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# Economic Theories of Nonprofits and Agricultural Cooperatives Compared: New Perspectives for Nonprofit Scholars

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## Abstract

This article explores the cross-fertilization potential that exists between the economic theory of agricultural cooperatives and that of nonprofit organizations. A number of central ideas in the agricultural cooperative theory are shown to generate two novel insights pertaining to the nonprofit economics literature. First, as with agricultural cooperatives, nonprofit organizations can be conceptualized not only as firms but also as service agencies and stakeholder coalitions. Second, the demand-side economic justification of nonprofit organizations, like that of agricultural cooperatives, likely includes reasons other than market failure. The article concludes by calling for research on how nonprofit economics can inform the theory of agricultural cooperatives.

## Keywords

nonprofit economics, agricultural cooperative, stakeholder, market failure

## Introduction

Cooperatives and nonprofit organizations have many things in common. Both are based on ownership structures that are different from those of for-profit investor-owned firms. By being different from for-profit firms, both constitute a minority in modern Western economies dominated by large profit-seeking corporations (i.e., in terms of economic and political power). Both cooperatives and nonprofit organizations

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exist because the operation of the market is not satisfactory to some stakeholders. Both also involve an ideological element, in the form of the “social nature” of cooperatives and the mission-driven nature of nonprofit organizations. Moreover, in the United States, where nonprofit organizations are defined by their tax-exempt status, there exist a large number of nonprofit organizations that are similar to cooperatives in that they envisage benefits to members. Indeed, the U.S. tax code classifies agricultural cooperatives as a variety of tax-exempt organizations that are not eligible for tax-deductible charitable donations (Boris & Steuerle, 2006, p. 69).

The abovementioned commonalities notwithstanding, cooperatives and nonprofit organizations are often seen as being quite different from each other. Most important, cooperatives are avowed business organizations, and their business orientation has been the main cause of the primarily healthy tensions regarding their inclusion in the nonprofit sector. Although excluded from the “structural-operational” definition of the nonprofit sector (Anheier & Salamon, 2006), cooperatives nevertheless play a central role in the European concepts of social economy and the third sector (e.g., Nyssens, 2006). The difference between the American and European definitional approaches can be exemplified by the argument of Levi and Davis (2008), who essentially posit that cooperatives embrace a special understanding of “nonprofitness” as the distribution of surplus in proportion to patronage rather than to capital investment. Therefore, according to these authors, as long as cooperatives distribute surpluses in the former way, they may be legitimately regarded as nonprofit organizations.

This article contends that the structural differences between cooperatives and nonprofit organizations, and the associated conceptual tensions, create the potential for a useful dialogue between strands of economic theory addressing these institutional arrangements. The aim of this article is to contribute to this dialogue by analyzing some of the ways in which the economic theory of cooperative organizations can inform modern nonprofit economics. Within the former literature, the theory of agricultural cooperatives stands out not only as being the most systematically developed but also as synthesizing the results gained from theoretical investigations of other types of cooperative organizations. Therefore, in seeking to draw novel implications for nonprofit economics, the present article will refer primarily (though not exclusively) to the theory of agricultural cooperatives.

The key issue of nonprofit economics that is likely to benefit most from a critical analysis of the theory of agricultural cooperatives is related to nonprofit firms’ relationships with stakeholders. This is because the focus on stakeholders, most importantly members, is the central theme of the theory of agricultural cooperatives. Indeed, the very rationale of agricultural cooperatives, and cooperatives more generally, is traditionally seen as providing useful services to their members. In fact, the very first school of thought in the modern theory of agricultural cooperatives (Emelianoff, 1942; Phillips, 1953) explicitly denied these organizations any independent economic identity apart from being an agency serving member farms. It was only later that cooperative scholars recognized that cooperatives have scope for discretionary decision making independent of member farms and that cooperative managers may pursue their own

agendas, which do not necessarily coincide with those of their members (Helmberger & Hoos, 1962; Rhodes, 1987).

The contrast with the beginnings of modern nonprofit economics could not have been more striking. Steinberg (2004) identifies the first wave of economic theories of nonprofits as models of organizational behavior based on managerial utility maximization. Managerial objectives included, among others, budget maximization (Niskanen, 1971; Tullock, 1966), output maximization (Steinberg, 1986), and maximization of pecuniary or nonpecuniary income (Migue & Belanger, 1974; Pauly & Redisch, 1973; all cited in Steinberg, 2004). These models thus assumed that the objectives of nonprofit organizations were determined by managers without the involvement of any other group of stakeholders. It was only later that nonprofit economists recognized the need to derive managerial objective functions from a broader institutional context of stakeholder interaction (Steinberg, 1993).

