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Public Limited Companies and Cooperative Principles in Ireland's Dairy Sector

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In recent years, several large dairy cooperatives in Ireland have been restructured in various ways into investor-oriented corporations (public limited companies). A primary reason advanced by leadership of these cooperatives for going the PLC route was that additional capital was required, and members were unwilling to invest that additional capital. The attitude of members toward cooperative investment appeared to have eroded because the principle of current active member ownership appeared to have been ignored. Net income was not allocated, and equity redemption policies were not in place. The argument is advanced that member investment in cooperatives can be given new incentives by bringing some dynamics to the principle of current active patron-member ownership.

Milk production is a major enterprise in Ireland's agricultural economy, representing about 35 percent of the value of total agricultural production. Most (90 percent) of the 12 billion pound annual milk output is processed into manufactured dairy products, and about two-thirds of the milk supply moves into export markets.

Historically, cooperatives have been the dominant institution in the dairy sector, processing more than 95 percent of the milk used for manufacturing and for liquid products. Presently, 37 dairy cooperatives are registered in the relatively small (27,000 square miles) nation. A national federated cooperative, An Bord Bainne, is the primary export mechanism for almost all these organizations.

There was widespread agreement in Ireland's dairy sector in the 1980s that amalgamation, the usual Irish term for merger, was the key to advancing a strong cooperative movement. However, the will to make the decisive moves to bring about merger was lacking. A reluctance to change and lose identity, a strong conservatism among directors and members, and a sense among managers that their positions would be at risk kept postponing strategic merger decisions indefinitely.

In the 1986-90 period, seven dairy cooperatives, handling approximately one-half of Ireland's milk, either restructured themselves into public limited companies (PLCs)[1] or were taken over on a bid basis by a public limited company. Three factors seemed to explain the emergence of PLC activity among the dairy cooperatives. First, some larger dairy cooperatives concluded that additional capital was required to pursue various growth objectives and that access to capital markets through a PLC organization was the best way to acquire that capital. Second, a major existing food processing-marketing PLC was searching for additional milk volume. This company identified the fact that the shareholder-ownership structure of many dairy cooperatives made them vulnerable to takeover bids. Finally, the introduction of European Community milk quotas in April 1984 was a factor placing pressure on all dairy organizations to seek additional milk supplies and/or to diversify in various ways. The net result of these various forces has been to place dairy cooperatives in a defensive position and to raise fundamental questions about what future changes are in prospect.

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The growth objective dominated the discussion of amalgamation and/or public limited company organization. In large part, the growth objective was management driven rather than member service oriented. The manager of one of the cooperatives turned PLC commented, "As part of our development strategy, which is clearly defined in our five year plan, we are actively engaged in a search for relevant expansion possibilities. The scale of such developments over the next four years will require the harnessing of a number of sources of investment funds. In this regard, the Board has requested that all ground work be completed with a view to establishing a quoted public limited company, should that particular source prove attractive at the point at which funding is required" (Jacobson).

Leadership of those dairy cooperatives making PLC overtures believed that growth was necessary to survive. They sought economies in size and scope; they wanted to maintain and increase market share, particularly for manufactured dairy products going to export; and they saw rewards to management from growth that could not be realized under the existing cooperative structure. The growth goal dominated to the point of excluding any cash-out goal for members. Yet, in two instances where shareholders were actually provided a cash-out choice, the shareholders voted by ratios of two to one and four to three to accept market values for their shares and dissolve their cooperatives.

In his 1989 article on the restructuring of cooperatives as investor-oriented firms in the United States, Schrader commented that: "Cooperative principles and practices place capital constraints on growth" (p. 52). One conclusion that will be demonstrated from the Irish experience is a converse case, i.e., the failure to effectively implement cooperative principles and practices has placed capital constraints on growth.

