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Evolution of Business Structure and Entrepreneurship of Cooperatives in the Horti- and Agribusiness

1. INTRODUCTION

Cooperatives have experienced considerable change in the past two decades. They started as self-help and countervailing power organizations. Thus the cooperative increased the social security and realized the emancipatory wishes of members. The members traditionally regarded the cooperative firm as a task organization in a common back-office and maintained the entrepreneurial lead for themselves i.e. for their own business.

Market developments have had a strong impact on the cooperatives since the 1980's. They were fuelled by liberalization of markets and by diminishing of the involvement of government policy. They forced cooperatives to consolidation and to more complex business structures.

More complexity means more differentiation. In this paper cooperatives are defined by entrepreneurial differentiation in view of marketing requirements. Entrepreneurial lead is synonymous with market orientation and with having front-office functions. Differentiation of entrepreneurial activities in a cooperative structure means differentiation in corporate governance, finance and supply chain management. Some examples are discussed. It is concluded

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that managers, entrepreneurs and directors in the cooperative more and more operate in a differentiated business structure. The bigger market driven cooperatives cannot be monolithic in their entrepreneurial role. Therefore the members also have to take a different role vis-à-vis their cooperative.

2. DEFINITION AND TAXONOMY

Entrepreneurship is distinct from management; entrepreneurial qualities are not the same as managerial qualities. From the 18th century economists have paid attention to the importance of entrepreneurship. Marshall wrote that general skills rather than special skills are the most important determinant: ″To be able to bear in mind many things at a time, to have everything ready when wanted, to act promptly and show resource when anything goes wrong, to accommodate oneself quickly to changes, to be steady and trustworthy, to have always a reserve of force″ (A. Marshall, 1930, Principles of Economics; MacMillan London, p. 206–207).

Schumpeter refers to new combinations, the willingness to show alternatives and alternative behaviour. Entrepreneurs are able to stand social opposition. Schumpeter refers to the psychological factors which lead entrepreneurs to own an ′own concept′ on which to build their ″kingdom″ and social acceptance; to be successful for the sake of success, the drive to be creative, to change matters, to show that ideas were worth the energy to change matters. (J. Schumpeter, 1934. The theory of economic development. Harvard UP. Cambridge Mass. On cooperative entrepreneurship see also G. van Dijk, 1996. Die thou old forms? Cooperative entrepreneurship on the threshold of the 21st century. Nyenrode UP., 1996)

In ′t Veld distinguishes between task oriented and market oriented organizations. In task oriented organizations managerial capacities prevail. In market oriented organizations entrepreneurial capacities are required. (R.J. In ′t Veld, 1996 Cooperatives as an organizational form for the future; in: Seizing Control, 1996. L. Egerstrom, P. Bos and G. van Dijk, eds. Lone Oak Press ltd. Rochester Minn. USA, p. 60–61)

Cooperatives are defined as a two-layer entrepreneurial system in which a cooperative firm (CF) is owned, used and controlled by member firms (MF). The CF is compared and contrasted with the investor owned firm (IOF); however the member firm can in itself represent an IOF.

It is assumed that the prime goal of IOF′s is to maximize shareholder value, whereas the CF is required to maximize member value or customer value, that is to say that the customer is also the user and as the owner they are the supervisors concerning strategies of the CF and have the residual rights of control.

The MF holds basically three relationships with the CF namely: A) ownership; that is the