A probable reason for the predominant early focus on managerial utility maximization is the difficulty in providing other analyses given the startling heterogeneity of the nonprofit sector. As stated by Boris and Steuerle (2006, p. 66), the sector "... includes religious congregations, universities, hospitals, museums, homeless shelters, civil rights groups, labor unions, political parties, and environmental organizations, among others. Nonprofits play a variety of social, economic, and political roles in the society. They provide services as well as educate, advocate, and engage people in civic and social life." Given this diversity, it is overwhelmingly difficult to identify a common pattern of stakeholder interaction that would explain how the goals of specific nonprofit organizations are derived. One feasible way to take account of this diversity was by relegating these goals to the sphere of idiosyncratic managerial preferences. Yet this is clearly incomplete and fails to identify the broader patterns of stakeholder interaction (see Krashinsky, 1997; Steinberg, 2006). Indeed, the sheer diversity of the nonprofit sector constitutes a widely acknowledged challenge to any attempt to generalize about it.

The contribution of the present article is to help meet this challenge of nonprofit diversity by opening up additional theoretical perspectives suggested by the theory of agricultural cooperatives. This theory sees cooperatives as arenas for the interaction of multiple stakeholders, such as managers, directors, and members. The latter especially exhibit substantial heterogeneous interests. Moreover, the theory of agricultural cooperatives explicitly acknowledges that managerial utility maximization is necessarily circumscribed by the need to provide useful member services. This theory thus provides a conceptual framework for understanding nonprofit organizations not only as manager-controlled entities but also as organizations that are useful to multiple and heterogeneous stakeholders, likely even more heterogeneous than those of agricultural cooperatives.

The strategy of this article is to summarize the state-of-the-art theories of agricultural cooperatives and, based on that, to suggest potentially new insights for modern nonprofit economics. The article focuses on two fundamental issues: the economic nature of the cooperative organization, and the economic justification of agricultural cooperatives.

## **What Are Cooperatives?**

The modern economic theory of the (agricultural) cooperative firm has been developed by three distinct schools of thought that view the cooperative as (1) a form of vertical integration (or an agency) serving member farms, (2) a firm separate from member farms, or (3) a coalition. Nourse (1922) introduced the first approach and, subsequently, Emelianoff (1942) formally analyzed the cooperative as a form of vertical integration. These authors' basic argument is that due to the operation-at-cost principle, a cooperative does not incur profits or losses itself and, thus, it is not a separate firm. On the basis of this argument, Phillips (1953) modeled the cooperative as one plant of a multiplant firm and thus derived the rules for cooperative pricing and output decisions. A representative example of an agricultural cooperative acting as a form of vertical integration is the traditional, local, multipurpose cooperative found in most of Europe and North America. These cooperatives epitomize Nourse's philosophy of cooperation—that of the “‘competitive yardstick’ with the objective of keeping IOFs [for-profit investor-owned firms] competitive” (Cook, 1995, p. 1155).

The second scholarly approach views a cooperative as a separate firm that optimizes some objective function. Following the pioneering contribution of Enke (1945), numerous scholars have contributed to this line of research, each proposing a different maxim and, most commonly, referring to various definitions of members' welfare (e.g., Helmberger & Hoos, 1962). Empirically, cooperatives acting as business organizations separate from their members' farms are commonplace and involve various forms of alienation from their membership. Indications of this alienation include members' free riding on their governance duties or opportunistic behavior by cooperative managers who are disinterested in serving the true needs of members.

The third prominent approach views the cooperative as a coalition of participants who have different goals and participate as long as they feel that their goals are being fulfilled. Consequently, cooperative behavior is the result of the bargaining process reflecting the relative power of participants. Kaarlehto (1955) and Ohm (1956) pioneered this view in the 1950s. The strength of this approach is in its realistic assumptions, such as membership heterogeneity, principal-agent conflicts, and nonnegligible information costs. Drawing from the public choice and game theory bodies of literature, this approach sheds considerable light on conflicts among co-op stakeholders, on bargaining processes, and on the conditions of maintaining the cooperative coalition.

Empirically, cooperatives act as coalitions every time they seek to reconcile the interests of their heterogeneous memberships. A recent example of failed reconciliation of this type is described by Agrell and Karantininis, who refer to a Danish dairy cooperative that, some years ago, included two subgroups of members. One subgroup produced regular milk and the other one produced value-added organic milk that was more profitable. The cooperative practiced the so-called common-pool system where all members receive the same average price for their product deliveries. The common-pool system was dissatisfying to the second subgroup of members because it prevented them from capturing the full additional profit of their value-added milk. The

first subgroup, by contrast, was happy for the possibility to appropriate a part of the additional profit earned by the organic milk producers. As the conflict between the subgroups threatened the viability of their otherwise successful cooperative, organic milk producers left to set up their own new cooperative (Agrell & Karantininis, 2000).

