However, even if this shift does take place, it will obviously take time and real difficulties can arise during the transition period. The effect on the sales force would probably be devastating. Furthermore, a customer could discuss his problem with the salesman, wish him well, and then order from the factory, thus making the best of both worlds. It is precisely because of such major transition problems that there have been few radical changes in the distribution system of the industry.

C.C.I.L.'s present system of distribution has the added disadvantage of having company representatives (paid employees) handling trade-ins. This does not seem to work and large losses have been incurred; trade-ins seem to be more efficiently handled by independent dealers. C.C.I.L. felt it was forced to take trade-ins in order to sell new machines. This may well be the case, given its price policy and distribution system. However, it made no serious effort to reduce the price substantially below the prevailing market price. Whatever reasons existed in the past for failing to do so (claims of unfair competition by Cockshutt dealers to the parent company, or lack of financial resources) these reasons do not exist at present. A drastic price decline is probably an essential prerequisite for penetrating the market and introducing further reductions in distribution cost.

C.C.I.L.'s trade-in losses were 23 per cent of retail sales in 1966. Obviously, prices could be reduced by this amount if trade-ins were not accepted. During the same year it had a surplus of 13 per cent of retail price. Therefore, a 36 per cent discount could have been offered in 1966 with the company ending up no worse off at the end of the year than it was at the beginning (assuming the same volume of sales). It could have made the same losses on trade-ins and offered an additional 13 per cent off list, or paid the 13 per cent as a cash dividend. (This example exaggerates the power of C.C.I.L. to lower prices, since 1966 was an exceptionally good year.)

C.C.I.L. has failed to capture the imagination of the farm community. If it is to do so, a drastic act is required -- the

more drastic the better. Therefore, a policy offering the greatest immediate price cut should be considered. Two standard reasons are given for not utilizing this one, and perhaps only powerful weapon co-operatives have. First, a price cut by the co-op would be followed by similar or greater price cuts by private profit firms in an attempt to maintain their share of the market. Second, a co-op does not have resources to win a battle of this kind.

The theory is that the giants will immediately follow suit if C.C.I.L. cuts price. But will they? Perhaps C.C.I.L. is over-estimating its present importance in the market. Suppose it had cut its price an additional 13 per cent or offered a straight 35 per cent discount off list. Let us say the trade felt it had to lower price by 10 per cent (one must bear in mind the imponderables) in order to remain competitive. A price cut of this size would cost the trade $25 million and there can be little doubt that the manufacturer would bear the brunt of the cost. At the end of the year farmers would have saved $25 million at the expense of the trade and C.C.I.L., as a farmer-owner organization and an extension of the farmer's business, would be in the same financial position as it was at the end of the previous year.

Given the fact that C.C.I.L. has only 5.5 per cent of the market, and given the enormous cost to the trade of accepting C.C.I.L. as a price leader, a more probable strategy by the full-line companies would be to adopt a wait-and-see attitude. If C.C.I.L.'s policy proved successful and it captured a significant portion of the market, then the trade would have to act. However, if successful, C.C.I.L. would be in a position to further rationalize its distribution system and the trade might be forced to follow suit.

A policy of drastic price cutting may not significantly increase C.C.I.L.'s sales. Despite the protestations of farm leaders and organizations, the fact of the matter may be that the vast majority of the farmers want the distribution system they have and are willing (accompanied by the appropriate disclaimers) to pay for it.

> ...I have pointed out that there is almost as close a relationship between the farm equipment dealer and the farmer as there is between the farmer and his wife, when the company store is put into effect there is a hesitancy on the

> customer's part, because he regards it as more or less a machine operation. There is no feeling in marketing of that kind.16/

If farmers in fact have and want this kind of relationship with their dealer, then surely anyone familiar with the consequences of matrimony must conclude that the cost of distribution in the farm machinery industry is remarkably low. If a customer wants "friendship", "advice", etc., in short, a human relationship (and who is to say he ought not to want it), then the price is bound to be high in a market economy.

The suggestion that the local independent dealer satisfies a need, technical or psychological, which could not be satisfied by a more impersonal distribution system is certainly open to question. In one survey of buying habits,17/ farmers were asked how much contact they have with their machinery dealer. Forty-six per cent stated that it was more than one year since a dealer or salesman called on them, and an additional 11 per cent said it was from seven to twelve months. Therefore, one may challenge the contention that there is a special relationship between the farmer and independent dealer and that the replacement of independent dealers by a 'chain' distribution system would involve a significant loss to the farmer.

16/ Mr. L. Sykes, Secretary, Canadian Federation of Farm Equipment Dealers, Standing Committee on Agriculture and Colonization, Minutes of Proceedings and Evidence No. 7, May 8, 1961, pp. 465-66.

17/ "Farmers' Buying Habits", op. cit.

7. CONCLUSIONS

The failure of the distribution system in farm machinery is, to an important extent, the failure to provide alternatives to the personalized service of the local dealer or small local outlet. There is no organization providing the equivalent of the mail order house or direct factory ordering system. There is no bargain-basement counterpart to the highly personalized service provided by the trade. Each system of distribution satisfies different tastes and preferences and it would be desirable if both systems were available. The special conditions in the industry make it extremely difficult to provide a number of alternative methods to cater to a multitude of tastes.

C.C.I.L. attempted, for a limited time and to a limited extent, to provide an alternative system. However, it did not develop the alternative for a sufficiently long period of time and did not generate a sufficient difference in price to attract a large part of the market. The system was never given a "run for its money", and therefore there is no way of knowing how large a market there is for an inexpensive system. The only alternative apparently available to C.C.I.L., other than the present suggestion, is:

> ...To create confidence in this organization in the minds of farmers. This cannot be done by exhortation and appeals to co-operative loyalty. It can only be done by patient hard work year after year, in providing good machines, good service and good dividends to those who patronize us.1/

But presumably this has been done by C.C.I.L. for the past 26 years without significantly penetrating the market. The argument is therefore unconvincing. Moreover, C.C.I.L. has alienated itself from an important segment of the farm community by its present approach. The co-op cannot but conclude that as noted earlier:

> Western organizations don't need to worry about those who prefer to buy from profit making machine companies. They have made their choice as they have every right to do and, in so doing, have prescribed their own medicine.2/

1/ C.C.I.L. Annual Report, 1966, p. 10.

2/ Ibid., p. 3.

This conclusion may be proven correct ultimately, but it is, in this writer's opinion, premature.

An aggressive price policy would entail considerable risk, given C.C.I.L.'s present financial structure, its position in the market, and the power of its competitors. However, the degree of risk could be substantially reduced by an agreement or understanding between C.C.I.L. and other large and successful co-operatives. A pooling of financial resources of the financially strong co-operatives in relatively low-risk industries and co-operative enterprises in relatively high-risk areas would be highly desirable and perhaps essential if C.C.I.L. and similarly situated co-operatives are to expand and become an important part of the market. An agreement of this kind would enable C.C.I.L. to acquire some of the advantages that many private profit firms in the industry now possess. As noted above, C.C.I.L.'s main competitors have the financial and technical resources available to spread their risks by product diversification and by operating in a large number of markets. Without such an agreement the risk involved in attempting to capture a larger share of the market might be unacceptable to both the members and management of C.C.I.L.

The decision to gamble on a policy of lower prices or higher cash dividends must, of course, rest with the members of C.C.I.L. The majority of the membership may prefer the present policy and the writer is not challenging their right to do so. He is suggesting that there is little reason to believe C.C.I.L. will make significant gains in the market unless its policy is changed; and if its policy is not changed, one should expect the rift in the farm movement to persist.

C.C.I.L. and many co-ops are faced with a dilemma. Initial funds raised in organizing a co-op are usually relatively small, given the long-run objectives of the enterprise. In order to expand it must generate funds through savings which are held by the co-op, and it cannot, therefore, afford to pay out cash dividends. By not paying cash dividends, it may seriously reduce the number of customers and sales. Almost invariably, when faced with this dilemma, co-operative leaders choose the financially conservative solution. They choose not to pay out cash dividends, to strengthen the financial position of the company, and they hope to increase demand by other means. The co-op may, with good management, become a viable economic unit and serve its members well. Often it will

not, however, grow rapidly or have a serious impact on the total market. C.C.I.L. has followed the traditional co-op pattern of behaviour with the traditional consequences.

A brief summary will now be provided in an attempt to present the above arguments in a proper perspective. C.C.I.L.'s absolute growth rate and "savings" have been excellent. This is an outstanding achievement from three points of view: (1) its record as a co-operative in general is outstanding; (2) its record as a co-operative in the farm machinery industry is virtually unique; (3) its record as a producer and distributor at competitive prices and services also appears to be excellent. Nevertheless, C.C.I.L.'s relative growth or overall penetration of the market has been modest. In a sense it is ironic to ask why. But we do often ask why those who have succeeded have not been more successful. Of primary importance, from a social point of view, is the fact that farm leaders continue to voice their traditional complaints that the industry is inefficient and exploitive. The writer has suggested that C.C.I.L. may have increased its sales by expanding the number of its depots and that it may have failed to provide a sufficiently large management team. However, even if these arguments are valid they are only of secondary importance. The crucial considerations are the modest funds available to C.C.I.L. at its inception combined with the nature of the industry, i.e. a highly integrated, high-risk industry dominated by multi-national conglomerates. Also of great importance is the high ratio of inventory to sales and thus rapid expansion by a relatively small regional firm is exceedingly dangerous. Therefore, the suggestion that C.C.I.L. simply rapidly expand into the manufacture of tractors and other large machinery or cut prices is unwise given the present organization of C.C.I.L. The writer has suggested that deeper penetration into the farm machinery market by C.C.I.L. would probably require a "co-operative conglomerate".

A Highly Tentative Proposal for the Rationalization of Distribution and Servicing in the Farm Machinery Industry

Many attempts have been made to reduce the high cost of distribution in the farm machinery industry. All such attempts have failed. A combination of factors -- farmers' buying habits,[3/]

3/ See, for example, Alexander Segall, Farmers' Attitudes to Farm Machinery Purchases, Royal Commission on Farm Machinery, Ottawa:

(Footnote continued on p. 64.)

the economies of scale in manufacturing, and the substantial integration of manufacturing and distribution -- has to date made it impossible for any firm to alter radically the present form of marketing and substantially reduce distribution costs. In addition, farmers have failed to provide an alternative organization that could sufficiently penetrate the market to "force" the trade to rationalize its distribution system.