Research Procedure

A research project was initiated in which data were collected from 15 dairy organizations in Ireland, including the "big six." The purposes of the inquiry were to: (1) discover why PLC type structural changes were occurring among Ireland's dairy cooperatives; (2) evaluate practices and principles in the dairy cooperatives to find why members of some cooperatives were prepared to vote for PLC type organization; and (3) prescribe and recommend cooperative practices that would address the ownership and share valuation problems that appeared to be undermining investment in cooperatives.

The 15 organizations received approximately 75 percent of all milk marketed in Ireland. They ranged in size from an annual milk intake of 10 million (imperial) gallons up to 137 million gallons. They were all multipurpose organizations in that farm inputs and other activities were a part of their operations in addition to milk processing. However, the sale of milk products accounted for about two-thirds of annual turnover for most of the organizations.

At the time of the interviews, eight of the fifteen organizations had maintained their traditional dairy cooperative structure. The other seven had recently adopted some type of a PLC structure or been taken over by a PLC.

Separate but related questionnaires were developed for the traditional dairy cooperatives and the PLC organizations. The interview schedules were constructed so as to measure the manner in which cooperative principles and practices had been implemented by the organizations. The schedules were also designed to help distinguish the philosophies of the leaders of the traditional cooperatives as compared with the leaders of the PLCs (See Jacobson and O'Leary).

Interviews that averaged three hours in length were conducted with the leaders of all 15 organizations, usually in their offices. The leaders included chief executive officers and board chairmen for the most part.

Member-Patron Ownership Structure

Preliminary observations of the dairy cooperative situation indicated that the ownership structure of the cooperatives had not been kept current. Therefore, primary attention was directed to shareholding patterns, allocation of earnings or surpluses, and equity redemption practices. Although seven of the fifteen organizations had converted to some type of PLC status, the cooperative shareholder data reflect the ownership structures that existed while maintaining cooperative status.

Two key observations are evident from inspection of the data in table 1. First, a large proportion (47 percent) of the more than 70 thousand owner-shareholders in the 15 cooperatives were not currently active patrons (referred to as "dry" shareholders in Irish terms).[2] In fact, a substantial number of the inactive shareholders (13 percent) were listed as dead or nontraceable.

A second ownership point that becomes apparent in the data is that many active patrons of the cooperatives were not member-owners of those cooperatives. Of the more than 35 thousand dairy farmers marketing milk to the cooperatives, more than 7,500 (21 percent) were identified as non-member patrons.

The key cooperative principle is that ownership of cooperatives should be held by currently active patrons, basically in proportion to their patronage (Roy, pp. 340-42). In fact, as the shareholder-owner data demonstrate, the ownership principle has been eroded substantially in the Irish experience. Many of the owners were not currently active patrons; many of the patrons were not currently active owners.

Table 1.—Shareholder Structure of 15 Dairy Cooperatives in Ireland, 1989[a]

Cooperative	Total Shareholders	Milk Suppliers	Dry Shareholders	Milk Suppliers Who Are Not Shareholders	Shareholders Who Are Dead or Non-traceable
Avonmore	13,000	4,000	6,000	Nil	3,000
Kerry	6,000	5,000	500	2,000	—
Waterford	5,500	3,218	2,750	1,000	1,000
Bailieboro	4,000	2,000	2,000	Nil	Few
Donegal	700	1,300	400	1,000	200
Westmeath	1,800	850	1,100	150	—
Golden Vale	7,593	4,243	4,350	1,000	—
Ballyclough	4,419	3,431	1,353	1,007	Few
Midwest	4,500	1,200	2,000	170	1,500
Mitchelstown	4,500	2,877	2,500	900	700
Nenagh	2,200	1,750	125	150	100
North Connacht	14,434	3,891	9,300	Nil	1,200
North Cork	450	350	30	30	Nil
Tipperary	2,101	973	890	0	460
Totals	**71,597**	**35,558**	**33,573**	**7,557**	**9,129**

[a]The data generally reflect the situation in mid-1989. For Avonmore, Kerry, and Waterford, the data reflect the structure for the cooperatives that represents the majority ownerships of the PLC. For Bailieboro, Westmeath, and Donegal, the share structure reflects what existed when they were terminated as cooperatives. For Golden Vale, the share structure reflects the situation in 1989 that existed before its transition toward becoming a PLC. The shareholder data for a given cooperative may not appear consistent in every instance. For example, Kerry reports 2,500 active patron shareholders (not shown) who are not milk suppliers. (Milk supplier is the usual Irish term for dairy farmer.)