## **Implications for Nonprofit Economics: Beyond the “Firm” View of Nonprofit Organization**

In contrast to the theory of agricultural cooperatives, the literature on nonprofit economics does not exhibit a comparable variety of perspectives on the nature of nonprofit organizations. In fact, it is dominated by the implicit “nonprofit organization as a firm” perspective. Central to this perspective is the notion of utility maximization by nonprofit managers and entrepreneurs, with resulting implications for nonprofit organizational behavior, for example, in the area of pricing and output determination. Although being fairly adequate for nonprofit organizations with a clear commercial stance, this perspective is less helpful for understanding nonprofits that are more community based, volunteer driven, and donor oriented. Arguably, the latter organizations are more appropriately conceptualized as agencies that serve their stakeholders in the sense of Emelianoff (1942), rather than as outlets for managerial utility maximization. By emphasizing their service to stakeholders, the service perspective explains, for example, why nonprofit organizations traditionally play important roles in supporting vulnerable people (Guo, 2010; Nesbit, 2010), even though it is less well suited to analyzing a number of nonprofit-specific phenomena such as philanthropy and volunteering.

Furthermore, the “nonprofit organization as a firm” perspective is incomplete in the sense that it assumes exogenous managerial or entrepreneurial objective functions and, thus, provides no account of their evolutionary derivation from a particular institutional context. It is this limitation that motivates the ongoing calls for research on endogenizing nonprofit firms’ objective functions, that is, explaining their evolutionary derivation from the context of stakeholder interaction (Steinberg, 2006). Again, an implication of the theory of agricultural cooperatives is to view nonprofit organizations as service agencies rather than as firms. Then the objective functions become endogenous. Just like the specific goals of cooperatives as service agencies are derived from their member service mandate, the goals of some nonprofit organizations are explicable in terms of the service they are called upon to deliver to their specific stakeholders .

Yet another advantage of the service agency perspective is in its ability to yield a straightforward explanation of the economic meaning of nonprofit orientation. As service agencies, nonprofit organizations (and agricultural cooperatives) cannot be acquisitive, profit-seeking units. Rather, in Emelianoff’s (1942) terminology, they are “aggregates of economic units” operating at cost in order to provide service to their heterogeneous stakeholders (which may be independent acquisitive units). Interestingly, Henry Hansmann’s (1996) theory of enterprise ownership upholds an essentially

similar position. Hansmann treats nonprofit organization as a firm without owners. This firm is patronized by (i.e., maintains transactional relationships with) many stakeholders, none of which can own it without incurring a prohibitive transaction cost and/or putting other stakeholders at a disadvantage. Accordingly, the nonprofit orientation of nonprofits indicates their value to stakeholders for the patronage they exercise rather than for the profit it generates on invested capital. Whereas Emelianoff's notion of service agency likewise admits no owners, it calls attention to the fact that an organization without owners may be more usefully viewed as a service agency rather than a firm.

In addition, the service agency perspective can inform some of the modern debates over the concept of social enterprise. In a recent literature review, Galera and Borzaga differentiate between American and European approaches to this concept. The former approach, among other things, "tends to qualify social enterprises as organizations running commercial activities [that are] not necessarily linked to the social mission," thus giving rise to possible mission–market tensions (Galera & Borzaga, 2009, p. 214; see also Kerlin, 2006; Young, Jung, & Aranson, 2010). Moreover, according to Galera and Borzaga, the American approach accentuates the major role of "extraordinary individuals" (p. 215) in operating social enterprises while potentially downplaying the significance of the broader institutional context. The European approach contrasts with the American one in both respects; it envisages an inherent linkage between entrepreneurial orientation and social mission–related activity, and it does not regard particular individuals or stakeholders to be significantly more important than others. Both of these characteristics of the European approach to social enterprise are supported by the service agency perspective, which is accordingly more consistent with the European approach than with the American one.

