



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

Cooperatives' Merger Strategies: The MD Foods – Kløver Mælk Case.

Per J. Agrell and
Kostas Karantininis

COOPERATIVES' MERGER STRATEGIES: THE MD FOODS – KLØVER MÆLK CASE

PER J. AGRELL
KOSTAS KARANTININIS

The Royal Agricultural University of Copenhagen

ABSTRACT:

Since March 1999 the two largest dairy cooperatives of Denmark, MD FOODS and KLØVER MÆLK have merged after a long relationship ranging from joint ventures (such as the P-AMBA and M-AMBA companies) to various alleged price wars. We point out that the main reasons for merger from the point of view of MD FOODS were: (i) to establish monopoly power on the domestic market, (ii) to pursue an international growth strategy, (iii) to exploit rationality and coordination gains in the operations. Further, the merger counters the threat of (iv) an alleged foreign take-over of KLØVER, (v) further pressure by the Danish Competition Authority, and (vi) the increased concentration through mergers taking place in the dairy and retail industries in Europe. The post-merger period exhibits some signs of price increases, mainly in the fermented milk market, whereas the price of fresh milk is still to catch up. Questions still remain as to the long term implications of the merger: Will the retailers react by importing milk and dairy products from Germany, The Netherlands, Sweden or elsewhere? General questions still remain as to the governance problems in large cooperative organisations. Relations between farmer-members and management went through a critical test. Since MD FOODS is now openly flirting with yet another merger, this time with Swedish ARLA, these problems may perpetuate. In addition, it is not certain whether this time they will overcome as easily as they have up to now European and national anti-trust regulation.

KEYWORDS: Merger, Danish Dairy Industry, Farm Cooperatives

PER J. AGRELL is Associate Professor of Managerial Economics arch at the Royal Veterinary and Agricultural University, Department of Economics and Natural Resources, DK-1958 Frederiksberg C, DENMARK.

E-mail address: **per.agrell@ipe.liu.se**

KOSTAS KARANTININIS is Associate Professor of Agricultural Economics at the Royal Veterinary and Agricultural University, Department of Economics and Natural Resources, DK-1958 Frederiksberg C, DENMARK.

E-mail address: **kok@kvl.dk**

INTRODUCTION

On March 10th, 1999, after a fairly turbulent autumn and spring, the board of directors of the two largest Danish dairy cooperatives, MD FOODS and KLØVER MÆLK, announced a merger to take place, retroactively from September 28th, 1998. The two cooperative dairies, being the two largest in Denmark, have been sharing a common raw milk distribution system and some common production facilities since 1992. However, the seven-year period between 1992 and 1999 – when the merger actually happened – was not a very "happy marriage". This period was marked by price wars and fierce rivalry to gain market share – especially in the butter and fermented milk markets. The recent merger itself was not a very pleasant event, turned down by KLØVER members in November 1998, and approved almost unanimously six months later by the very same membership.

In this paper we analyse the communicated or implied reasons behind the merger, the method of implementing the merger and some of the unresolved challenges for the future. Initially, we give a brief background of the market situation before the merger, the owner-farmers and the institutional framework. We then provide the most likely reasons that lead to the merger from the MD FOODS' perspective and sketch a schematic outline of the main events. Finally, we summarise the main points of this case and suggest five themes for further discussion.

MARKET SITUATION

Through their joint production company P-AMBA, MD FOODS and KLØVER control 88% of the Danish raw milk supply. The remaining milk is divided on 32 small local dairies, the largest of which has a share of 1.5% of the volume. As given in Table 1 and Figure 1, the Danish dairy industry has undergone a dramatic concentration where effectively 80% of the dairies in 1970 have disappeared from the market. There is almost no import to the Danish market, foreign farmers cannot be members of MD FOODS and hence not deliver to their dairies. Denmark is a large player in the international dairy market (Rabobank, 1998): it is the 10th largest cheese producer and the 4th largest exporter in the world; Denmark is also the 7th largest producer and the 6th largest exporter of whole milk powder internationally; whereas it is also a large exporter of skim milk powder (9th) and butter (8th). The milk market is heavily concentrated, as follows from market share data given in Table 2 and 3. The two cooperatives controlled between 75% - 100% of the relevant domestic markets, several of which are characterised by a low innovation rate and domination of non-brand products. The exceptions are found in the butter, butter spread and cheese markets, where brands like *Lurpak*¹, *Kærgården*² and *Danablu*³ successfully have captured export markets. The organic segment is stronger than elsewhere and amounts to around 20% of the fresh milk market, partially due to producer incentives and cross-subsidies. Notwithstanding the existence of two strong retailers that control 60% of the Danish consumer market,⁴ no private-label or imported fresh milk is sold. Among the stated reasons are the consumer preferences and the delivery frequency requirements. Due to a single-sourcing requirement posed by the retailers, each outlet only carries non-brand products from one of the two dairies. Branded products may be sold in any chain or outlet

¹ Butter spread: Joint MD FOODS – KLØVER brand name

² Butter spread: MD FOODS brand name

³ Cheese: National Danish brand name

⁴ Danish Competition Authority (1999) *Fusionen mellem MD Foods og Kløver Mælk*, Report.

In the European environment, the Danish market exhibits the highest concentration ratio, since one company will handle 84% of the raw milk. Comparable concentration ratios are those of Finland and The Netherlands, where two companies handle 84% (Table 3).

PRODUCERS

The Danish dairy farmers are among the most productive in Europe, next only to the farmers in Sweden in terms of annual output per farmer (Table 4). The producers are predominantly (94% of the delivered raw milk⁵) organised in cooperatives, of which the post-merger MD FOODS will be the most dominating with around 10 000 of 11 350 farmers as members. Figure 2 shows the membership development during 1994-1998, where KLØVER proportionally lost fewer of its members⁶. No farmer is member of more than one cooperative, nor sells to more than one dairy for contractual and logistical reasons. Before the voluntary agreement with the Danish Competition Authority (DCA), there was a required notice period of up to two years to cancel the delivery contract. A growing number of farmers are turning to organic farming, which since 1995 has enjoyed a premium of up to 50% on the milk price. The organic farmers are also over-represented in the limited but increasing number of small dairies, cf. Table 5.

ORGANISATION AND HISTORY

The recent merger we examine here did not happen in a vacuum. Consolidation in the dairy industry is the name of the game internationally, and in Denmark as well (Figure 1). The first cooperative dairies in Denmark were formed in the late 1800s. Their number peaked in the 1940s with more than 1600 dairies (Figure 1). In the fifties and most of the sixties, consolidation of dairies took place in a dramatic pace. Plans for the formation of a single Danish dairy company started already in the 1960s. Finally the Mejeriselskabet Danmark (Dairy Company Denmark – known later as MD FOODS) was formed in 1970 out of the amalgamation of four dairies. The amalgamation process continued until the 1990s. The members of the wealthier cooperative dairies who joined MD FOODS received a payment if their coop was profitable, poorer ones had to pay in order to join the group.

