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Agricultural cooperatives and globalization: A challenge in future?

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Abstract

Globalization is one of the greatest strategic challenges for agricultural cooperatives. Globalization has increased significantly over the last decade, and despite financial crises and recession in many parts of the world globalization will likely continue — albeit with less force than before. Cooperatives have specific challenges of globalization. In some areas, cooperative challenges have been solved. Critical issues such as the use of foreign raw materials and production abroad are now a part of business development in several large cooperatives. Foreign members are also increasingly common, still not without challenges. In other areas, however, more structural and fundamental problems persist. Here major changes in the organization of cooperatives are required if all advantages of globalization are to be exploited. Danish agriculture has for decades been characterized by a high market share for cooperatives and a structure which to a high degree has been export and globally oriented, indicating no specific problem concerning globalization of cooperatives.

Introduction

Agricultural cooperatives play a major role in the agro-industrial sector in many areas. In several countries, cooperatives are dominating companies in key agricultural markets. During the latest years, cooperatives have been undergoing rapid structural development in which growth, consolidation and especially globalization have been significant trends.

Globalization - in the form of moving products, capital, cooperation, knowledge and labor across borders - has been booming over the last decade. Transnational corporations with activities in many other countries are increasingly important.

Often cooperatives and globalization may be in conflict with one another: Cooperatives are mostly established in order to process and sell members' products. The aim is to ensure and improve the markets of the owners (farmers). However, this may be a barrier to ensure the optimal allocation of resources. The international competitiveness in a globalized world can steadily be improved when companies are able to purchase raw materials from around the world without any constraints. Thus, there are some inherent features of cooperatives which may be in conflict with the benefits of globalization. This paper identifies and assesses some important facts that may be barriers to the globalization of cooperatives.

Globalization

Globalization is far from a unique concept. Globalization can also have multiple dimensions and applications. In this context, globalization is defined as follows:

Globalization is the continuing development of a firm's international involvement concerning geographical markets, products, management, resources (labor, raw materials etc.) for the purpose of optimization of the international market opportunities and threats.

Globalization is not just about selling to foreign customers. It is also about recognizing the international competition and to adjust production, resources, investment and organization to these challenges. Globalization and internationalization are often used interchangeably as synonyms. Globalization, however, is usually regarded as anything more than just internationalization. The first step in the international development of a company- sporadic export to local markets, export agents etc. - is mostly to be regarded as internationalization, while foreign direct investment in production facilities, multinational diversion of resources, etc. can more be seen as globalization.

The status of agricultural cooperatives

Cooperatives play a significant role for many farmers around the world. The importance of cooperatives varies from country to country, although there is no clear pattern of the importance and development in global perspective. Generally, cooperatives in agriculture are most prevalent in northern Europe compared to the Mediterranean. Prevalence varies from sector to sector, and cooperatives have a high market share within the milk and meat sectors.

Viewed over a long time scale, there is evidence that cooperatives in the EU have gained increasing market shares, cf. e.g. Bekkum, O. F, and van Dijk, G (1997) and Hansen (2005).

In the U.S., the number of cooperative dairies fell by almost 70 per cent in the period 1973-2002, but during the same period their share of total milk sales increased from 76 to 86 per cent, c.f. USDA (2005). Generally, the cooperative dairies have had increasing market share in both the U.S. and the EU-15 in recent decades.

In Denmark cooperatives are completely dominant when it comes to pork, dairy products, grass seed, fur and grain and feedstuff. In other areas - like sugar and poultry - cooperatives have completely disappeared and their business is taken over by capital owned companies.

According to Hansen, H.O. (2009) the Danish cooperatives are expecting at least to maintain their market shares in the coming years. In general, the basic cooperative concept will remain unchanged, and cooperatives regard globalization as a positive challenge. Some cooperatives even regard cooperative ownership to be an advantage during this process of globalization.