Some strands of modern nonprofit economics provide indirect support to the service agency perspective. Avner Ben-Ner's (1986) theory of customer control of nonprofit organizations squares perfectly with the Emelianoff–Robotka–Phillips conception of agricultural cooperatives as controlled by member farms. Burton Weisbrod's (1991) governmental failure theory, which portrays nonprofit organizations as being extra-governmental providers of public goods, in essence asserts these organizations' service character with respect to minority consumers in need of extra-governmental provision of public goods. According to the logic of the service agency perspective, the goals of nonprofits addressed by these theories may be derived from the service mandate toward their respective stakeholders. Their nondistribution constraint merely reflects these goals being inconsistent with independent profit seeking. The nonprofit economics literature includes yet another important strand that seems to be in blatant opposition to the service agency perspective. This strand refers to the diverse set of writings that emphasize the role of ideological entrepreneurship in the nonprofit sector (Rose-Ackerman, 1996). This literature implies that ideological entrepreneurs are primarily interested in pursuing their own ideologies, and by doing so, they primarily serve themselves. Any useful services to other stakeholders, such as consumers (or beneficiaries), occur only as a byproduct of their indulgence to their own ideological



preferences. In various contexts, scholars exploring ideological entrepreneurship have long ago pointed out that, unless appropriate regulatory frameworks are in place, ideological orientation may indeed prevent nonprofit entrepreneurs from providing the best service to consumers (James, 1983; Rose-Ackerman, 1996; Young, 1983). Thus, deviations of the real-world nonprofit behavior from the requirements of the service agency perspective cause concerns about the legitimacy of nonprofit organizations and their congruence with public interest (Stone & Ostrower, 2007).

The derivation of nonprofit organizational goals from the embedding institutional context is also informed by another theoretical perspective in the theory of agricultural cooperatives, the coalition perspective. Specifically, stakeholders providing support to nonprofit firms (or being served by nonprofit firms) may exercise a legitimate voice in the definition of these firms' missions. At the same time, central to the coalition perspective is the heterogeneous nature of stakeholder interest. Given this heterogeneity, nonprofit missions must balance the various stakeholder interests. It is only natural to think of this balance as being determined by two opposite forces. Following the terminology of Holger Bonus' (1986) approach to cooperatives, these forces can be designated as centripetal and centrifugal, the former related to the benefits of collective action and the latter reflecting the collective decision-making costs under conditions of interest heterogeneity. In the proposed coalition perspective, low benefits of collective action and high costs of reconciling heterogeneous interests lead to the formation of narrow missions, whereas the opposite conditions explain why particular mission statements are kept quite broad. Mission breadth can thus be endogenized as a function of variables reflecting centripetal and centrifugal forces. Just as Buchanan's (1965) theory of clubs identifies optimal club size given the club's fixed mission and given the collective good to be provided, the coalition perspective identifies optimal mission breadth for a fixed set of heterogeneous stakeholders.

Even in its present rudimentary form, the coalition perspective allows extension of the Weisbrod-James argument about the nonprofit sector's importance being proportional to the level of population heterogeneity. Since greater heterogeneity leads to higher collective decision-making costs (for an individual nonprofit organization), it will be likely associated with nonprofit mission statements formulated more narrowly than would be the case if the heterogeneity were less significant. This argument exhibits some parallels to Hansmann's (1996) theory of balancing ownership costs against market contracting costs. Hansmann considered the costs of collective decision making as ownership costs that, if substantial, lead to a reliance on the market contracting and, thus, to the narrowing of the organizational boundary of the enterprise. In the proposed coalition perspective, high collective decision-making costs likewise lead to narrower boundaries of individual nonprofit organizations, in terms of both their mission definition and the number of stakeholders (such as members).

The coalition perspective, however, must be seen as acting in concert with numerous other determinants of mission breadth. For example, this perspective would explain the recent U.S. trend of nonprofit proliferation in terms of growing perceptions of



interest heterogeneity among the concerned stakeholders, yet it sheds little light on the extent to which this proliferation leads to the duplication of nonprofit activities. It is likewise of limited relevance for explaining the conditions of interorganizational collaboration that might be expected by donors who support multiple small nonprofits. Understanding this collaboration calls for other theoretical perspectives that emphasize the importance of social networks, resource dependence, and institutional legitimacy (see Sowa, 2009).

In the real world of the U.S. nonprofit sector, the tentative relevance of the firm, service agency, and coalition perspectives can be conveniently discussed using Salamon's (2001) distinction between member-serving and public-serving nonprofit organizations. In Salamon's typology, the main types of member-serving nonprofit organizations include social and fraternal organizations, business and professional associations, labor unions, and mutual benefit and cooperative organizations. Since these types of organizations exist primarily to generate benefits to their members, their rationale likely combines the service agency and coalition perspectives. Whereas the former perspective is implied in their member-benefit orientation, the latter reflects the necessity of collective decision making among members regarding the nature of the benefits they desire from their nonprofit organizations. In contrast, public-serving nonprofit organizations such as funding intermediaries and service providers are better viewed from a combination of the firm and service agency perspectives. The firm perspective seems particularly relevant for funding intermediaries and providers of health care, education, social and legal services, and arts and culture (Salamon, 2001), primarily because the technical complexity of these activity areas calls for effective managerial decision-making systems. To the extent that the stakeholders served by service providers are clearly delineated (which is likely the case with neighborhood-based organizations), the firm perspective may be usefully supplemented with the service agency perspective. At the same time, for some items in Salamon's typology, such as churches, action agencies, and political organizations, it is difficult to hypothesize about the comparative relevance of the three perspectives.

