6 Implementing the Sixth Reason for Co-operation: New Generation Co-operatives in Agribusiness

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This paper discusses changes in the agro-food markets with respect to the incentives to co-operation between farmers. The 'Sixth Reason' denotes that the historical reasons as such are no longer valid. It is concluded that each of the five historical reasons has taken on a meaning which is different from the past. The Sixth Reason indicates that each of the five historical reasons are to be regarded in a changed context. Thus the Sixth Reason consists of the following five elements:

- Co-operation is to create a firm that is to act as an interface between highly sophisticated and globalised food industries and ecologically sustainable farming in economically sustainable rural areas.
- Co-operation is a means to create a network economy which is indispensable to make fast moving technologies accessible.
- Safe and diversified food products require systems of passport production from the grass-roots to the final consumer; cooperatives are well equipped to manage such production systems.
- In more liberalised market conditions co-operatives can lower transaction costs to realise a diversified risk management among farmers.
- Diversification is an expression of entrepreneurial activity; entrepreneurship is expressed in new forms of co-operation.

A number of new generation co-operatives are discussed. Some were newly engineered, some were recently re-engineered. It is concluded that the historical co-operative principles are no longer valid. The NGC is the expression of smaller groups underlying homogeneity. Certain principles are reinvented. Others are about to disappear. Among these are open membership or free entry, and the one man one vote rule if there are differences in the enterprises controlled by the members.

Introduction

When studying the theory and practice of co-operatives, particularly in agribusiness, the student inevitably is confronted with the issue of the co-operative principles. Apparently founders and leaders of co-operatives had to adhere to structures and rules of conduct for co-operative managers and members without which the co-operative would go astray and thus would be in danger of loosing its 'raison d'être'. All the empirical evidence and practical experience from history brought co-operative organisations to a number of principles (Inter-national Joint Project, 1995). These were meant as an advanced warning: 'If you, co-operative leader, do not adhere to such and such rules you will surely fail. Learn from history how to set up and control a co-operative'.

Sometimes people and organisations went even further. The principles became rules: 'If you do not stick to these principles you should not call yourself a co-operative'. Yet we see in the last decade of the 20th century the birth of co-operatives which are structured in such a way that many a co-operative idealist would hesitate to call them co-operatives. If questioned 'Are you a co-operative?' the member of such a co-operative would probably respond by 'I guess this is as close as we can get'.

First, five historical reasons for co-operatives are discussed. Then, I argue why a good deal of these co-operatives features are now behind the horizon. Third, the Sixth Reason is described. Finally, the question is asked as to whether new principles are likely to emerge in the future.

Historical Reasons for Co-operation

Undoubtedly the need for countervailing power has been the most important historical reason for why farmers and horticultural producers have set up their co-operative enterprises. Co-operatives were created at a time when farmers began to integrate in the market economy. Their trade partners were private companies with superior market information who enjoy monopoly power vis-à-vis the farmers. By joining forces, the farmers were able to influence the market structure and the market behaviour of the buyers and/or suppliers. Many examples exist where cartels were dismantled due to co-operative firms (CFs) entering the market[1]. Thus, cut-throat price competition among farmers was mitigated and replaced by functional and quality-oriented competition.

When considering this First Reason for cooperatives it must be kept in mind that at that time markets for agricultural products and food products were, apart from crises, buoyant. From the point of view of farm inputs such as farm implements and fertiliser, the demand by farmers was growing strongly. Henceforth, a Second Reason for farmers to start co-operatives was to gain access to industrially produced goods and services. What should be mentioned in particular is the access to credit at favourable interest rates. The latter example is still today clearly visible in the former communist countries of Central and Eastern Europe. There is little doubt that in The Netherlands co-operative banking has been a crucial factor in agribusiness and farm development.

Like all other co-operatives, the co-operative banks could realise their goals due to economies of scale. By the sheer large scale characteristic of their activities they were able to bring the steady outflow of capital from farming and rural communities to a halt. Especially co-operative banks may be seen as forms of organised trust underlying modernisation and expansion of agribusiness.

The realisation of efficiency in processing co-operatives was and still is essential. Almost all agricultural products are of a bulky nature. Therefore unit costs of processing decrease sharply by expanding the operations of the CF. Hence, efficiency by economies of scale is the Third Reason for the creation of a co-operative. Co-operative auctions in flower, fruit and vegetable marketing have as their core business the market management under conditions of transparency. Market management yields competitive conditions so that the price system is efficient and in order that the right incentives are realised. Of course, intensive competition and prevention of monopoly positions is a prerequisite number one.

