

# **Agricultural Meat Marketing Co-operatives**

**Funding Mechanisms to help Achieve their Strategic  
Goals**

**A report for the Kellogg Rural Leadership Programme**

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## **Abstract**

New Zealand livestock farmers have faced unsustainably low returns for their livestock, particularly lamb, over the last three years.

Their response has been to pressure the NZ meat processing and marketing companies, dominated by two large co-operatives, to reorganize and consolidate the industry to counter the power shifts that have occurred in the value chain.

In this world of globalization, marketing co-operatives are facing:

1. consolidation in the value chain
2. changing consumer requirements

The co-operatives' response to this inevitably involves significant amounts of capital.

This report reviews the literature and discusses the common strategic goals the meat marketing co-operatives around the world have developed to counter the above two issues, and looks at the mechanisms which are available to fund these goals.

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## **Executive Summary**

To get a better understanding of the mechanisms that co-operatives have developed to fund their strategic goals, this report firstly discusses the co-operative model and the five fundamental issues and constraints that they commonly face. One of their main constraints is their ability to raise capital.

In the agricultural sector there are two basic co-operative models, the marketing or output co-operative and the supply or input co-operative. This report primarily focuses on the marketing and output co-operative, especially in the meat industry sector.

Globalization has seen some very significant changes in the value chain, between producer and consumer, with power shift changes giving supermarkets significant advantages.

Supermarkets have been consolidating and are increasingly operating across borders. Consumer preferences for their food requirements are moving towards the so called 'ready made meal' or 'quick food' range of products.

Meat marketing companies, which supply supermarkets, and other outlets, with consumer products, have had to adapt to remain competitive.

They have and are currently adopting strategies that revolve around:

1. Economies of scale ( horizontal integration)
2. Increasing control in the value chain ( vertical integration)
3. Product Development
4. Diversification



## 5. Specialization

Many of these strategies are capital intensive.

Co-operatives operating in this sector have all adopted one or more of these strategies, but to overcome the co-operative problem of raising capital they have developed a range of solutions.

These solutions often involve some form of structural change and tend to move the co-operative away from the traditional model towards the investor owned firm (IOF) model( which is not a co-operative), with many alternatives in-between.

As the co-operatives progress away from the traditional model towards the IOF, issues arise around the level of control the co-operative members retain and in some cases the conflicting demands for profit distribution.

Finally this report briefly looks at seven case studies of co-operatives (in their various forms) which give an insight into the mechanisms which have been adopted to fund their strategic goals and how the potential friction between member shareholders and investor shareholders are managed.

## **Introduction**

This report is broken down into six sections:

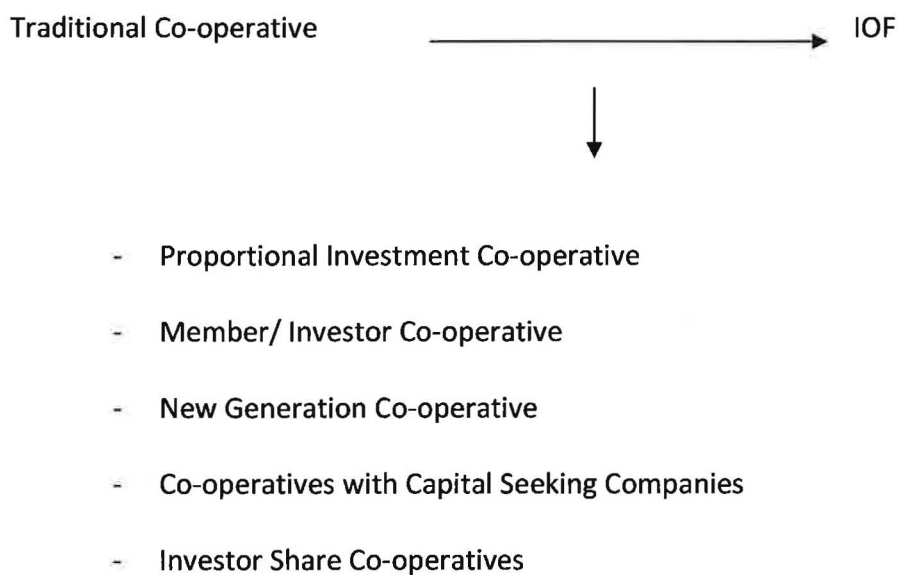
1. The comparison of co-operative principles with those of Investor Owned Firms (IOF)
2. Discussion of the common issues and constraints that are inherent in the co-operative model/ structure
3. Discussion of the common strategic goals found in most marketing/output agricultural co-operatives, with some examples
4. Discussion of the common mechanisms that are available to co-operatives, to fund and achieve their strategic goals
5. A brief look at seven case studies of agricultural marketing co-operatives found around the world, particularly in the meat industry sector
6. Conclusion

### **Comparison of Co-operative Principles with those of Investor Owned Firms (IOF).**

Evans and Meade (2006) discuss the features of the traditional Co-operative.

1. Ownership rights (commonly in the form of shares) are restricted to the patrons of the co-operative. The patrons are those people who do business with the co-operative. For example, in the meat sector the shareholder owners of the co-operative are those farmers who supply animals to that co-operative for processing and marketing. The co-operative is not necessarily restricted to doing business with member patrons only, but non-member patrons do not receive shareholder benefits.
2. Rights to residual returns (commonly based around shares) are:  
  
Non-transferrable and cannot be sold to anyone else.  
  
Non-appreciable and do not change in value relative to the success or otherwise of the co-operative.  
  
Are redeemable and can be sold back to the co-operative, hence allowing the member to exit.
3. Benefits (profits) are distributed back to members (generally shareholders) in proportion to their patronage. (level of business the member does with the co-operative)

Evans and Meade quote Chaddad and Cook (2002) who have put the Traditional Co-operative model at one end of the spectrum and the IOF model at the other end, with various intermediary co-operative models in between.



Bekkum and Bijman (2006) discuss how ownership issues are more complex in the Traditional Co-operative business model, in comparison to the IOF, because traditionally these ownership rights are linked to the transaction relationship the member has with the co-operative. Because the co-operative surpluses are returned to the member relative to his or her level of patronage, rather than his or her level of investment, there is limited incentive for the member to invest in their co-operative.

On the other hand the IOF has members (shareholders) who own shares as an investment. They do not necessarily do business with the IOF (but can do) and receive their benefits (return on their investment), commonly by way of dividends. Also their share values can alter in value to reflect the worth of the company.

1. Owner rights (shares) are not restricted to patronage, and in the case of the publically listed organization can be owned by anyone.
2. Rights to residual returns (shares) are transferrable (can be sold), are appreciable but are not redeemable (cannot be sold back to the company, as of right, as a form of exit) although companies do buy back shares from time to time for various reasons, at market value.
3. Benefits are distributed to members in proportion to their level of investment.

Brown, I (2007) quotes Barton (1988) who identified three fundamental principles that are most commonly used to distinguish a Traditional Co-operative from an IOF.