To summarize, the key lesson suggested by the theory of agricultural cooperatives is that it is useful to view nonprofit organizations not only as firms but also as service agencies and stakeholder coalitions. As service agencies, nonprofit organizations exist to serve the interests of heterogeneous stakeholders such as donors, clients, managers, volunteers and staff, as well as the broader public; as coalitions, they must balance the interests of these diverse stakeholders. Although it is possible to hypothesize about the comparative relevance of these perspectives for various types of public- and member-serving nonprofit organizations, it is a matter of empirical research to examine the actual relevance of each perspective in particular cases. At the hypothetical level, both the service agency and the coalition perspectives propose various possibilities for the nonprofit goal of endogenization, the need for which has been established by the dominant "nonprofit organization as a firm" perspective.

## What Is the Economic Justification for Cooperatives?

Both the historical and current bodies of economic literature posit the following six categories of motives for founding agricultural cooperatives. A significant fact about these motives is that only the first three are related to market failure.

*Market power avoidance.* This market failure–related rationale is the most frequently cited reason for forming agricultural cooperatives. As a rule, markets for agricultural inputs and outputs are imperfectly structured, with farmers having significantly less market power than their contractual partners located upstream and downstream in the food chain (e.g., input suppliers, processors, wholesalers, etc.). Thus, these contractual partners have an incentive to subject farmers to various forms of monopolistic exploitation (such as price discrimination). Cooperatives help farmers to protect themselves from this exploitation. For example, most dairy cooperatives around the world were formed by a group of farmers who were facing price discrimination by the sole dairy industry in their region.

*Provision of missing service.* Another case of market failure is when a for-profit firm does not find it profitable to operate in a particular geographic area or an industry. Because of this, farmers cannot market their output, purchase inputs, or have access to valuable services. Cooperatives help farmers fill these provision gaps. According to Sexton and Iskow (1988), the ability of cooperatives to fill these gaps is predicated on their goals being different from those of for-profit firms. A typical example of such cooperatives is U.S. rural utilities that provide their members with electricity and telephone services in those rural areas where for-profit firms would not invest.

*Achievement of gains from scale economies.* This motive for founding agricultural cooperatives refers to cases where economies of scale can justify the operation of only one business entity. If this entity is a for-profit firm, farmers will likely be subject to its opportunistic behavior. To avoid being confronted with this behavior, the farmers create their own large organization in the form of a cooperative (Cook, 1993; Schroeder, 1992). This market failure–related reason is exemplified by farmer-owned grain elevator cooperatives or supply cooperatives that dominate the local, isolated market in which they operate (Staatz, 1987).

*Risk reduction.* Minimizing exposure to risk provides a non–market-failure-related economic rationale for forming agricultural cooperatives. Even though cooperatives sometimes assume insurance functions because of the failures of insurance markets, they reduce risk in a number of additional ways, including horizontal and vertical integration, cost-averaging over commodity lines, establishing product pools, and so on. The net effect of these activities is to shift risk from members to nonmembers or ration risk among all members. In addition, cooperatives minimize exposure of their members to the risk of ex–post opportunistic behavior of contractual partners (Cook, 1993, p. 160). Empirically, this type of agricultural cooperative is exemplified by agricultural bargaining associations observed in several U.S. states. They reduce the exposure of commodity producers to price and volume risks and lower the likelihood of ex–post opportunistic behavior by powerful processing industries (Iliopoulos, 2009).

*Achievement of additional marketing margins.* This motive refers to offensive collective entrepreneurship organizations that take advantage of their positions in the commodity system, often at the expense of other supply chain stakeholders. This is achieved by controlling the supply of a product or by improving a product or service. Since the early 1990s, more than 400 cooperatives of this kind (so-called new-generation cooperatives) were formed in North America and Oceania with a clear objective of achieving additional marketing margins for their members (Cook & Iliopoulos, 1999).