Unfortunately, to date no one involved in the industry has been able to break through the vicious circle resulting from these factors. Nevertheless, there may be alternatives that would yield advantages to both manufacturer and farmer. It might be possible for a new distribution system to be developed by the industry under government auspices. We will now discuss one tentative proposal.

1. An association of farm machinery manufacturers could be formed for the purpose of organizing and managing "machinery marts" in a small number of centres in Western Canada.[4/] The association would purchase or lease buildings which would be used as show-rooms by its members. New farm machinery would be purchased by ordering from company representatives at these show-rooms. The machinery could then be shipped directly from the factory to the farm. Thus the cost of selling new machinery would be greatly reduced and although the farmer might have to travel farther to purchase his machine, he would have a far better opportunity to select the machinery best suited for his needs and to purchase it at the lowest available price. If new machinery were purchased in this way a great many franchise dealers would be displaced. Changes in the distribution of repair parts, maintenance and servicing of machines would be required, and the second-hand market for machinery would also be altered.

(Footnote continued from p. 63.)

Queen's Printer, 1970; Purchase Behaviour, Purdue University, Research Bulletin No. 797, May 1965; and Farmers' Buying Habits -- A Complete Study, a condensation of a series of articles based on data from a national research project conducted by The National Farm & Power Equipment Dealers Association under the supervision of Drs. George M. Beal and Joe M. Bohlen, Rural Sociologists, Iowa State University.

4/ This proposal is in no way inconsistent with the suggestion that C.C.I.L. might have grown more rapidly had it increased the number of its depots. In this case we are assuming a radical change in the system of distribution in the entire industry. The proposal with respect to C.C.I.L. assumed that the distribution system remained unchanged.

2. The "machinery marts" (perhaps only two or three of the main ones) should also contain major repair parts depots.[5/] These depots could provide most spare parts and through a central communications system could order missing parts from the factory. In emergencies air service could be used. Air service from the factory to the depots should be excellent since the depots would be situated in large cities. Furthermore, with the small number of centrally located depots it would be economically feasible to use a helicopter service (to be available to all manufacturers in the mart) direct from the depot to the farm. Such service could be provided for perhaps six to eight weeks during the harvesting and seeding periods. In this way, virtually all spare parts could be delivered to the farm within 12 to 24 hours, thus eliminating one condition that has created considerable anxiety among farmers. Moreover, the amount of inventory and the cost of handling it should be greatly reduced and therefore the cost of repair parts could be reduced.

With the establishment of a machinery mart the traditional franchise dealer would lose his main source of revenue. Many dealers would be eliminated. However, a number of them might continue in business as franchise repair and service centres. Warranty contracts might be established between the manufacturer and the dealer. These dealers could operate a repair and service station in a manner analogous to the garage man in the automobile industry. The servicing of equipment might improve since repair and service would be the bread-and-butter item of the establishment. Alternatively, the manufacturer might prefer to establish a number of large, well-equipped service centres.

This proposed system of distribution would radically reduce distribution costs. Retailing costs would be cut substantially by the drastic reduction in the number of outlets. Repair parts service would be rationalized and the servicing of machines would be improved, especially during those periods of the year when service is of crucial importance.

Obviously, this radical proposal is presumptuous, given the limited nature of the present study. However, I feel that parts of it, especially the second proposal, have some interesting possibilities. It may be feasible and others may be interested in exploring these possibilities.

5/ This proposal is independent of the first one presented above and it is, I believe, far more feasible.

APPENDIX A

THE CANADIAN CO-OPERATIVE
(Incorporated by Special Act under the
BALANCE SHEET AS
(with 1965 figures

ASSETS

	1966	1965
CURRENT ASSETS:		
Cash on hand and in banks	$ 441,962	$ 373,157
Accounts and notes receivable	956,445	562,413
Inventories of goods and materials (Note 1)	13,028,397	9,077,209
Sundry deposits and receivables	8,674	9,929
Prepaid expenses	26,069	29,368
Total current assets	14,461,547	10,052,076
OTHER ASSETS:		
Receivable on agreements for sale of property	28,562	32,519
Investments in other co-operatives — at cost	97,192	80,615
Total other assets	125,754	113,134
PROPERTY, PLANT AND EQUIPMENT (Note 2)	2,554,472	2,323,473
Less accumulated depreciation	1,305,463	1,162,516
Net property, plant and equipment	1,249,009	1,160,957

Approved by the Board:

B. LILAND Director

H. FULTON Director

TOTAL	$15,836,310	$11,326,167

The attached notes are an integral part of the financial statements.

Source: C.C.I.L. Annual Report, 1966.

IMPLEMENTS LIMITED

Laws of the Province of Saskatchewan)

AT OCTOBER 31, 1966

for comparison)

LIABILITIES

	1966	1965
CURRENT LIABILITIES:		
Bank loan (Note 3)	$ 3,391,000	$ 340,000
Accounts payable and accrued liabilities	687,695	1,349,819
Members' credits	308,317	148,407
Income taxes	59,334	51,300
Total current liabilities	4,446,346	1,889,526
MEMBERS' EQUITY:		
Capital stock (Note 4):		
Authorized - 10,000,000 shares of $1 each		
At credit of members	8,142,764	6,914,386
Reserves:		
Statutory reserve	613,484	518,526
General reserve	104,591	104,591
Total reserves	718,075	623,117
Surplus for the year	2,529,125	1,899,138
Total members' equity	11,389,964	9,436,641
TOTAL	$15,836,310	$11,326,167

THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED

STATEMENT OF SURPLUS

FOR THE YEAR ENDED OCTOBER 31, 1966

SURPLUS FOR THE YEAR ENDED OCTOBER 31, 1965.....		$1,899,138
Apportioned as follows:		
To statutory reserve.....	$ 94,957	
Patronage divided credited to capital stock.....	1,804,181	1,899,138
		NIL
SURPLUS FOR THE YEAR ENDED OCTOBER 31, 1966		
To be allocated by the directors in accordance with the by-laws by setting aside as reserve not less than $126,456, and by allocation of the balance or such proportion thereof as may be determined as a credit to members' capital stock accounts.....		$2,529,125

The attached notes are an integral part of the financial statements.

Source: C.C.I.L. Annual Report, 1966.

THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED

STATEMENT OF OPERATIONS

FOR THE YEAR ENDED OCTOBER 31, 1966

(with 1965 figures for comparison)

	1966	1965
GROSS SALES	$19,994,351	$20,336,387
DEDUCT:		
Loss on goods taken in trade (Note 5)	3,871,806	3,935,523
Discounts to member customers	537,567	383,228
Discounts to agents	76,715	79,861
	4,486,088	4,398,612
NET SALES	15,508,263	15,937,775
COST OF GOODS SOLD	9,963,870	11,199,813
GROSS MARGIN	5,544,393	4,737,962
EXPENSES:		
Sales, service and parts department	2,471,278	2,318,126
Factory	83,914	90,089
Administrative and general	188,423	162,706
Interest	190,135	209,828
	2,933,750	2,780,749
DEDUCT:		
Interest income	2,315	2,943
Sundry revenue	25,943	26,918
Net gain on disposals of fixed assets	12,058	3,940
Reduction in allowance for doubtful accounts	8,166	17,124
	2,885,268	2,729,824
SURPLUS BEFORE INCOME TAXES	2,659,125	2,008,138
PROVISION FOR INCOME TAXES (Note 6)	130,000	109,000
SURPLUS FOR THE YEAR	$ 2,529,125	$ 1,899,138

The attached notes are an integral part of the financial statements.

Source: C.C.I.L. Annual Report, 1966.

THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED

STATEMENT OF SOURCE AND APPLICATION OF FUNDS

FOR THE YEAR ENDED OCTOBER 31, 1966

FUND PROVIDED:		
Surplus for the year	$2,529,125	
Depreciation	163,027	
Total funds from operations		$2,692,152
Principal payments received on sale agreements		3,957
Total funds provided		2,696,109
FUNDS APPLIED:		
Additions to property, plant and equipment - net	251,078	
Repayment of capital stock at credit of members (Note 4)	575,803	
Increase in investment in other co-operatives	16,577	
Total funds applied		843,458
DECREASE IN WORKING CAPITAL - arising from excess of funds provided over funds applied		$1,852,651

The attached notes are an integral part of the financial statements.

Source: C.C.I.L. Annual Report, 1966.

THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

OCTOBER 31, 1966

1. INVENTORIES

Inventories at October 31, 1966 and 1965 have been valued as follows:

	1966	1965
At the lower of first in - first out cost of replacement cost:		
Raw materials	$ 1,377,674	$1,291,177
Supplies	31,006	27,015
Machines and parts	8,100,773	4,509,988
At estimated cost:		
Work in process	155,954	140,864
Finished goods	457,920	429,675
At estimated realizable on sale:		
Used machines	2,905,070	2,678,490
	$13,028,397	$9,077,209

2. PROPERTY, PLANT AND EQUIPMENT

The major categories of property, plant and equipment and related depreciation at October 31, 1966 were as follows:

	Property plant and equipment (at cost)	Accumulated depreciation	Rate
Land	$ 96,380	$ -	-
Buildings	1,255,966	462,354	5-10%
Machinery and equipment	827,914	592,743	20-30%
Trucks	374,212	250,366	30%
	$2,554,472	$1,305,463	

It is the company's practice to provide depreciation under the declining balance method at the rates shown above. The amount so provided for the current year was $163,027 (1965 - $153,003) and is included in cost of goods sold and expenses.

3. BANK LOAN

The bank holds a registered general assignment of accounts receivable as collateral.

Source: C.C.I.L. Annual Report, 1966.