Time and time again it has been proven that accumulation of supplies (or suppliers) causes accumulation of demand (or buyers). Therefore co-operative auctions represent a very good example of both effectiveness and efficiency due to size of operations.

The Fourth Reason for a co-operative is risk management. No doubt CFs had to find their place in the market by gradual quality improvement involving all members. So on the one hand CFs reduced competition among members as was discussed under the First Reason, but on the other hand competition was based on such marketing elements as quality of farm products. It helped farmers to introduce continuity in delivery and achievable quality standards. This contributed to the farmers' knowledge the market and more stable conditions of investment. In addition, it must be said that there has always been an element of mental solidarity among co-operative members.

There is certainly a transaction cost element behind risk management and solidarity. CFs are more able to mitigate opportunistic behaviour and uncertainty. When CFs integrate with farmers, there is less fear that one of the parties will behave in an exploitative manner. Because a CFs are owned by its patrons it is less likely to default on agreements.

The Fifth Reason, finally, improvement of members' income and the rural economy. This aspect was the desired outcome of all activities mentioned above. In particular, however, it was realised by managing excess supply. The management of excess supply was in virtually all markets solely the activity of co-operatives.

Most of these reasons are not as acute as they once were. However, in many market structures the need for co-operation would reappear if CFs would disappear.

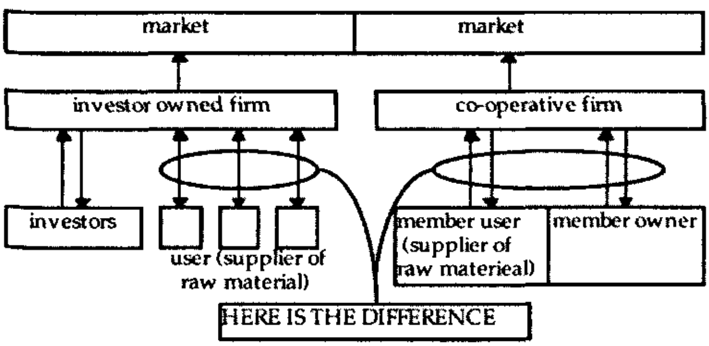
Changing Market Conditions

Co-operative agribusiness is operating under very different conditions in the industrialised market economies as compared with conditions when co-operatives were still social and business innovations. In, for instance, The Netherlands and Denmark co-operative agribusiness is characterised by export-orientation, an increasingly internationalised industry and pursuit of direct foreign investments.

The CFs are commonly U-form, that is to say they do not integrate different main products into conglomerate co-operative companies. Dairy co-operatives are not involved in meat, and potatoes are not marketed together with grains by one CF. The farm supply co-operatives are usually more diversified. In countries with sparsely populated areas like Ireland, it is more common to integrate more products in one co-operative structure.

Under normal market circumstances co-operatives play the role of price leader. As a matter of fact they almost automatically become price leaders if they are founded for the reason of creating countervailing power in the market. A second reason is that they become price leaders because of their cost leadership. The costs in co-operative processing are decreased by efficiency. Efficiency-strategies always have been of key importance to co-operatives in agriculture. In most processing firms in agribusiness a one percent decrease in costs has the same effect as a 10 percent increase in demand. Co-operatives naturally would raise prices paid to members according to their performance. Henceforth the price to be paid to the farmer by the CF has a buffer function to the CF in that a price leader-CF will distribute its results on the basis of the proportionality rule. Risks are expressed in price. In other words, price performs the income and risk allocation role. When looked at from the point of view of the CF as a business, this buffer is comparable to risk bearing equity share capital in an IOF. Price being a performance allocator, it can be said that members share liability and risk on a transaction basis. Adverse market results in first instance means lower prices to the members. To them it means lower returns on investments in their farm (see Figure 1). Own equity in the CF, however, can have lower solvency than in IOFs because CFs are backed by members. Increasingly co-operatives seek for more permanent forms of risk bearing capital. Mostly the interests or dividends paid on such capital are related to capital markets. Thus they represent fixed, accountable costs to CFs, leaving risks to be born by members.

Figure 1 Difference between IOFs and Co-operatives



When markets become more international and competition more intensive, traditional co-operative price leadership in the sense of market correction loses its traditional rationale. When standardised qualities of the raw product can be imported or exported, and the EU or world markets are effective, CFs can only pay a better price than IOFs to their members when at least one of the following conditions apply: transaction costs are low, and quality is superior, in the sense that it better fits in the value-added chain system. Each of these leads to better margins for the CF and thus better dividends to the members.