1. User owner principle – members who own and finance the co-operative are those that use it, whereas those that own and finance an IOF may not necessarily use it.
2. User control principle – control of a co-operative is by those that use it, by democratic voting rights, often one member one vote regardless of level of patronage and or investment.

Control of an IOF is by voting rights allocated to shares, usually one vote per share, with unrestricted ownership, which can allow individuals or firms to build up their level of ownership to have absolute control.

3. User benefits principle – benefits of the co-operative are distributed to the owner users on the basis of patronage (use) compared to an IOF where the benefits are returned based on the level of investment.

Edgar Parnell in 'Reinventing Co-operation – the challenges of the 21<sup>st</sup> Century' puts it very simply;

"A company is designed as an association of capital, whereas the co-operative is designed as an association of people".

'Put simply, co-operation is about doing something together, as a group, because this is more beneficial than doing it on your own'.

Evans and Meade suggest that "co-operatives tend to arise where multiple, small and competing producers of a product face market power, due to industry concentration further downstream in their supply chain, particularly where product perishability exists which accelerates their exposure to such power".

In other words co-operatives tend to develop where there are imperfect market competition conditions, where one sector feels it is at a competitive disadvantage, due to its fragmented nature versus the strength on the other side of the equation.

The New Zealand Co-operative Association defines co-operatives as “an autonomous group of people who jointly (collectively) own and democratically control a business by (on behalf of) the group of people (members) and which engages in business activities for the benefit of its members.

In comparing the dairy industry with the meat industry around the world we find there is a much higher usage of co-operatives in the dairy sector than in the meat sector. The reasons for this are that milk is harvested twice daily and is very perishable until it is processed. Dairy farmers feel very exposed if they have to rely on non-co-operative businesses to collect and process their milk. They prefer to own and therefore control the milk processing businesses to guarantee their milk will be collected and processed.

On the other hand meat farmers do not see such an absolute need to own their processing companies, as animals have a much longer window of opportunity to be processed, giving the meat producer the ability to ‘shop around’ for the best deal.

Ironically, once milk is processed into its many products, a significant number have quite a long ‘shelf life’, whereas meat, with the trend to fresh/chilled products, is falling into a shorter ‘shelf life’ category and is much more limited in its range of products. Under these circumstances you would have expected co-operatives to be as popular in the meat sector.

However in both cases there is the imbalance between the multitude of producers (milk or meat) and the few processors (dairy companies and meat companies). So in this respect both producers feel a need to co-operate.

### **Issues with the Co-operative Model**

Inherent in the Traditional Co-operative structure are some issues that materially affect the way the business is run.

Evans and Meade quote Cook (1995) and Cooke et al (2004 b) who summarize five key criticisms. These arise because the residual rights of control (ownership and hence shareholder voting rights are only held by those that patronize the co-operative) and the residual return rights (profits which can be distributed back to the shareholder based on their level of patronage) are poorly aligned.

Conversely in IOF's these rights to control, being based on the actual number of shares owned by the shareholder in the IOF, are aligned.

These five criticisms are:

#### **1. Free Rider Problem**

- In the competitive world the success of the co-operative to reduce input costs or to increase output returns are often reflected with non-shareholders who do business with some other firm, benefiting in the reduced input costs or increased output returns, caused by the competition factor in that sector.
- Also an internal free rider problem can exist, especially where the co-operative entry (cost of membership usually by way of shares) is based on a nominal value (does not reflect the inherent value of the co-operative) so



that new members benefit from past member investment and co-operative growth, effectively getting an entry subsidy.

- This is now, often, corrected by
  - a) members required to build their shareholding to a level relative to their level of patronage
  - b) Co-operatives moving to a “fair market value” share structure.

## 2. Horizon Problem

- This problem arises when the members (shareholders) have an expectation of the co-operative to distribute its profits in the short term, compared to the long term or productive life of the co-operative.  
  
i.e. members want their benefits, particularly in terms of reduced input prices or increased output returns, now.  
  
Thus the co-operative has difficulty in raising capital, by way of retained earnings, for longer term investments.

## 3. Portfolio Problem

- Arises because ownership and patronage decisions are tied (bundled).  
  
i.e. level of ownership reflects the level of patronage the shareholder does with the co-operative.

For example: capital and numbers of animals supplied are linked, in the case of the meat sector, therefore members cannot easily diversify their investment portfolio because their investment in the co-operative is tied to their need to patronize (do business) with the co-operative.

- This in turn creates pressure on the co-operative to adopt less than optimal investment decisions. Because members want to minimize or spread their investment risks, the co-operative feels the need to minimize capital retained in the co-operative.
- Also there is an internal portfolio problem when directors represent all members from young to old. The young tend to have more of an appetite for risk than the old. Directors tend to err on the side of caution and hence tend to reflect the appetite for risk by the more conservative older members.

#### 4. Control Problem

- Arises when the ownership and the management of the organization are vested in different people.  
i.e. shareholders and manager (CEO)
- Traditional co-operatives without a fair or market value share scheme are unable to measure the success of the co-operative by the change in share value.

- Managers do not own shares in the co-operative and hence do not have their own investment at stake, cannot participate in incentive share schemes.
- Often the interests of owners and managers diverge.

Thus co-operatives have additional costs associated with monitoring management decisions.

#### 5. Influence Cost Problem

- As co-operatives diversify and increase their range of activities, and/or with increasing diversity of members, there is greater scope for the interests of members to diverge.
- This in turn allows incentives for interest groups to form, within the membership, to try to influence the co-operatives operation to their benefit at the likely expense of other owners.

With the movement from production based strategies to market led strategies, meat processing/marketing co-operatives have become more capital intensive.

This, in itself, has raised significant issues. With the co-operative model it is more difficult to communicate capital investment signals verses production signals, back to the members through the traditional member user relationship.

Evans and Meade in discussing access to capital refer to Chaddad and Heckelal (2003) who summarize the main theoretical constraints that co-operatives face when raising capital.