THE CANADIAN CO-OPERATIVE IMPLEMENTS LIMITED

NOTES TO THE FINANCIAL STATEMENTS

OCTOBER 31, 1966

4. CAPITAL STOCK

The change for the year in capital stock at credit of members is as follows:

At credit of members October 31, 1965		$ 6,914,386
Add patronage dividend on 1964-1965 business		1,804,181
		8,718,567
Deduct:		
Shares applied on members' purchases	$ 468,838	
Refunds to estates and members:		
Allocated shares	77,966	
Original shares	32,770	
	579,574	
Less share subscriptions received	3,771	575,803
At credit of members October 31, 1966		$ 8,142,764

5. LOSS ON USED GOODS TAKEN IN TRADE

This is comprised as follows:

	1966	1965
Sales of trade-ins	$ 6,383,586	$ 7,678,454
Trade-ins on hand at beginning of the year	2,678,490	2,697,778
Cost of trade-ins taken in during the year including service and reconditioning charges	10,481,972	11,594,689
	13,160,462	14,292,467
Trade-ins on hand at end of the year	2,905,070	2,678,490
	10,255,392	11,613,977
Loss on trade-ins	$ 3,871,806	$ 3,935,523

Trade-ins on hand are stated at estimated value realizable on sale.

6. INCOME TAXES

Estimated income taxes are based on taxable income equal to 3% of capital employed, less interest paid on funds borrowed from sources other than banks or credit unions.

APPENDIX B

TABLE B-1

FARM IMPLEMENT AND EQUIPMENT SALES

(Including Repair Parts)

(Values at Wholesale Prices)

	Manitoba	Saskatchewan	Alberta	Total
1946	9,987,683	20,308,054	15,698,660	45,994,397
1947	15,583,121	33,382,699	25,953,168	74,918,988
1948	23,369,284	46,505,877	36,748,138	106,623,299
1949	37,474,620	59,629,464	44,459,129	141,563,213
1950	29,308,664	62,629,271	45,117,409	137,055,344
1951	31,698,984	61,147,757	48,267,092	141,113,833
1952	31,578,047	75,859,527	53,505,361	160,942,935
1953	28,030,312	80,333,503	51,302,523	159,666,338
1954	18,854,021	45,271,951	34,043,228	98,168,200
1955	18,609,712	40,328,513	31,380,094	89,718,319
1956	22,532,551	50,104,179	39,676,998	112,313,728
1957	18,699,296	41,568,005	38,213,577	98,480,878
1958	21,530,215	46,421,324	45,504,705	113,456,244
1959	28,571,930	61,396,984	56,426,827	146,395,731
1960	31,024,616	69,052,381	53,335,647	153,412,644
1961	23,233,194	51,541,781	54,118,752	128,893,727
1962	33,140,097	70,751,308	64,713,739	168,605,144
1963	41,569,998	96,617,831	72,338,059	210,525,888
1964	51,107,648	110,985,209	78,884,181	240,977,036
1965	55,087,506	133,266,618	93,632,404	281,986,524

Source: Dominion Bureau of Statistics, "Farm Implement and Equipment Sales", 1950, 1955, 1959, 1965.

APPENDIX C

DISTRIBUTION

Distribution in the farm machinery industry divides into two parts: wholesale, carried on by the farm machinery companies themselves, and retail, carried on by independent, franchised distributors for the farm machinery companies. C.C.I.L. combines the two forms of distribution in that its depots correspond closely to the functions of the independent retail distributors while the wholesale function is carried on by C.C.I.L. in its Winnipeg central location. In order to compare C.C.I.L. distribution activities, it is therefore necessary to sub-divide its activities between the retail and wholesale sectors, comparing the data of the former to data published by the North American dealer organizations and the latter to the data provided to the Commission by other companies engaged in the wholesale distribution only. The limited data available, however, allow only a limited comparison of retail costs in the first area, and selling, general and administrative costs in the latter.

Retail Trade Earnings and Costs

Table C-1 provides data for an 8-year period (1960 to 1967) on the sales and costs for C.C.I.L. depots and private retail outlets. The final row of the table shows that C.C.I.L. depots have sustained losses each year and these losses are a xonsequence of the large trade-in losses suffered by the depots. These data are constructed from the assumption that the C.C.I.L. depots "purchased" their machines from the C.C.I.L. wholesale operation at 71.8 per cent of suggested retail selling prices (the result of adding the standard discount in the trade of approximately 22 per cent for machines and 30 per cent for repair parts, weighted by the 1967 machine/parts mix, and the average bonus for volume sales of approximately 6.2 per cent). The estimated losses on the sales of used machines as a percentage of the value of new machines at suggested retail price has increased from 13.7 per cent in 1960 to 21.2 per cent in 1967. (The average for all dealers for the *Cost of Doing Business Study* for 1967 was less than

1 per cent.) The very high percentage losses on trade-ins, 21.2 per cent of the total value of sales of new machines as compared to the imputed 28.2 per cent retail discount, makes it virtually impossible for the depots to show a profit, taken by themselves.

Another aspect of looking at depot operations is to examine their operating expenses as a percentage of total sales against corresponding expenses for independent dealers. During the period 1960-67, C.C.I.L. depot operating expenses approximated 9 per cent of total sales while the corresponding figure for independent dealers was approximately 13 per cent. The data suggest that the depot system is more efficient in the sense that costs are lower. This may be reasonable in view of the fact that the depots cover so much more territory and are therefore of larger average size than the typical dealership.

The "earning" and "cost" criteria led to opposite conclusions. On the basis of "earnings" the depots appear to be inefficient as compared to independent dealers and on the basis of "costs" they appear to be relatively efficient. The apparent contradiction arises because C.C.I.L. depots have incurred large losses on trade-ins. In the present context, the "cost" criteria are more relevant. From a social point of view it makes little difference whether C.C.I.L. depots showed lower earnings combined with lower market prices or higher earnings at market prices. Real C.C.I.L. prices have been below the market price (the price reduction was in the form of large discounts for trade-ins).

Wholesale Sector

In the wholesale sector of distribution, separate data are not available because C.C.I.L. is also a manufacturer and its general and administrative (G & A) expenses related to manufacturing costs are associated with these expenses relating to selling costs. These same "un-allocated" G & A expenses are associated with all other companies, as well and are shown in Table C-2. C.C.I.L. expenses as a percentage of wholesale sales are considerably below those of the large private firms although the expenses of Versatile Manufacturing Co., a relatively small private firm, are only slightly above those of C.C.I.L. The data are not inconsistent with the view that C.C.I.L.'s wholesale costs are low. Because C.C.I.L. is unique in being involved in manufacturing, wholesaling and retailing, it is not possible to

determine whether C.C.I.L.'s distribution costs are low because of the structure of the firm, or its size.

The tentative proposal in the last section of this study is based on the premise that appropriate changes in the structure of distribution in the firm and industry will result in significant reduction in distribution costs.

TABLE C-1

C.C.I.L. DEPOT OPERATIONS

(Thousands of Canadian Dollars)

	1960	1961	1962	1963	1964	1965	1966	1967
Sales at Retail:								
New Machines and Parts	6,486	7,717	8,739	13,218	19,191	20,336	19,994	19,779
Used Machines	1,691	2,060	3,048	3,992	5,645	7,678	6,384	6,316
Total Depot Sales	8,177	9,777	11,787	17,210	24,836	28,014	26,378	26,095
Gross Margins								
New Machines and Parts1/	1,830	2,170	2,460	3,730	5,400	5,740	5,630	5,570
Used Machines (loss)	(890)	(1,325)	(1,178)	(1,951)	(3,496)	(3,936)	(3,872)	(4,197)
Discounts to Member-Customers	(146)	(162)	(194)	(269)	(345)	(383)	(538)	(523)
Discounts to Agents	(146)	(115)	(152)	(128)	(101)	(80)	(77)	(70)
Combined Gross Margin on New and Used Sales	648	568	936	1,382	1,458	1,341	1,143	780
Combined Gross Margin as Percentage of New and Used Sales	7.9	5.8	7.9	8.0	5.9	4.8	4.3	3.0
Comparable Estimated Gross Margin Based on Data from *Cost of Doing Business Study*2/	10.2	10.2	9.3	9.5	8.9	8.2	8.6	8.4
Depot Operating Expenses	890	982	1,080	1,394	1,879	2,262	2,252	2,589
Depot Operating Expenses as a Percentage of Total Sales	10.9	10.4	9.2	8.1	7.6	8.1	8.5	9.9
Estimated Level of Dealer Operating Expenses as a Percentage of Total Sales - Based on *Cost of Doing Business Study*	15.1	14.6	13.9	13.7	13.3	12.7	12.2	12.2
Depot Profit (loss)	(242)	(414)	(144)	(12)	(421)	(921)	(1,109)	(1,809)
Depot Loss on Sale of Used Machines as a Percentage of New Machine Sales	13.7	17.2	13.5	14.8	18.2	19.4	19.4	21.2

1/ The margin on new machines and parts was computed from Commission records of retail discounts granted by the main line companies. The margin as computed includes volume bonus and works out to approximately 28 per cent. The 1967 mix of whole goods to parts was used in computing the margin for all years.

2/ This comparison probably understates the difference in average dealer gross margin between C.C.I.L. and the dealers covered by the Cost of Doing Business Study. The assumed gross margin for C.C.I.L. includes volume bonus while it appears that the Cost of Doing Business Study treats volume bonus as "other income" which, in 1966, amounted to three percentage points. Figures shown for Cost of Doing Business Study are for average of all dealers.

Source: C.C.I.L. Annual Reports, 1960-67.

TABLE C-2

C.C.I.L. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES - 1960-67

(Thousands of Canadian Dollars)

	1960	1961	1962	1963	1964	1965	1966	1967
Wholesale Sales - from Schedule 2	4,656	5,547	6,279	9,488	13,791	14,596	14,364	14,209
C.C.I.L. Selling, General and Administrative Expenses (S, G & A)	80	125	147	166	187	219	408	472
C.C.I.L. S, G & A Expenses as a Percentage of Wholesale Sales	1.7	2.3	2.3	1.7	1.3	1.5	2.8	3.3
Other S, G & A Percentage to Wholesale Sales Ratios:								
Deere and Company	12.8	12.4	12.0	11.4	11.8	11.1	10.3	10.6
International Harvester (Chicago)	11.2	12.0	11.0	11.5	10.6	10.7	10.5	
International Harvester (Canada)	10.3	11.1	10.3	9.5	8.8	8.4	7.8	7.8
Massey-Ferguson Limited	12.4	13.0	12.9	12.7	12.0	12.3	12.1	
Financial Questionnaire - Major Canadian Companies	10.4	11.5	10.1	8.6	7.8	7.2	7.0	
Financial Questionnaire - Complete Sample of Canadian Companies	12.2	12.8	11.2	9.7	8.8	8.3	7.9	
Versatile Manufacturing Limited					2.5	4.9	3.8	3.9

Source: C.C.I.L. Annual Reports, various years.