If the CF has the lowest costs by far in comparison with competitors or when the CF has a market position, e. g., with branded products which brings it in a monopolistic position, this means that membership represents extra-value. Such extra-value is not likely maintained under conditions of free entry of new members. Instead CFs which enjoy monopoly powers will not continue to follow free entrance policies. Members will be accepted on the basis of market opportunities and are expected to share risks by capital investment which is proportional to the amount of product to be processed and marketed by the CF on their behalf. Members try to avoid that value added operations on behalf of themselves are diluted.

Monopoly power is mostly based on market positions in the consumer market. In agribusiness they are closely related to specialised resources. The most crucial resource is genetics. For many products the genetic basis is essentially determining costs of production, costs of managing the integrated chain, costs of processing and consumer acceptance. So monopoly power in the agro-food sector is gained by moving to either the starting point or to the end of the chain. Or to both, of course.

CFs (and their members) which have achieved such monopoly power will normally limit production and limit the entry of new members.

But the market laws also work the other way round. Farmers operating in a market with stiff competition for their products or where the suppliers of their inputs are in intense competition will judge the performance of their CF on normal market parameters: price, quality, service, new market opportunities on behalf of inputs engaged in the farm enterprise and returns on capital 'invested' by the CF's members.

Closely related to the foregoing is the observation that co-operatives by their very nature cover an over-normal transaction span in the market chain. Farmer-members begin to 'correct' their market partners at both ends of the agro-food system. They continue to seek a better position by integrating both forward and backward. It is also necessary to take into account the special nature of farming.

In farming long periods with low returns are not unusual. Therefore, farmer-members are inclined to seek continuity in their CF. Investments made in times of depression pay off in times of market booms. For co-operative members this is only realised if they commit themselves. Thus co-ops can become monopsonists due to member commitment. This phenomenon is underpinned by the fact that usually the co-ops have realised considerable economies of scale in processing which makes the entrance of new competitors difficult because of large investments needed. That CF then has a monopoly or a monopsony position. If CFs are achieving real competitive advantage which provides them with market leader positions, members will not want to restrict their CF to the home market nor to processing and marketing the members' product only. Members rather will let their CF expand with foreign members or let it, be it partly, go as an international IOF.

When a CF becomes a monopsonist there is at first glance a danger too, namely that the CF takes on a monopsonistic position vis-à-vis its own members because there are no other firms which compete for the members' product. Should not the farmer who sees his product processed by only one CF fear that the absence of competition in the market may eventually cost him his market position? Such conditions are more likely to occur when markets are protected from foreign competition by market policies of the government. Under conditions of international trade liberalisation such situations are likely erased, however. Notably the effects of the GATT negotiations on international competition will be open markets for foods and agricultural products. The effect for farmers will be that a wider range of firms will compete for their raw material if their farming is price competitive. Competition on quality and decreasing transaction costs will likewise become more important.

There is a condition under which farmers and their CFs work in a way so that market competition is excluded. No other firms are interested in buying the farm produce and the CF is not allowed to stop processing the members' production. The reasons can essentially be twofold. One reason is that the firm is highly specialised and cost of entry at the processor's (= CFs) level is prohibitively high. In this case the competitive position of the CF in the consumer market will determine the returns on investment for the co-operative: both at the level of the farm and the CF. The other reason can be that the CF and the co-operative members have built a strong system in which transaction costs are so low as to create a monopoly power for the system as a whole. In this case the entrepreneurial power of the co-operative market system will be decisive for the future which is ultimately in the hands of the farmer-owner/investor. The land rents have an opportunity value which is determined by other productions and the willingness of farmers to invest is determined by the opportunity cost of capital outside the co-operative farming business as compared with its returns within.

The reason to co-operate under these conditions will be that otherwise the competitive farmer cannot reach the market, but because participation in his CF will yield better returns than just selling the raw product or than from stopping farming altogether.

Finally, co-operatives originally were established on the concepts of countervailing, 'negotiation-driven' power and of partial integration by which the markets between farmers and their CF were replaced by 'system-driven' markets. In the 'system-driven' markets market prices are more or less based on formula pricing, the elements in the formula being the performance of the CF in its own market, risks, costs, quality, equity formation and member liability.

The markets in which the CFs' performance was to be realised were mostly 'negotiation-driven' markets. The members' 'system-driven' markets were normally based on homogeneous membership. Besides, as most agricultural inputs and products are of a bulky nature the economies of scale to be gained stimulated open membership and homogeneous member-business. This has changed considerably. In the first place most CFs have developed strategic alliances, joint ventures, and forward and backward integration contracts with their suppliers or buyers. The result is that the agro-food market has changed towards a 'system-driven' right through the chain. In the second place more segmentation in the market is creating member segmentation. In the study 'The Co-operative Enterprise - Perspectives of Development in Denmark Towards the Year 2010' an example is given in which eggs are segmented into cage eggs, free range eggs, non-cage eggs and ecological eggs. Each of these are produced by four different producer groups.