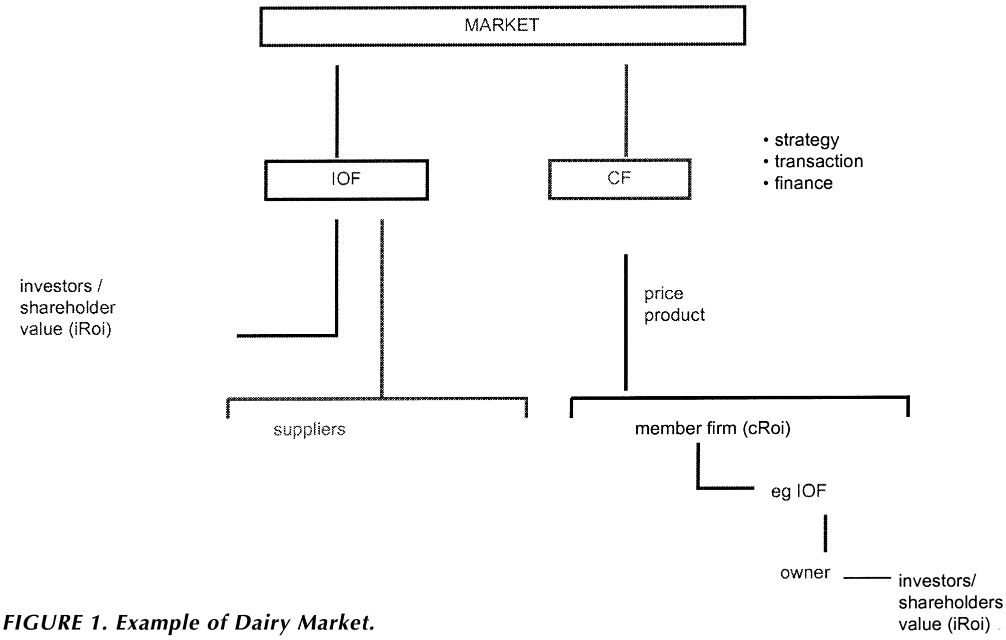

FIGURE 1. Example of Dairy Market.

right to residual claims; B) transaction; C) strategy, development, disciplinary control, and management assessment.

Often the question is asked if there is a real difference between the market behaviour of cooperative firms and investor owned firms. Here the position is taken that there is a difference. In the case of consumer cooperatives the essential difference is that the performance of the investor owned firm on quality and price to the customers is enforced by competition, such performance is, however, the primary goal for cooperative firms. In the case of producer cooperatives the difference is found in the right of entrepreneurship by members so that cooperative firms cannot autonomously decide on the volume of production to be marketed. Sometimes cooperative firms are requested to market the produce delivered so that new destinies, new product-market combinations have to be developed. Therefore cooperatives distinguish between 'investors returns on investment' – which is fully comparable to this yardstick of IOF's (iRoi) – and 'cooperators returns on investment'(cRoi), a yardstick which also takes into account the returns on investment on the MF. In fig. 1 the differences are depicted schematically by the example of the dairy market. (As regards taxonomy of cooperatives I refer to producer owned coops and mostly to the example of marketing coops.)

From the point of view of production economics and farm management, most cooperatives are extensions of the member firm. They started as local coops. Economies of scale led