APPENDIX D

PRICE POLICY

C.C.I.L. sales of new machines and parts have increased from approximately $7.7 million to approximately $20 million between 1960 and 1967. However, increased sales in the farm machinery industry often result in very large increases in inventories held by farm machinery companies; i.e. increased earnings and assets take the form of increased inventory rather than increased cash. Thus expanding sales lead to short-run indebtedness to finance the additional sales. The tabulation following shows the extent to which inventories and sales are correlated.

	1960	1961	1962	1963	1964	1965	1966	1967
Sale of new machines and parts	6,486	7,717	8,739	13,218	19,191	20,336	19,994	19,779
Total inventories (at year end)	3,818	3,437	3,794	9,275	11,086	9,077	13,028	13,330
Sales ÷ Inventories	1.7	2.2	2.3	1.4	1.7	2.2	1.5	1.5

The ratio of sales of new machines and repair parts to inventories of new machines and repair parts varies from 1.4 to 2.3, suggesting that an increase in sales of $1.00 requires an increased investment in inventories of between $.44 and $.72.

As long as a firm's earnings are high and its debt-equity ratio is not too high, then increases in short-term indebtedness are not a matter of major concern. The management of C.C.I.L. has succeeded in maintaining this ratio at a safe level. However, should C.C.I.L. attempt to expand its sales and at the same time reduce its earning through price cutting the situation would change radically.

A policy of price cutting would most likely result in sharp increases in the debt-equity ratio and the short-run indebtedness of the firm. How would C.C.I.L. raise the additional funds to finance the expected increase in inventories? Banks and other

lending institutions would certainly be reluctant to, would probably refuse to, provide additional money. After all, the proposed policy is dangerous. The only apparent alternative is to receive support from other co-operatives who are well established in relatively low-risk industries.

APPENDIX E

COMMENTS ON THE DEVELOPMENT OF AGRICULTURAL CO-OPERATIVES IN WESTERN CANADA

The initial organization of a business usually requires a considerable amount of time, energy and business acumen, and the number of persons capable of successfully initiating a new enterprise is fairly limited. Even more limited are the number in this group who are prepared to organize co-operatives rather than private profit firms. Therefore, the probability of starting a successful association without the aid of an established co-operative seems small.[1/] In addition, there are many important economic areas which do not lend themselves to the co-operative form. It is hard to conceive of irate consumers forming a toy co-operative to reduce the price of toys; the item simply is not important enough. Nor is it probable that consumers will organize a steel or automobile factory, the capital requirements are too high. There are many markets or economic areas in which, at least until very recently, the co-operative form was never given serious consideration by a group of co-operators. This meant co-operatives were limited in scope and only provided serious competition to private profit firms in a small number of markets. The markets in which co-operatives have played important roles are closely associated with the agricultural sector and in finance or credit and retail trade rather than in manufacturing. The fact that co-operatives have been primarily associated with the agricultural sector and the distribution industry in general, may have an important bearing on their future development since economic growth of a country usually implies a relative decline in agriculture.

The difficulties of organizing co-ops and the small number of areas in which they operate are factors which seriously circumscribe the development of the co-operative movement. We live in a highly dynamic world. Industries and firms rise and fall within short periods of time in a fairly consistent manner; the grain trade is

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1/ These comments do not apply to small co-operatives such as credit unions.

a good example of how quickly the relative position of an industry or trade can change. Private profit firms can shift from one industry to another since firms of this kind are in every sector of the economy and the organization of a new profit firm as contrasted with a co-operative is relatively easy. The spontaneous development of new co-operatives will only take place under special conditions. Although these conditions appear to vary considerably from industry to industry and country to country, a short discussion of the main co-operative developments in Western Canada, agriculture co-operatives and credit unions, may prove helpful.

AGRICULTURAL CO-OPERATIVES IN WESTERN CANADA

There was a remarkably long time gap by present-day standards between the initial settlement of Eastern Canada and the serious colonization of the West. It took a remarkably short period of time, even by present-day standards, to populate the West once the influx began in earnest. The development of Western Canada lagged behind the Western United States for geographic and climatic reasons; the pre-Cambrian shield and the severe climate were serious obstacles to Canada's growth. Prior to the settlement of the Western United States and the completion of the C.P. Railway (1883) the influx into Western Canada had been modest.

Rapid growth of the West and the wheat economy began at the turn of the century.

> Exports of wheat increased very little from 1890 to 1900. From about 9 million bushels in 1901, they rose rapidly to the high figure of 100 millions in 1916. In the fiscal year 1900-1 there were inspected in the Western Inspection Division 10,178,000 bushels of grain of all kinds; in the fiscal year 1915-16 the corresponding figure was 333,000,000. Similarly the total storage capacity of Canadian grain elevators increased from 18,000,000 bushels in 1901 to 221,000,000 bushels in 1919. In the face of this extraordinary growth of the industry, caused not by the withdrawal of agricultural endeavour from the production of other commodities, but by the settlement of large areas of new land, it was inevitable that fundamental changes should be made in the marketing process. As increasing demands are made upon machinery devised for the performance of any industrial function, the problem of control becomes more and more difficult to solve. This has been notably the case with the grain trade. 2/

2/ W.A. Mackintosh, Agricultural Cooperation in Western Canada, Toronto: The Ryerson Press, 1924, p. 7.

The rapid expansion of Western Canada took place when Canada itself was young, expanding and short of capital. The wheat economy imposed additional capital requirements for projects of a highly seasonal nature; two main items were additional railway cars for the shipment of grain and elevators for storage purposes. Although wheat was sold in a highly competitive world market the intermediate markets were either a monopoly (transportation) or monopolistic or imperfectly competitive (the shipping points for farmers). On the purchasing side the farmers were faced with the high cost created by the national economic policy. The farmers in Western Canada felt exploited by the industrial and financial sectors in the East and by middlemen. They adopted many instruments and policies to redress their grievances. The plea for lower tariffs and anti-monopoly legislation, the organization of co-operatives, pressure on provincial legislatures to implement policies to protect farmers and the organization of farmers' political parties were all designed for this purpose. It is within this context that an analysis of agricultural co-operatives should be made.

"Grading", "Railway Transportation", "Elevators", and the "Grain Exchange" were the main marketing areas farmers were concerned with -- that is, farmers were concerned with every important stage in the process between the harvesting and sale of wheat to foreign and domestic milling companies.

In 1900, the *Manitoba Grain Act* was passed and hailed as the grain growers' Magna Carta.

> The act provided that its administration should be placed in the hands of a Warehouse Commissioner, with headquarters at Winnipeg. His duties were to see that all owners and operators of both country and terminal elevators were duly licensed and bonded under the provisions of the act; to supervise the handling and storage of grain in and out of elevators and cars; and to investigate all complaints made under oath of undue dockage, improper weighing or grading, refusal or neglect on the part of railways to furnish cars within reasonable time, or any fraud or oppression in connection with the handling of grain. In order that farmers should not be deterred from obtaining their full rights under the act through fear of legal expense, the Commissioner was empowered to institute proceedings at government expense 'whenever he considered a case proper therefor'. The Warehouse Commissioner, in short, was to function as an attorney-general for the grain growers.

> With a view to affording the farmer greater competitive freedom in the shipment and selling of his grain, railways were required to supply cars without discrimination for loading over platform or through flat warehouse as well as through elevator. 3/

> The Manitoba Grain Act, ... instituted a comprehensive regulation of grain middlemen, and of the entire movement of grain in commerce. Its enactment was essentially the outcome of representations by the grain growers themselves. Its provisions embodied quite literally the recommendations of a commission composed chiefly of Manitoba farmers. Its administration, moreover, was entrusted to an experienced farmer as Warehouse Commissioner. 4/

In the following year, in Indian Head, the Territorial Grain Growers Association was formed. In 1902, the Association laid a complaint before the Warehouse Commissioner against the C.P.R. agent at Sintaluta for violating the *Manitoba Grain Act* by failing to allocate cars in the manner required by the *Act*. The Association won its case against the railway and, in the course of doing so, gained the support of a large proportion of the grain growers.

E.A. Partridge, a farmer from Sintaluta, was convinced the farmers' interests and understanding of the grain trade could be enhanced by organizing a commercial grain company. He felt the best way to proceed was by forming a commission firm rather than an elevator association; farmers' elevator companies had been tried and had failed. The leaders of the Grain Growers Association were rather skeptical and only endorsed an investigation of the Grain Exchange. In 1906, Partridge proceeded to organize a commercial firm for the purchase and sale of grain; the company was to be separated from the Association.

> I have repeatedly stated that it is not desirable for the Association to engage in trade .... The Association has many important functions to perform in connection with the securing of legislative enactments required in the farmers' interests, and it would weaken them in their request for legislation to be a trading concern, as they could then hope for no greater recognition from legislative bodies than would be accorded to any other corporation .... It is in the interest of the farmers to establish a trading company separate and distinct from the Association, which, by actual experience obtained in the world's markets, would secure an intimate knowledge of conditions surrounding the trade that would be of incalculable service

3/ Harold S. Patton, Grain Growers, Cooperation in Western Canada, Cambridge, Mass.: Harvard University Press, 1928, pp. 23-24.

4/ Ibid., pp. 28 and 29.

> in disclosing to the farmers what legislative remedies were requisite to enable them to secure the full returns for their labor.5/

Partridge was probably correct in insisting on separation of the commercial firm on the one hand, and the political, social, and educational organization on the other. At the same time, separation contained the seeds of future conflict within the farm movement.

