ON THE RELATIVE DISADVANTAGE OF COOPERATIVES: VERTICAL PRODUCT DIFFERENTIATION IN A MIXED OLIGOPOLY

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Abstract

We investigate the incentive to provide goods of high quality in a vertically related market for different types of business organizations, a farmer-owned cooperative and an investor-owned firm. Contrary to the firm, the cooperative is characterized by decentralized decision making, which gives rise to overproduction and problems coordinating the quality decisions of its members (free riding). Comparing both manufacturers acting as monopolists we show that the cooperative will never supply final goods of higher quality than the firm, and that the problem of quality coordination is mitigated if the cooperative succeeds in preventing overproduction. When a cooperative faces competition of an investor-owned firm (mixed duopoly), it will – except in one limit case – never produce final goods of a higher quality than the firm and will deliver lower quality in a number of scenarios.

Keywords: cooperatives, mixed oligopolies, agricultural markets, product quality