KLØVER MÆLK was the other cooperative dairy who survived the consolidation process, and made the first cooperation agreement with MD FOODS in 1992. Except for a minor investment in Poland by KLØVER, MD FOODS was responsible for the export market with fully owned subsidiaries in the U.K.; Germany, Scandinavia, Saudi Arabia, South Korea and 13 other countries. Foreign subsidiaries of MD Foods were handled by MD Foods International Group (MDIG) – a wholly owned subsidiary of MD Foods. In 1989 MD FOODS entered the U.K. market by acquiring a dairy in Leeds and formed MD Foods Plc. In 1998 MD Foods Plc was handling 13% of the UK's liquid milk market, but operated at a great loss⁷.

⁵ Danish Competition Authority (1999) *Fusionen mellem MD Foods og Kløver Mælk*, Report.

⁶ It must be pointed out, however, that over the critical period of the consolidation of the Danish dairy industry, when the number of Danish dairy farmers decreased from 96000 in 1974 to little over 11000 MD Foods' membership grew slightly from 7600 to over 8000, whereas its share of milk intake grew from 9% to 70% (Harvard Business School, 1998)

⁷ Børsen (July 1, 1998) *MD-Foods nødt at fusionere*. See also *Harvard Business School* (1998) for a detailed story of the British experience of MD FOODS.

THE MERGER AGREEMENT

Very briefly, we outline here the main points of the agreement since they are used in various parts of the discussion. There are three parts in the agreement. The first is simply the settlement offer by MD FOODS to both KLØVER MÆLK and MD FOODS members. The other two parts concern the voluntary agreement between MD FOODS and the DCA, one is related to member relations; and one concerns competition.

A. Settlement

- A.1 KLØVER MÆLK's cooperative owners receive a payment of 40 øre per kg. of milk supplied – corresponding to an approximately DKK 160,000 for the average member, provided that has been a member for at least the last five years. Otherwise the payment is reduced to 8 øre per kg. Half of the payment will be received for the 1998/99 year and the other half will be due for the 1999/2000.
- A.2 MD FOODS' members will receive 5 øre per kg over the five past years corresponding to approximately DKK 100,000 per active member. This amount will be retained as capital in the company for a minimum of two and a maximum of ten years, and will be interest bearing.

B. Member relations:

- B.1. Farmers have a notice period of 4 months to cancel their contract with a dairy. This period was previously 12 months.
- B.2. Farmers are allowed for side deliveries of up to 20% of their milk to a second dairy.
- B.3. There will be open membership – absolutely no entry requirements for farmers to join a coop dairy.
- B.4. Free delivery: MD FOODS must accept milk from non-members also.

C. Competition

- C.1 All competitors must be allowed to buy raw milk from MD FOODS at a fixed call price
- C.2 MD FOODS must sell 5% of their capacity (MD FOODS chooses which plant, which product and when – there is actually a secret time limit of the completion of the 5% capacity sale)
- C.3 Competitors have access rights to the MD FOODS distribution system
- C.4 Protection of minorities in the Danish Dairy Board (DDB): The DDB consists of 11 members, 9 of which now belong to MD FOODS. The DDB has some considerable power in the dairy industry, and among others has ownership of several brand names. This clause in the agreements protects the rights of smaller dairies against any abusive actions of MD FOODS.

REASONS FOR MERGER

"Looking back to those who formed MD FOODS in 1970, it has always been MD FOODS' intention for the Danish cooperative dairies and Danish milk producers to join together in order to secure a strong position in the competition against the dairy industries in the rest of the world"
 Knud Erik Jensen, Managing Director of MD FOODS, 26, March 1999 (one day after merger is approved by the Board of Representatives of KLØVER MÆLK)

Through the merger, MD FOODS may realise the opportunities (i) to establish monopoly power on the domestic market, (ii) to pursue an international growth strategy, (iii) to exploit rationality and coordination gains in the operations. Further, the merger counters the threat of (iv) a foreign take-over of KLØVER, (v) further pressure by the DCA, and (vi) the increased concentration through mergers taking place in the dairy and retail industries in Europe. Below, each of these reasons will be discussed in some detail.

I. MARKET POWER

As a producer of non-branded products, MD FOODS operated in a duopoly environment with declining market shares in high value segments, such as the fermented milk market (cf. Figure 3 for fruit yoghurts and Figure 4 for plain yoghurts). Similarly, the market share of KLØVER on the profitable domestic fresh milk market increased from 29% in 1992 to 41% in 1998⁸. Partially this is caused by the organisation with a common production capacity (P-AMBA), which increases the similarity of the product range and necessitates competition on price, rather than on variety or quality. The price recovery in the high value segments has been quickly realised, cf. Figure 5, whereas the market operations on publicly more sensitive products, such as fresh milk, have been delayed (Figures 6 and 7). Figure 6 illustrates the development of the markets for fresh milk, yoghurt, cream and butter. However, in a widely spread estimate of economic gains from the merger, MD FOODS alleged DKK 250 mil in 'organisational and market synergies'⁹, which may be a euphemism for the desired price recovery. The refusal to sell closed dairies to continued dairy production¹⁰ and alleged shirking¹¹ in the distribution of competing products after the merger may indicate tendencies to establish market power. The voluntary agreement with the DCA is not particularly obstructing as it leaves crucial definitions at the discretion of the regulated, i.e. MD FOODS, and furthermore lacks sanctions for observed abuse¹².

II. INTERNATIONAL GROWTH

MD FOODS has a stated strategy to be one of the largest dairies in Europe through mergers and acquisitions of promising candidates. Since 1995, MD FOODS has acquired five Danish dairies and detailed negotiations are underway with the largest Swedish dairy cooperative ARLA. Financial indicators regarding the three cooperatives MD FOODS (pre-merger), KLØVER, and ARLA are presented in Table 6. Clearly, MD FOODS is the largest in terms of sales. However, the added turnover from export operations has low profitability (cf. gross margin in Table 6) due to the low margin on milk powder and the competitive nature of the markets in, e.g., Germany and the UK. The European high-value dairies in Table 2, Nestle (DKK 90.9 bio.) and Danone (DKK 40.6 bio.) allocate 1.1% and 0.9% of their turnover, respectively, to product development. In spite of the joint research initiative with ARLA, the MD FOODS product development is on an internationally low level. Thus, rather than capturing the markets using a product differentiation strategy, which is costly and carries a substantial risk for an enterprise with high leverage (78%), MD FOODS pursues a cost superiority strategy¹³ by realising economies of scale. The long-term rationale behind

⁸ Børsen (Dec 18, 1998) *Malkekrig bliver optrappet*.