Such an example shows that the markets have also changed in the sense that the consumer behaviour is felt more directly at the farm level. The characteristics of investment in the CF and the farm are becoming more specialised and of a short term nature. Therefore we see that equity formation by unallocated reserves is less fashionable and is being replaced by member investments with higher rates of depreciation.

The Sixth Reason for Co-operation – The Historical Reasons Revisited

Have the historical reasons for co-operation lost their meaning for the efficient, competitive farms? From the preceding paragraphs it can be concluded that open, competitive markets for agricultural products are the effect of a trend towards globalisation and liberalisation of international trade policies. Many observers conclude from this development that there is no need for co-operatives in the classical sense, since market information is precluding monopolist behaviour. Firms cannot protect their markets and governments will remove sheltering effects by abolishing protective national trade policies.

This is not to say that farmers can survive financially without co-operation. When governmental trade policies are liberalised it is still impossible for individual farmers to influence the market behaviour of industrial trade partners in the market chain. It is hoped that international competition will create more market opportunities. On the other hand during recent years there has been a strong trend towards concentration in the food retail industry. Not only have retail organisations in their country of origin merged to the effect that three to five supermarket chains may control 50–70 percent of food retail sales, the supermarket enterprises have also become international. Moreover, there are several instances of retail chains operating in purchasing organisations and developing products jointly. The Federation of Danish Cooperatives concludes (1996, p. 4):"*There is an increase in the use of private labels, the chains strive to differentiate in relation to each other by establishing their own individual product profiles. Often, the retail chains are at the head of a considerable portion of the development activities regarding these products. When the chains became larger and international, their strength increases face to face with the societies supplying the food*".

There are, however, new opportunities for farmers to develop marketing structures by which farmers can keep pace with new demands of markets. Among these are differentiation, vertical integration, alliances, joint ventures and collaboration between co-operatives across the national borders. Therefore the historical First Reason has obtained a new content. This is the creation of a new interface between the highly sophisticated and globalised food industries and the primary farms, which seek sustainable methods in a sustainable rural economy.

A similar observation holds for the historical Second Reason. Co-operative banking provides us with a good example. On the one hand, with the exception of newly established market economies in Eastern Europe, farmers have all desired the bank products made available to them. So at first glance it would seem that it is no longer acutely necessary for farmers to have co-operative banks to gain access to financial markets. On the other hand, the capital markets still need re-engineering to operate efficiently towards the farm sector. This is true when looking at co-operatives themselves. Co-operatives are in need of permanent, risk-bearing capital first from members, but possibly also from non-member sources. In the last case members do not want to give away their control. Therefore, farmers would prefer other capital markets for their co-operatives rather than the stock exchange where they have to comply with general rules concerning ROI and allocations of plants and business centres.

Co-operatives are also bound to certain regions where the businesses of the members are located. This means that the Second Reason for co-operation, namely the access to capital and money markets is also supplemented by a Sixth Reason. With changing market conditions for farm products as mentioned before and the steep rise in the use of information technology, the financial markets become the heart of the economy. Each sector will make its own use of these opportunities. Farming is characterised by varying scale and by great variation in natural conditions over relatively short distances. Therefore the financial servicing has to be adjusted to the various farm sectors and to regional differences.

Co-operative banking can contribute to farm adjustment by making new services available and by assisting the members to develop strategies and to manage these. For banking the core-business will be the management of information flows on financial markets and economic developments that are relevant at individual firm level and at industry level.

Such networks need the input of both the co-operative banks and their members. A good example is provided by the German car industry BMW. They realised that individual freedom is a meaningful concept only if it is in harmony with freedom of others. Therefore, a 'Co-operative Traffic

Management System' was developed. A co-operatively financed system was installed by the car industries, government, municipalities and transport organisations to develop sophisticated computerised information system for managing the logistics of cars, buses, trains etc. The system should take into account the functioning of public and private transport under the condition of road space, public transport capacity and environment as the scarce resources. Such a co-operatively managed system can only succeed when all partners contribute. The concerns are with up-to-date information supply on plans and restrictions faced with.