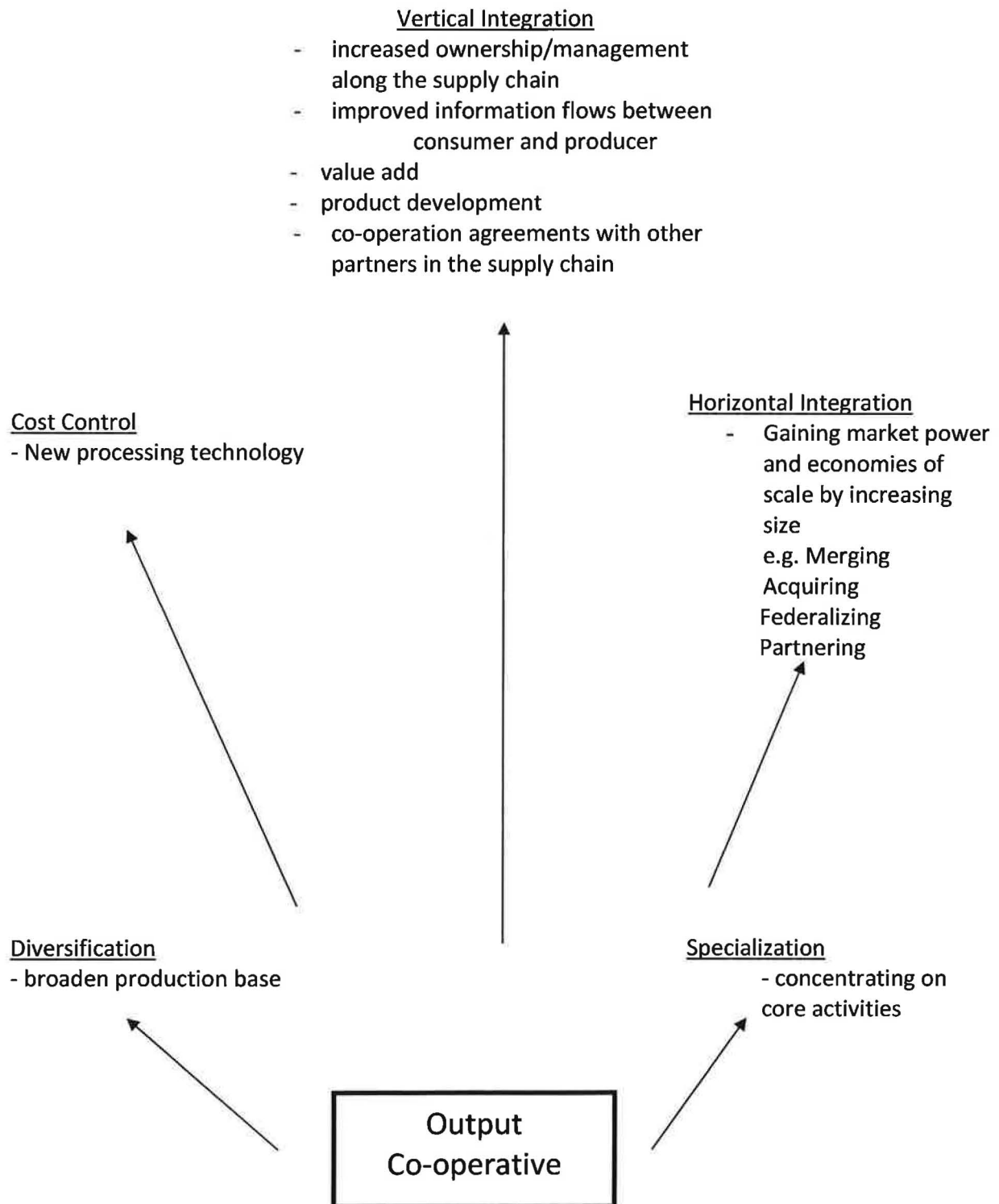
1. Co-operative residual claims (profits) are restricted to active owner patrons.
2. Co-operative members lack investment incentives due to vaguely defined property rights.
3. Co-operatives rely on internally generated capital as they have limited access to external funds.
4. Co-operative capital is not permanent.  
i.e. are subject to redemption, the risk of which increases when shares are valued at "fair market value".

### **Common Strategic Goals found in the Agricultural Marketing Co-operatives.**

Over the recent past, particularly the last two decades, co-operatives have had to shift to a market led focus, away from a production led focus. The pressure for this change has come about by:

- Changes in consumer demands/preferences.
- Technological developments
- Supply chain power shifts (consolidation of supermarkets)
- Globalization

In response co-operatives have adopted various strategies as outlined in the following diagram.



Some examples of strategic goals are:

1. Danish Crown - pork, beef based in Denmark.

Danish Crown has a corporate vision to make the company a strong player in the Danish market, first, and in the global market, second.

It has achieved this dominance by a process of merging with other Danish pork processors to become by far the largest pork processor in Denmark, whilst also adopting a focus on adding value, cost control, supply chain management and developing new processing technologies.

The co-operative also states that it aims to be a professional, engaged partner with the modern farmer, returning greatest possible returns on their livestock investment.

2. Vion Food Group – pork, beef and sheep meat based in the Netherlands.

Geert Jansen, CEO of Vion, explains issues within the European meat industry; “the European meat industry was threatened by the growing power of supermarkets, a fragmented farming industry, high competition and poor profitability”.

With this in mind Vion was originally formed by merging three meat businesses giving them the size needed to expand from, and have since acquired other meat co-operatives and companies.

They have a focus on the European market, cost control, and development of new products including consumer ‘ready made’ products.

3. Atria Group plc. –pork, beef, based in Finland

This companies' website has this quote; "strong consolidation in the retail sector creates challenge, in particular, for the smaller players in the meat processing industry whose negotiating power with the large consumer goods retail chains is clearly weaker than the bigger players. The key factors for meat processing industry competitiveness are sufficient size, efficient production, logistics and marketing".

Atria have expanded by amalgamation and acquisition, and have extended into co-operation agreements with partners in the value chain, for example supermarkets, to jointly develop new products for the consumer (ready made meals and fast food).

Atria has also diversified into other complimentary food lines such as bakery and catering/restaurant products.

4. US Premium Beef – beef, based in the USA.

USPB was primarily formed with vertical integration in mind. The promoters of this New Generation Co-operative wanted better communication, control and understanding of each segment in the value chain from rancher → feeder/finisher → pack house → marketer → retailer.

The company has a view that a good flow of information, both ways, along the value chain is needed so that breeders actually produce animals that supply the quality meat demanded by the consumer.



They believe that the farmer owners of USPB need to be committed to ownership of their company, and committed to consumer-oriented beef. They developed traceability systems so that market information can be relevant and actually gets to where it is needed. Livestock payments are based on a quality meat programme, rather than livestock auctions.

5. Goldkist – chicken based in the USA.

Originally Goldkist grew to become a very diversified co-operative, over a period of time, then reduced its wide portfolio to eventually concentrate on chicken. Size and ability to serve larger markets, in the US and globally, became extremely important for survival, so consolidation became the norm in the USA.

Goldkist grew its chicken business to eventually become the largest poultry business in the US, whilst expanding its export business. Goldkist also concentrated on developing processed chicken items, meals and delicatessen products.

6. Kerry Group plc – dairy, beef, food items based in Ireland.

Kerry originated from dairy co-operative beginnings, but in the 1970's decided to reduce its dependence on commodity dairy products and diversify into a wide range of food products. It achieved this by a very aggressive expansion program, acquiring many firms that sold branded food products, initially in Ireland, but later globally, so that now it is a truly diversified food business operating globally concentrating on consumer food products.

### **Mechanisms used to fund and achieve these Strategic Goals**

Bekkum and Bijman review some innovative capital and ownership structures which are now appearing in the co-operative sector.