Surplus Allocation and Equity Redemption Policies

A second cooperative principle that effectively has been sidestepped by the dairy cooperatives in Ireland is that of operation at cost. This criticism requires some explanation because there can be different philosophies of what it means to operate at cost.

The balance sheets of the 15 organizations were relatively strong, with equity-to-assets ratios averaging about 60 percent. The income statements generally have reflected reasonable annual surpluses (net earnings). However, closer scrutiny of the financial statements reveals that only about 7 percent of the owner equity was allocated; the other 93 percent was simply identified as unallocated shareholder reserves (table 2). The normal practice in most of the cooperatives has been to assign annual surpluses as unallocated member equity. Patronage refunds that would reflect individual patron increases in equity have not been allocated.

The net effect of having a large proportion of member equity identified as unallocated reserves was that everybody owned the cooperative and

Table 2.—Shareholder Equity Status for 15 Irish Dairy Organizations

	Eight Traditional Dairy Cooperatives	Seven PLC Type Organizations[a]
	Percent	
Allocated equity as percentage of total equity	4.6	10.2
Range in allocated equity as percentage of total equity	0.8–11.4	1.5–19.0
Shareholder equity as percentage of total assets	63	47
Range in equity as percentage of total assets	53–85	21–80

[a]The data for the seven PLC type organizations refer to the shareholder structures for the cooperatives that are in place or were in place at the time the PLC structure was adopted.

nobody owned the cooperative simultaneously. In effect, the cooperatives have operated as profit-making corporations that retained all the net earnings. Limited stock dividends have been paid in some instances.

One major factor that weighs for allocating surpluses in the United States is the income tax issue. Unallocated net income is subject to corporate income taxes. In Ireland, the surpluses are not taxed at the cooperative; neither are they taxed at the patron level if allocated. One observation that comes out of this contrast is that national tax policy can be an important factor in motivating cooperatives to abide by cooperative principles.

It became evident in the course of the interview process that custom or tradition was a primary reason explaining why surpluses were not allocated by Irish cooperatives. This attitude was summarized succinctly by one manager who stated: "We wanted to keep the surplus as a nest egg. If surplus was allocated, then there would be claims against the organization. Also, not allocating is the easy way out for the organization" (Jacobson and O'Leary, p. 68).

A more philosophical rationale for not allocating could be inferred from the discussions. This rationale was a somewhat idealistic or communal view that the cooperative was a part of the community, and that earnings from cooperative operations should be held in the cooperative (community) and not be parceled out to individuals.

In any case, net income was not allocated and most member equity was identified as unallocated reserves. This situation is exactly the reverse of the balance sheet profile in major U.S. dairy cooperatives where more than 90 percent of member equity is allocated and identified with individual member ownership.

Compounding the problem of having only a limited number of shares issued or allocated was the general lack of any kinds of equity redemption practices. Eleven of the fifteen organizations essentially indicated that they did not have equity redemption practices in effect. The other four organizations had only the most limited forms of policies, e.g., redeeming estates if descendants were not farming. In effect, there was no internal market for cooperative shares. Cooperative ownership has economic meaning only if the cooperative adheres to its responsibility of redeeming equity according to policies that identify ownership with current active patrons.

