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How Will European Farmer Cooperatives Cope with the Challenges of Today and Tomorrow?

1. BACKGROUND

The two earlier sessions have dealt with the theoretical background for cooperatives and the historical background as a basis for evaluating cooperatives for the future. With this as a background I have understood the purpose of this, the third session, is to try to find an answer to the question whether it is possible in the rapidly changing world around us to be successful in running the business with enterprises that have as a goal to bring down as much as possible of the value added on the market to the producer instead of the capital-owners or shareholders of the market agents.

Because as I see it, and this might be unnecessary to say in a so qualified assembly as we have here today, the main purpose for an agricultural cooperative, be it a market or a supply cooperative, is to maximise economic returns to its owners in their capacity as small enterprises with a weak position on the market. To get an answer to this question, or at least a judgement of the possibilities for the cooperatives, we should identify the changes taking place in the world around us and the strengths and weaknesses in the cooperative type of business.

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Of course this can not be done extensively in my speech or even in this session, but I will try to identify key developments and key characteristics of cooperatives to evaluate their possibilities in the future. I will limit myself to producer or rather agricultural cooperatives, as in my judgement consumer cooperatives are facing quite a different and more annoying challenge in a market economy where the consumer is the king.

Changes in the world around us are of course well-known to you but let me just focus on some changes of importance and come back to how this might affect cooperatives. First the rapidity of changes is greater than earlier and will probably increase. This is a problem for the political system and is as well a problem for cooperatives with a traditional democratic decision-making system. The changes we are facing are towards a more market-driven economy which becomes more diversified as well as more international or rather globalised. Market-power is transferred more and more towards those who are close to, or have direct access to, the consumers e.g. the retail-chains.

The consumer-demand for food is becoming more and more diversified. Earlier the demand was mainly focused on standard qualities with measurable quality attributes at standard prices. Partly this depended on standards set by agricultural policy. The products produced on the farm were commodities. Today, and probably more so in the future, more and more consumers are demanding quality-attributes that are difficult to measure in the end-product. Attributes that expresses real or imagined food-safety aspects such as hormones, GMO etc. Or attributes that represent ethics, environment-friendly and sustainable production methods on the farm and all the way through the production and distribution chain. This is most clearly voiced on the market by consumers demanding ecological food products. Thus traceability and consumer trust will play an increasing part in the marketing of food.

Although this type of demand might not be expressed by a majority of consumers, a big enough group will express this type of demand to make the retail chains use it as a profile for their concept in the war on the market about marginal-consumers. Furthermore, this type of demand adds value not only to the end-product but this value is created already on the farm. The product at the farm gate is not any longer a bulk-commodity. Thus, this is a positive development for the farmer and certainly a positive challenge for our cooperatives. The challenge is to refine the value added at the farm gate and bring it down to the farmers.

Thus, challenges from these market developments are:

- To develop producer-owned cooperatives to truly market oriented enterprises, and
- To raise risk capital for investments, mainly in the market

The majority of cooperatives were founded to solve market-imperfections on local or regional markets, as this was the relevant market at that time. The relevant market at present is at least

the EU-market or often, and increasingly so, the world market. Thus, there is a challenge for the owners of cooperatives to create structures that could meet the new relevant market. In many cases we have been successful in doing so historically when the local market became regional and national. Partly that success depended on the fact that the development was not so rapid. We were able to adjust to the development step by step, although very often with great difficulties in the merger processes. In the market of today and tomorrow it is my conviction that we have to create transnational cooperatives and/or joint-ventures between cooperatives to meet our real competitors, the transnational enterprises. We must face that these are the real competitors, not our neighbouring cooperatives. To meet this challenge is of course up to us. But we must as well demand that the politicians create the necessary legal conditions for this. This means to finally decide on the European cooperative statues and to adapt the European and national competition laws to the new market conditions. In this process COGECA plays an important role as the agricultural cooperatives agent in Brussels.

With this as a background how will, and maybe can, cooperatives cope with the challenges. When I am trying to evaluate this you must remember that my background is the Swedish cooperative arena. Some of the problems and solutions might not be relevant to you and I might leave out problems and solutions that you identify as more relevant in your countries. But let us leave that for the final discussion.