1. Appreciable and/or internally tradable shares ("fair or market value shares"). The share value alters to reflect the changing worth or value of the co-operative over time. Therefore members benefit from some of the co-operative's value increase (or decrease) over time. This gives a much improved signal back to the members as to the value of their investment, and hence allows the co-operative to increase its share capital requirements and/or retain a larger portion of its profits.

As an aside, it does give shareholders a measure of the co-operatives performance over time and hence can focus senior management on overall co-operative performance.

Example: Fonterra on its formation in 2001, issued shares that

are:     supply linked

          non tradable

          interest bearing

          fair value (annually re-valued by directors based on an external recommendation. These shares have moved from \$3.00 each in 2001 to \$6.79 in 2008)

          hold voting rights (one vote one share)

2. Externally tradable sub-ordinate bonds.

This is an attractive option to raise external capital without losing member control. These bonds are classified as debt rather than equity on the balance sheet, and are tradable.

Example: PPCS, now Silver Fern Farms, issued two tranches of bonds. \$75 m NZ in 2002 and \$50m NZ in 2004. The 2002 bonds were reissued in 2007 and are due to be repaid in 2010, whilst the 2004 bonds are due to be repaid in 2009.

3. External corporate investors at subsidiary or group level.

This model is a form of the hybrid model, with the investor shares not listed. This model is becoming more popular and can be achieved as a special member or as a shareholder.

Example: Silver Fern Farms and Pyne Gould Guinness Wrightson Partnership arrangement, where PGW will receive shares in the Co-operative for a \$220m NZ capital injection, giving PGW a 50% ownership in the recapitalized Co-operative. There are various agreements in place, with this arrangement, to maintain the Co-operative structure and farmer shareholder "control".

There are many examples in Europe where banks have taken an ownership stake in the Co-operative in return for a capital injection.

4. Public Listing of Preferred Stock.

The public listing of preferred stock, rather than the common stock (shares) keeps control with the common stock holders (shareholders), which in the case of co-operatives, keeps control with the members. The preferred stock attract fixed dividends and therefore do not affect the 'performance' and 'patronage' based returns to the member patrons. This has become a popular option.

Examples: Dairy Farmers of USA listed preferred stock November 2004.

Pro-Fac/Birdeye Foods in October 1994.

5. Conversion into Farmer-owned Limited Liability Company.

In this model the member patron owned co-operative converts to an investor owned firm, whilst still remaining member owned. A variation of this is the model where the co-operatives have converted their commercial activities into a Limited Liability structure, sometimes as a subsidiary, but retained 100% co-operative ownership. This allows improved business level decisions by giving more freedom to the executive management.

(In the USA the conversion to a Limited Liability Company has seen many of these companies finally taken over, so can be seen as a possible exit strategy.)

Example: US Premium Beef originally set up as a New Generation Cooperative converted in August 2004. This company converted to improve investor orientation and for tax reasons. The original share structure and production linked internal tradability was not affected.

## 6. Converted Listed Co-operatives and Hybrid Listed Co-operatives

### a) Converted Listed Co-operatives.

As these Co-operatives list (on the stock exchange) they convert to shareholder companies, allowing the co-operative/company easier access to capital. As the shares are now openly tradable, it gives shareholders the ability to cash their share of the value locked up in the Co-operative. It is basically an exit strategy for the co-operative shareholders.

The decision to convert and list is often made in an environment where market conditions are nearer to perfect.

i.e. there is plenty of competition to guarantee producers market access and fair market prices for their products.

b) Hybrid Listed Co-operatives

There are many forms of this model, which often overlap with the External Corporate investor model. The difference in this case is the investor shares are listed. This model allows access to investor capital from non member patrons without fully converting to an IOF form.

The Hybrid co-operative in this model has two classes of shares, one being the standard member patron class of shares and the other being the investor shares, which are listed. The investor shares may not necessarily have voting rights.

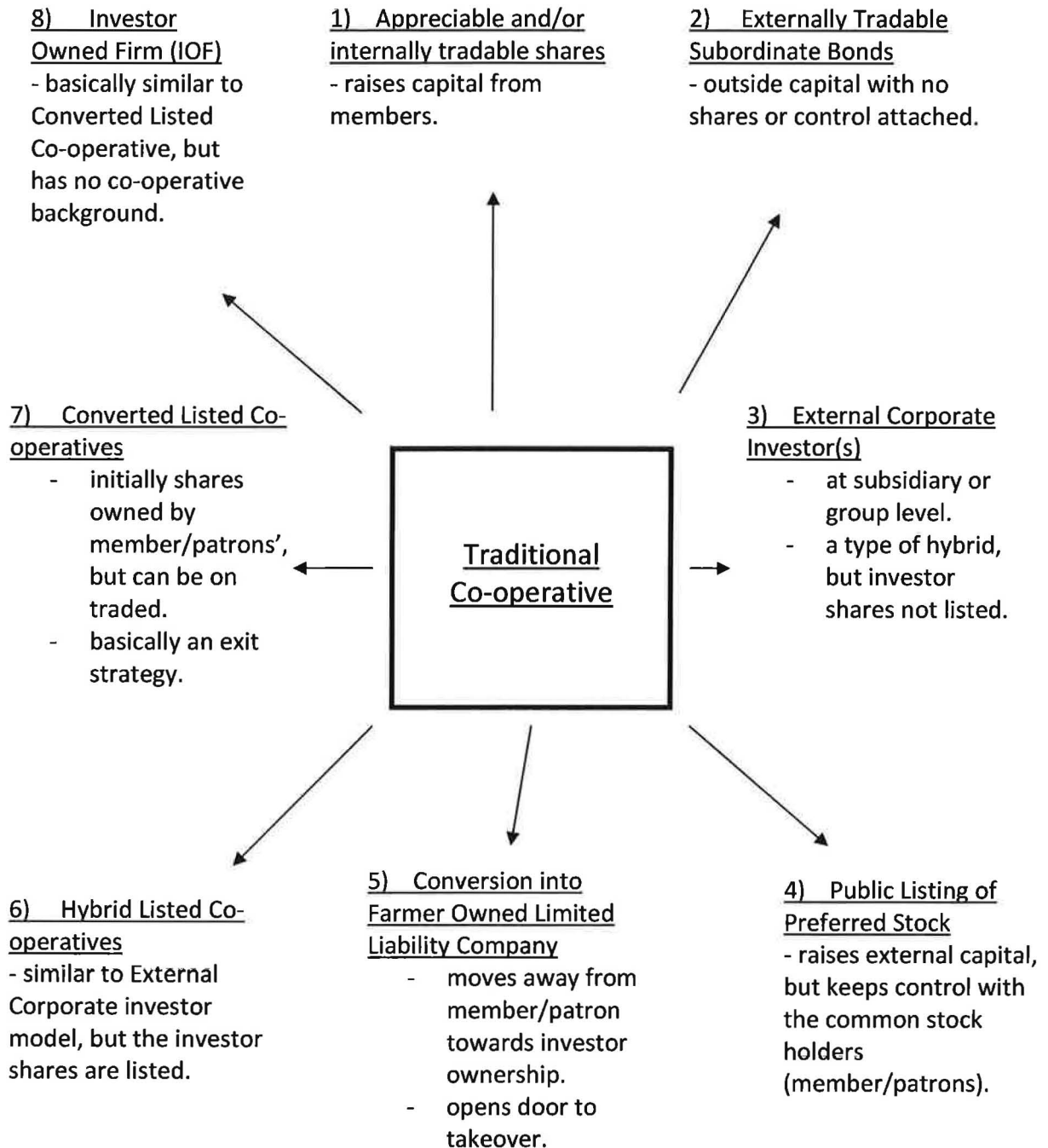
Example: Kerry Group initially floated 49% of its shares in 1986, and further floats have reduced the co-operative shareholding to no less than 20%.