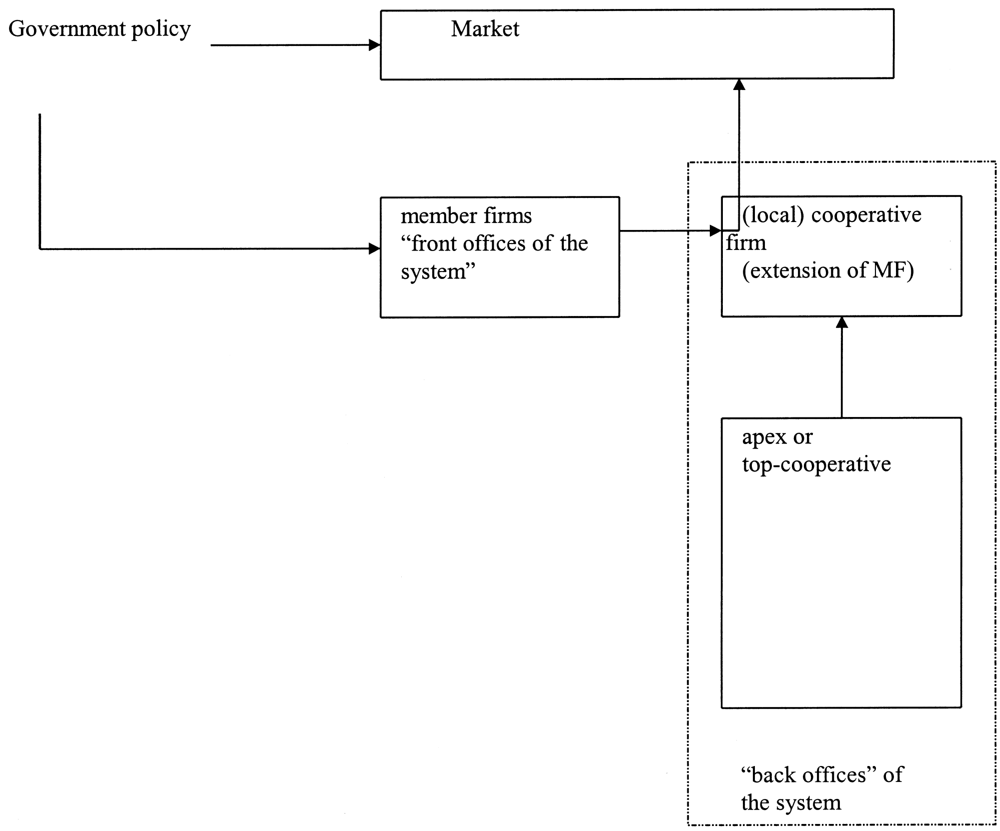

FIGURE 2. Structure of production (task or management) oriented cooperative system.

them to merging into regional and even national cooperative firms. Sometimes coops established apex cooperative institutions or federations when the necessary scale of coordination, marketing and pricing policies so required.

In present day terminology the apex or top-coop had a similar position vis-à-vis the local or regional coop as the local coop had to members. The apex or the local coop had to perform as the *back-office* whereas the member firm or member coop acted as its own *front-office*. In other words the member cooperative taking the entrepreneurial lead and the top-cooperative representing the back-office manages capacity functions on behalf of its member firms. Figure 2 shows this structure, which basically may be labelled as production oriented. This production or management orientation of the system has changed into market or entrepreneurial orientation and I will come back to that change below.

3. INVESTMENT, GROWTH AND EQUITY IN FARMER COOPERATIVES

In production oriented systems the CF's have typically, as the back office of farms, invested in physical assets, factories, machinery, storage etc. As has been described in terms of transaction cost theory these investments have different time-horizons from investments in market oriented systems. The latter are acquisitions of subsidiaries, investments in R&D, development of marketing strategies and product innovation.

The prime rationale of investments in physical assets of the CF is that these will yield lower costs of the back office in the short or medium term (less than 5 years). Costs will be decreased as a result and thus the results for the front offices (MF's) increased. Capital invested in the unallocated reserves through retained earnings is an efficient route for this purpose. This holds the more where cultural characteristics lead to family-owned businesses and the new generation farmer-entrepreneurs take over the business of their parents.

The change from own equity of the coop via unallocated reserves towards allocated equity i.e. cooperative shares or member certificates can firstly be explained by changing risk profiles. A second factor behind this change is the difference of time horizon between CF and MF. Thirdly, there are strong consolidation trends in most farming sectors. Therefore members are only willing to accept that coops would retain earnings instead of following pay out policies if they are sure that the retained earnings converted into shares have the characteristic of loans by the MF to the CF. These loans or shares can be used by the members as the basis for attracting loans from the banks in order to expand the farm (MF). For the CF, however, this member-policy has a severe disadvantage. When they become more market-oriented, i.e. entrepreneurial, the CF's need equity which is both permanently available and of a risk bearing nature.