⁹ Børsen (March 11, 1999) *MD sluger Kløver*.

¹⁰ Information (Sept 22, 1999) xxx

¹¹ Information (xxxx) shirking in organic milk distrib

¹² Børsen (April 29, 1999) *Når raven betros at vogte gæs*.

¹³ "Thus, MD Foods should have a critical mass and develop in such a way that no competitor in Europe will be able match our production costs.. /.../ This will force the competitors to think twice before they start to

the growth strategy is moreover to match the perceived competitive requirements to be a supplier to the multi-national retail chains: high volume due to single-sourcing and local presence in as many global key-markets as possible. MD FOODS is answering the concentration in the retail chain by an analogous horizontal integration. Seen from a cooperative perspective, the growth strategy by acquiring companies in the export markets in combination with monopoly power in the domestic market gives MD FOODS a strong competitive position that turns the milk quota utilisation to an advantage rather than a price reducing force. Seen from this perspective the acquisition of KLØVER, even if it may have been expensive¹⁴, is a logical first step in a growth strategy that takes its stronghold in the North-European market.

III. COST EFFICIENCIES

The dairy industry has limited economies of scale in the processing stage due to transportation costs and the short time frame for transportation, processing, packaging and distribution. The prior existence of the joint production company P-AMBA indicates that the gains in the process may be limited or blocked by managerial inertia or deadlocks in the rationalisation process. The alleged goal for the cost reduction, DKK 300 mil in three years may prove difficult to realise. The initial cut-backs are made on the previous KLØVER administration and sales force¹⁵ and the closure of the excess cheese and powder production facilities. However, unless the latter were outside of the P-AMBA structure, the cost efficiency gains might have been achieved in the existing organisation, were it managerially efficient. Perhaps the latter circumstance is one of the explanations to the meagre outcome (DKK 36 mil 1995/96) compared to promised rationalisation gains of DKK 69-84 mil at the formation of P-AMBA¹⁶.

IV. TAKE-OVER THREAT

KLØVER, as opposed to MD FOODS, did not have the resources to acquire dairies neither in Denmark, nor in Europe. Pushed in the fierce price competition on the fresh milk market, KLØVER tried to find other form of alliances to minimise the dependency on MD FOODS. Early KLØVER alliances with smaller dairies, such as SKÅNEMEJERIER in Sweden, did not pose a serious threat. However, when the giant DANONE and KLØVER announced a collaborative agreement in December 1998, the MD FOODS management immediately responded to what they saw as a hostile action and an escalation of the current conflict¹⁷. DANONE, who has less than 5% of the fermented milk market, offered KLØVER access to range of high-value added products without posing a threat in the core businesses; the fresh milk and cheese markets. The chairman of MD FOODS publicly expressed his concern over a foreign intervention in the Danish market calling it a “horror scenario from the viewpoint of the Danish dairy farmers¹⁸”. Considering that the KLØVER management labelled the process as a hostile take-over by MD FOODS, the threat must be taken seriously. Given the high frequency of mergers and offers of mergers in the industry, the political

compete with us on price.” CEO MD FOODS, Jens Bigum, interviewed in Børsen (May 31, 1999) *Fusion sætter farmers value i fokus*.

¹⁴ Børsen (March 26, 1999) *Mejerifusion lægger hårdt pres på MD-ledelesen*.

¹⁵ Børsen (March 11, 1999) *MD sluger Kløver*.

¹⁶ Danish Competition Authority (1998) *MD Foods og Kløver Mælks aftaler om P-amba og M-amba*. Note Jnr.: 2:8032-166.

¹⁷ Børsen (Dec 22, 1998) *Fransk mejeri-gigant nyt våpen i mælkekrig*.

¹⁸ Lantbrugsnet (Week 2, 1999) *MD Foods skærper kampen om hjemmemarkedet*.

climate and the comparative advantage of a strong-hold on the Danish market must have lead to reflections in many board rooms at the turn 1998/99.

V. DANISH COMPETITION AUTHORITY

The DCA has ever since the collaborative agreement in 1992 been occupied with the two dairies. The original P-AMBA and M-AMBA construction in 1992 was repelled by DCA in 1994, with resulting changes in the pricing and distribution of resulting profits. DCA urged the dairies to assess how the gains of the collaboration would benefit the consumers. This assessment was subsequently used in 1996, when DCA noted that the prices of dairy product consistently had been 10% above the world market prices and only limited merger gains had materialized. The judicial process 1996-97 was very intense and in absence of a voluntary agreement, DCA annulled a number of clauses in the 1992 agreement, opening up for third party purchase of processed milk, e.g., for private label packaging. MD FOODS and KLØVER stalled the implementation and appealed the annulation, resulting in an upheaval of the decision by a higher court in December 1997. A new legislation against collusive behavior in effect 1998 also caused additional stress on the MD FOODS- KLØVER cooperation, with a process initiated in July 1998 aiming to lower fresh milk prices by court order. However, the Danish legislation does not regulate mergers or acquisitions. Thus, it became progressively clear to all involved that the legal costs of continuing the loose collaboration must be weighed against the cost of a merger, if necessary hostile. Albeit not very effective in their consumer protection role, the DCA may have exercised some coercive power to accelerate the merger process.

VI. MERGERS IN EUROPE

During the same time the merger discussions between MD FOODS and KLØVER were taking place, there have been discussions – some of which actualised – of at least four related mergers in Northern European countries. (a) In Northwest Germany, Nordmilch AG merged with four other dairies: Bremerland Nordheide, Hansano, Milch-Erfassung, and MZO Oldenburg. The new company will have 12,800 producers and a turnover of DKK 18 billion. Given that Germany is MD FOODS's largest export market, this merger is very significant as well as the following occurring across the border between Germany and The Netherlands: (b) Holland's Campina Melkunie, Europe's fourth largest dairy is having discussions with German Emzett (Meirei-Zentrale Berlin) concerning "intensive cooperation" agreement. Campina has a turnover of DKK 26 billion, and Emzett DKK 6 billion. (c) The English dairy group, Express Dairies, acquired the Irish Glambias liquid milk business in the UK for DKK 1.143 billion. The acquisition gives Express 30% share of the British dairy market, with MD FOODS third with 13%. The acquisition is not considered a major threat for MD FOODS, since Glambias was mainly in doorstep distribution, whereas MD FOODS Plc has switched mainly to supplying large retailers. (d) Since last September, the two French giant retailers, Carrefour and Promodès have merged creating the second largest retail chain in the world with an estimated turnover of DKK 400 billion, after America's number one Wal-Mart with DKK one trillion.

PHASES OF THE MERGER

Somewhat schematically, we distinguish between five periods of varying tactics to implement the strategies: (A) Flirting and first date 1992-1995, (B) Persuasion 1995-1998,

(C) Sleeping with the enemy – coercion, summer 1998 – March 1999, (D) Absolution March 1999, and (E) Post-merger stress (PMS) from May 1999.