2. DECISION-MAKING PROCESS

As I said the changes in the world around us are getting faster and faster. This is creating problems for true democratic decision making. We do experience the problem on the political arena. And we certainly experience it in our cooperatives. Some people identify the problem as being the "one man one vote" principle which is mostly used in cooperatives. A principle which has to be applied in Sweden to be recognised as a cooperative by the taxation laws. I do not think that this is the main problem. The problem in most cooperatives are much more complicated. The members/owners of cooperatives are, as far as they are commercial farmers, equally dependent on the business success of the cooperative. In most cases cooperatives need to pool their total output and the members are thus dependent on keeping the total volume produced in the hands of their cooperative, as long as the sales to the cooperative are paid according to costs. Furthermore, in cooperatives with a membership above 1000 members, as is the case in many cooperatives, a graded voting-right according to e.g. turnover does not really increase the power of the bigger producer. Having 100 votes out of 10,000 does not really give you an important advantage as compared with having 1 out of 1,000. For me graded voting-rights are in most cooperatives only window-dressing.

Instead I think it is more important to discuss if qualified majority should be needed for certain decisions or not. In Sweden qualified majority is needed on the second decision, if unanimity is not reached on the first, for certain changes in the by-laws and for mergers. In these cases I do think that simple majority could be enough on the second ballot. A minority of owners should not be able to stop a development that a majority wants.

To qualify as a member of a cooperative I do think that a minimum level as far as the farmer's turnover with the cooperative should be set. The level should be at such a level that only farmers with a commercial interest could be members. This does not mean that only big producers could be members, as rather small farmers can have a commercial interest. A practical solution is to have a minimum requirement on the level of share-capital that each member should contribute to become a member. The level of share-capital above that level should be direct proportional to the members' turnover with the cooperative.

Furthermore, I do think that what should be decided at the annual meeting of the cooperatives could be question. Maybe it should be limited to granting discharge and to elect the board. Such changes could speed up the decision-making process but still leave to the board of directors the responsibility for keeping the members informed and for creating a majority in favour of the decisions taken. If they do not succeed in this they should be replaced. Still it is important that cooperatives get the opportunity, when needed, to take quick decisions to be able to act on rapidly changing conditions in the business environment.

3. MARKET ORIENTATION

Although we all talk about market orientation, too many cooperatives are still working with marketing what their members produce instead of getting their members to produce what the market asks for. As I said the marketplace becomes more and more diversified and at the same time more global. Traditionally thinking this should mean that the market should be more difficult to survey. But the IT-revolution, of which we only have experienced the beginning, will lead to the opposite situation. Our customers whether they are retailers, wholesalers, processors or farmers will be able to collect much better information about the market than was possible when the market was less diversified and more regional or national. I do not think that anybody here can completely grasp the full effects of the IT-revolution. My conviction is that the biggest effects will be on the wholesale and distribution sectors, but the effects on the production sector will be great as well. The buyers will not accept any extra costs which do not add an extra value to the product or service. The sellers will be able to check the market for the best buy for his products.

The market could be described to fall into three different main groupings without definite borders between the groupings. The niche market, the brand market and the commodity market. Do not ask me to clearly define when a niche-market becomes a brand market or a brand market becomes a commodity market. I trust that you recognise the grouping. Cooperatives, as well as other actors, have to decide on which part or parts of the market they want to operate. Each market puts different requirements on the cooperative.

3.1 Niche markets

On a niche market somebody has identified or created a demand for a specific product that can get price premium from a limited number of consumers or a product which is demanded on rare occasions. Although the volume demanded is small on the local market it could still be big for a limited number of producers on a global scale. To exploit such a niche the producer must be able to limit the volume produced and in most cases have full control of the production and marketing process. Investments in the market are needed to introduce and promote the product on the market. Investments that of course are risky, but if successful, give a good return on the capital and premium prices to the farmers who produce the raw-material for the product.

In a cooperative with many possible or presumptive producers among their members a successful launching of a niche product could create problems depending on the cooperative rule of equal treatment of the members, if the price premium to the producers is high. If the premium is limited, this volume could easily be limited to market needs by contractual arrangements, within an existing cooperative structure. If the price premium is high this could be a problem if handled within a cooperative enterprise. In that case the cooperative could invite a limited number of members to be shareholders in a subsidiary company where the cooperative has the majority ownership. In that way the interested members share directly the risk for investments with the cooperative but as well its benefits. The production rights could be directly tied to the number of shares the member owns and a bigger part of the premium could be paid as dividend on stocks, as should have been the case in the cooperative.