The CF's of most farmer coops are forced to become more market oriented and entrepreneurial. The driving forces are the changed nature of consumer demand in the first place, withdrawal of government influence and liberalization of international trade, foreign direct investments and of course, in sum, competition in oligopolistic settings.

The IOF's operating in the same market as the CF's were, however, favoured by the legal and fiscal conditions in society. It is hardly possible to overrate the impact of present day conditions on the stock exchange. By issuing shares IOF's have created considerable opportunities for growth[1]. As the western consumer has become extremely rich because, for one reason, people have been able to grow older after having had successful saving strategies and pension schemes during a lifetime, – and then see their life insurance capital paid – they look for investment. There are not enough interesting projects in which the capital can be invested on a

1 I owe this argument to prof. W.L. van Dinten, Rabobank and Erasmus University Rotterdam.

long-term basis. So, this money seeks also more speculative opportunities. These speculative motives even seem to dominate the demands for ordinary profitability since the risks seem so minor. As a result we see that people share risks without experiencing losses for a long period. As a result equities of IOF's have been boosted to an unprecedented degree. Shares or funds of firms listed on the stock exchange may rate 30 times or more the nominal value, yielding ample opportunities to IOF's to acquisitions. With acquisitions firms are able to maintain the necessary business growth rates and growth in profits that are necessary to keep up with the ratings asset by stock indexes. Those acquisitions are highly paid: 20 or 30 times their value but, of course, are paid with shares that also are overrated to similar degrees.[2]

As such cooperative capital is at a drawback in competing with IOF's. Each acquisition by a CF is paid with hard, very hard, currency. And if cooperative firms try to be in step with such high growth rates the members have to invest all the more or to accept the influence of others. Although the cooperative firm can have increased turnover, higher profits and increased market shares it may yet see its solvency ratios deteriorate to such an extent that CF's have to increase own equity. CF's need a larger capital base in comparison with IOF's. Equity forms of the required quality are unallocated reserves, member certificates and cooperative shares which are not to be redeemed: i.e. permanent and risk-bearing or compatible with shares in ordinary (stock listed) IOF's. Members will regard the allocated forms of equity most attractive and will be asked to make more efforts to capitalize the CF along this line. That is why New Generation Cooperatives make shares transferable. However, even then, it is not possible for the CF to enjoy the same capital growth as do stock listed IOF's. The reasons are that there is no such open tradability and because of the linkage between transactions (usage) and the financial results of the CF. Lower prices and decreased transaction costs will lead to better results of the CF but can also be "translated" into better results for the MF's. In total, the point must be made that IOF's have more acquisition power than CF's, all other conditions (performance of both types of firms) being equal. All other conditions being equal therefore, CF's are at a disadvantage in acquisition activities to build a new business portfolio.

This means that cooperatives have to make up strategies of growth that enable them to maintain the cooperative governance and financial structure. However, cooperatives can also decide that the growth ratios that are necessary to realize their cooperative goals requires that CF's and/ or subsidiaries (SF's) have to go the public route – wholly or partially. For the CF this

2 This argument does not deny the view that stock exchanges have played and do play an important, and unbiased according to Holmström, role in the restructuring wave in large businesses since the 1980's. The restructuring implies the reallocation of capital 'over long distances' and to make new portfolio's for enterprises. One result is that in this way firms are able to 'buy profit growth' and thus maintain their position in the cohort or stock price trends that are relevant for them. An important question is whether this restructuring process will slow down or not and what will be the consequence for stock prices and growth opportunities.

route is irreversible in that market prices then have to be determined independent of the CF's policies concerning price leadership. Hence the CF will have to cease its role as a price leader and may even become a free rider on colleague cooperatives in this respect.

4. BUSINESS STRUCTURES

Cooperatives that face the conditions described in the previous paragraph have a few alternative strategies, all of which can be observed at present. The first, of course, is to change into an IOF structure. Various models have been tried, much of the success depending on the business profitability of both the CF an the MF's. If price leadership in the industry can be taken over by CF's in the industry which continue their cooperative mission as was the case in Ireland, farmer-members have much to win and little to lose.