So the new content of the Second Reason is the creation of a network economy by which access and keeping up with fast moving techniques can be secured – both to the CF and the member firms

Under conditions of open competitive markets the historical Third Reason does not seem to be affected. Probably it is significant for processing the farm product and inputs at lowest cost today as it was during the genesis of co-operatives. However, new requirements emerge. The new demand is that diversification and variety at the consumer level not only affects the processing but also the production methods, plant breeds and animal breeds at the farm level; 'passport' or system-integrated production is the new element added to the historical Third Reason.

Here, we should mention the role of technology, and especially that of biotechnology in reshaping the agro-industrial complex. Seed and agrochemicals, primary agriculture, and food processing are more likely to be co-ordinated to achieve food with functional requirements matching consumer preferences for health, convenience and low cost. As goverments withdraw from funding agricultural research, co-operatives have to bear the costs of R&D, if they want to reap the benefits of process and produce innovation. But it is here that economices of scale appear to be relevant. The huge costs and risks of biotechnology require large scale of operation and purposeful strategic alliances. Access to new technology is an irreversible option for co-operatives if they want to penetrate the food chain (Kyriokopoulos et al., 1996)

The historical Fourth Reason is risk management. In the past this had to do with member solidarity, especially concerning the handling of surpluses. There is little doubt that the changing conditions on the food and agricultural markets have changed the risk profiles of co-operatives and their members. As food markets become more mature, branding and market segmentation has set the scene. At consumer markets the profit margins are higher with more value added. However, risks are also higher. As CFs are becoming larger it is their 'natural' business to integrate forward and to expand geographically. The risks are born by the members. Their risk profile is changing fast with forward integration. At the same time forward integration is a means to reduce risks run by farmers as trade liberalisation decreased the effect of income protection policies by the government.

Increased risk has in some sectors stimulated new forms of ownership and special company structures with subsidiary companies and holding companies (Federation of Danish Cooperatives, 1996; van Dijk and

Mackel, 1994). New forms of risk management while a variety of business alliances and abstracts emerge is the present content of the Fourth Reason.

Historically, co-operatives accepted all products delivered to them. The management's job was to find market outlets and realise the best prices possible. This need to take all produce has been dealt with in three ways (van Dijk and Mackel, 1994):

- Maximising the use of public support measures to minimise commercial risk, (e.g., grain co-operatives in France and their use of the intervention/subsidised export schemes);
- Trading freely with a range of suppliers using price as the method of procurement rather than group discipline; and
- Organising an auction system in an attempt to optimise price transparency for producers and to create a focal point for the market distribution system.

The Fifth Reason, namely to handle situations of oversupply, has taken on a different road as excess supply is less likely, farmers being contracted and markets probably operating more efficiently. The seeking of income improvement is likely to assume a more entrepreneurial character. Farmers may have to undertake more diversified entrepreneurial activities to prevent their rural economy from marginalisation.

There are a number of cases where co-operatives were transformed into corporations to finance future investments. Where the circle of owners is expanded with non-user members who also bear risks, this causes the original member-user owners to lose influence. However, it also opens new ways of entrepreneurship to members in relation to their CF.

The changing market conditions and their impact on the relationships between members and co-operatives can be illustrated by the example of flower auctions. Market gardeners invest heavily on their farm enterprises and as a result they become more demanding with respect to marketing activities of their CF. Flower auctions, limiting themselves to a "price discovery" function, are anable to take an elaborated marketing activities. Thus, dynamic and market oriented growers resort to direct agreements with private companies, surpassing the co-operative auction.

From the foregoing is concluded that the historical five reasons for co-operating have changed their nature quite considerably. The above considerations therefore gave rise to formulating the Sixth Reason. This Sixth Reason will lead to new policies concerning the relationship between the CF and the co-operative member.

The Sixth Reason – New Generation Co-operatives (NGCs)

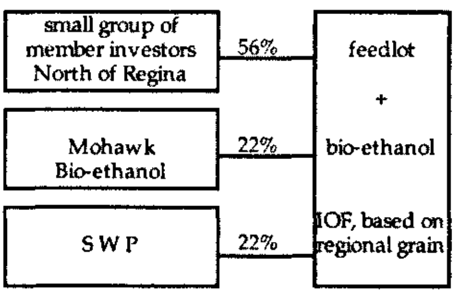
The Sixth Reason represents the need for new member strategies as a result of the changed nature of the classical reasons for co-operation.

In this section the characteristic elements are listed first. Second, examples of new member strategies are discussed in order to make the concept more comprehensible. The Sixth Reason in essence is to let CFs create new market opportunities for the co-operative members under the conditions of investor-driven membership, diversified membership and market fragmentation. The Sixth Reason is to make investments in such a way that new markets are created in which the members can add value with their land, labour, capital investments and skills. The Sixth Reason thus is the combination of the original reasons for co-operation in a state of flux. New conditions have stirred farmers to co-operate in new ways and have caused long-standing co-operatives to re-engineer. They are the so-called New Generation Co-operatives.