Example: Atria Group plc was originally formed by three co-operatives combining, with the two largest retaining separate shareholdings in Atria. They own 58% of Atria, with the remaining 42% of its shares listed. The original co-operatives, in this structure, hold 92% of the voting rights.

Other variants of the hybrid listed model include the situation where a subsidiary is formed and some of its shares are listed. Often the parent co-operative remains a significant shareholder in the subsidiary with investors owning the rest.

Example: Dairy Farmers Group in Australia split its business in 2004 into a supply co-operative and a processing company. Initially 80% of the shares in the processing company were distributed to members, but could be sold on, with the supply co-operative retaining 20% ownership.

The following diagram gives another perspective of these co-operative models.





As you move in a clockwise direction, in the previous diagram, the co-operative gradually loses its close connection with its member patrons, and the member patrons increasingly lose control.

However, as you move in this clockwise direction, there are a wider range of opportunities to raise capital, to fund capital intensive goals and strategies.

Also, as you move away from the traditional Co-operative model towards the inclusion of investors, tensions arise between the requirements of the member/patrons and the investors. These tensions generally fall into two categories:

1. Tensions around control.
2. Tensions around the requirement of the member/patrons for maximum return on their products (in the case of the output co-operative) and the requirement of investors for a maximum return on their investment (often by way of dividends).

These highlight the dilemma that the modern output/marketing co-operative faces in the current globalized market place.

## Case Studies

Now, let us look briefly at a few co-operatives (mainly in the meat sector) who are examples of what has been discussed in this report.

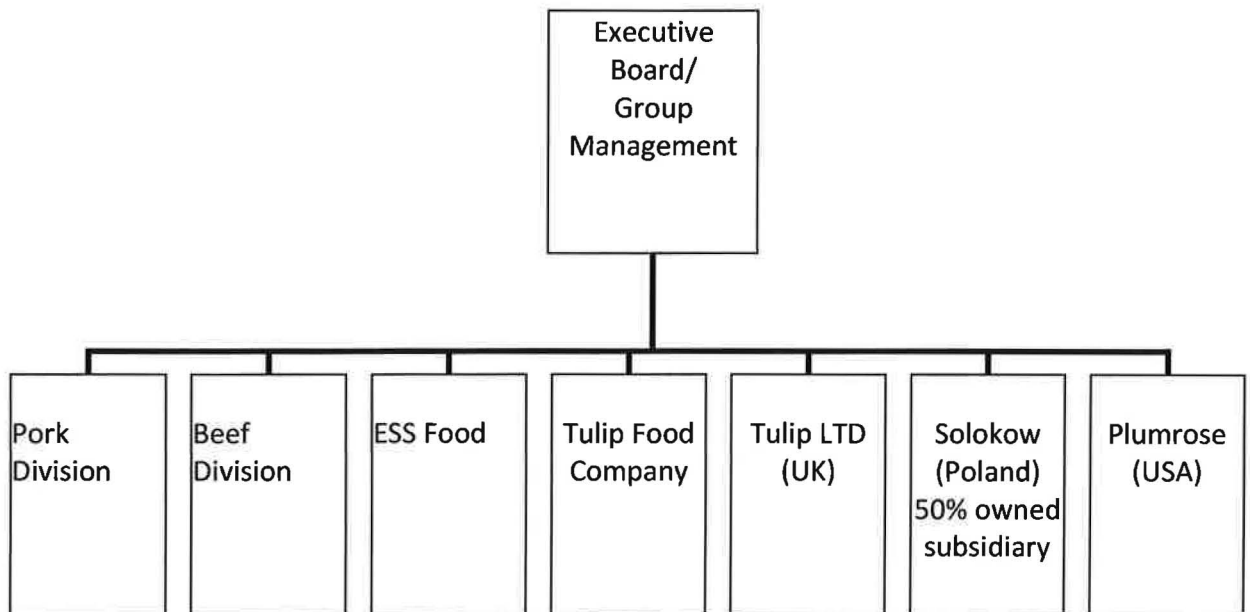
### Danish Crown ( Denmark)

The Co-operative 'Danish Crown' has been achieved by a process of merging the many Dutch pig slaughter houses over a period of years.

It now controls around 90% of Dutch pork production, and is the largest pig producer in Europe and third largest in the world.