Consequences on Capital Acquisition and Ownership

Two major consequences evolved from the member-ownership practices associated with the dairy cooperatives in Ireland. First, membership reached a point where they were unwilling to contribute additional investment to their organizations in various capital drives. The cooperatives were constrained for additional capital by whatever annual surpluses they could generate and/or by capital that could be borrowed. However, this was true only for those cooperatives that had PLC-growth aspirations. For the eight cooperatives that maintained their cooperative status, the leaders were unanimous in stating that they had ready access to as much capital as was required.

For the four organizations that restructured themselves as public limited companies, the attitude on capital acquisition as expressed by cooperative leaders was as follows: "we had to grow—farmers said they would not meet our capital needs. . .capital gained through share offerings was vital to pursuing the growth objective. . .it is difficult to get additional capital from shareholders on a voluntary basis. The need was always there but we could not get it translated into action" (Jacobson and O'Leary, pp. 93-94).

It is no surprise that farmer-shareholders were unwilling to invest additional capital in their cooperatives. The practices of these cooperatives had essentially turned the investment of individual members into the classic forms of worthless paper. The PLC solution, to be noted subsequently, seemed to make sense.

The second major consequence that evolved out of member ownership practices is that over time, a relatively few shares of stock were associated with a substantial net worth. Shares continued to have a par value of £1, but a £1 share might have an implicit market value 20 to 30 times higher than that because numbers of shares had not increased, while unallocated reserves had increased many times. Meanwhile, shares were not redeemed, or in the few instances where they were, a cooperative would redeem them at their £1 par value. Entrepreneurs recognized the situations and, in two instances, offered the shareholders bids on shares that approached the book values of the shares. Shareholder meetings were held, and shareholders voted to dissolve their cooperatives and gain full market value for their ownership. The tragedy from a cooperative viewpoint is that the failure to honor the principles of current patron ownership and operation at cost had invited investor takeover.

The important question regarding residual rights of members in situations of co-op dissolution is complicated and, in the cases of the PLC structure, had not been answered. Tradition and practice in Ireland have assigned all those rights to the original shareholders. But as one retired cooperative manager pointed out, many of those original shareholders are "under the clay." Many of the cooperatives have been attempting to "tidy up the share register" through various inquiry and redemption processes, but this is a slow undertaking. Furthermore, the rules (or bylaws) for the cooperatives, because of statute, do not permit mandatory redemption in cases where descendants and nonpatrons prefer to continue holding shares.

One general situation and two specific situations of residual rights of shareholders can be noted. In the general situation, without the economic motivations that a pending dissolution could bring, shareholders traditionally have been indifferent regarding their ownership rights in the cooperative. This attitude has been shaped by long-standing practices where shares were rarely redeemed, surpluses were not allocated to new patrons, and it was held to be a shareholder's community duty to preserve investment in the cooperative.

In the two specific instances where outside entrepreneurs approached shareholders with offers far in excess of the par values of the shares, the residual rights of the shareholders were fully honored. However, it should be emphasized that many of these shareholders were no longer patrons; also equity paper had not been issued in the recent years when net income occurred. As a result, it was the residual rights of longstanding shareholders that were honored in dissolution, and the contributions to equity in recent years that could be attributed to patronage were bypassed.

The second specific situation in which the residual rights issue has emerged concerns adoption of the PLC-cooperative organization (see the following section for detail on structure). The cooperatives that spawned PLC organizations have continued to postpone or avoid the residual rights issue in the cooperative, i.e., no realistic equity redemption policies. Yet, values of shares in the cooperative are now implicitly quoted through the value of the PLC traded shares in the stock market. Debate continues in Ireland's cooperative movement as to how the cooperative shareholders should be compensated, but thus far, no decisions have been made and patience has been urged.

The PLC-Cooperative Solution

Three of the large cooperatives restructured themselves as investor corporations (PLCs), while retaining majority *ownership* and *control* in the parent cooperative. The process of doing this is relatively straightforward, although it can appear complex, and its long-term implications to cooperative patrons are uncertain.