Partridge's business judgement proved correct and the Grain Growers Grain Company was an immediate success. The new company was also faced with a serious crisis. It was expelled from the Grain Exchange on the grounds that its intention to pay patronage dividends was tantamount to splitting the commission, and hence a violation of the Grain Exchange regulations. After much bitterness and considerable pressure from the Manitoba Government, the farmers' company was reinstated on condition it did not pay a patronage dividend. The publicity accompanying the struggle insured the company support among farmers and the Grain Exchange regulation resulted in large surpluses and greater financial stability of the company. It is interesting to note the extent to which Partridge and other farm leaders (Kennedy and Spencer) were prepared to sacrifice their own interests in order to organize the company. When faced with the financial crisis of 1906, the bank demanded unlimited security from the three executives, Partridge, Kennedy and Spencer.

> If they signed on the [dotted] line and the Company, deprived of its trading privileges, failed, the three men would be beggared.
>
> It was a tough decision to make. Partridge looked at the other two. They nodded. McCaffrey had the document with him, all ready to sign. "Down she goes", said Partridge and he affixed his signature. The others followed. 6/

The time and energy required to organize a co-op cannot in most cases be compensated for by the economic gains obtained from the co-op.

Soon after the establishment of a successful grain growers commission agency, Partridge and the other leaders pressed for greater control of the Grain Elevators and advocated government ownership. The Governments of Manitoba, Saskatchewan, and Alberta were reluctant to enter the elevator business and even more

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5/ Ibid., p. 47.

6/ R.D. Colquette, The First Fifty Years, pp. 44-45.

reluctant to defy the wishes of the farmers as expressed by their leaders. After much hesitation the Manitoba Government, in 1910, decided to enter the elevator business. *The Elevator Act* contained many objectionable features which farm leaders noted and the project in question was a complete failure as these leaders had predicted. The failure of the Manitoba scheme discredited the idea of government ownership. The farmers turned to co-operatives as an alternative instrument to counterbalance the power of the line elevator companies. The United Grain Growers Company purchased the provincial elevators from the Manitoba Government and a Co-operative Elevator Company was formed in Saskatchewan and Alberta with government assistance. Failure to implement the government scheme led to the development of co-operatives. Had the Manitoba scheme not failed (the reasons for its failure lie in the nature of politics at the time and not in the economics of government ownership), the strongest co-operatives in Western Canada, the elevator co-operatives, would not have been organized.

The U.G.G. and the Co-operator's Farmers Grain Companies expanded with the expansion of the grain trade between 1910 and 1920. For the 1919-20 crop year, the Canadian Wheat Board was established for one year under emergency war-time regulations and was disbanded in the following year although farmers seemed to be satisfied with a compulsory marketing board. The desire for re-establishment of the Wheat Board and disillusionment with the co-operatives[7/] led to strong opposition to the farmers' commercial companies by many farmers. When it became evident that the Wheat Board would not be established, this opposition advocated the establishment of wheat pools. Again, farmers appeared to have a strong preference for a compulsory marketing board and only after the federal government refused to institute a permanent wheat board were the pools established.

> As the failure of the interprovincial campaign for public ownership of elevators at an earlier period had led the organized Grain Growers to undertake the coöperative ownership and operation of elevators, so in 1923, when the futility of the campaign for a reëstablishment of government marketing became conclusive, the Western farmers' organizations turned their efforts from the direction of government compulsion and monopoly to voluntary and coöperative action.8/

7/ The co-operative elevator companies did not pay dividends until they were reorganized as 'pools'. The failure to pay dividends was bitterly resented by many farmers.

8/ Patton, op. cit., p. 210.

Pools were organized in the three Prairie Provinces with remarkable rapidity and in 1924 a central selling agency for the three pools was established. In Manitoba and Saskatchewan the pools purchased the elevators of the co-operative elevator companies. In Saskatchewan this involved a protracted battle between the grass roots and commercial farm leaders; the latter had established control over the commercial companies and the agricultural associations and also held Cabinet positions in the provincial government. The pools operated successfully despite many difficulties until the crash in 1929. Their initial payments to farmers during 1929 and 1930 were higher than the final sale price of wheat and the agency found itself in an untenable financial position. The Central Selling Agency disappeared as an effective marketing instrument although the elevator companies survived. In 1935, the Wheat Board was established as an alternative method of marketing. Compulsory government marketing was established in 1943 and has continued since that time.

The struggle to organize a pool revealed a basic cleavage within the farm movement. The Farmers Union, organized in Saskatchewan in 1921, was far more militant and radical in its basic approach to farm problems. Leaders of the Grain Growers Co-operatives were liberal in their political philosophy. The pool movement split the liberal wing of the farm movement since the pool was supported by one group and the established co-operatives by another. The Farmers Union sided with the pool supporters since the pool represented a move in the direction of centralized control of marketing and planned to pay patronage dividends.[9/] Politically, the Farmers Union leaders and the pool leaders had little in common other than their dislike for the Old Guard that had dominated the economic and political organizations of the farmers. Broadly speaking, Partridge and Crerar symbolized the difference within the farm movement. Partridge was essentially a socialist who believed in a co-operative commonwealth -- "The private ownership of the machinery of production and the private control of currency and credit are the two great forces which prevent a co-operative society."[10/]

9/ The established elevator co-operatives argued that patronage dividends were too difficult to calculate and did not pay them.

10/ S.M. Lipset, Agrarian Socialism, University of California Press, 1950.

Crerar was a liberal.

> In politics Crerar was a Liberal and an agrarian, ... In his economic thinking he was a *laissez-faire* free trader, holding the creed of the old school of Sir Richard Cartwright and the Liberal party before 1896. Crerar had formed intimate political ties with the Norris Liberals of Manitoba and with Dafoe of the *Free Press*, and their influence confirmed and perhaps refined his agrarian but broadly national liberalism. In 1917 he was representative, as few, if any, others could claim to be, of both western Liberalism and the western organized farmers.11/

The Crerar wing not only controlled the commercial co-operative organizations and farm associations, they represented the views predominant among farmers on most occasions. The Partridge group, or Farmers Union, exerted enormous influence and perhaps represented the majority of farmers in some specific situations. The pressure from this group was often felt within the more conservative commercial farm organizations.

> 'I note that the *Grain Growers' Guide* in its current issue is whooping it up for independent action', continued Dafoe on July 24, 1919. 'There is a certain amount of hypocrisy about this for some of the most influential leaders among the Grain Growers -- Crerar, Langley, Dunning notably -- hope to make a deal with the Liberals; but the fact is they have started something they cannot control'.12/

It seems more accurate to state that on this and other occasions the leaders were forced to go along with policies they disagreed with in order to maintain their control over the farm movement.

Farmers are usually considered to be middle class and conservative. Nevertheless, in Western Canada, there was a strong radical element within the farm movement. Some observers of the agrarian sector suggest that the farm movement in Saskatchewan was essentially an agrarian socialist movement. Lipset takes this position in his study, *Agrarian Socialism*. A summary of his argument is as follows:

> To sum up, the first three decades of the twentieth century witnessed the creation of a powerful, organized, class-conscious agrarian movement in Saskatchewan. The wheat farmer, who was situated at the producing start and consuming end of a highly

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11/ W.L. Morton, The Progressive Party in Canada, Toronto: University of Toronto Press, 1950, p. 56.

12/ Ibid., p. 66.

> organized and often monopolistic distribution system, became convinced that he, as a primary producer of wealth, was being exploited by vested "interests." He developed hostile class attitudes to big business, to the newspapers, which he believed served the "interests," and to merchants. As a result, a large proportion of the farming population supported an agrarian socialistic program designed to eliminate private profits by governmental or co-operative action before an explicitly socialist party appeared upon the scene.13/

However, the statement above seems inconsistent with the following statement made 40 pages later in his study:

> The 1935 election in Saskatchewan resulted in a greater defeat for the C.C.F. than that of 1934. The party elected only two members of Parliament from the twenty-one seats in the province. One of the victorious C.C.F. candidates had been endorsed also by Social Credit. The total strength of the C.C.F. declined from 25 per cent in the provincial election in 1934 to 19 per cent in 1935. Social Credit took away much of the socialist support in western Saskatchewan, and received a slightly higher provincial vote than the C.C.F. The total vote of the two third parties was, however, 39 per cent larger than that either of the old parties.
>
> ... The 1935 vote and the unity movement within the C.C.F. indicate that the protesting farmers had not become socialists.14/
>
> It is highly significant, that the proposal to reverse C.C.F. policy and unite with other "progressive" parties [Social Credit and Conservative] met very little opposition from the convention delegates. Only 8 votes out of a total of 312 were cast against the unity resolution. The agrarian reform tendencies in the Saskatchewan farmers' movement had overwhelmed the original hopes of the small socialist promotion group. The farm leaders wanted immediate economic action and political power, and did not care whether or not the goal was socialism.15/

Finally, Lipset states:

> The years 1940-41 proved to be the turning point in the fortunes of the C.C.F. Again the fight for higher wheat prices was responsible ... The C.C.F. was, however, the only political party to give all-out support to the farmers' demands.16/

13/ Lipset, op. cit., p. 71.

14/ Ibid., p. 109.

15/ Ibid., p. 111.

16/ Ibid., p. 117.

In the first quotation Lipset suggests there was a strong agrarian socialist movement; in the second, that the "agrarian reform" wing overwhelmed the small "socialist group". In the third, he suggests that the success of the CCF was based on the vigorous and successful plea for higher wheat prices by the party and not on either its socialist or reform policies. Since the CCF represented the most radical wing of the farm movement, it seems safe to argue that the agrarian movement, even in Saskatchewan, was primarily a protest movement.

The farm movement undoubtedly had a hard (but small) core of radicals who from time to time influenced the farm movement to a far greater extent than their numbers would suggest. But, by and large, farmers seemed to adopt instruments and advocate policies consistent with the position of the grain growing industry, not with any ideology or way of doing business. The fact that some radical measures were advocated was only part of the revolt against the national economic policy, big business or the middlemen. To say one is against tariffs and in favor of free trade in other peoples' industries and high prices in one's own industry is the essence of conservatism; this is precisely what all free enterprises believe in! The farmers were not in favour of "eliminating profits by governments or co-operative action" as Lipset suggests. They were in favour of reducing the profits of those who sold goods and services to them and increasing their own profits by whatever legitimate means available. They organized and fought to redress their grievances or for parity and if this meant nationalizing the C.P.R. or banks, then they favoured nationalization. There apparently were few who believed in nationalization *per se* or that public ownership is a superior type of property relationship.