A. FLIRTING AND FIRST DATE: 1992-1995

The two dairy cooperatives have a history of close cooperation intertwined with periods of intense competition, crowned in 1992 when a price war ends in the formation of the joint production and distribution companies. The whole process was instigated after KLØVER MÆLK, a Jutland based company, undertook the distribution of raw milk on a national basis for an ex-customer of MD FOODS. This resulted in non-sensible cross-hauling, and consequently, to increasing pressure by farmers to end it. Finally, the two coops reached an agreement to form two joint companies, one for the distribution of raw milk (named M-AMBA), and one production company (named P-AMBA) where they amalgamated 20 dairy plants (15 by MD FOODS and 5 by KLØVER). The structure of the two companies after the 1992 agreement is illustrated in Figure 8.

M-AMBA – to which all members of both coops deliver their milk – distributed the milk to the joint production company P-AMBA for the Danish market, the joint production company K-AMBA for milk powder, MD FOODS butter production, MD FOODS cheese factory for export, or KLØVER export cheese production facility. The cooperatives maintained their separate managerial, marketing and sales functions.

This period is characterised by a constructive and non-obligating collaboration between the two, with MD FOODS regularly inviting to closer collaboration in press releases¹⁹ and annual reports. Initially, the phase is a win-win situation for the two dairies that enables them to take profit of economies of scale in the process while maintaining market independence. The focus is the cost-efficiency aspect and a consolidation of the domestic market, while swerving around obstacles raised by the DCA concerning the organisation.

B. PERSUASION 1995–1998

As soon as the rationalisation gains from P-AMBA and M-AMBA are exploited, the expansion strategy and the market domination strategy come to surface. In spite of its smaller size, KLØVER stands out as being the slightly more profitable (Table 6), the more productive in terms of sales per employee and the less dependent on bulk export at world market prices due to its domestic profile. These relative advantages strengthen the members confidence in the KLØVER management, who gradually take a seemingly political standpoint in the merger discussions. Plausibly in fear of losing influence and mistrusting the governance structure in MD FOODS, the smaller competitor took occasionally a very independent stance, including capturing market shares in previously protected markets (the *Kærgården – KløverBlomst* butter spread debacle in 1998) and by filing complaints to the DCA against their opponent²⁰.

The butter debacle unfolded as follows: The collaboration between the two dairies came under intense stress in the Danish spread market during 1998. The KLØVER brand, Kløver Blomst, was relaunched in a major segment of the market and quickly multiplied the previous 3-6% share. MD Foods, threatening an undermining of the profitable domestic butter market with a 10-15% premium compared to the world market, responded aggressively by slashing the price of their product, Kærgården, and by pre-empting a

¹⁹ Børsen (Dec 20, 1995) *MD-utspil til fusion med Kløver*.

²⁰ Landbrugnet (Week 2, 1999) *Mejeristrid optrappes*.

distribution license from their MD FOODS Butter company to KLØVER²¹. As KLØVER until 1998 distributed to around 40% of the Kærgården market, the act resulted in a 65 MDKK blow in gross sales (Annual Report, KLØVER 1998). By the end of 1998, Kærgården was the market giant with a market share of around 97%.

Noting that the overall market did not grow during that period, the relative gains for KLØVER on the profitable domestic fresh milk market corresponded to equal amounts of less profitable export of butter, spread and milk powder at bulk prices for MD FOODS. Still, the tone in the public discussion was inviting and persuasive on behalf of MD FOODS, stressing the common dependencies on the cost superiority and international growth strategy.

C. SLEEPING WITH THE ENEMY – COERCION: 1998–1999

In the late spring and early summer of 1998, MD FOODS and KLØVER find themselves in an intensive competition on price on fresh milk, butter and cheese. MD FOODS declared that the close collaboration cannot continue in the current form, the cohabitation must lead either to a full marriage or to a complete divorce in their view. Arguing that the farmers collectively would lose on a duplication of the process investments, MD FOODS regurgitate the invitation to merge. The price war is accompanied by frequent seize-fire offerings by MD FOODS in the press, directed directly to the KLØVER members. Nevertheless, internal politics forces the merger-friendly chairman of KLØVER to resign in October 1998 and a vote among the representatives in November 1998 reconfirms the independent strategy. Attempts to get an impartial investigation of the potential merger effects are rejected by the KLØVER management. The war is escalated by MD FOODS at the end of 1998, when the DANONE-KLØVER deal is made public and the take-over threat becomes evident – at least in MD FOODS' eyes.. During the beginning of 1999, the two cooperatives engage in a fierce undercutting of prices and tariff-elements to the large retail-chains (see Figure 7 where both nominal and deflated prices are compared). Allegedly, the contractual length was reduced to two weeks during this turbulent period²². Finally in February 1998, in an unclear combination of financial exhaustion and internal politics, the KLØVER management surrenders and accepts negotiations under the mediation of the president of the Danish Agricultural Council²³.

D. ABSOLUTION: 1999

The KLØVER members are reasonably well compensated in the resulting deal that also leads to more generous interpretations of the delivery clauses in the contracts. However, the DKK 270 mil that MD FOODS agrees to pay is substantially less than the per kg price paid for some smaller diaries.²⁴ The settlement should be seen from the background of the costly competition and the claim²⁵ that KLØVER was in financial distress at the time of the merger. The KLØVER management has not offered any public statements after the merger and the staffing of the resulting structure reinforces the impression of a hostile take-over.

²¹ Lantbrugnet, (week 20, 1998), *Andelshaverne har afgørelsen*

²² Børsen (May 31, 1999) *Fusion sætter farmers value i fokus.*

²³ Landbrugnet (Week 11, 1999) *Fred og fusion på mælkefronten.*

²⁴ In a merger with the unprofitable Randers & Viborg cooperative at about 20% the KLØVER size, DKK 80 mio. was paid. Børsen (July 23, 1996) *MD Foods slår Kløver.*

²⁵ Børsen (May 14, 1999) *Chok-tab i Kløver Mælk.*

March 25th, the members of KLØVER vote on the merger with the votes 142-41 in favour of the proposal, in line with the recommendation by their management. A couple of months earlier, in November 1998, the very same assembly had turned down a similar proposal with votes 125-32, backed up by a unanimous board of directors. The acquisition was signed along with phased payment of DKK²⁶ 0.40 per kg raw milk delivered, corresponding to around DKK 160 000 per KLØVER active member. The merger was subsequently approved by the DCA under the Danish Competition Act of 1997, primarily because of the initiative with a voluntary unilateral agreement by MD FOODS. In the agreement, intended to curb anti-trust criticism early on, the new company obliges itself to open its distribution channels to other producers, to sell off 5% of the production capacity and to loosen the delivery contracts for the farmers. Although the new constellation becomes the fourth largest agent on the European dairy scene (cf. Table 3), there is no need for an approval from the European Commission, since the expected turnover of DKK 27.3 billion (EURO²⁷ 3.7 bill.) does not exceed the limit of EUR 5 billion according to the pan-European anti-trust regulation.