An example may help. The cooperative establishes or organizes a PLC but continues to survive as a cooperative. The cooperative turns over or exchanges all its assets and properties for a majority (more than 50 percent) of the shares of ownership in the new PLC. These shares (B ordinary) carry voting power and represent ownership, but they are possessed by the cooperative and are not tradable in any market or stock exchange. At the same time, A ordinary shares are issued by the PLC up to an amount of less than 50 percent of the total shares (A and B) outstanding in the PLC. The A ordinary shares also have voting power and represent ownership, but in addition, they are tradable on the public market and represent the essential avenue for the PLC to acquire additional capital. As a result, the business can grow, diversify, acquire. Capital has now been generated from outside investors, and market trading values have been established for shares.

However, the thorny questions about the parent cooperative have not been addressed. The member shares in the cooperative, which own the B ordinary shares in the PLC, continue not to be redeemed or be redeemable in ways that reflect their real investment in the PLC. The PLC-cooperative solution has solved the problem of gaining capital, but has continued avoiding the principle of current member ownership in the cooperative.

Cooperatives Remaining as Cooperatives

The fact that eight of the fifteen organizations surveyed have continued to operate as cooperatives raises the WHY question. After all, the member ownership practices of these eight cooperatives had been virtually identical to the seven cooperatives that adopted PLC structures. If traditional capitalization procedures had been insufficient for the PLC set, what was the situation for the eight cooperatives?

Leaders of the traditional dairy cooperatives, in contrast to the PLC leaders, did not perceive that demands for additional capital or outside capital were necessary to pursue their business strategies. Generally the cooperative leadership placed a higher priority on paying milk producers the highest price possible and on servicing members, while the PLC leaders placed a higher priority on organization growth. Leaders of the traditional dairy cooperatives indicated that using their annual profits on an unallocated basis normally had been a sufficient means of capitalizing their organizations. The need to engage in bank borrowing had been quite limited.

Evidently, the more expansive growth objectives of the PLCs found traditional cooperative capitalization procedures to be inadequate, especially in view of the fact that members had not seen any return on their investment under the old ways of doing things. The differences between the two groups were not mutually exclusive, and they differed more in emphasis and strategy than in organizational objectives.

Conclusions

In many kinds of circumstances, cooperatives may have a sense that restructuring themselves as investor corporations offers significant advantages. In his 1989 article in this Journal, Schrader noted that "A common feature. . .is that top management concluded that growth is essential for the organization to remain viable. . . .Dependence on internally generated capital was viewed as limiting the rate of growth. . . .The initiative for restructuring originated from management or an outside expression of interest" (pp. 50-51).

The dairy cooperatives that have restructured themselves as PLCs in Ireland would express similar views. However, one of the great ironies of Ireland's PLC activity in recent years has been that the same farmers who were unwilling to invest further in their cooperatives opened up their checkbooks and invested substantially in the same organizations as investor corporations. Why should investment and ownership in an investor corporation be honored and the same in a cooperative be dismissed?

On the basis of information generated in this inquiry, it is evident that member-owners of the cooperatives saw tradable shares on a public stock exchange as having major advantages over the dormant arrangements that described the treatment of their ownership in the cooperative. The principle of current active member ownership in a cooperative cannot be ignored. A cooperative must create its own ownership market. New owners, i.e, receivers of equity paper, must come into the cooperative as their proportionate allocations of patronage refunds are issued. Old owners must be canceled out as appropriate equity redemption policies come into play. Such actions give meaningful economic value to member ownership and create the environment for inviting additional investment by members. At least in the Irish experience, it was not cooperative principles that were deficient, but rather the failure to adhere to cooperative principles that undermined member investment in the cooperatives.

Notes

1. Public limited company (PLC) is the equivalent of a corporation or investor-owned firm.

2. A "dry" shareholder is a shareholder who no longer patronizes the cooperative. The number of inactive shareholders was difficult to estimate in some instances due to difficulties that management has in measuring patronage (feed, fertilizer, etc.) of some members who are not milk suppliers.

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