Globalization of cooperatives

The aim of globalization of companies is to improve the international competitiveness and the future profit and value of the company - in short or long term - for the benefit of the owners. The globalization of a company is not the objective itself - but rather a tool to achieve the overall objectives for the company.

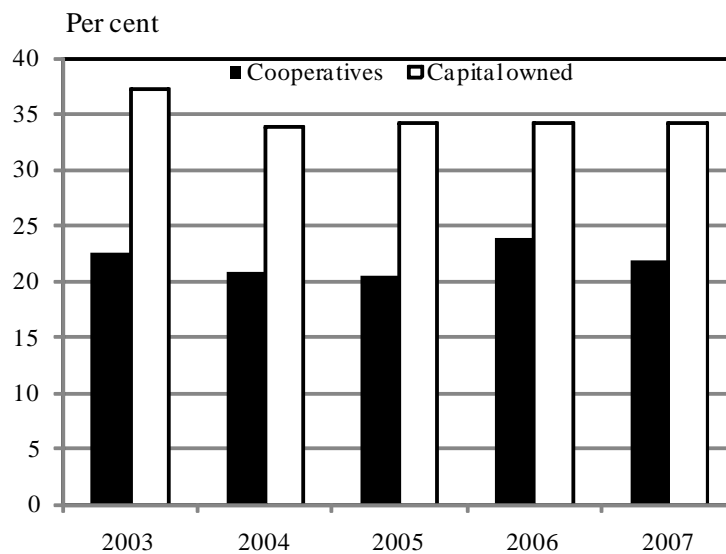
Both cooperatives and capital owned companies usually have the objective to ensure owners the highest possible earnings. A shareholders profit will come through dividends and stock price. Profits of member of a cooperative will come through dividends and through more favorable sales or purchase prices. Both cooperative members and shareholders have, thus, the common fundamental interests of creating the greatest possible earnings of the company. There is, however, in practice, significant differences in the globalization and cooperatives and of capital owned companies - and the cooperatives have special challenges. This is particularly true when globalization takes the form of foreign investments.

There is much focus on the role of cooperatives in globalization. The public debate about the cooperatives' foreign activities and particularly investment in foreign production is very timely. The background is that a number of issues may be an obstacle to cooperatives' participating in globalization. Moreover, ignorance or prejudice against cooperative may influence the debate. These critical challenges - and possible solutions - are outlined in the following.

Challenge 1: Capital

Globalization - mainly through foreign direct investment, acquisitions, etc. - is capital intensive. At the same time the equity ratio in cooperatives in agro-and food industry is relatively low. Among the 100 largest food companies in Denmark, 52 per cent of the turn over comes from cooperatives, and 48 per cent from capital owned companies. However, there is a significant difference in the equity ratio since own capital ratio (own capital in per cent of total assets) as the average of the period 2003-2007 is 22 percent for cooperatives and 35 per cent for capital owned companies. The development has been relatively constant over recent years, cf. figure 1.

Figure 1. Equity ratio of 100 largest Danish food companies. Cooperatives and capital owned companies



Source: Own calculations based on the annual accounts from companies.

The low equity ratios in cooperatives are, however, in several areas compensated by the supply commitment that exists in many cooperatives. This means that the farmers more or less function as a buffer, and that cooperatives can transfer their price fluctuations to the farmers. In this way the farmers' supply commitment is a supplement to the equity.

As farmers' supply commitment in several places has been weakened, and in line with the rising demand for capital for product development, investments, acquisitions, etc., the relatively small equity ratio in the cooperatives will, however, be a noticeable barrier to the globalization of cooperatives. Furthermore, it is a fact that globalization increasingly takes the form of foreign investment and to a lesser extent in the form of exports from the domestic market - and this shift will also increase the capital requirement.

Challenge 2: Access to capital

A low equity ratio combined with limited access to capital and equity funding will be a major limitation for the globalization of cooperatives. While capital owned companies often raise capital on the stock market, cooperatives can in fact "only" obtain equity funding through a consolidation where a portion of profits is retained in the company. This also - *ceteris paribus* - limits cooperatives' future investments in globalization.