E. POST-MERGER STRESS 1999–

The time after the painful merger has been a time of only partial price recovery, due to intensified attention from the press and political groupings. It is clear that the expectation on the result will be substantially lower for 1998/99 than the previous years and that this will pose challenges to the new management. Also, the negotiations to merge with ARLA will actualise unresolved conflicts regarding the preservation of cooperative democracy in a highly complex, multi-national food enterprise. The situation on the export market has also been characterised by increased competition since the merger²⁸. Eventually, the ARLA merger will force MD FOODS to battle with regulatory bodies in at least three legislatures, of which the Swedish and European may show to be less workable than the domestic.

SUMMARY

The 1992 cooperative agreement between MD FOODS and KLØVER MÆLK to join their entire primary distribution and some of their production capacity did not suffice to dampen the rivalry between the two dairy cooperatives. The competition between the two partner/rivals culminated in price war and brand proliferation. Clearly, there was a difference in corporate philosophy: The giant MD FOODS concentrated in cost advantage and exhibited an extraverted strategy of exports and international expansion, culminated by its UK subsidiary. On the other hand, KLØVER MÆLK concentrated on the local market and pursued a policy of product innovation which went as far as to join forces with French multinational DANONE which was considering (according to MD FOODS) to take over KLØVER MÆLK. This was perhaps the last drop of bitter milk that KLØVER dropped in the MD FOODS' glass. Its management started to pursue, a bitterly opposed, and finally "successful" merger. It was considered successful by many, although it was labelled as a "hostile take-over" by others – certainly by the KLØVER sales force who were replaced almost immediately after the merger. It was definitely successful from the point of view of

²⁶ 1 DKK = CAD 0.2106 = USD 0.1437

²⁷ 1 EUR = DKK 7.4288 = CAD 1.5646 = USD 1.068

²⁸ Børsen (June 2, 1999) *Mejerifusion udfordrer MD*.

those pursuing it – namely the MD FOODS management and the majority of its membership. It was also successful for the KLØVER members – at least in the very short run – since they realised a compensation of an average of DKK 160,000 in settlement payment. Many question, however, how much of the alleged DKK 300 million in post-merger cost savings will actually be realised. Also, it is not clear whether the claim for a DKK 250 million in "organisational and market synergies" is not a mere euphemism for monopoly rents. In any case, MD FOODS has now put its house in order. It is virtually the only player in the Danish market and can pursue undisturbed its international expansionist strategy. Although heavily criticised for its multinationalist experience – mainly for consecutive losses in its UK subsidiary – MD FOODS is now in merger discussions with the Swedish cooperative ARLA. As this report was printing, it appeared in the daily press that this merger most likely will not be realised, because of stringent Swedish anti-trust law. It is certainly expected, however, that some form of cooperation between MD FOODS and ARLA will take place.

DISCUSSION

The merger between MD FOODS and KLØVER illustrates the transition from a traditional national producer cooperative to a multi-national food enterprise. As such, this actualises the recurrent question of the power balance between the management and the cooperative members in such a structure, the incentive structure and the governance across judicial, cultural and language barriers. However, we will focus the attention to five issues that concern the chosen strategies and their implications for the merger.

PUBLIC IMAGE. Active in Denmark, a market with highly nationalistic consumer preference and stated aversion against 'foreign' or 'manipulated' food, the dairies have enjoyed public support in their previous battles against regulation and foreign entrants. Will the disappearance of the second brand and the price recovery act as a token gesture to provoke antipathy among the consumers? The alternative, an intensified collaboration on the producer side, would have been less visible to the consumer and with effectively the same profitability. Is monopolistic power in the domestic market always an economic advantage?

RETAIL COUNTERMEASURES. The retail chain in Denmark, as well as in Scandinavia and elsewhere, is highly concentrated and potentially powerful. It is highly likely that the merger may be followed by initiatives from the retail to maintain variety, e.g., by import or private-label production. How may MD FOODS prevent or limit counter measures from the trade as to break the monopolistic power? What risk does MD FOODS take with the dependency on export in doing so?

STRATEGY. The merger and its preceding events were much inspired by managerial conflicts between two structures and it is unclear as to what extent the farmers were informed and supportive of the undertaken decisions. MD FOODS has stated in its expansion strategy that the acquisition of private dairies in foreign markets is a possible alternative. How does this change the role of the cooperative members versus the independent farmers in a Europe with open borders? What is the strategic difference between a multi-national producer cooperative, such as MD FOODS, and an investor owned firm, such as DANONE?

VARIETY. The analysis made by MD FOODS suggests that size and global presence are the most important order winners in the future market. The international growth strategy is a

consistent consequence of this worldview. How does product development and market variety enter into the picture? How may this aspect pose a potential threat against constellations of the MD FOODS type?

COMPETITION POLICY. In the merger agreement there are established several mechanisms to guarantee fair competition in the Danish dairy market. However, it is questionable, for instance, how much a competitor would trust the MD FOODS distribution system to distribute their products. Shirking, delays, and information access are some of the problems that could arise.

REFERENCES

1. MEJERIFORENINGEN (1998) *Mejeribruget i Europa – mod et nyt årtusind*. Report from the Danish Dairy Board.
2. DANISH COMPETITION AUTHORITY (1999a) *Fusionen mellem MD Foods og Kløver Mælk*. Report.
3. DANISH COMPETITION AUTHORITY (1999b) *Konkurrenceredogørelse 99*. Annual report.
4. DANMARK STATISTIK (1999) *Mejeristatistik*, Dairy statistics.
5. KRISTENSEN, S (1986), *Kampen om mælken* (The fight for milk), Landbohistorisk Selskab (Agricultural history society)
6. SVENSK MJÖLK (1999) *Mejeristatistik*, Dairy statistics.
7. RABOBANK INTERNATIONAL, (1998), *The World Dairy Market*

Table 1. Concentration on the Danish dairy sector 1970-1999

Year	No of producers	Ave prod./ mil. kg	producer.	No of coops	No of IOFs.	Total dairies.
1970	-	-		410	114	524
1980	42 400	115 000		147	64	211
1990	22 000	207 000		30	27	57
1999	11 350	392 000		16	26	42

Source: Danish Competition Authority, 1999a

Table 2. Selected producer statistics 1997.