The second strategy is to maintain the 100 pct. cooperative ownership and cooperative transaction policies towards the members of the cooperative at the level of the "parent company", the "parent CF", but by accepting non-members' equity in subsidiaries (SF's). Thus CF's may have subsidiaries which may be stock listed in their own right. So, in theory at least there is a three-layer model: the CF, the MF and the subsidiary firm (SF).

The key question then is who has the entrepreneurial lead if the MF has transaction relationships next to purely an investor relationship with the SF? Most cases with such structures I have come across were either of the type that the CF and the SF were subdued to the MF – the case of cooperative banks and in some countries of supply coops e.g. seed producers – or that the SF's have the entrepreneurial lead: both the MF and CF operating as a 'content provider' or supplier of raw material for the SF who controls all elements of the marketing mix. This latter situation, which mainly occurs in the case of marketing cooperatives, is one in which the MF supplies the CF and organizes the discipline and quality requirements from the MF's via the CF. So, the CF takes a part of the content organizing tasks. But essentially the SF is leading. In current terminology: the SF is front-office, the MF and CF are primarily back-office.

Cases of differentiated entrepreneurship are The Greenery International and Rabobank.

The Greenery International is a cooperative firm resulting from a mega-merger process of 11 auction cooperatives for horticulture (fruits & vegetables) in the Netherlands. This CF has as the leading concept that it is to market products of its members, the market gardeners. In order to deliver the major supermarket chains in the Netherlands and abroad it brings together a full product basket all year. It was meant to act as the front-office of the MF's and to organize all marketing activities. Naturally this includes that the MF's should accept the back-office role, or to behave as the production department of the Greenery. Besides, as the supermarket chains also want to purchase tropical fruits and often products which cannot be produced by

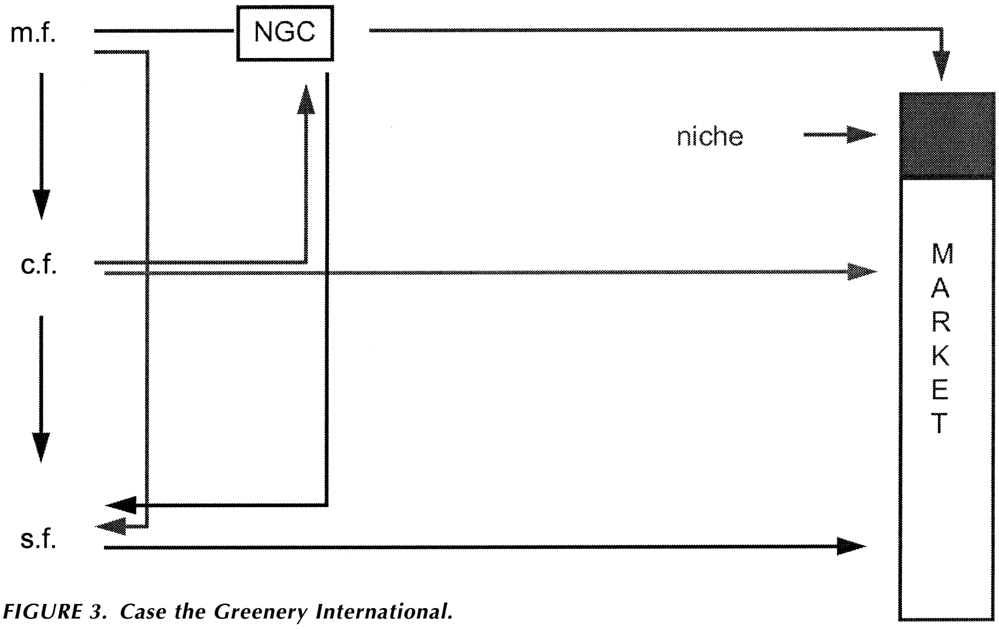

FIGURE 3. Case the Greenery International.