Generally, cooperatives have no severe problems to obtain loans. Cooperatives have proved to be very creditworthy and it is extremely rare that there are bankruptcies or severe financial losses among cooperatives. Still, strategic globalization necessitates access to equity funding - especially when equity ratio is already relatively small.

Limited access to capital and equity funding may to some extent be solved or compensated by converting subsidiaries to shareholding companies and inviting external investors to buy shares. This has happened in several cases, and it helps to relieve the pressure on demand for capital.

Equity funding by allowing external investors to be owners of subsidiaries etc. is a crucial strategic decision that involves several important considerations and aspects:

Firstly, a part of the influence, control and profits is abandoned when you invite external investors to be co-owners. Cooperatives can no longer manage completely on their own, and members must be prepared for this situation.

Secondly, external investors require a return on their investment. Equity capital will require a higher return than loans, so access to capital and equity funding by inviting external investors to the owners will often be relatively expensive for the cooperative.

Thirdly, very clear rules for prices, profit sharing, supply chain etc. must be negotiated. It will always be discussed how to pay farmers' raw materials and how to pay investors' capital.

Challenge 3: Incentive

In a share holding company it is less critical to the owners whether profits are distributed to shareholders, or whether it is invested in the company as equity capital or invested in, for example, foreign plants. In this last case, shareholders will benefit in terms of future share price increase. In a cooperative the incentive to invest the surplus in the company is much smaller. A member will not have an immediate gain by allowing a portion of the profits to remain in the company. Many members will have a short or - quite naturally - selfish interest in getting such a large part of the surplus earnings instead of investing in, for example, foreign plants.

The incentive problem is solved in several places by the formation of "New Generation Cooperation" where farmers increasingly can have a direct interest in investing money in the company.

Challenge 4: Horizon

Foreign direct investments often have a relatively long payback period. This fact is not so critical to shareholders in a limited company where investors often look for long-term profit. Investors like pension funds normally operate with a long time horizon. If a cooperative makes a profitable investment in a foreign company which creates a net profit after 5-7 years - which is not unusual for foreign investment - a significant proportion of members will not benefit or have an advantage of the investment. A significant number of members have retired or left the cooperative before the pay-back period is over. It will be difficult to convince these members about the value of such a foreign investment.

In a cooperative the present members should at all times ensure that performance and future competitiveness of the cooperative are intact – otherwise, the members withdraw values from the

cooperative that previous generations have built. Maintaining competitiveness will often require investment abroad.

Challenge 5: Globalization as a strategic goal

Many food companies have the vision or strategy to become a global company. Globalization thus becomes an explicit strategic objective for the daily business of the company. Growth and globalization of share holding companies are often driven by investors' expectations. Cooperatives are not subject to the same pressure from the expectations of external investors.

Globalization must solely be regarded as a tool to increase revenues - and not as an explicit objective for companies. A survey of strategies among the major Danish cooperatives shows that globalization is a strategic goal, and that foreign direct investments, global market power etc. are common tools in their globalization strategy.

Challenge 6: Profit seeking

Cooperatives are sometimes perceived as "special" companies which do not operate according to normal commercial and economic business principles. The perception may be that the objective of cooperatives is not solely to maximize profits, but that there are a number of non-economic motives for cooperatives. The perception also is that cooperatives do not seek to achieve the potential economic benefits generated by globalization - and thus there may be a barrier to cooperatives in the globalization process.

Reality is often very different. Cooperatives operate under exactly the same commercial principles as limited companies where profit maximization is the primary and overall goal. Globalization is a driver for future profits regardless of ownership form.

Challenge 7: Supply coupled to members

Cooperatives in agricultural and food industry are primarily established to protect and improve farmers' interests when it comes to marketing their products like milk, meat, eggs etc. Cooperatives give farmers more market power and an alternative market for their commodities.