To identify and exploit such niches has been the business idea of the so-called "New generation cooperatives" in the US as far as I understand. To succeed in limiting the volumes to market demand, the membership has been closed and production rights have been tied to the share-capital. This is of course a solution if the law so permits. In Sweden, as in some other countries, this would not be possible as a closed membership does not qualify the enterprise to be a cooperative. But as the law is not given by God this could, or rather should, be made possible as far as market niches are concerned. I do not think that a closed membership is or should be applied in general dairy, slaughtering or grain cooperatives.

3.2. Commodity markets

On the other extreme of the scale we have the commodity market. Characteristics of that market for food are well defined bulk products usually in abundant supply. The only way to compete on that market is to be cost-efficient in all parts of the process. The need to be cost-efficient will be emphasised by the IT-revolution ahead of us, and the internationalisation of the markets.

With a high efficiency and a competitive structure in the primary production at the farm level, the success of cooperatives in these markets will rest with their possibilities to be cost-efficient in processing and marketing on a European or world market level. Thus the owners/members must be prepared not only to accept structural adjustments etc. to be cost-efficient. They must be the driving force to adjust the cooperative to being cost competitive. This means among other things the producer must be prepared to accept strong and long-range contractual bindings with the cooperative concerning volume and time of delivery to secure full use of the capacity of the cooperative.

The question to be asked in this situation is if such a cooperative arrangement is of greater value to the owner than to be a producer to a private investor? Certainly the security in having access to the market is bigger in a cooperative arrangement than e.g. with a transnational integrator. The sellers on a commodity market are very often sub-suppliers to processors working on branded markets. Thus the alternative such cooperatives should always evaluate is whether they should invest in giving their product a profile that either ties their buyers closer to them or establish a brand for their product with the consumers.

3.3 Branded markets

This brings us to the branded food market. This market is between the two extremes the niche and the commodity markets. The strength of the brand does depend partly on the investments made and partly on the characteristics of the product. The biggest part of the food-market falls in this category, whether producer, processor or retailer brands are in question. This part of the market will increase in importance, depending on the demand for food-safety on the part of consumers and retailers. The BSE crisis or the present dioxin scandal in Belgium will promote such a development.

To establish a brand does require market-investments. Investments that the cooperative owner seems to be reluctant to make. The investment is not visible as a dairy or slaughterhouse. It does not appear as an asset in the balance-sheet. Neither does it appear as an increase in the value of the share capital as the value of a successful brand does in the values of stock on the stock-market. In the traditional cooperative investments in the market does only appear as operating expenses.

Partly the reluctance depends on a lack of market-orientation. But it also depends on that the owners of the cooperative in most cases do not identify what amount of the price that he receives for his product comes from the market-investments. Neither does he profit from the value the market-investment has created if his shares were traded on a stock-market. The former problem could, at least partly, be solved. The latter, with an increased value of shares is more difficult to solve within the cooperative model.

As far as the return on market-investments is concerned I do think it is important that a cooperative pays an interest on the share-capital corresponding to the return on the market-investment. This is not the case at present in most cooperatives in Sweden. Interest on the share capital should have two important effects. First the farmer will get the true market-price for his product. The extra value created by the brand will come to him as a return on his share-capital as a result of market investments. Secondly this should make the owners of cooperatives more ready to invest in share-capital as risk capital for the cooperatives.

To allow farmers to convert a fictive value increment that should be possible to get if the shares were traded on the stock-market is not possible within the cooperative model. That value is created on a separate market where investors put a price on the shares depending on the expected return on the capital be it direct return or capital gains. To get a good price on the shares on that market the cooperative cannot have as a primary goal to give as good as return as possible to the producers. To quote an old Swedish proverb: "You cannot eat the bread and still have it." In this case the owners of the cooperative have to make their choice. To put the cooperative on the stock market can certainly make the owners of the cooperative rich at the time of introduction to the stock-market. But in the long run they will lose the control of the enterprise.

A challenge to the owners of cooperatives will be if they can resist bids from external investors that are prepared to pay for a successful cooperative brand. A temptation that can be difficult to resist if there are relatively few owners and if they judge it impossible to exploit the brand as could be done by an external investor who wants an entry to a market. I am rather certain that we will experience such "take-overs".