the MF's of the Greenery, the Greenery also acquired two subsidiaries which are wholesaling and importing/ exporting firms that also deliver to supermarkets. During the period in which the new cooperative structure had to settle itself, the MF's began to take on entrepreneurial activities for themselves and their product groups. Examples were special varieties of apples, pears, tomatoes, cucumbers, peppers, etc.. The peculiar thing of these actions was that the farmers (horticultural growers) organized themselves in new generation type cooperatives. They also do direct marketing to supermarkets and to the SF's of their CF, the Greenery. Besides, the Greenery International, which acts as a holding company of the SF's (exporting firms VDD and PFG) provides these NGC's with marketing services.

The result is a differentiated business structure: the entrepreneurial lead is located in the NGC's of the cooperative and in the SF's. The CF. (i.e. the Greenery) is prone to become the locus of dissatisfiers: all complaints are centralized to this holding, which in itself is set up with the ambition to be an entrepreneurial, i.e. market-oriented organization. Fig. 3 shows the relationship of this three-layer structure, which sometimes is a four-layer structure where also big MF's find their way to the market directly.

Rabobank in the Netherlands is another case of a differentiated organization. The Rabobank consists of slightly over 450 local cooperative banks. Members of the local banks are clients which do not have an ownership position but do have a control and disciplinary position and who enjoy benefits on the basis of their transactions relationship. The local bank also

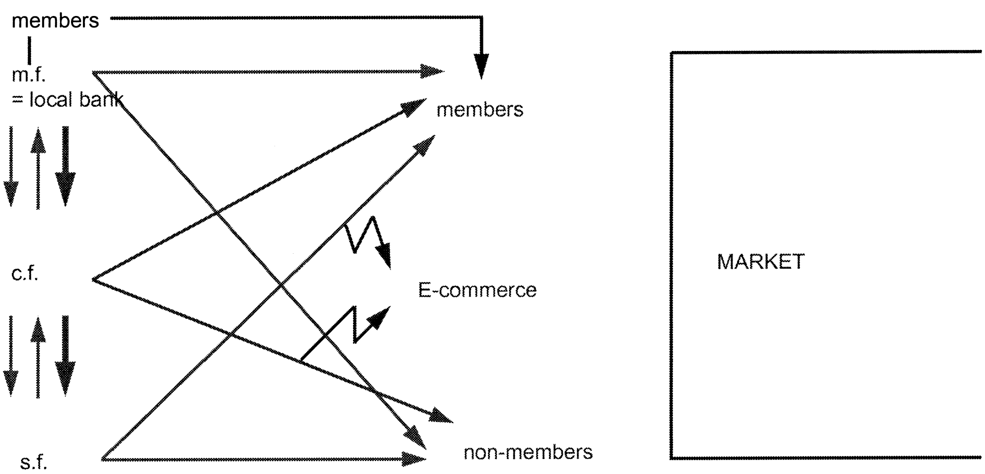

FIGURE 4. Case Rabobank.

enjoys the advantage of member loyalty as a marketing tool and as a factor strengthening solvency ratios.

The local banks have the CF Rabobank Netherlands as their top-coop. Local banks own it, control it and have transaction relationships with it. On the other hand, local banks are disciplined by their CF as the Central Bank has given supervisory authorities over local banks to Rabobank Nederland. Rabobank Nederland then owns subsidiaries in insurance, investment banking, etc. The schematic representation is found in fig. 4. Fig. 4 indicates clearly that local banks act as front-office and content organizers. Increasingly the CF Rabobank Nederland acts as back-office and content provider. The SF's act both as back-office and front-office; content organizer and content provider. They would be acceptable to become listed in their own right, if Rabobank's policy would lead in this direction.