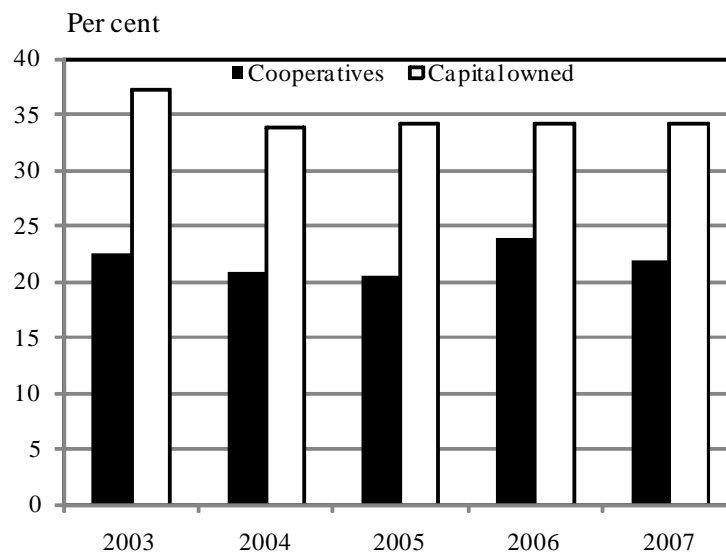
An important dimension of globalization is to develop a company's international involvement concerning geographical markets, products, management, resources for the purpose of optimization of the international market opportunities and threats. If a company can provide the necessary raw materials for a better quality or cheaper from a foreign supplier, it should do so as it will increase the profit of the company. A farmer owned cooperative will face a dilemma: Should the cooperative opt the members own raw materials (meat, milk, eggs, etc.) and instead rely on foreign raw materials if it is economically advantageous and results in a higher profit for the company?

In the long term it is not sustainable for a company to rely on too expensive raw materials, as this in the short or long term would destroy the company's competitiveness, and thus earnings. This also applies to cooperatives.

However, a pressure from members will arise if the cooperative prefers foreign commodities rather than domestic production from the members. In addition, cooperatives are often obliged to receive member deliveries, and this may also limit the possibility to rely on foreign raw material supplies.

In recent years, Danish cooperatives have been very focused on global off shoring of production and the use of foreign commodities. For several large cooperatives production abroad now exceeds exports based on the members' own production, cf. figure 2.

Figure 2. Exports and production etc. abroad for Danish food cooperatives



Note: Selected representative cooperatives

Source: Own calculations and estimates based on annual and business reports.

The figure shows that cooperatives' production in foreign countries is now more important than the direct exports from the domestic market. It also stresses that the tie to the members own commodities is far from ultimate.

Challenge 8: Management

In cooperatives the assembly and the elected board are primarily for the members - it would effectively say farmers. Thus, the composition of these governing bodies is significantly different compared to capital-owned companies, which are typically managed by professional investors and directors.

There are several aspects of this issue - which also directly or indirectly may have an impact on the globalization of cooperatives:

The owners of a cooperative do have a strong interest in having a highly successful company as the economic development of a cooperative will have great impact on the earnings of the individual farmer. Therefore, it may also be obvious that they themselves have the decisive influence in the board and at the general assembly - and that they themselves are elected to these governing bodies.

On the other hand, you can of course not imply that all elected members automatically have the best commercial background and competence to perform as board member in a big transnational cooperative in the best possible way. Indeed, having big and global cooperatives, it can be difficult for any farmer to follow, monitor and influence the future development of their cooperatives.

Several members have thus pointed out the risk that strategic development and globalization of cooperatives fail because the elected board and members do not have the best power and competence to make the necessary decisions. Restricting participation to members/farmers may in itself be an obstacle to optimal election of the governing bodies. Although there are new examples of external professionals joining the elected boards of cooperatives - the general picture remains that the members themselves are elected to the board. This unique pattern may be a significant barrier to the development and globalization of cooperatives.