		Processed raw milk [Mkg]	Sales [GDKK]	Ave raw milk price [DKK/kg]
Friesland Coberco	NL	6 100	32.2	2.16
Campina Melkunie	NL	5 200	23.7	2.16
Besnier	F	5 000	30.1	2.10
MD Foods + Kløver	DK	4 400	27.3	2.31
MD Foods	DK	3 700	23.9	2.31
Glanbia	IRL	3 300	22.4	-
Bongrain/CLE	F	3 200	13.1	2.10
Nestlé	intl	2 800	90.9 ²⁹	-
Sodiaal	F	2 400	20.5	2.10
Arla	S	2 100	11.0	2.47
Danone	F	2 000	40.6	2.10
Kløver	DK	700	3.5	2.31

Source: Dairy Industry Newsletter, Kløver Annual Report 1997/98, Industry data

²⁹ Product Group Milk Products, Nutrition and Ice Cream.

Table 3. The largest dairies in ten selected countries along with total raw milk volume and share of domestic market 1999

Country	Dairy	Vol, Mton	Share of total domestic volume
DK	MD Foods	4.5	Top 1 = 83%
SWEDEN		3.3	Top 3 = 84%
	Arla	2.1	64%
	Skånemejerier	0.4	13%
	Milko Mejerier	0.2	7%
FINLAND		2.4	Top 2 = 84%
	Valio	1.8	75%
	Group Ingman Foods	0.2	9%
NORWAY		1.6	Top 3 = 66%
	Tine Midt	0.5	42%
	Tine Sor	0.4	21%
	Østlandsmeieriet	0.3	16%
GERMANY		27.0	Top 3 = 33%
	Nordmilch AG	4.5	17%
	Campina Melkunie (Dutch)	2.3	8%
	Humana Milchunion	2.0	8%
FRANCE		22.9	Top 3 = 55%
	Lactalis/Besnier	6.4	28%
	Bongrain/CLE	3.6	16%
	Sodiaal	2.5	11%
UK		14.1	Top 3 = 33%
	Express	1.7	12%
	Dairy Crest	1.6	11%
	Unigate	1.5	10%
Netherland		10.6	Top 2 = 84%
	Friesland Coberco	6.0	57%
	Campina Melkunie	2.9	27%
Irland		5.1	Top 3 = 60%
	Glanbia	1.5	30%
	Dairygold	0.9	18%
	Kerry	0.6	12%
USA		71.9	Top 3 = 35%
	Dairy Farmers of Am.	14.3	22%
	Land O'Lakes	5.5	8%
	Cal. Milk Prod. m.fl.	4.7	7%

Source: *Ugenytt fra Mejeriforeninge* Nr 31, August 7, 1999, *Mejeristatistik*, Svensk Mjölk, 1999

Table 4. Statistics on dairy farms in Denmark, Sweden, United Kingdom and the Netherlands 1995

	DK	S	UK	NL
No. farms (1000)	14	18	37	40
Milk cows (1000)	714	481	2 631	1 777
Ave. herd size (1000)	49.6	26.7	71.1	44.4
Ave. yield (kg/cow/year)	6 269	6 869	5 350	6 092
Ave annual prod per farm (ton)	310.9	183.4	380.4	270.5

Source: Mejeriforeningen, 1998

Table 5. Market shares (in percent) on the Danish dairy market 1999

Product	MD FOODS	KLØVER	Others DK	Import
# of Members (1997/98)	72	16	12	–
Raw Milk				
Fresh milk, normal	55	40	10	0
Fresh milk, organic	50	25	25	0
Fermented milk	60	30	5	5
Hard cheese	55	30	10	5
Butter	80	20	0	0

Source: Danish Competition Authority, 1999b

Table 6. Financial indicators for MD FOODS, KLØVER and ARLA 1997/98 fiscal year (DKK mil, ave. rate)

	MD FOODS	KLØVER	ARLA
Sales	23 771	3 501	11 329
Costs excl members' del.	15 604	1 740	5 828
Result excl members' del.	8 167	1 761	5 501
Net result/kg delivered	2.536	2.550	2.604
Producer margin ³⁰	34%	50%	49%
Solidity	22%	35%	42%
R&D expenses/sales	0.44%	N/A	0.83%
Sales/employee (MDKK)	1.80	3.27	2.02

Source: SEK/DKK, annual reports

³⁰ (Net result + producer payments)/Total sales.

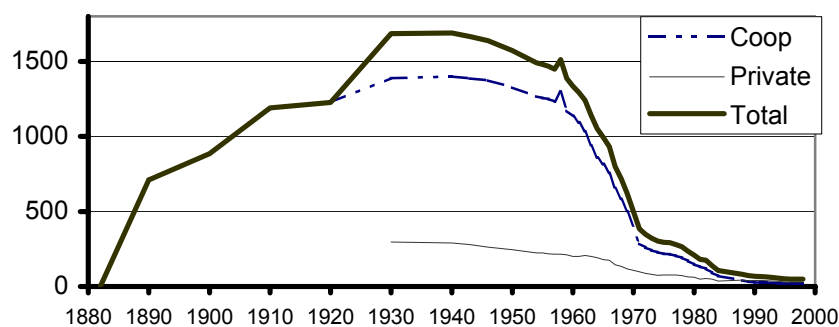


Figure 1. The development in the number of dairies (*Kristensen, 1986*)

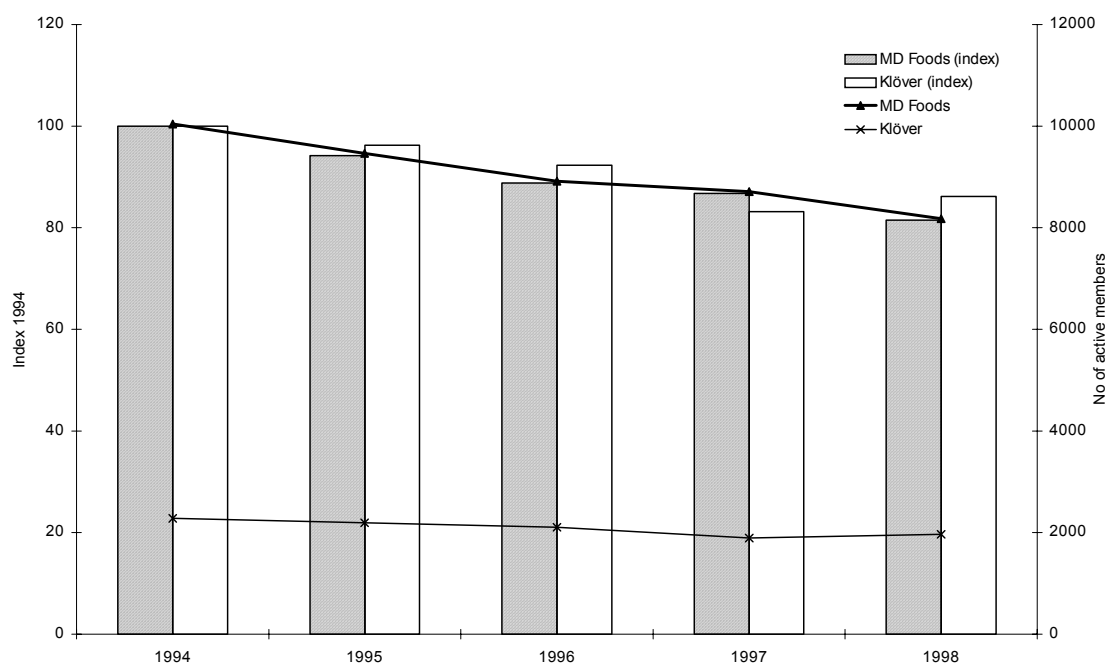


Figure 2. Membership in MD FOODS and KLØVER 1994 – 1998. The lines demark absolute numbers and the bars development from index (base = 1994) (*MD FOODS and KLØVER Annual Reports*)