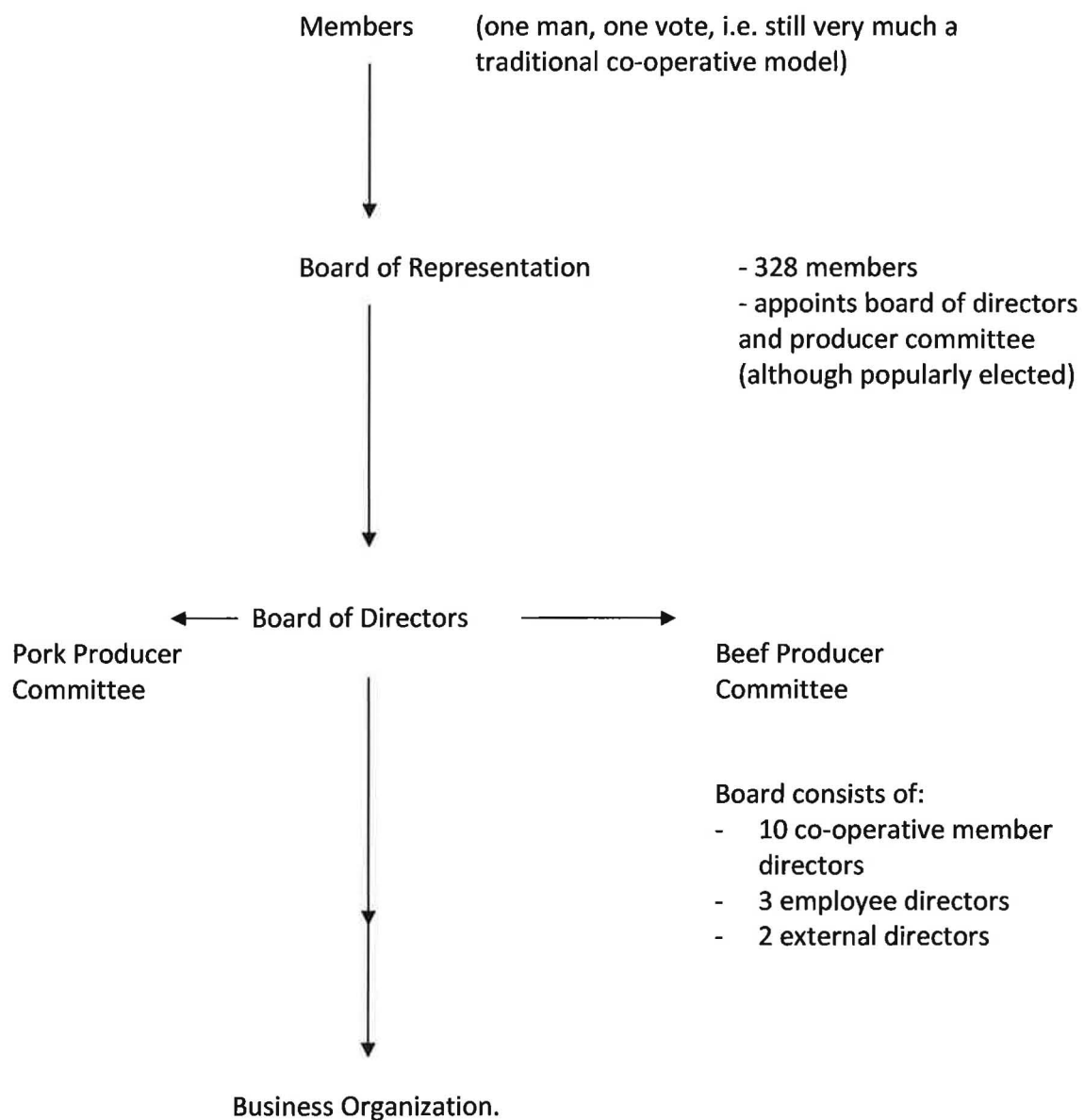
90% of its production is exported and/or processed outside Denmark.

Business Structure:



- Pork and Beef Divisions contributed approximately 50% of turnover
- Each division/subsidiary has its own board of directors and are not required to trade within the group
- There are many more partially owned subsidiaries.

#### Governance Structure:



### Turnover

2003	2004	2005	2006
5435m€	5960	6512	6507

### Vision/Strategy

- 1) First to be a strong player in the Danish market..
- 2) Second to be a strong player in the Global market.
- 3) Add value through product innovation and development.
- 4) Lower costs of production through adoption of best practice and technology.
- 5) To maximize member returns on their investment by maximizing returns on their livestock.
- 6) To be a professional, engaged partner for the modern farmer.
- 7) Vertical integration along the value chain, by keeping as many links as possible within the company.
- 8) Vertical integration along the supply chain including close relationships with its member suppliers
- 9) Involved in livestock genetics, etc, contract supply with specifications designed for specific markets.

Hobbs J.E. in 2001 wrote this;

“ Despite its (Danish pork industry in general) apparent production cost disadvantage, the Danish industry is extremely competitive in global pork markets, primarily because of its structure. Through close vertical and horizontal integration, the industry is able to reduce transaction costs, increase efficiency, and enhance the quality of its products. It is able to tailor products to specific market needs and to respond to the evolving demands of a range of different markets. The industries co-operative structure helps in achieving these goals by putting in place the vertical supply chain relationship necessary to facilitate the flow of information among various stages of production, slaughter and processing/marketing” .

Due to its dominance in the Danish pork industry, Danish Crown is taking over some of the roles of the Danish Pork Industry Organization “Danske Slagterier”, including: Market research, Breeding/genetic research, Technology development.

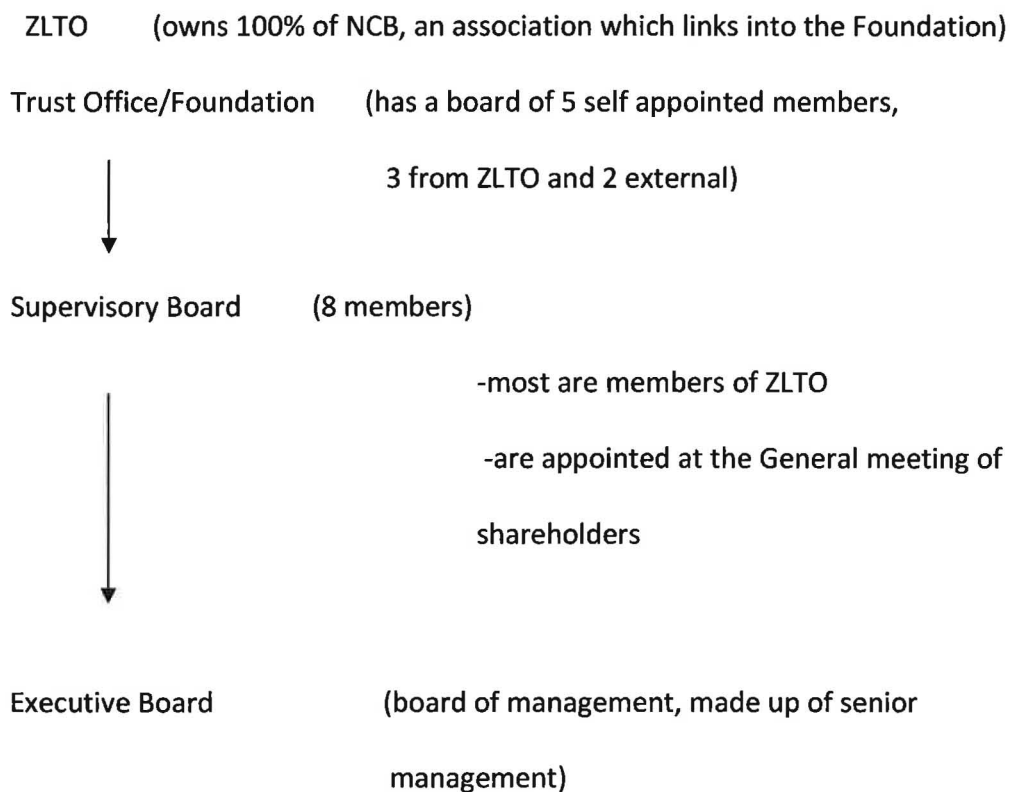
Danish Crown has achieved its goals of dominance, particularly with pork, by the process of merging with similar co-ops in Denmark.. It has also used borrowings to fund its expansion and product development activities .It currently operates on a relatively low equity of approximately 20% (2008).

### **Vion Food Group** (Netherlands)

Vion is a company owned by two groups, the largest, ZLTO, is a farmers union (similar to Federated Farmers of New Zealand), and a small holding by executive management.