Many managers and board members of cooperatives' subsidiaries and affiliates are however professional managers. In many places there is a combination of cooperative member and senior managers on these boards.

The election of the employed management (CEO) of cooperatives in the agro and food industry is also different in many cases compared to other types of companies. Here, the specific conditions in agro-industry and food industry, however, explain some of this diversity.

Challenge 9: Foreign members

Cooperatives having both domestic and foreign members - often referred to as transnational cooperatives - have a particular dimension of globalization. As members are both suppliers and owners at the same time, and as the objective of cooperatives is to benefit the suppliers' competitive position and earnings, it is a crucial strategic decision to have foreign shareholders.

Foreign shareholders may occur by either allowing membership to foreign farmers, or by merging with a foreign cooperative.

There is a number of advantages and disadvantages of allowing foreign shareholders in the company. The benefits of implementing international mergers and acquisitions are numerous, cf. Hansen, H. O. (2005). Economies of scale, exploiting synergies, better matching of customers and suppliers are the essential drivers behind the growth and globalization.

The disadvantages of the foreign members include following:

- Cultural barriers, including language, democratic tradition, etc. can be a major barrier. Even among neighboring countries there can be large differences in the perception of how a cooperative must be operated.
- Legal structures can still be very different from country to country and may therefore be a major obstacle.
- Structural differences may imply that members of the two countries can have very different interests. If the group of foreign and domestic members is very heterogeneous there can be internal disagreement about the future.

The objective of the cooperative means that competitiveness and profitability of the members must be improved - largely at the expense of competitors on the market. When a cooperative at the ultimate "invite foreign competitors to join the company" the cooperative cannot maintain this relative competitive advantage of the original members. There will certainly always be a pedagogical challenge to explain to members that they are not "selling the family silver", but that they also achieve a common stronger competitive position on the market by attracting foreign members in the company - in one way or another.