*Most efficient organizational structure.* Cooperatives are also formed for reasons related to their ability to economize on transaction cost (Bonus, 1986) and to balance the costs of market contracting and ownership (Hansmann, 1996). A recent, more sector-specific rationale relates agricultural cooperatives to the importance of family farms for Western agriculture (Valentinov, 2007). Family farms have a limited ability to realize economies of scale and to develop market power comparable to that of their trading partners. The role of agricultural cooperatives is to help family farms to overcome these limitations. This motive for the creation of agricultural cooperatives can be observed in industries where farmers make major investments in highly specific assets (e.g., in the dairy industry).

Historically, four positions have been developed regarding the relationship of agricultural cooperatives to market failures (Rhodes, 1985). The “Cooperative Commonwealth” approach posits that capitalistic markets are a political and social failure that should be replaced by a system of cooperatives. The “Cooperatives as Investor-Owned Firms” position argues that cooperatives have become just like for-profit firms and so farmers do not need cooperatives anymore. The third approach, “Strong Market Failure Rationale,” states that market failure, as perceived by farmers, is the only economic justification for a cooperative. Consequently, cooperatives are seen by their farmer members to be solving a market failure. According to the fourth approach, “Historical View” or “Soft Market Failure Rationale,” market failure has been neither the necessary nor sufficient condition for the development of cooperatives. As shown below, it is the latter approach that is of particular interest for nonprofit economics.

## **Implications for Nonprofit Economics: Beyond Market Failure Theorizing**

The six economic justifications for agricultural cooperatives readily lend themselves to comparison with the economic justifications for nonprofit organizations. Economists of nonprofit organizations justify them in terms of their ability to address two basic types of market failures: missing supply of collective goods, and contract failure (i.e., information asymmetry-related market failure; see Steinberg, 2006). These market failure types correspond fairly closely to two of the above-listed justifications of agricultural cooperatives: the provision of missing service, and risk reduction, respectively. Indeed, any donor-funded nonprofit firm provides a service that would otherwise be missing, whereas the reduction of information asymmetry-related risks is the central

reason for the existence of those nonprofit firms that derive their rationale from their superior trustworthiness (Hansmann, 1987). Moreover, the ability of nonprofit organizations to reduce information asymmetry-related risks explains why they can present efficient transaction cost-economizing organizational structure in situations of information asymmetry, thus corresponding to yet another economic justification of agricultural cooperatives (see Enjolras, 2009). The other justifications of agricultural cooperatives are also applicable to the nonprofit sector to some extent, but not as centrally as the providing missing service and risk reduction.

For example, achieving additional marketing margins is apparently not a highly relevant rationale for nonprofit organizations, but there are some relevant examples, such as Wine Routes (European nonprofit organizations operated by wineries seeking to attract visitors and thus increase wine sales). Achieving gains from scale economies is relevant for many nonprofits (such as those attracting multiple small donations), but it is difficult to designate it as a rationale for adopting the nonprofit organizational form. Of particular interest, however, is the rationale related to market power avoidance, which is usually not discussed as a market failure rationale for nonprofit organizations (see Jegers, 2008; Steinberg, 2006). Yet this rationale is applicable to some organizations such as industry associations, labor unions, mutual life insurance companies, and interprofessional associations in Europe (e.g., French Interprofessional Association for Wine).

This rationale is interesting because many nonprofit organizations, particularly those that serve vulnerable populations, pursue pricing policies that are largely opposite to those of market power avoidance. In the terminology of Steinberg and Weisbrod (2005, p. 2205), such nonprofit organizations pursue distributional objectives and accordingly “care about the level and distribution of consumer surplus provided to their clients.” Maximizing consumer surplus is at the core of Ben-Ner’s (1986) customer control theory of nonprofit organizations. This theory, however, is concerned with the improvement (from the customers’ perspective) of firm–customer relationships and, thus, already presupposes the existence of customers. In contrast, distributional objectives of nonprofit organizations are often motivated by the fact that particular groups of low-income vulnerable people have limited participation in the market and, thus, limited customer roles. Thus, there seems to be a spectrum of possible market power-related pricing policies for nonprofit organizations. Although distributional objectives (requiring policies opposite to those of market power avoidance) envisage helping vulnerable people with limited participation in the market, stakeholders who do participate in the market (e.g., employees) may be supported by other nonprofit organizations seeking market power avoidance (e.g., labor unions).