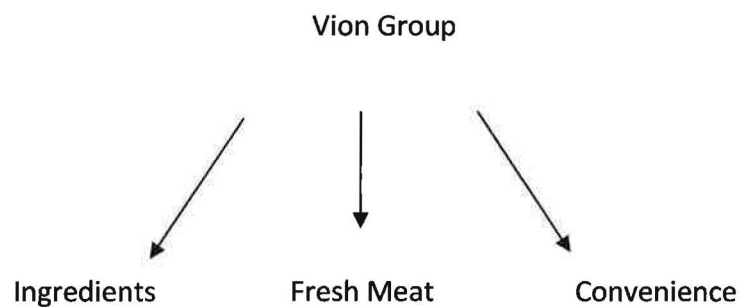
The company is a closed limited company, not listed on a stock exchange. Farmers are the ultimate owners, but basically have no ownership rights.

#### **Governance Structure:**



- Appointed at a general meeting of shareholders at the recommendation of Supervisory Board.
- This board runs the business.

Business Structure:



Turnover:

2003	2004	2005	2006
2875m€	5930	6285	7413

Vion was formed by merging the original companies Dumeco, Hendrix Meat Group and NZF. Since then it has acquired various companies in Europe and around the world. (currently owns Tatiara Meat Co. Australia's largest exporter of chilled and frozen lamb).

It has concentrated on the European market, which by global standards, is a large but condensed market, logistically easier to service.

Vion has broadened/diversified its product range to include:

- fresh and frozen meat products
- convenience foods
- health care and technical products based in natural raw ingredients.

Although Vion is fundamentally a Co-operative, its owners, being a farmers union, cannot distribute any profits back to its members. So the company has had the unique ability (in the co-operative scene) to retain profits, thus helping to fund its expansionary goals. They also operate on a relatively low equity, around 26% in 2008.

However farmer suppliers have benefited from their relationship with Vion by receiving premiums for their livestock, in 2007 a 6% premium above the average prices in the market for their pork, beef and lamb.

This company expanded by a mix of merging in the initial phases, then by acquisition. It has also diversified away from basic meat items, although they still remain the core of its business.

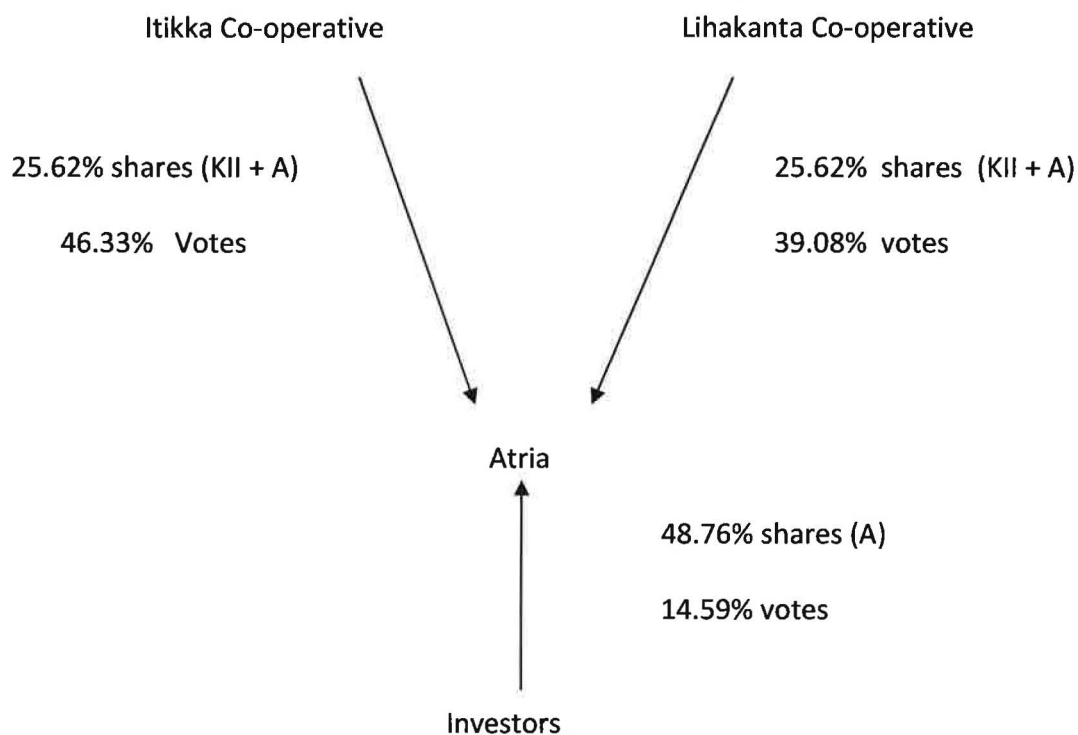


### **Atria Group PLC (Finland)**

Atria represents a form of Co-operative that is classified as a hybrid, with its investor shares listed on the stock exchange.

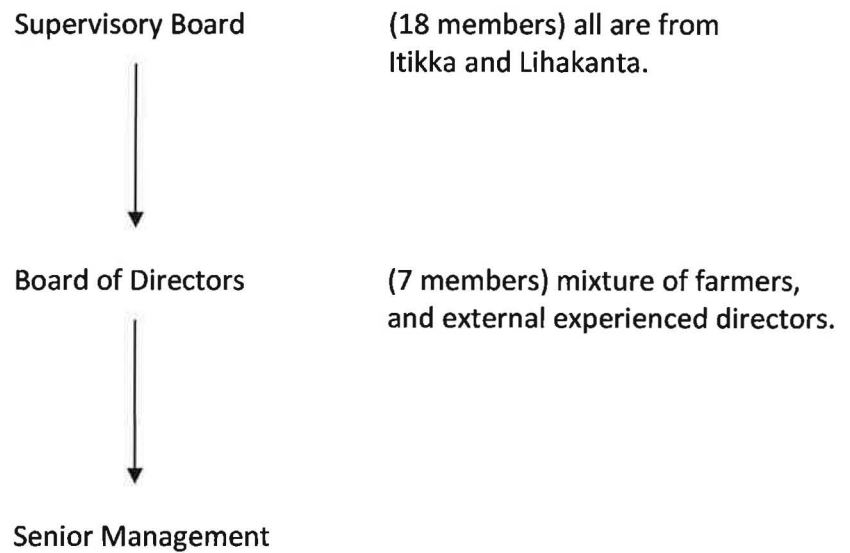
Originally formed in 1991 when two large regional co-operatives and a smaller co-operative effectively merged, although the larger two still retain separate shareholdings in Atria. i.e. a form of Federalization.