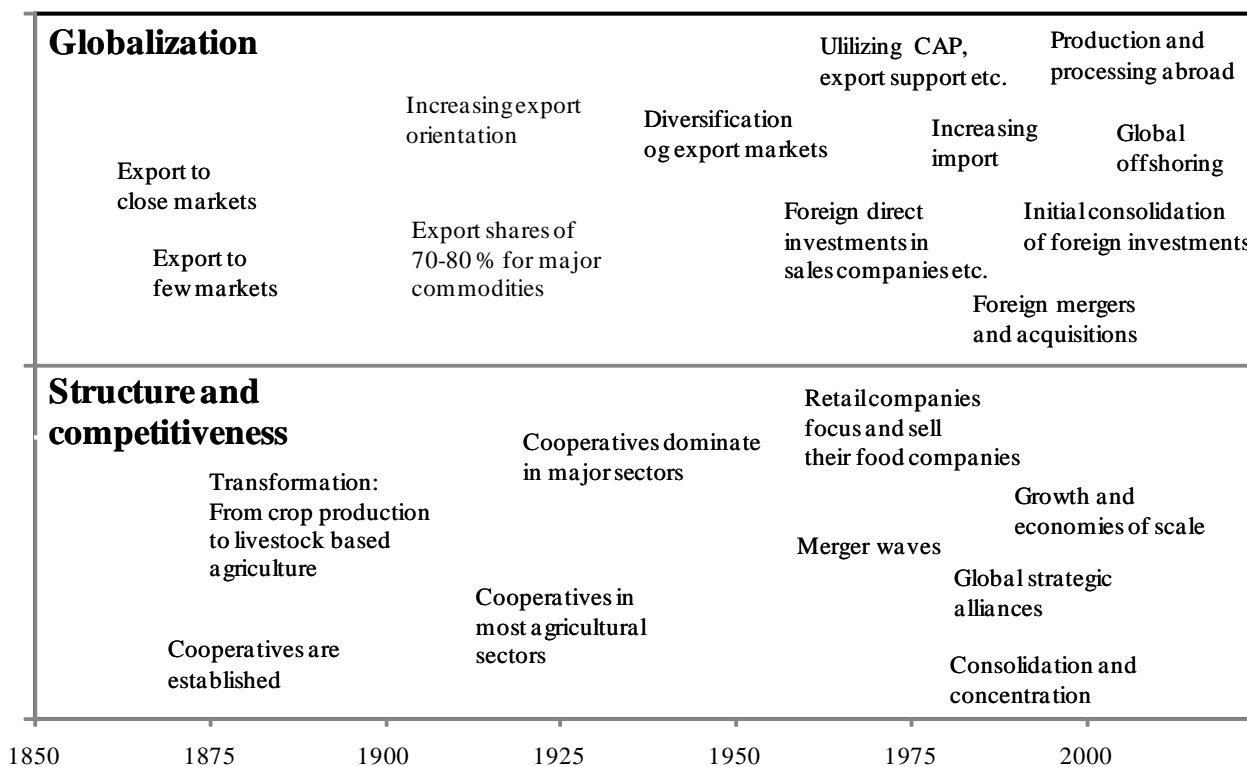
Danish cooperatives and globalization

Danish agriculture has for decades been characterized by a high market share for cooperatives and a structure which to a high degree has been export and globally oriented. Also in a global perspective the world market shares, the global focus and the size of cooperative food companies etc. in Denmark are remarkable. From this point of view globalization and cooperatives managed to work together, and obviously there seemed to be no paradox between cooperatives and globalization. On the contrary cooperatives may have been a major solution to the globalization challenge.

Cooperatives have succeeded in building up more market power to strengthen the marketing of farmers' products. By pooling products in larger and larger cooperatives the market position has improved, and managing the globalization process has been facilitated. The globalization barriers were avoided as the big cooperatives had resources and products to invest in international marketing.

The process of globalization, structuring and creating competitiveness has developed for many decades. Cooperatives were established in 1880'ies, and the transformation from domestic orientation to export orientation started in the same period. The major stages in globalization and structure/competitiveness of Danish cooperative are shown in figur 3.

Figur 3. Stages in globalization and development of structure/competitiveness of Danish cooperatives



Source: Own presentation

Since the end of the 19th century the globalization process of the Danish agricultural sector has focused on cooperatives being a central driver for development and globalization. Common interests among farmers, a homogenous group of farmers, and a high level of education and social capital are the main reasons for the successful development of Danish cooperatives.

During the latest decades foreign direct investments have played an increasing role in the globalization process of Danish cooperatives. Until now this stage of development has been rather successful, but the challenges of globalization are becoming more and more present.

Conclusions

Globalization has been booming over the last decade, and despite financial crises and recession in many parts of the world, the globalization trend is likely to continue - albeit with less force than before. Globalization will therefore be one of the most important parameters in the world to the strategic development of cooperatives in the next ten years.

Globalization will be an important dimension in the optimization of market and resource, and location of business units and facilities in future. Together with a further liberalization of agriculture and food, globalization will be a major driving force for increasing international competition.

Globalization will push the cooperatives to consider and implement major structural and strategic changes. According to Hansen, H.O. (2009) the big Danish cooperatives expect their market shares to

be maintained in the near future and that there will be no significant adjustments in the legal organization of cooperatives.

Cooperatives are recognized to be structurally robust in many areas. Vertical integration, traceability, supply management, etc. give cooperatives a competitive advantage. Many cooperatives have proved to be extremely competitive having a high class of management and business administration.

Globalization of cooperatives in the form of foreign members, increased use of foreign commodities, investments in foreign production, etc. will imply a shift of paradigm for many cooperatives.

Globalization will thus be a major future challenge and will require structural adjustments in many cooperatives if all benefits of globalization are to be exploited.

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