Farmers have often been caught in a cost-price squeeze. During the cost-price squeeze of the 1950s there seemed to be little evidence of radicalism. What we did see was a remarkable expansion of marketing boards. In 1953, 13 per cent of cash income from the sale of agricultural products was sold by marketing boards, exclusive of milk and wheat. The number of boards had more than doubled, from 31 in 1956 to 66 in 1959 -- during the fifties there was also a large increase in purchases of farm products through co-operatives.

Under present conditions farmers, however, are able to obtain government regulated marketing agencies. The grain trade, for example, is highly controlled in all its aspects. Perhaps this fact, above all others, explains the decline in radicalism in the West. The farmers' protests now take more conventional forms. Some of the battles have been won and others lost, but at present, apparently, none of them seems to lead to advocacy of socialism or agrarian radicalism and the traditional conservatism of the farmer seems to have reasserted itself.

The above argument suggests the farmers' attachment to co-operatives *per se* is probably weak when other alternatives such as government regulation are available. This position is easy to understand. If the co-operative can be an effective countervailing force, despite the fact that it usually does not obtain more than 50 per cent of the farmers' business, then evidently compulsory marketing boards can be an even more effective countervailing force. This raises a conflict between one's allegiance to co-operation and one's preference for compulsory government agencies. As noted, the farmers appear to prefer government control and from the point of view of the co-operative way this represents a continuous threat.17/

Western Canada had a number of factors favourable to development of co-operatives: an isolated group in which the members were highly conscious of the problems of their industry, a group extremely suspicious of the firms with which they did business -- the suspicion arose from the monopoly and oligopoly positions of these firms and the geographic isolation of the group; a national economic policy highly detrimental to the farmers' interests; a group containing a highly articulate and highly intelligent core of socialist thinkers opposed to "private profit"; provincial governments who feared the farm leaders and were prepared to implement most of their wishes except their desire to nationalize certain industries -- these reasons led to strong government

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17/ Government control represented a logical development, not a threat to radical co-operators of Partridge's persuasion, but this was not the case for liberals of Crerar's and McPhail's persuasion.

support of co-operatives.[18/] Despite the highly favorable conditions, it is important to note and difficult to explain in general why 30 to 60 per cent of the farmers did not and do not support co-operatives although co-operatives have been an integral part of western agriculture for almost half a century.

18/ The Saskatchewan Co-operative Elevator Company was organized through Government support, and in Manitoba, in 1911, the Government sold their recently purchased elevators to United Grain Growers although private elevator companies had made higher bids.

APPENDIX F

THE ECONOMIC THEORY OF CO-OPERATIVE ASSOCIATIONS

Students of co-operatives have often expressed concern about the unsatisfactory state of the theory of co-operative associations. "The co-operative problem still remains, as it has always been ... an attenuating nebulosity".[1/] The economic theory of co-operation also appears to be in a highly unsettled and undeveloped state. Richard Phillips, for example, expressed a widely-felt uneasiness in his comment that "the literature is dominated by social-reformistic, historical and descriptive interpretations".[2/] Despite their long history, the development of an economic theory of co-operatives has been meager and one wonders whether it is in fact necessary, since no such special theory has been developed for each of the other types of private economic organizations, viz., individual proprietorships, partnerships and corporations.

The economic analysis of co-operatives has rested on one of three special features of these associations: (1) their unusual customer- (or supplier-) owner relationship, i.e., the customers or suppliers are the owners; (2) their non-profit orientation; (3) their political power structure, i.e., one man -- one vote. These characteristics have led, broadly speaking, to two economic theories of co-operatives. The first theory, developed by Emelianoff and expanded by Phillips, emphasizes the non-profit aspect of these associations. They are considered to possess a different morphology or structure, as profit-seeking is regarded as an essential feature of ordinary enterprises or firms. In the second theory, the co-operative is considered to be a firm in the usual sense. However, it is said to behave differently than a private profit-firm under certain market conditions because of the unique owner-customer (or supplier) relationship and power structure.

1/ Ivan V. Emelianoff, Economic Theory of Cooperation, Washington, D.C., 1942, p. 1.

2/ Richard Phillips, "Economic Nature of the Cooperative Association", Journal of Farm Economics, February 1953, Vol. XXXV, No. 1, p. 74.

Emelianoff's definition of a co-operative and his analysis of the structure of co-operatives are derived, to an important extent, from his interpretation of the private profit-firm which is an 'enterprise', has an 'entrepreneur' and is organized for the purpose of making 'profit'. The terms 'enterprise', 'entrepreneur' and 'profit' are often used in an ambiguous manner and have been the source of much debate and confusion. It is, therefore, worth noting the particular meaning attached to them by Emelianoff.

> [Enterprise] - Where single persons, families, or collective personalities invest and employ their capital and labour in accordance with existing customs and laws in some lasting organization with the purpose of acquiring a profit through purchase and sale for their living expenses or at least covering their costs, there we speak of an enterprise.
>
> [Entrepreneur] ...is understood to mean *the recipient of the residual income of enterprise, and, therefore, the assumer of the responsibility of independent acquisition.*
>
> [Profit] ...the 'risks' of entrepreneurship are the risks of acquisitive efforts made in anticipation of uncertain, unknown in advance and not necessarily positive residual income of enterprise.

This income is referred to as profit.[3/] Co-operatives, Emelianoff argues, do not have an entrepreneur, are not organized for profit-making, and therefore cannot be defined as an economic enterprise or firm.

Emelianoff defines co-ops as an aggregate of enterprises or households.

> The conception of an aggregate of economic units is a strangely difficult concept. It can not be comprehended precisely unless it is clearly understood, that *an aggregate of economic units is not the independent economic unit but the group of functioning economic units - acquisitive (enterprises) or spending units (households) and, therefore, all the 'functions of the aggregate' are ultimately the functions of the aggregated economic units, and not of the aggregate itself.*[4/]

The co-op is simply an agency organized for the purpose of providing services and goods which the members could not provide efficiently

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3/ Emelianoff, op. cit., pp. 45 and 65.

4/ Emelianoff, op. cit., p. 105.

on their own. The co-op has no life of its own and is nothing more than the sum of the extensions of the firms of the individual co-operators.

Emelianoff's study is primarily concerned with defining co-operatives and not with the question of co-operative behaviour. The traditional problems concerning the equilibrium position of the firm and how firms react to changes in prices, etc., are not discussed. We are told what the "essence" of the co-operative association is supposed to be, but there is virtually no mention of how one can use this definition of co-operatives for purposes other than classification. Does this definition imply differences in behaviour between co-operatives and acquisitive economic units (non-co-operatives), or what does Emelianoff's definition or concept of co-operatives imply with respect to the behaviour of the association? Phillips[5/] deals with this question in his analysis.

Phillips is interested in developing a workable theory of co-operation. He suggests that all aspects of co-operatives, i.e., voting rights and capital, etc., should be organized on a proportional basis and should reflect the percentage of total patronage contributed by each co-operator. He accepts Emelianoff's basic definition of a co-operative as an aggregate of independent economic units as contrasted with a collective organization such as a firm. He uses the analogy of a multi-plant firm to explain the co-operative association:

> ...when two or more economic units cooperate with respect to some function or activity that is integrally related to their individual economic operations, the result is not a new firm; instead it is a common economic plant. The cooperative *association* consists of the sum of the multilateral agreements among the firms participating in the joint activity, in order that these firms may function coordinately through their common plant. The co-operative *activity* is an economic plant operated jointly as a part of these several firms.[6/]

In discussing the equilibrium conditions of the firm and of the co-op, Phillips states the marginal conditions as follows:

> 1) [Allocation of resources]...for each participating firm the marginal productivity of each resource allocated to the cooperative plant must be equal

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5/ Phillips, op. cit.

6/ Phillips, op. cit., pp. 75 and 76.

to the marginal productivity of that resource in the individual plant of that member firm.7/

2) [Volume of Patronage] - The cooperating firm equates the sum of the marginal cost in its individual plant or plants and the marginal cost in the joint plant with the marginal revenue facing the firm in the market where the product is sold.

The point Phillips does not discuss is the difference in equilibrium conditions arising in individual enterprises and their co-operative associations as compared with an entrepreneur who owns a number of horizontally integrated individual units and a vertically integrated plant. If we assume a change in ownership from a co-operative to a multi-plant firm in the usual sense, do the equilibrium conditions change? If the equilibrium conditions are the same then obviously no economic theory of co-operation is necessary, since the standard theory of the firm will apply. This seems to be what Phillips is implicitly arguing. Changes in the voting rules from one man - one vote to voting on the proportional basis and investment in the co-op on a similar basis as recommended by Phillips will presumably bring the co-operative structure closer to that of the private profit-firm. If co-operatives organize as Phillips suggests, and if the behaviour of the individual firm and the co-op is no different than it would be if the entire operation were part of a multi-plant firm (other things equal), why should one attribute a different structure to the co-op,8/ i.e., define the co-op as a sum of individual acquisitive units rather than a collective organization? Herein lies the difficulty in the analysis of Emelianoff and Phillips. They suggest a different "structure" for co-operative associations without providing any new insights into co-operative behaviour. They are both looking at the problem from the point of view of 'price' economists but neither explains the difference in co-op and non-co-op behaviour from this point of view.9/

7/ Phillips, op. cit., pp. 75 and 79.

8/ The question of whether a difference in the equilibrium position of the individual firms and integrated plants would arise from a change in ownership is not discussed in detail because the writer feels the alternative approach discussed below is preferable.

9/ Emelianoff's morphology does contain some very important implications with respect to the initial organization and stability of co-operatives.

Let us now examine Phillips' analysis in greater detail. He illustrates his concept of a co-operative structure by means of a simple diagram.