How should cooperatives meet these challenges? Successful market investments which create profits that can be consolidated in the cooperatives could be used as an issue of bonus shares to the members. This will of course only be a partial solution as the cooperative still needs to consolidate and as the share-capital of the members will leave the cooperative when the members retire as members. In Sweden we have got the possibility to make such an issue of bonus shares from this year on. Still there are some tax questions to be clarified. But two cooperatives have already this year used the new possibility to strengthen the share capital in this way.

If a cooperative finds it impossible to raise enough money or wants to share its risk with somebody when doing market investments it could form a stock-company and invite members, other cooperatives or external investors to join. This is to my mind quite possible when cooperatives invest in the market close to the consumer and where it does only to a limited degree affect the market for the farmers produce. In this case there are a number of options, depending on the situation. The cooperative could form the company as a majority owner and invite the members of the cooperative to subscribe for shares in the company. The shares could then be traded either according to a formula or between members. This solution could be used as well when a cooperative does it jointly with one or more cooperatives of the same kind. But of course it is also possible to form a company with an external investor, either as majority or minority owner and with the possibility for members to subscribe shares. The shares could be quoted on the stock market.

Once again this solution could be used when the basic function of the cooperative is not affected. The basic function being to strengthen the market-power of the farmers and give them as good as possible a return on their production from the market. This is a possibility when the investment is too big or risky for the cooperative or there are synergies between the cooperative and the private investor. This could be the case if it for example creates possibilities to use existing marketing channels, to use a specific competence or creates structural effects on production or on the market. But my conviction is that the cooperative model is to be preferred in the first steps in the processing and marketing chain up to the point where farmers, through their cooperatives could negotiate on an equal basis with the buyers.

4. TRANSNATIONAL COOPERATIVES

A challenge the cooperatives have to meet is to adapt their structure to the new market conditions. Most cooperatives are local, regional or at the best national. When many cooperatives were formed, they were formed to correct market failures on the local market. As the infrastructure in society gradually improved the cooperatives amalgamated or collaborated on the enlarged relevant regional or national markets.

Today the relevant market is the European market and will become more and more global. This development is very rapid and as far as I can see we in the cooperatives do not adapt to the new situation. It is remarkable that we are not collaborating in a better way across the borders between the supply cooperatives in the purchase of fertiliser and plant protection products. Our counterparts are big transnational companies with almost a monopsony market position. The only collaboration across the borders known to me is the joint venture between DLG (Denmark) and SLR (Sweden) on fertiliser and plant protection. My conviction is that we can-

not in the cooperative sector limit our transnational collaboration only to the supply side. We have to recognise who first of all are our real competitors, the big transnational companies not our neighbouring cooperatives or the cooperatives in other European countries.

I am aware of the problems involved in creating transnational cooperatives. It is not only a question of different national legislation concerning cooperatives, taxation and competition rules. It is as well a language and cultural obstacle. But we have to meet and solve those problems. The legislation should be solved through active work in Brussels by COGECA and its members, the Agricultural Cooperatives. The language and cultural problems have to be solved within the cooperatives themselves. I know that some small steps have been taken on the continent and that discussions are under way to try to create transnational cooperatives or collaboration. But more has to be done at a faster pace than at present.

5. CONCLUSIONS

I have tried to describe some of the challenges that cooperatives have to cope with today and tomorrow. As agricultural policy will lose in importance at the sacrifice of the market as the main source of income to farmers, the need for cooperatives will increase. I am convinced that Cooperatives will meet that challenge. To meet the rapid changes we will have to be creative in finding solutions in the following areas:

- The decision-making process. It has to be speeded up and made more transparent.
- Market orientation. As farmers we, the owners, have to be more market oriented and our personnel in the cooperatives should rely more on market orientation than on policy or institutional measures.
- Raising risk capital for market investments and creating motivation for cooperative owners to invest in the market
- Identify the relevant market and create cooperative solutions across national borders to exploit those markets to the benefit of the owners, the farmers.

I have indicated some possible solutions. But I am certain that more and more creative solutions will be raised. Because the cooperative will be of the utmost importance to farmers on the market of tomorrow. It is up to us as cooperative leaders to act in a way that cooperatives will fulfil the goals of the owners. ■