Differences in the economic justifications of agricultural cooperatives and nonprofit organizations stand out. First, the set of relevant justifications is more diverse for agricultural cooperatives than for nonprofit organizations. Second, in contrast to agricultural cooperatives, the set of relevant justifications for nonprofit organizations includes only those reasons that are explicitly related to market failure. The second difference reveals a striking contrast between the theory of agricultural cooperatives

and nonprofit economics. Cooperatives are avowed business organizations. Yet the economic theory of agricultural cooperatives explicitly acknowledges that their economic justification might include reasons other than market failure. Indeed, in the words of agricultural economist Terence Centner (1988, p. 98), "A major historical factor in the formation of many cooperatives was the desire for an organization to respond to social, philosophical, and human needs. Such needs are basically related to human interaction . . . and still constitute a major justification for some cooperatives." At the same time, in contrast to their colleagues in the field of cooperative studies, nonprofit economists confine the economic explanation of the nonprofit sector to addressing market failures. They are less receptive toward softer notions, such as the social needs mentioned by Centner, despite the acknowledged mission-driven approach of nonprofit organizations.

The relevance of market failure-unrelated rationales for nonprofit organizations can be inferred from the limitations of the market failure-related ones. Steinberg (2006, p. 128) argues that the latter rationales ignore those roles of nonprofit organizations that are concerned with: restoring fairness (toward vulnerable stakeholders), changing preferences, and expressive and affiliative activities ("making statements and being with others," p. 129). All these roles, which are ignored by the market-related rationales, simultaneously represent the market failure-unrelated rationales that may be tentatively attributed to specific types of nonprofit organizations. Returning to Salamon's (2001) typology, ensuring a fair treatment of vulnerable stakeholders may be a relevant rationale for labor unions, mutual benefit, and cooperative organizations, as well as various types of service providers and action agencies. The goal of changing preferences of the broader public is often embraced by advocacy organizations, action agencies, and possibly churches. Expressive and affiliative activities are pivotal to social and fraternal organizations, action agencies, political organizations, and again possibly churches. The traditional market failure-related rationales most prominently apply to service providers, funding intermediaries, and mutual benefit and cooperative organizations. Again, it is a matter of empirical research to sort out the rationales that are most relevant to specific types of nonprofit organizations.

Incomplete market failure explanations for the nonprofit sector has, in fact, long been recognized in the nonprofit economics literature. This is most clearly evidenced by the continuing dualism between the so-called demand-side and supply-side reasons for nonprofit firms' existence (e.g., Anheier, 2005). Whereas the former reasons refer to various types of market failure, the latter refer to nonprofit firms as outlets for ideological entrepreneurship, altruism, and the realization of social values (Rose-Ackerman, 1996). It is noteworthy that, to date, both groups of reasons remain largely disconnected from each other (Hansmann, 1987, p. 37; Steinberg, 2006). In Steinberg's (p. 128) words, market failure theories "explain why consumers would want to buy from and donors donate to nonprofits, but do not explain why nonprofits are there for them to use. What is needed is a theory of the supply of this organizational form to complement the theories of demand."

Given the logical disconnect from the demand-side reasons, the existence of the supply-side reasons per se does not change the reduction of the nonprofit sector to a market failure–addressing device. Moreover, this disconnect calls into question the validity of the market failure justification for the nonprofit sector. Although this justification certainly does reconcile the operation of the nonprofit sector with neoclassical economics, it fails to explain “the supply of nonprofit organizational form” (Steinberg, 2006) and, thus, undermines the very meaning of market failure theory. Specifically, if nonprofits are to be effective at addressing market failure, the incidence of market failures must generate the supply of the nonprofit organizational form. This is implicitly assumed by cooperative theory for the case of agricultural cooperatives. If this supply remains uncertain or accidental, the value of such market failure theory to explain the real-world nonprofit sector is limited indeed. It is particularly true in view of the empirical findings about donor behavior being more supply driven than demand driven (see Wolff, 2001, p. 96).

It may be that the very dichotomy between the demand-side and supply-side justifications of the nonprofit sector is a consequence of the inconsistency of the neoclassical market failure framework with real-world societal problems that are addressed by the nonprofit sector. The latter problems such as those of protecting human rights, delivering humanitarian aid, promoting social welfare, and so on do not easily lend themselves to interpretation in terms of market failure but are rooted in the complex institutional structure of specific societies. The limitations of the neoclassical framework to take account of the institutional structure have been the point of departure for Anheier and Salamon’s (2006, p. 106) “social origins” theory, which

emphasizes the embeddedness of the nonprofit sector in the cultural, religious, political, and economic realities of different countries. It thus views decisions about whether to rely on the market, the nonprofit sector, or the state for the provision of key services as not simply open to choice by individual consumers in an open market. . . . Rather, it views these choices as heavily constrained by prior patterns of historical development and by the relative power of various social groupings that have significant stakes in the outcomes of these decisions.