CFs that were set up (Nadeau and Thompson, 1996) for the Sixth Reason are called New Generation Co-operatives. Egerstrom (1996), Cook (1996), Nadeau and Thompson (1996) give a number of examples for the US, van Dijk (1996) gives examples from The Netherlands. Below some characteristic examples are described.

A group of Saskatchewan grain farmers, all members of The Saskatchewan Wheat Pool (SWP), are faced with a threat of excess supply of wheat in the lower quality ranges. Therefore they invest in a feed lot of approximately 25.000 head of cattle and a bio-ethanol plant, a by-product of which is also used as a feed-component for the beef cattle. The farmers hold 56 percent of the shares. SWP holds 22 percent and the company in the bio-ethanol business (Mohawk) holds the other 22 percent (Figure 2).

Figure 2 Co-maker Co-operative: Saskatchewan Wheat Pool



From the very start the founding farmers decided that they would sell their wheat at market prices, but that the shareholders would receive a First Right of Refusal to deliver at that price. During the starting period all required raw material was delivered by the original 'members'. The amount they could deliver was agreed to be proportional to their investment (shares). Presently this still is the case, but now far more wheat is needed than members can deliver.

As a result of the business structure, the performance of the 'CF' is expressed in the value of the shares linked by a wheat-delivery right and their dividends. The members have reached their goal: demand for feed quality wheat is enhanced and a profit is made.

This co-operative is a joint investment activity by farmers. The CF is both a market leader and a price leader. New members cannot enter unless they buy stock and delivery rights. The Board of Directors elected democratically. The other board members are appointed by their shareholding companies. When questioned, however, it turns out that these farmers are presently more interested in expansion and profits than in having votes.

The University of Saskatchewan Centre for the Study of Co-operatives (cited in Cook, 1996) concludes that the New Generation Co-operatives have two common bonds. The first is that their major focus is value added processing, representing a departure from the main objective of commodity marketing held by their predecessors. *"Rather than acting as clearing houses for the product, a NGC is restricted to only accepting a predetermined amount of product from its members. In fact a 'two-way' contract exists between members and the co-operative that requires the member to deliver a certain amount of product by the co-operative and requires the co-operative to take delivery of this product"* (Cook, 1996, p. 145).

The examples of NGCs given by the authors Egerstrom, Cook, Nadeau and Thompson all have in common that open membership is not the normal rule, except in cases where people in a community co-operate to avoid its economic decline. But product oriented co-operatives have the system of limited access. Shares are coupled with delivery rights and are tradable. There is proportionality in most cases between shares and user transactions. Democracy is maintained as much as possible. There is no fundamental objection to making profits and to distribute these on the basis of share capital.

In sum, the new co-operatives follow an investor-driven strategy. 'You have to pay to play'. There is closed membership, or it is better to say, *"there are membership-policies controlling entrance in the venture in by-laws and operating practices (....). The NGCs have resolved issues to co-operative property rights and 'free rider' memberships, have asset appreciation mechanisms, delivery right mechanisms, proportional patronage distribution, base equity capital plans"* (Egerstrom, 1996, p. 148).

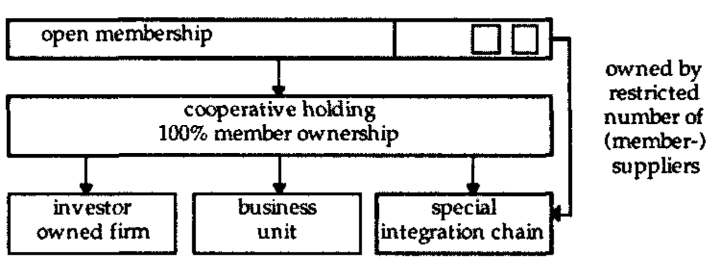
The Sixth Reason – Re-engineering the Co-operatives

When the Sixth Reason conditions prevail co-operatives seem to follow either of these two routes: the CFs can convert to IOFs in order to gain better access to equity and pursue growth policies. There are examples in Ireland in which co-operatives members have released their control for this purpose. Or the co-operative's member relationships are strengthened on a new basis. The latter route is inevitable when market competition makes the CF too much dependent on the members. It is also inevitable when the members have become too dependent on their CF. In both cases the balance of business between member firm (farm) and CF is lost. In both cases members ceased to regard the CF as 'their' CF. Nor are they committed through a 'united we stand, divided we fall' attitude to their business. Instead members judge the co-operative at its competitive performance vis-à-vis the members as if it was an IOF. This holds especially in countries where CFs and IOFs exist in the same market. A timely re-engineering and re-inventing policy is then necessary. Interestingly however the CFs begin to value the membership of their clients or suppliers. It is increasingly regarded as an asset by the managers rather than a nuisance. Below some successful or at least very promising cases of re-engineering/re-inventing are described. These are Harvest States (USA), The Saskatchewan Wheat Pool (Canada), Dumeco (The Netherlands), Campina Melkunie (The Netherlands) and Friesland Dairy Foods (The Netherlands).

