# Cooperative Members' Preferences for Patronage Refunds

## ACCC Fact Sheet Series – Paper #1

**Executive Summary and Implications of the Journal Article:**
**Briggeman, B. and Q. Jorgensen. "Farm Credit Member-Borrowers' Preferences for Patronage Payments,"** ***Agricultural Finance Review,*** **69(2009): pp. 89-97**

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One unique aspect of the cooperative business model is the payment of patronage refunds. Cooperatives offer many benefits to their members, but patronage is unique because it is the portion of profits generated by and returned to cooperative patrons. A cooperative's board of directors will determine if a portion of profits will be distributed to cooperative members, and if so, how much should be paid out. In general, larger payments are received by patrons as they conduct more business with the cooperative. Thus, cooperatives have an incentive to pay patronage refunds because it may encourage additional business being conducted with the cooperative (Fulton, 1999).

In this way, patronage can be thought of as a marketing tool. As with any effective marketing tool or plan, it is important to understand customers' preferences for the product being promoted. In the case of patronage, it is especially important to understand cooperative members' preferences for patronage because a board of directors may or may not distribute a portion of the profits.

So, how would members react if no patronage was paid? How would they react if a large amount was paid? Or if an average payment was paid? What are preferences for cash versus retained patronage refunds? Answers to these questions will likely vary across members, board of directors and cooperatives' senior management. In the academic literature, very few studies exist on cooperative members' preferences for patronage.

The purpose of this paper is to report the results of one academic research study that did examine cooperative members' preferences for patronage, and draw implications for future research. To illustrate patronage preferences, the findings of a survey conducted by Briggeman and Jorgensen (2009) are summarized.[1] This survey was distributed among East Central Farm Credit of Oklahoma member-borrowers and elicited their preferences for patronage refunds received as a cash payment versus lower fixed real estate loan interest rates. While Briggeman and Jorgensen focused on a financial cooperative, the finding that Farm Credit member-borrowers strongly prefer cash patronage over lower fixed interest rates has implications for other cooperatives, and suggests further research is needed.

In January 2007, a survey was designed and distributed among the East Central Farm Credit membership. From the returned surveys, it was found that the majority of farms/ranches are small. That is, they have less than $100,000 in sales and operate less than 700 acres. In addition, the average operator age was 53, and most operators and/or their spouse worked off the farm. According to East Central Farm Credit senior management, this finding was representative of the entire East Central Farm Credit membership and was representative of farmers and ranchers in east central Oklahoma.

[1] To read the entire article, please go here: http://www.emeraldinsight.com/journals.htm?articleid=1793824

To isolate preferences for cash patronage and lower fixed interest rates, the survey asked member-borrowers to rate various loan options for a hypothetical farmland purchase of $150,000. A total of 9 loan options were presented, with interest rates ranging from 8% to 9% and cash patronage payments ranging from $0 to $1,500 or 0% to 1% of the total loan. Each survey respondent then circled the desirability of each loan option as follows:

| Options | Fixed Interest Rate | Expected Annual Cash Patronage Payment | Circle the number of how desirable the option is: 1 = very undesirable | | | | | | very desirable = 7 |
|---|---|---|---|---|---|---|---|---|---|
| 1 | 9% | $750 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 2 | 8.5% | $1,500 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 3 | 9% | $0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 4 | 8% | $750 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 5 | 8.5% | $0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 6 | 9% | $1,500 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 7 | 8% | $1,500 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 8 | 8.5% | $750 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| 9 | 8% | $0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

Based on the survey results, East Central Farm Credit member-borrowers *really* prefer cash patronage payments over lower fixed interest rates. This statement was confirmed through a statistical model that was estimated using the collected surveys from member-borrowers. To illustrate this result in this ACCC fact sheet, consider loan option 6 and loan option 9 above. Each has the same "net" impact on a member-borrower's total loan payment. That is, option 6 has a 1% higher interest rate than option 9, but option 6 pays $1,500 (or 1%) cash patronage, while option 9 pays $0 cash patronage. Despite the "net" impact being the same, member-borrower's *clearly* indicated that option 6 was more desirable than option 9. The table illustrates this point:

| Loan Option | Fixed Interest Rate | Patronage Basis Payout | Net Cost | Desirability of Loan Option |
|---|---|---|---|---|
| 6 | 1.0% | 9.0% | 8.0% | 4.22 |
| 9 | 0.0% | 8.0% | 8.0% | 3.38 |
| Change (9-6) | -1.0% | -1.0% | 0.0% | -0.84 |

Furthermore, the results of the survey and statistical model suggest that member-borrowers are willing to pay a higher interest rate as long as they receive a cash patronage payment. Assume that fixed interest rates are going to rise 1%. The results from the statistical model, which is shown in the academic research study, would suggest that member-borrowers would be indifferent to the interest rate increase as long as the cash patronage payout rose 0.7%. Bottom line, the East Central Farm Credit cash patronage program is valued greatly by their member-borrowers.

While this ACCC fact sheet has focused on the cash patronage program from East Central Farm Credit, there are still implications for nonfinancial cooperatives such as agricultural cooperatives. First, a cash patronage refund program is most likely well thought of and valued greatly by other cooperative member-patrons. If this is true, could eliminating or even significantly reducing patronage payments lead to unrest among member-patrons? Second, one should consider marketing patronage programs to existing members and potentially new members as a way to generate new business. However, if this discussion does occur in the boardroom, do not forget that in some years the cooperative may not be able to pay or even allocate retained patronage. Third, patronage may be a way for cooperatives to enhance member commitment to remaining with the cooperative.

Of course, more research is needed to fully investigate the idea of using patronage as a marketing tool. But in the meantime, the results presented in this paper clearly demonstrate that one cooperative's member-borrowers, East Central Farm Credit, greatly value their cash patronage program.

**References**

Briggeman, B. and Q. Jorgensen. "Farm Credit Member-Borrowers' Preferences for Patronage Payments," *Agricultural Finance Review*, 69(2009): pp. 89-97.

Fulton, M.E. "Cooperatives and Member Commitment," *Finnish Journal of Business Economics*, 4(1999): pp. 418 – 437.