A third model of growth is the differential model. In this model of investor oriented cooperatives the New Generation Cooperative (NGC) seems to fit in very well. In the NGC the MF's do the content providing and the content organizing is carried out through a market-led CF which is fully in the position of an IOF, except stock listing. The value of the shares is directly linked to the added-value for the raw material produced by the MF's. It is decided on the basis of the share-holder value whether production is expanded or not.

Similarly, cooperative banks, insurance mutuals and other service coops can grow along this line. The model implies that local coops maintain a strong foothold in the community and organize a fringe of content providers which partially act as co-makers for the local CF. This local CF is a member (MF) of a top-coop and this top-coop (CF) is a holding company of a fringe of IOF's. Part of the shares of these IOF's may be held by the MF's (= local CF's).

A fourth model is the co-operation of cooperatives cross-border. This is the multi-domestic concept in the case of consumer cooperatives, and producer cooperatives become multinational concerning membership. Grosskopf has suggested that national coops may become shareholders of international top-CF or of an IOF with international orientation (W. Grosskopf, 1996, A view from Germany, p. 130 In: Seizing Control). A few examples are known. The governance and culture problems are much bigger, however, than is commonly assumed. Yet the route is not unpromising.

5. THE ENTREPRENEURIAL LEAD

Most coops have started on the understanding that their members are independent entrepreneurs who decide on the quantity and quality of produce for which the CF subsequently will have to find markets. IOF's only contract such amounts and qualities that correspond with their conjectured demand and which seem fit to maximize shareholder value. Again it is the changed conditions which have stimulated the CF's to act in a way different from the traditional way. Most CF's nowadays operate supply chain management policies (SCM) with their MF's in order to reverse front and back office positions. The reason is very well known. Firms that create the finishing touch in value-added to either the final consumer or the final distributor are best positioned to fine-tune the marketing mix. If CF's or subsidiaries are not in the position of having A-brand positions they may still be preferred as suppliers because of their ability to fine-tune the marketing mix elements. The most important asset for the CF's to take that position is that they can adjust product quality and production methods to the demands, expectations and ambitions of their clients. But that means that the member firm has to fully accept a back office or co-maker position as a producer of raw material.

As regards price formation this reversal of entrepreneurial performance may in the future even mean that in the case of auctioning the traditional auctioning of supplies by farmer-members of the cooperative auction is reversed upside down to auctioning the "available" demand[2]. Essential in both cases is that buyers and sellers, who are gathered around the clock, have a true interest in doing business with each other.

With the change to market-oriented cooperative firms the management of the CF's need more entrepreneurial freedom. It can be said that members have to decide that they hand over the power of market discipline to their CF. In doing this, member firms become the production

2 In selling available supplies the Dutch clock is running from high to low, where exporters, wholesalers, supermarkets and manufacturers are the buyers. In selling (tendering) demand the clock will run from low to high, 'selling' available market demand for certain amounts and qualities to producers, members of the demand-auctioning coops. Then MF's push the button.

department of the system. Moreover, the CF may acquire subsidiaries which, although 100 pct owned by the cooperative, also obtain the freedom to take the entrepreneurial lead. SF's mostly do not do business with the MF's, but if they do, they act as IOF's and MF's would probably not notice other modes of conduct from 'their' IOF as compared with other, normal, IOF's. In some cases the CF itself changes to a financial rather than a management holding. In that case the SF's take the lead. If the holding CF is itself a top-cooperative, owned by member cooperatives, these member cooperatives become more agressive in defending their MF's, vis-à-vis the SF's in the common holding. The IOF's of the top-coop-holding have got the mission to make a decent return on investments and are agressive too. Not seldom does the top-coop-holding then become the 'locus of dissatisfiers'. In the hybrid or differentiated model the members have transaction-relationships with all three levels: primary CFs., the top-CF, and the SF's. This situation requires clear rules and discipline.