Harvest States changed its constitutional by-laws to give the co-operative greater flexibility in forming subsidiaries, joint ventures and strategic alliances with local co-operatives. Harvest States is transforming to a Holding Company in which farmers-investors-users can participate on their own terms. Harvest States thus does not pay so much attention to their members as the normal member-users, but as investors. The Harvest States Investment Plan provides producers and co-operatives an opportunity to increase their returns from the Harvest States food processing operations by investing in 'equity participation units' in those areas. Investments would be available on a 'per bushel' basis. Capital raised by selling the equity participation units to member-investors provides a stronger, more feasible financial base, designed to improve returns and redemption of exiting member equity. The infusion of capital also enables Harvest States to expand existing operations and launch new value-added activities.

The plan is simple. Eligible investors (producers or co-operative of producers) invest in a specific Harvest States value-added food processing activity by purchasing equity participation units. This investment carries with it a right and obligation for the member-investor to deliver the bushels involved to an authorised delivery point, normally a nearby member-co-operative or Harvest States facility. So members can choose to participate in the earnings of a specific value-added operation. In this sense the plan is quite similar to that of Canadian farmers who are also member of the Pool. The remaining earnings are divided in the traditional way over the member-users of Harvest States (Figure 3).

Figure 3 Re-engineering the Co-operative Harvest States



Equity participation is subject to depreciation and appreciation in value and shares are tradable to eligible producers and co-operatives. The background of the plan is that Harvest States' overall grain volume has increased much faster than its processing capacity. As a result returns from these value-added operations have been diluted.

A second example of re-engineering the co-operative due to the Sixth Reason is the Saskatchewan Wheat Pool. Faced with ageing membership, few new entrants and world market influences The Pool decided to go public. In this way The Pool effectively prevented a large outflow out of the agribusiness sector. Besides the new business of members with The Pool gives the right to shares options. Here again the proportionality principle is introduced. When looking at the present member administration it can be concluded that The Pool is as close to co-operative principles as a co-operative can possibly get given the Sixth Reason.

The third example is the Dutch Meat Company Dumeco that was re-engineered in 1995 out of two traditional meat co-operatives and an IOF in the meat business. The co-operatives had both been faced with unusual market circumstances. Due to over-capacity in the slaughtering plants both in The Netherlands and Germany price competition for slaughtered hogs grew very intensive. So the situation arose that members gave up the balance between delivery right and delivery obligation and the obligation required from the CFs to accept the member produce was released. The latter situation of course was natural since also the CFs were competing intensively for the hogs to be supplied by the members. The result was that the co-operatives more or less dissolved. Virtually no member commitment remained and it became increasingly difficult to finance the CF from member capital. As the CFs threatened to go broke a re-engineering plan was established.

The result was a merger between the two CFs and a successful smaller IOF. The CEO of the IOF became the CEO of the new company. This new company was set up as an IOF in which farmer-users of the former CFs were invited to become member-investors. This was realised via a new co-operative of member-suppliers to Dumeco IOF. The Dumeco co-operative became the owner of 30 percent of the shares. The other shareholders consisting of two big co-operatives operating in the feed industries (Cebeco and Cehave). The fourth and fifth parties are the IOF and a farmers' union.

The interesting feature of this operation is that the establishment of the Dumeco co-operative was very much stimulated by the management of the Dumeco IOF. The relationships are based on transaction cost reduction, investor-owned relations and co-makership between the members of Dumeco co-op and Dumeco IOF. New contracts were established stating that co-makership has the following elements:

- Acceptance by the members of Dumeco IOF as a price leader;
- Delivery contracts where number of pigs to deliver, plant they shall be delivered to, and time of delivery are specified in order to achieve efficiency in logistics and smooth us of available capacity;
- Transaction cost reductions by members to be remitted to them;

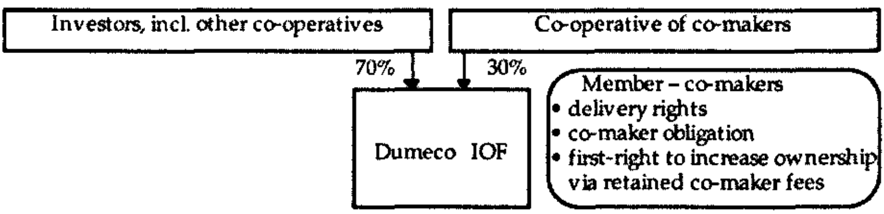
- Dumeco IOF accepted as a leader of the production-marketing system concerning quality requirements, time of delivery, place of delivery.