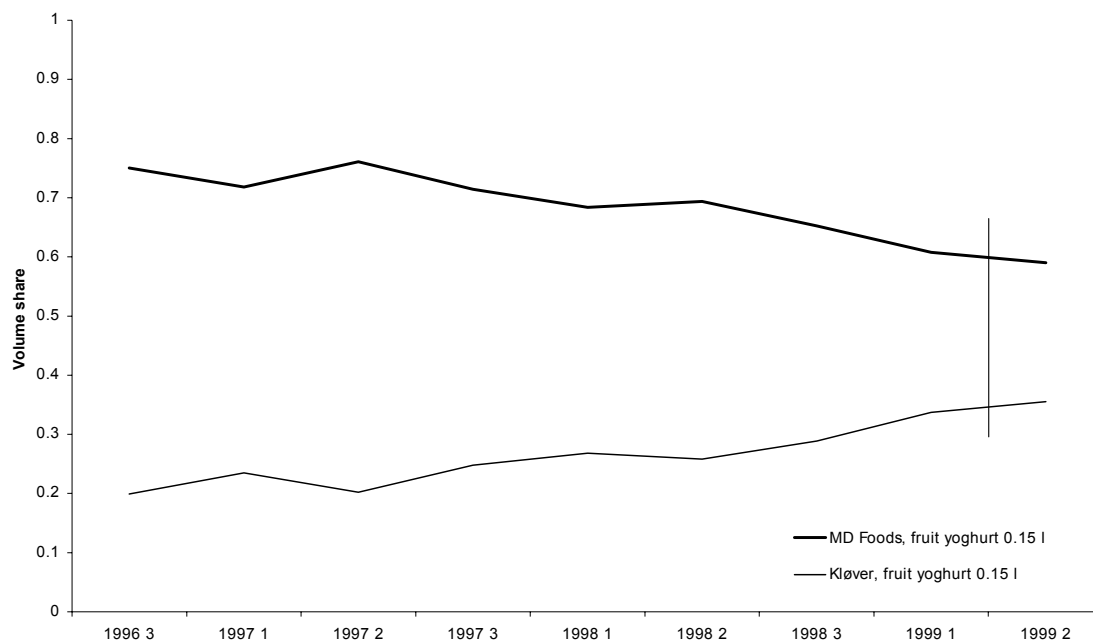


Figure 3. Volume share of the fruit yoghurt segment by md foods and kløver. Sept 1996 — July 1999. The date of the merger is marked by a vertical bar (Industry data, 1999)

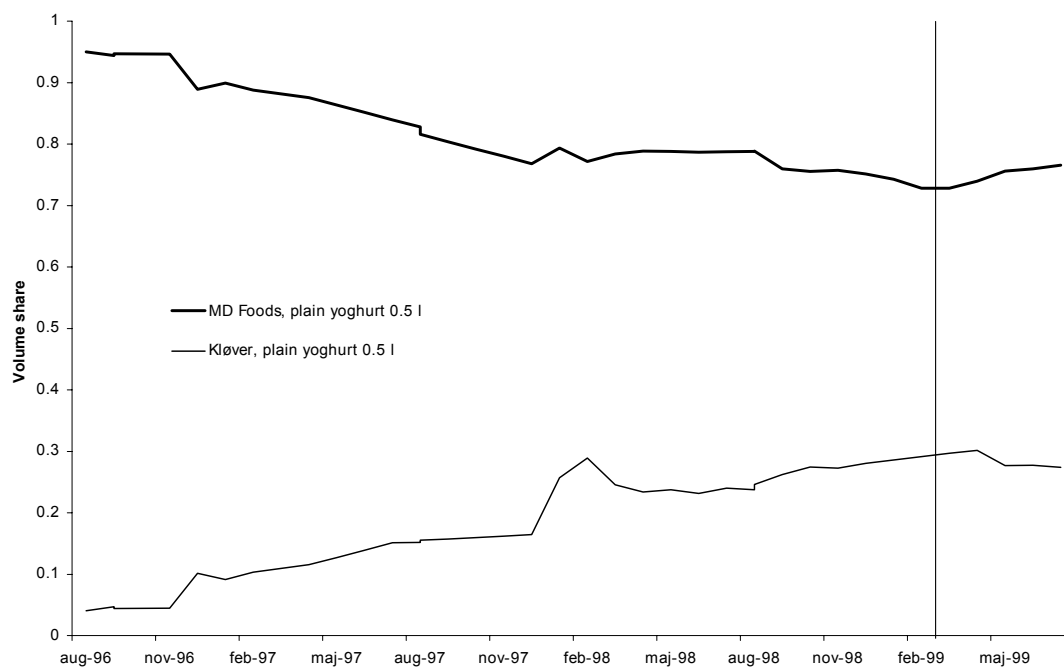


Figure 4. Volume share of the plain yoghurt segment by md foods and kløver. Sept 1996 — July 1999. The date of the merger is marked by a vertical bar (Industry data, 1999)