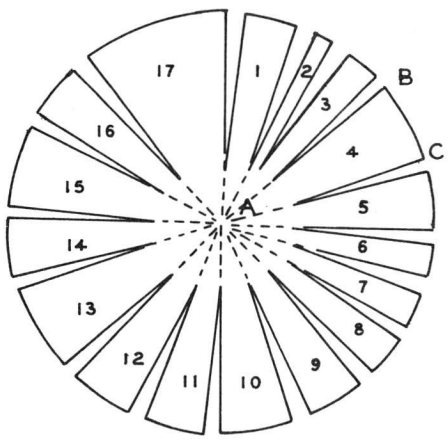

DIAGRAM 1. THE CO-OPERATIVE STRUCTURE

> The triangular numbered sections represent the member firms. The small uninscribed circle at A denotes their joint plant.10/

Phillips states that the plant decreases or increases in proportion to the amount of business carried out by the co-operative. If the number of firms in the co-operative doubled and sales doubled, the co-operative plant would double in size. Surely, this is an unusual interpretation of the concept of the plant. Ordinarily, the cost curves of the plant are functions of output; the size of the plant is in some sense fixed in the short run. To introduce a one-to-one correspondence between the size of the plant and output makes it difficult to interpret the concept 'plant'. At the same time, Phillips' definition must imply this peculiar attribute since the co-operative plant is nothing more than an extension of the co-operators' plants which are jointly operated. This must mean that when output of the co-op plant is zero, the size of the plant is zero. If this is the case then apparently the co-operators have no fixed commitment independent of output.

10/ Phillips, op. cit., p. 76.

If the co-operator is a profit maximizer and has no commitment to the co-op as such, then his attitude toward the co-op must be the same as his attitude to any other firm in the industry of which the co-op is a member. The association merely represents any agency from which he buys inputs or to which he sells outputs. To treat the problem as an integrated or multi-stage operation introduces unnecessary complications since there is neither a long-run nor short-run problem from the point of view of the co-operator vis-à-vis the co-operative. The co-operative presumably enters the co-operator's calculations with respect to resource allocation in the same way as any other economic unit, i.e., investment will be made in that organization (including his 'own business') in which the highest yields are expected and the individual firm will simply sell to or buy from the organization which gives him the best price.

Vertical integration exists when a firm owns and operates plants at contiguous stages in the productive process, e.g., a firm owns one plant producing a product and another plant which wholesales it. Under normal circumstances, the first plant would do business with the second. If the producing plant could sell at a higher price to a competitor in the wholesale trade then it might mean the wholesale is inefficient and should, in the long run, be disposed of. However, in the short run, it would most likely pay the firm to have its producing plant 'sell' to its wholesale. Perhaps this is the main difference between a multi-plant firm and a co-operative. The co-operator's financial commitment to the co-operative is in most cases very small, and therefore, from the point of view of profit maximization, the co-operator should treat the co-op as he would any other firm; the fact that he has some small share in the company will influence his decision very little. In most cases the main considerations will be the price he can get for his output or the cost of his input. Why should the co-operator look upon the co-op as part of his multi-plant firm? Even if his financial commitment is large, unless his patronage is relatively so large that its withdrawal would jeopardize the existence of the co-op and his investment in it, he would purchase or sell to the firm that gave him the best offer, taking into account the estimated patronage dividend from the co-operative. Since in most cases his financial commitment

is small, one would therefore expect him to treat the co-op as he would any firm in the industry.[11/] These observations lead to the alternative economic theory of co-operatives.

In this theory the co-operative association is considered to be a firm which in most cases is owned by the patrons of the firm or the majority of the patrons and in most cases has a different theoretical power structure, i.e., one man - one vote instead of one share - one vote. These attributes distinguish the co-operative from other forms of private business. The question is whether they will alter the behaviour of the co-op. Would the price, output, distribution and growth policies of the association be any different if it were an ordinary firm? Clark[12/] analyzed the relationship between price and output behaviour of co-ops and private profit firms.

The essence of Clark's argument is that the equilibrium position of a co-operative is different from that of a private firm in many important market situations. The extent to which each firm will approach the socially desirable output will depend, he argues, on the market structure and the type of co-op. In a perfectly competitive situation, for example, Clark contends that the private firm will operate (in equilibrium) at the socially desirable position in terms of resource allocation whereas the output of a purchasing co-operative will be restricted (in equilibrium) to some point below the optimum. His conclusion is based on the following argument: The private profit firm will attempt to maximize total profit and hence will tend to operate

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11/ The extreme variability in types of co-operatives, in terms of financial and emotional commitment, makes it very difficult to generalize about the nature of co-operatives. At one extreme there is the urban retail co-operative in which most members appear to have both a small financial and emotional commitment. At the other extreme we may have some marketing co-operatives consisting of a small number of suppliers who have a significant financial and emotional commitment. In the latter case the multi-plant concept may be appropriate. However, the situation does not seem to be sufficiently common to justify the kind of general theory developed by Phillips.

12/ Eugene Clark, "Farm Cooperatives and Economic Welfare", Journal of Farm Economics, Volume XXXIV, February 1952, No. 1.

at the point where MC = MR. The co-operative is interested in minimizing costs for its patrons and, therefore, its equilibrium position is at the minimum point on the average cost curve. If average cost is below average revenue then the co-op will be in equilibrium at a smaller output than the private firm. Diagram 2 shows the difference in equilibrium positions for the two economic units.

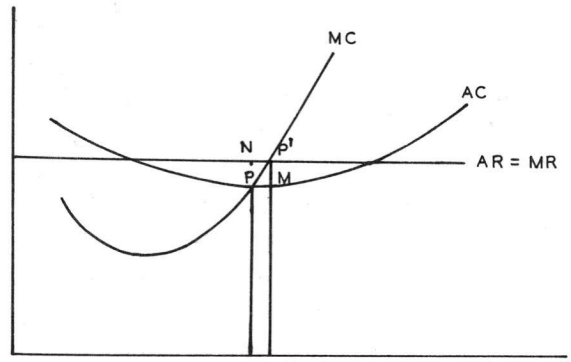

DIAGRAM 2

Source: Diagram from "Farmers Cooperatives and Economic Welfare", by Eugene Clark, Journal of Farm Economics, Vol. XXXIV, No. 1, February 1952.

The two firms are assumed to have the same cost curves. The difference in equilibrium positions arises from the special nature of the co-operative. The co-operator, unlike the private firm, is not interested in the total surplus; the co-operator supplies an approximately fixed amount to the co-operative and is therefore interested in maximizing the gap between average revenue (price) and average cost, i.e., in not producing beyond the point OR.

Clark assumes the market is in short-run equilibrium and in long-run disequilibrium. The long-run disequilibrium is evident from the position of the average cost curve, i.e., in long-run equilibrium the average cost curve would be tangent to the average revenue curve and the co-operative and the private profit firm would be producing at the same output. It is the presence of the surplus which creates a difference in output; the nature of the

surplus, however, raises difficulties. Clark assumes that "entrepreneurial rent is not treated as a cost to an intra-marginal firm". Entrepreneurial rent with respect to the co-operative is defined in the special sense of a return to "anyone who shares in the surplus over necessary cost... This meaning of the term 'entrepreneur' is necessary in order to include within the definition the patron who is not a member but nevertheless shares in the distribution of the economic profit".[13/] This is certainly a radical definition of entrepreneurial rent and will be commented on later. Let us first review Clark's treatment of an imperfect market situation.

The equilibrium position for the private firm and co-operative is shown below in Diagram 3.

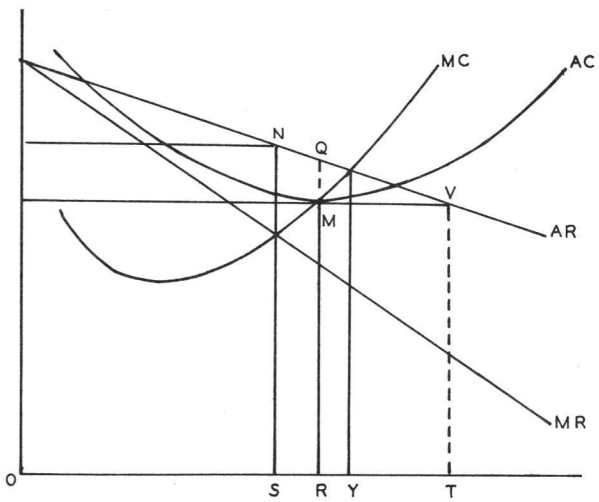

DIAGRAM 3

Clark states that the private firm will operate at OS (MC = MR) and the co-op at OR (at the point of minimum average cost). The private firm will charge NS. Obviously if the co-operative also charges NS it cannot sell OR. Clark attempts to cope with this problem in the following manner:

> The common practice of cooperatives is to charge the going market price. Since the commercial firm will charge NS this might be thought to

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13/ Eugene Clark, op. cit., pp. 35 and 36.

> prevent the cooperative firm from charging the same price if it wished to obtain a volume of OR. However, if it is assumed that the cooperative patrons purchase in the expectation of some patronage dividend, the effective price to them approaches TV. To the extent that this is recognized by prospective patrons, the demand for the cooperative's goods would approach OT, and so no difficulty should be found in obtaining a volume of OR.14/

Surely this is tantamount to regarding the surplus as a price rebate. In effect, Clark argues that the patronage dividend is an entrepreneurial return when he is discussing pure competition and a price rebate when he is discussing imperfect competition.

The issue of whether the difference between average revenue (AR) and average cost (AC) times the number of units sold is an entrepreneurial income of some sort, or a price rebate has been the cause of a long and bitter controversy between co-operatives and their competitors. Income tax laws in Canada and the United States have treated the surplus as a rebate, subject to certain qualifications, and this is considered discriminatory by private profit-firms. Clark seems to contradict himself on this point and he is by no means unique in this regard.

The confusion arises from two assertions made by co-operatives which are inconsistent although each one appears to be correct. On the one hand co-ops usually state that they charge the market price. On the other hand they argue that the surplus is a consequence of miscalculating the price which they wish to charge; the patronage dividend paid out of the surplus is a price rebate since service is provided at cost. To argue that one charges the market price and that one provides service at cost are obviously inconsistent statements unless AC = AR.

The surplus has some features of entrepreneurial income and some features of a price rebate. It is the difference between the declared or market price and the average cost, times the number of units sold and is, therefore, similar to abnormal profit. The surplus is not a predetermined amount; there is no specific commitment by the association as to what it will be and the amount cannot be calculated until the end of an accounting period. For these

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14/ Eugene Clark, op. cit., pp. 40 and 41.

reasons it can be viewed as some sort of entrepreneurial rent. However, there are also reasons for regarding the surplus as a price rebate. Co-operatives have the avowed policy of distributing their surplus as a price rebate, i.e., customers receive this surplus on the basis of the number of units purchased from or sold to the co-operatives. The rebate need not be related to any function performed by or capital held by those who receive it. To consider the surplus as entrepreneurial rent means introducing even more ambiguity into the concept of entrepreneurial rent or profit. However, these considerations are essentially taxonomic and do not get to the heart of the matter.