Profits are distributed in the form of co-maker fees to members on a proportional-to-transaction basis. The co-maker fees are not paid in cash but are transferred as certificates of shares. These certificates are transferable among members but in the future non-members can be included (Figure 4).

The fourth example is Campina Melkunie, the largest dairy co-operative in The Netherlands. As a primary co-operative Campina Melkunie has maintained its role as price leader. This CF is managed on the basis of adding value to the member produce. This means that members also accept the roles of their CF. These risks are expressed in the milk price.

As the CF requires more long term equity, a new financial product was designed in the form of bonds issues by the CF to members. The bonds are compulsory and are proportional to the volume of milk delivered. However, bonds are transferable, also to non-members. In this way Campina Melkunie established market conditions for capital supplied by the members without having a situation in which the investor-relationship between the CF and the member becomes paramount.

Figure 4 Co-maker Co-operative Dumeco



A fifth example is Friesland Dairy Foods (The Netherlands). Becoming increasingly internationalised it decided that high milk prices due to good results in Asia causes distortion of incentives to farmers. Therefore the FDF follows the weighted average of the five best paying dairy firms in the country. In other words, foreseeing the Sixth Reason to become effective in a few years time also in the milk and dairy sector of Europe, FDF decided to anticipate this change. At the same time members are invited to become shareholders in the Far East activities.

In FDF the control is still exerted by members on the basis of milk transactions. The unallocated reserves were transferred in the A-shares held by the FDF co-operative. Members can have B-shares in the FDF IOF without a proportionality-to-milk restriction. B-shares are tradable to other milk supplying members only. B-shares have no voting power.

These are examples of co-operatives where the Sixth Reason caused a re-engineering. If members are looked at and treated as business partners with co-makerships and investment interests they contribute to the co-operative firm and can reap the benefits. Membership is no longer undivided. It distinguishes transaction costs and how to minimise these, investment relationships and how to secure the returns (on price or on capital) and how to build a market organisation to realise continuity of the farm and the rural economy.

Co-operative Principles under the Sixth Reason – What is Left?

Like theory, co-operative principles are based on long-standing practices and experiences. People learned to introduce rules of conduct in order to strike a balance between rights and obligations, freedom and risk versus commitment and security.

Open membership and education no doubt had important effects in times when co-operatives were locally based and information was scarce. The co-operative principles were the outcome of a development towards both vertical and horizontal expansion. The co-operatives, at least most of them, were product oriented, not capital oriented. Members were seeking countervailing power and access to scarce goods and services. The common interest was to maximise the return on the resources owned by the members. The tradable product on the basis of the resources was regarded as the scarce resource. All other productive factors like labour and capital were to earn their returns on the basis of a fair price. Fair deals presuppose solidarity and democracy on a one member – one vote basis. If people live near subsistence it is important that there is no outflow of capital out of the neighbourhood. Instead the capital should remain 'in the family'. This is the basis for co-operative banking.

It seems that under present conditions members start re-engineering processes in their co-operatives because the old balances have changed. Different markets cause members to become heterogeneous. Farmers control not only fixed resources but also capital goods with higher rates of depreciation and turnover. Risk profiles differ strongly between individual entrepreneurs. Consumer pressure also contributes to the disequilibrium between farmer interests and the CF. For the scarcely populated areas it must be added that farmers see the natural end of horizontal expansion. It is only with new ventures and alliances with companies elsewhere that the rural economy can be maintained at satisfactory performance. Therefore NGCs are investor- and system-driven. Such conditions demand that acceptance of entrepreneurial risks are rewarded. Thus, there exist closed membership and depreciation and appreciation of co-operative shares.

New balances between solidarity, democracy and competition will appear. However, it is likely that a considerable time period will have to elapse before we dare to speak of principles of NGCs and re-engineered co-operatives.

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Note

1 By CF is meant a co-operative firm, which is a from like all other businesses except that it is owned, used and controlled by the members. Members are representing businesses. The Member Firm (MF) is called farm, horticultural firm, or just member, interchangably.