6. CO-OPERATE GOVERNANCE

There is no doubt that the changes as described not only affected structures but will in the first place affect conduct, or should affect it. This is especially visible in co-operate governance. It is increasingly difficult for farmers to both invest in a business (CF or SF) which is to discipline them and to take the risks for the same business as it operates on markets which are difficult to oversee and to control. It can be observed that cooperatives have to adjust to member administrative rules and to redefine member's principles. At the same time governments in most market economies are delivering agriculture to market forces and withdraw disciplinary powers exerted by public policies. Farmers now cooperate to escape the devastating effects of sheer price competition. The CF is required to apply instruments so that the cooperative can secure some monopoly profits. That means long-term investments, risk bearing, permanent equity and entrepreneurial freedom. Managers of CF's are all too keen to grow at rates which are comparable to their (listed) competitors. The leaders of the CF's also ask for some entrepreneurial independence, which inevitably means a different role of farmer directors in this respect. From "driving" they become more "supervising".

All these questions are dealt with in the cooperatives' board rooms. In this place farmers (MF's) are faced with entrepreneurs who have to oversee the farming business and to understand the rationale of modern cooperatives. And CEO's of CF's and SF's face farmer entrepreneurs who have to see why it is necessary to grow out of the region where their cooperative business owns all the fixed assets.

There is little doubt that there is growing tension between CEO's, CFO's and COO's of the CF's and their SF's on the one hand and the directors representing the MF on the other hand. There are several signs. As was pointed out above, the first one is that CEO's need more entrepreneurial freedom and have growth ambitions to maintain performance levels which are customary in the industry. Directors therefore are under pressure to act as a supervisory board as is the situation in ordinary IOF's. Often it is forgotten, however, that it is not less difficult to act on a supervisory board, than being a director on the traditional board of directors' in the cooperative firm.

Most serious is the question of ownership and the growth rates that may threaten the cooperative structure. Usually, the first signs are that the cooperative structure, that is the relationship between 1. ownership and finance; 2. transaction between MF and CF; and 3. the directors influence, is no longer maintained nor understood.

Then the transaction relationship is made independent from ownership so that members are shareholders and as shareholders they have no proportionality to their transaction relationship. Sometimes even the influence on strategy, management recruitment, etc. have no longer a direct bearing on the transaction or usage the members make of the cooperative firm. Inevitably, this "modernization" leads to looser cooperative characteristics, notably the proportionality between usage (transaction relationship) and finance/ risk (ownership). It appears extremely difficult to renew the cooperative characteristics in face of the development and market dynamics of the CF as a firm. Many CEO's regard the cooperative mission as costly and as a brake on business development. Many farmers think too quickly that growth, differentiation and some diversification are not necessary. It is also very difficult to give up as the MF the entrepreneurial lead. One may feel oneself fully in the hands of the "big cooperative" system. This is a dangerous position as the member firm is fully dependent on the price of a product that is still a most homogeneous one.

7. CLOSING REMARKS

This paper argues that in most economies IOF's are favoured by legal and fiscal conditions concerning growth. The growth in equity and share value goes hand in hand with acquisitions and the concomitant growth of profits. Cooperative firms, on the other hand, are endangered to grow 'out of their cooperative ratios'.

In addition, it is observed that the market developments require the cooperative system to shift the lead of entrepreneurship to CF's and SF's That means that members have to accept a fundamentally different position. If at the same time their influence on strategy and the relationship, ownership and transaction is weakened, there is a fair chance that the cooperative is losing its prime mission. The solution for the described problems seems to be that a differentiated cooperative structure will have to be made in which the entrepreneurial lead is clearly defined for each market, lest the structure is becoming chaotic. If this occurs various stakeholders of the same cooperative will compete with each other rather than make efforts to let MF's have their fair share in the consumer dollar.

The conclusion must be that big, monolythic cooperatives are likely to disappear. Different parts operate in different markets and each has to take on the entrepreneurial role which fits its market or its tasks within the cooperative concern. In the latter case we may speak of *intra*preneurship rather than entrepreneurship. In the big market driven cooperatives members and directors are also required to play more than one role.