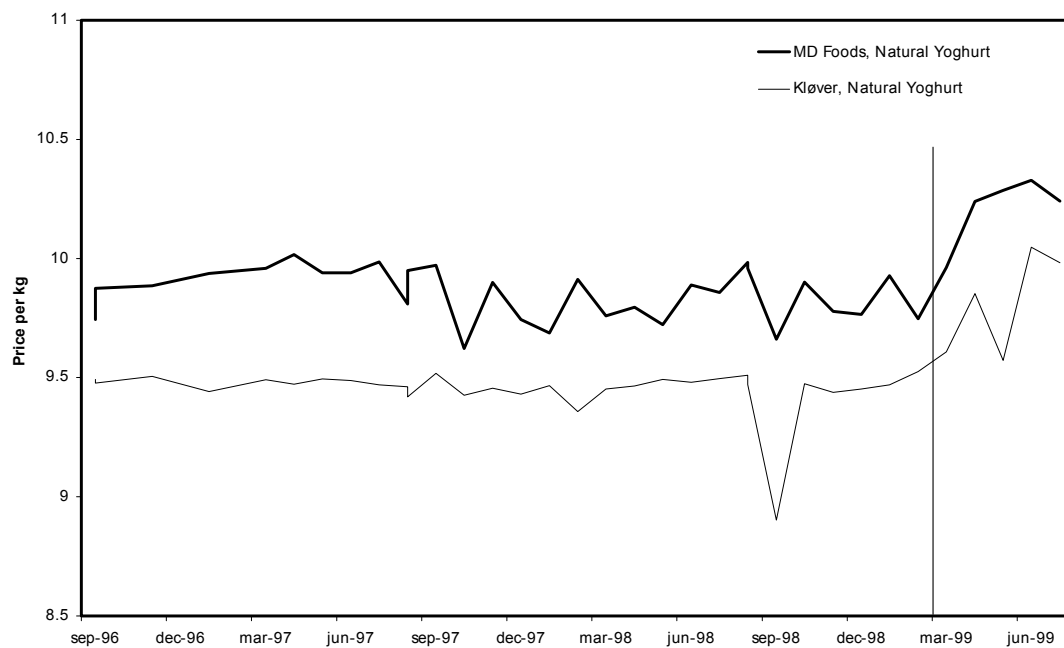


Figure 5. Retail price (DKK) per kg. plain yoghurt by MD FOODS and KLØVER Sept 1996 — July 1999. The date of the merger is marked by a vertical bar (*Retailer data, 1999*)

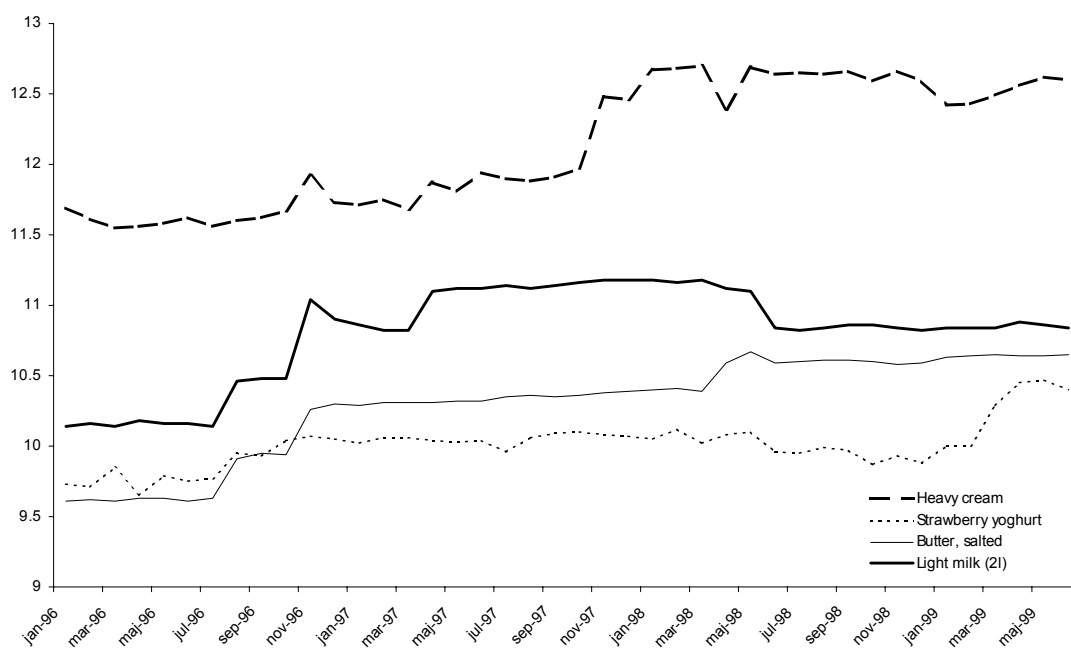


Figure 6. Average retail prices (DKK) for selected products. July 1996 — June 1999 (*Danmark Statistik, 1999*)

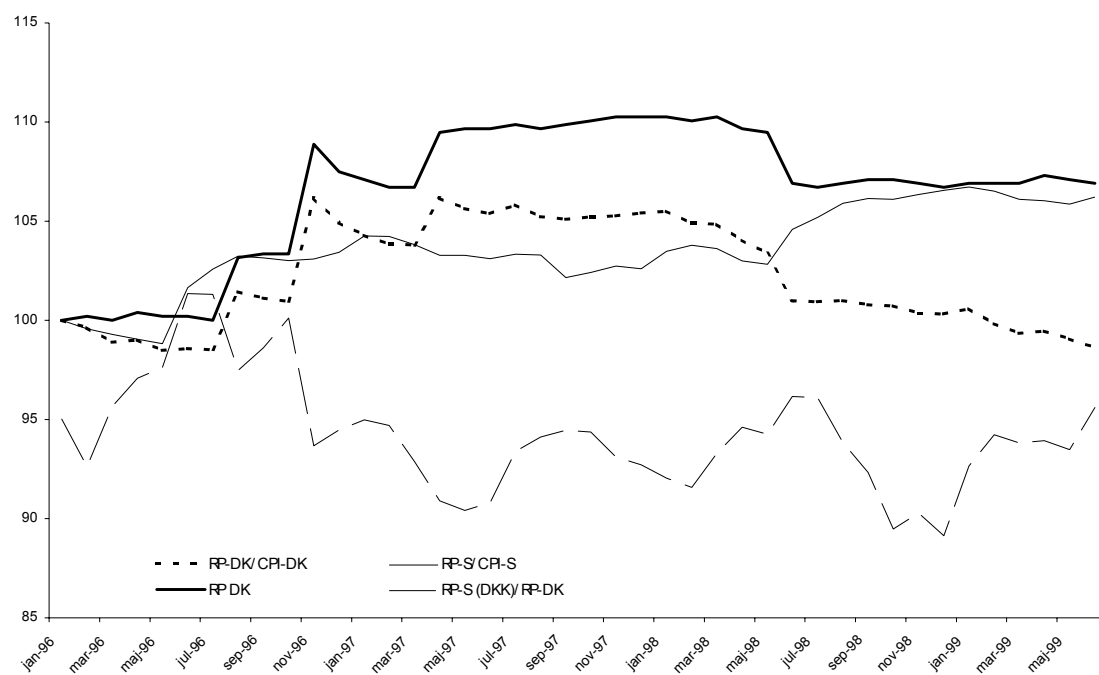


Figure 7. Retail price (DKK) per kg. 1.5% light milk in Denmark (DK) and Sweden (S). gross and controlled for CPI . July 1996 – May 1999 (*Retailer data, 1999*)