The problem arises because of the peculiar relationship between customer and owner in the co-operative and this relationship has very important implications with respect to economic theory. Supply and demand analysis is based essentially on the premise that the demanders and suppliers of goods and services are by and large different people or different economic units. When the supplier influences or creates demand through advertising, for example, the analysis becomes more complicated or the standard 'tools' become less useful. Similar complications arise in a co-operative since the buyers and sellers are by and large the same people in the sense that the customers are the owners (in purchasing co-operatives). From an internal point of view it hardly matters whether the surplus is a price rebate or entrepreneurial rent; any concept based on the implication that demanders and suppliers are different people will be somewhat strained. From the point of view of the industry it matters a great deal. The price rebate is a price reduction and as such will affect the market price and the demand functions of the other firms in the industry directly, whereas entrepreneurial rent is price-determined, and affects price and output in a far more indirect and ineffective way.

How do buyers in a market look upon the dividend? There is probably a small group of persons who are strongly opposed to co-ops and will not do business with them. There is undoubtedly another small group of strong supporters of co-operatives who will always do business with them. Most buyers probably treat the co-op as they do any other firm. In other words, they regard themselves primarily as customers of the co-operative. It may well be that co-ops cannot survive without a hard core of active supporters;

there is ample evidence that a co-op cannot survive with only this hard core. The remainder of its customers, albeit owners, is shopping in the market. Therefore, the size of the rebate will influence the demand for the co-op's and its competitors' product, In this situation, it is incorrect to treat the initial co-op price as the market price and the dividend as entrepreneurial rent or, as noted above, the co-operative as part of a multi-plant firm of the co-operators.

The remarkable economic feature of co-operatives is that they perform, because of their internal structure, a function economists traditionally attribute to the price mechanism, viz: what the private profit-firm is forced to accept as a consequence of the external environment, the co-op automatically implements as a matter of policy. This means that co-ops are, in a great many situations, excellent instruments for improving the efficiency of the price system, i.e., in markets where abnormal profits exist and tend to persist. In many market situations the price system will move resources towards the optimum allocation very slowly indeed; the co-op assists and accelerates the operation of the price system in carrying out its social functions.

To illustrate this argument, we can consider a hypothetical retail market. Let us assume that we are dealing with a small town or suburban area. There is an independent retail store which provides poor service and many families shop elsewhere at considerable inconvenience to themselves. A chain-store opens a modern efficient super-market and drives his competitor out of business. The super-market now has a 'monopoly' in the market. It raises prices and makes abnormal profits as a consequence of its efficiency, of the imperfect market and because the firm took the risk of moving into what appeared to be a poor shopping area. Since the firm is making abnormal profits another chain considers a similar move and at the same time a group of residents considers forming a co-operative. Will there be any difference in output, price or distribution policies if the second store is a private profit-firm as contrasted with a co-operative?

Let us first assume that the second store also belongs to a private profit firm and that the two stores are identical with respect to cost and output. The tendency will be for these firms

to reach an agreement, through trial and error or collusion, to split the market and maximize their profits. The extent to which their profits are abnormal will depend on the relationship between cost and revenue or the size of the market, the distance to the closest adjacent market and the degree of competition in it, etc. Both firms may be merely making a competitive return on their investment. Let us assume they are making abnormal profits and other firms do not enter the market. The abnormal profits are made because all other entrepreneurs interested in the market realize they cannot enter it as a third firm and do well; at this point it is the acumen of others which enables the two existing firms to prosper. Nevertheless the firms may feel quite secure and capitalize some aspect of their organization, e.g., good will or rent, so their average costs shift upwards to the point of tangency with the average revenue curve and long-run equilibrium is established.

Let us now assume that the second firm is a co-operative, and that it charges the market price. The co-op also reaches an understanding with the first firm, either through trial and error or collusion. The co-op has the same abnormal surplus as its competitor and it also feels secure. However, it does not capitalize its abnormal profits; it provides a patronage dividend. Under the circumstances one would expect the dividend to be paid each year. In other words, the dividend is an obvious, expected price rebate, but a rebate means the co-op is not charging the market price as originally assumed. The contention of co-operatives that they charge the market price and that they provide service at cost are inconsistent claims in precisely the situation in which the co-operative is most likely to be effective.

In this case it will become evident that the co-operative is not, in fact, charging the market price, although initially it does so. Customers will shift from the private firm to the co-operative. The former will lower its price to regain its share of the market and the co-operative, since it claims to charge the market price, will follow suit. As long as the patronage dividends are forthcoming, the co-op's effective price will be below that of its competitors. Equilibrium will be established by the reduction of price to the competitive level or at the level where patronage dividends are eliminated. This, in theory, is the essential

difference in the behaviour of a co-op and a private profit-firm. The co-op by the very nature of its organization imposes upon itself a long-run optimum condition by charging a price which reduces average revenue to average cost, not by increasing average costs, through capitalization of a factor, to average revenue. In so far as the co-operative is efficient, it forces its competitors to behave in a similar manner, i.e., to lower price until the surplus is eliminated.

In practice a co-operative may, of course, be of lesser, equal or greater efficiency than its competitors. In the last two cases the co-op would tend to drive its competitor out of business either by capturing its competitor's market or by reducing the rate of return to an abnormally low level since co-operators accept relatively low rates of return on their investment. However, the view is widely held that co-ops in general pay their management lower salaries than their competitors and hence tend to get poor management, on the average. Perhaps this factor explains why co-operatives rarely overwhelm their competitors as one might expect, other things equal. There remains the problem of entrepreneurial income, i.e., the gains and losses arising from risk-taking. It can best be resolved by considering the case of a private profit-limited company.

In the limited company there is a certain degree of asymmetry between gains and losses. Profits have no clearly defined upper limit; losses have a clearly defined lower limit. The purpose of forming a limited company is to define a lower limit and it is the capital value of the company. Co-operatives, which are limited companies, have limits at both ends. The maximum profit, although unspecified in the private firm, is usually clearly defined by the co-operative, i.e., approximately 5 per cent of the capital invested. This limit is self-imposed by the co-operators. By viewing the problem in this way there are no difficulties raised with respect to the co-op that do not arise in all limited companies. Limited companies are allowed a lower limit on their entrepreneurial losses; co-operatives impose an upper limit on their entrepreneurial profits. To argue that the co-operative has no entrepreneur, defined as risk-taker, is obviously incorrect, since the co-operative is faced with the same economic environment as any other firm. It is, however, correct to argue that the

surplus is not a form of entrepreneurial income in precisely the same sense as losses beyond the capital value of a limited company are not entrepreneurial losses (of the firm in question).[15/]

As noted above, Clark assumed the existence of long-run disequilibrium and short-run equilibrium. The short-run equilibrium is arrived at by treating the co-operative market price as the effective price. If the dividend is treated as a rebate, then the market is not in equilibrium. Despite the assumption of pure competition, there are two prices in the market, i.e., the price charged by the private profit firm and the lower co-op price. As noted, there will be a shift of customers from the private-profit firm to the co-operative. If the co-operative rigidly enforces the short-run interests of the existing members, production or sales will stop at OR (Diagram 2) and a form of (non-price) rationing will be imposed.[16/] There will be pressure to expand the existing co-op or to start a new co-operative, depending on the relationship between the short- and long-run cost curves; i.e., demanders wish to buy more at the prevailing (co-op) price than the supplier is prepared to produce at that price and, hence, the market is not in equilibrium. However, the co-operative will directly, through expansion, or indirectly, by encouraging new co-operatives, exert a downward pressure on the market price. In a competitive market the price system is assumed to work effectively and this pressure will be prevalent in any case. On the other hand, co-operatives are none too common in these markets; most co-operatives function in imperfectly competitive or oligopolistic markets.

The case of monopolistic selling by a purchasing co-operative is illustrated in Diagram 3. As noted, the co-op will sell an amount OY (the minimum point on the average cost curve) at price TV and there will be an unsatisfied demand MV. Pressure will exist

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15/ The part of the surplus allocated to a general unspecified reserve fund is difficult to define. If the co-operative were sold, who would receive the money? Presumably this part of the surplus would be a type of entrepreneurial income or profit if it were distributed on the basis of shareholdings and a sort of price rebate if it were distributed on a patronage basis.

16/ Such behaviour seems unlikely but is implied in the assumptions used in the analysis.

to either expand the co-op plant, build a new plant, or form a new co-op. In the case of two or more profit-firms, this dynamic element need not exist. The co-op not only immediately removes its own "abnormal profits" but in the course of doing so it exerts pressure on the private profit-firms to lower their prices. In this case, as contrasted with the pure competitive situation, the co-op will have an immediate effect on market price (after the dividend payment). If there is little product differentiation and there are large abnormal profits, the co-operative may have an important short-run effect on price. If entry into the industry is difficult the presence of the co-operative may also have an important long-run effect. Co-operatives may be more effective than anti-combines legislation and other methods in reducing the degree of monopoly power[17/] and there may be a great many situations in which government support and encouragement of co-operatives would prove highly desirable on economic grounds.

Co-operative associations are predominantly distribution or handling agencies and financial organizations. Retail stores, credit unions, livestock commission agencies, and grain elevators often function in oligopolistic markets. The marginal cost curves will often be negatively sloping or of zero slope for the usual range of output. In this situation the price-cutting effects generated by co-operatives would be even stronger than under conditions of rising costs since the co-operative would welcome new members[18/] and the loss of business of other firms in the industry would lead to an immediate decline in price. If large abnormal profits exist, the establishment of co-operatives will result in a dramatic decline in price and the association may establish itself as a viable economic unit with remarkable rapidity.[19/]

17/ There may also be situations in which a co-operative is a monopolist and acts like one; each case must be judged on its merits.

18/ This case is probably a very common one.

19/ These cases become part of the folklore of co-operation.