In contrast to market failure theory, the social origins theory is open ended regarding the nature of specific societal problems addressed by the nonprofit sector; it does not require these problems to take the exclusive form of market failure. This theory is centrally concerned with explaining the cultural and geographical variation in the characteristics of the nonprofit sector, rather than with this sector’s economic justification. Arguably, it is in bringing societal problem solving to bear on the latter justification where the key implication for further research on nonprofit economics resides. Following the tradition of the theory of agricultural cooperatives, this research must be more receptive toward economic arguments going beyond market failure. Furthermore, in the spirit of the social origins theory, it must be aware of the pervasive institutional embeddedness of the nonprofit sector.



More specifically, nonprofit research has to conceive of societal problems as a common frame of reference for nonprofit stakeholders on both the demand side and the supply side. Given this common frame of reference, it would no longer be accidental that, for example, preferences of donors largely coincide with those of ideological entrepreneurs. The common frame of reference would make it understandable why a donor may find a suitable ideological entrepreneur to whom to donate and an ideological entrepreneur would find donor funding that enables the pursuit of his ideological preferences. It is not the concern with public goods per se, but rather the coincidence of public good-related motivations of various stakeholders that makes for the vibrant nonprofit sector. The meaning of the institutional embeddedness and the common frame of reference lie in effecting this coincidence, and thus, in enabling the demand-side and supply-side stakeholders to pool efforts in the delivery of the respective public goods.

## **Concluding Remarks**

This article compares some of the basic approaches in the theories of agricultural cooperatives and nonprofit economics. The main revealed contrast is that the theory of agricultural cooperatives has been less strictly framed by neoclassical economics than that of nonprofit economics. Indeed, the former theory views cooperatives not only as firms but also as service agencies and stakeholder coalitions; it also explicitly includes justifications unrelated to market failure. Ideas found in the agricultural cooperative theory highlight the ways in which nonprofit scholars can extend the existing economic explanations of the nonprofit sector. Specifically, apart from being arenas for firm-level managerial utility maximization, nonprofit organizations can also be seen as serving stakeholders and balancing stakeholder interests. Their rationale may also be found not only in redressing market failure but also in solving broader societal problems.

Due to its predominant neoclassical framework, modern nonprofit economics still has to tackle the important challenge of explaining the supply side of the nonprofit organizational form and, specifically, the goals of nonprofit organizations (Steinberg, 2006). The theory of agricultural cooperatives can be helpful here in two respects. First, it contains the service agency perspective, which sheds light on the societal meaning of the nonprofit goals. This meaning consists of serving various groups of stakeholders in ways that go beyond addressing market failure. Second, the theory of agricultural cooperatives contains the coalition perspective, which clarifies the derivation of particular goals of specific nonprofit organizations as a result of the bargaining process among various stakeholders.

What do these insights imply for the further development of the neoclassical approaches to the nonprofit sector? It is an open question whether neoclassical economists would develop modeling approaches that would do full justice to the service agency perspective. Although agricultural cooperative scholars did develop this perspective in neoclassical terms (using the theory of the multiplant firm), it is not clear whether similar analytical tools would apply to the nonprofit sector. The full development of the service agency perspective requires taking into account the nonprofit sector's



complex institutional structure and, thus, relaxing the methodological individualism assumption. Heterodox economic approaches, such as classical institutionalism and evolutionary economics, are likely to be more suitable here (see Borzaga, Depedri, & Tortia, 2011). At the same time, there does seem to be a large potential for using neo-classical tools to model the coalition perspective and, specifically, to understand the trade-offs between the costs of collective decision making by heterogeneous stakeholders and the costs of creating and maintaining individual nonprofit organizations. One of the authors has already undertaken initial steps in several of the abovementioned directions (Valentinov, 2011; Valentinov & Larsen, 2011).

The argument suggests two main areas for further research. First, the proposed extensions of the nonprofit economics literature call for further theoretical elaboration and empirical testing. In line with the potential extensions, empirical questions would include the following: Do real-world nonprofit organizations operate like firms or rather like service agencies? What is the actual and societally acceptable scope of managerial discretion in the nonprofit sector? What stakeholder interests had to be compromised in order to arrive at the definition of particular nonprofit mission statements? To what extent can societal problems addressed by nonprofit organizations be designated as market failures? The global trends of increased commercialization and managerialism in the nonprofit sector would, for example, suggest that nonprofit organizations often act as manager-driven firms primarily concerned with market failure-related issues. The second area for further research is related to reversing the direction of learning described in this article. Whereas nonprofit scholars may benefit from exploring the agricultural cooperative theory, what can agricultural cooperative scholars learn from nonprofit economics? The authors hope that the article will encourage an interdisciplinary conversation along the suggested lines.

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