#### **Current ownership structure:**

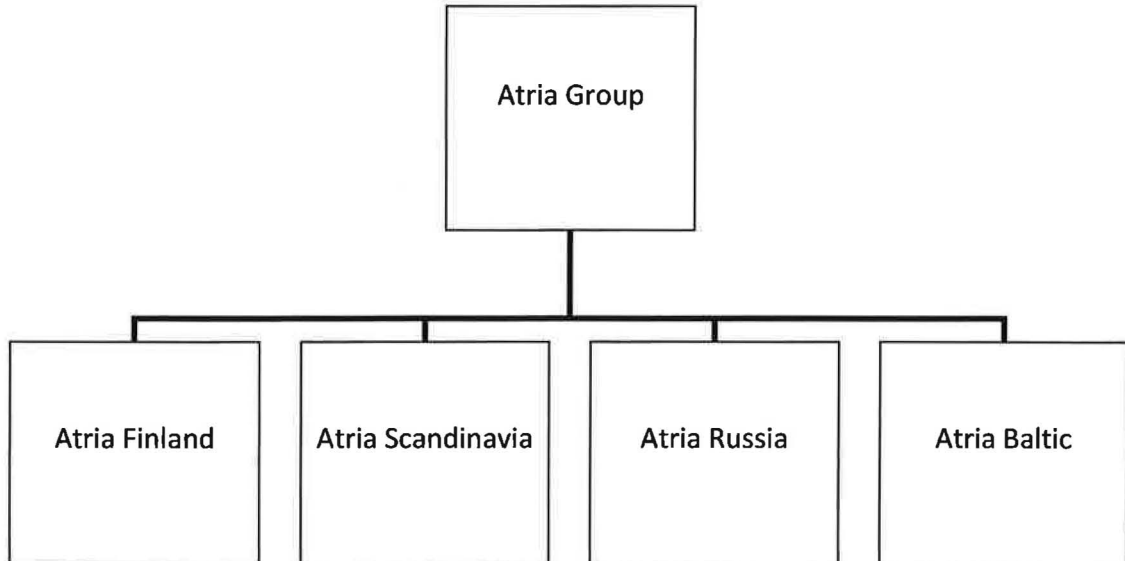


'A' shares attract first call on dividends and have 1 vote per share  
'KII' Shares have 10 votes per share and can only be traded with board approval.  
Strong shareholder agreements between Itikka and Lihakanta keeping their KII share ratios in tack and their respective ability to elect chair and vice chair of the boards.  
This effectively keeps control with the two co-operative owners.

Governance Structure:



Business Structure:



Turnover:

2003	2004	2005	2006
765m€	834	977	1103

Since its formation Atria has;

- issued investor shares to raise capital to:
  - a) position itself in the Finnish market
  - b) expand internationally
  - c) develop new products
- formed alliances with other business partners, including retail chains, through co-operation agreements to jointly develop new products, e.g. ready made meals and fast food.
- acquired various businesses in Scandinavia, Russia and the Baltic Region.

This Hybrid co-operative has used outside investor capital to expand, to gain power in the value chain, and has put considerable emphasis on developing new consumer products in close cooperation with its supermarket partners and clients.

### **US Premium Beef (USA)**

US Premium Beef is a New Generation Co-operative formed in 1996.

Briefly, a NGC is a closed co-operative (i.e. has a limited shareholding which is linked to patronage). New members can only enter by purchasing shares off exiting members, usually only with board approval. Cost of entry (level of shareholding) can often be high to reflect the capital needs of the co-operative.

USPB was formed:

- To improve the profitability of US Beef farmers, especially the cow/calf segment.
- In response to lack of market signals flowing back down the value chain to the breeders.
- To change member behavior from that of trading livestock at auction to being committed to consumer oriented beef.
- In response to the above factors leading to long term loss of market share for beef.

On formation, members were expected to capitalize the co-operative up front, rather than by retained earnings/profits. This, in effect, created a high level of commitment by the members.

USPB was originally set up as a marketing co-operative, but soon realized that control of the harvesting facility (processing) was preferred and necessary.

Therefore in 1997, USPB decided to purchase up to a 50% stake in Farmlands National Beef, a beef processing/marketing business, itself a subsidiary of the large Farmland Industries. USPB initially purchased 25%, but have since increased their share to an undisclosed level.

Farmlands National Beef is the fourth largest beef packer in the USA, with four well recognized brands and their own refrigerated display cabinets in store.

Together, they developed a beef tracking system, and export to Japan, Korea and Mexico.

By partnering and taking an ownership stake in FNB, US Premium Beef gained access to the consumer through existing brands and infrastructure. They were able to get the information (market signals re quality, quantity, product preferences, etc) back along the value chain to the farmers, and hence have an influence on breeder's decisions on:

- genetics
- supply patterns
- carcass attributes

(i.e. move away from commodity meat production).

The combination of a New Generation Co-operative (US Premium Beef) partnering with an IOF (Farmlands National Beef) appears to be a win win situation.

- 1) Farmers getting the market information they needed to alter their behavior (enabling them to move away from the commodity trade).

- 2) Farmlands National Beef connecting with and building a closer relationship with farmer/producers.

The latest move in the history of US Premium Beef was in 2004 when it converted into a Farmer owned limited liability Company, as discussed earlier in this report, with the share structure and internal links between patronage and ownership remaining unchanged.

### Goldkist (USA)

This co-operative has an interesting history. It originally started as the Cotton Producers Association in 1933. It soon grew and diversified into the supply side of agribusiness with an involvement in fertilizer, farm supplies and marketing poultry.

In the 1950's CPA's feed sales grew to supply the ever expanding poultry industry, dairy, pork and cattle farming. It built a network of feed mills to service this side of its business. Further diversification into peanut shelling and Soy crushing occurred to service its members in the late 50's.

In 1951, CPA purchased a Pecan shelling and marketing business which had the brand 'Goldkist'. The co-operative started using the Goldkist brand for its poultry products. In the late 60's the co-operative became known as CPA-Goldkist and finally in 1974 became Goldkist Inc.

By the 1980's its primary business segments were:

- farm supply stores
- poultry
- peanuts
- pecans

By the 1990's it had grown to surpass \$2m US in sales and had accumulated over \$40m US in shareholder equity. Despite the see saw in agricultural commodity returns,

the company and its members have experienced over the years, Goldkist has been successful due to its co-operative status and its diversified business, operating both on the supply and marketing sides of agribusiness. It tended to isolate its farmer-members from the market risk associated with commodity markets.

During the 1990's some fundamental changes occurred in US business, where size and ability to service the larger internal and global markets become extremely important. Consolidation became the norm in the US industrialized base. US farmers realized that 'economies of scale' was one of their defenses against globalization and stagnant commodity prices.

Goldkist decided to consolidate and pursue growth in Farm Supplies and Poultry. It became the largest poultry processor in the US and gained recognition as a quality poultry supplier to foreign countries.

Farm consolidation was occurring at a pace putting the farm supplies business under pressure. In 1998 GK sold its loss making Farm Supplies Business to Southern States Co-operative. During his time is also withdrew from its share in the Golden Peanut Company.

By 2002 Goldkist had consolidated its original, diversified, business portfolio to concentrate on poultry. It developed new products, to the point where whole chickens



virtually disappeared off the supermarket cabinets, being replaced by chicken parts and further processed chickens products.

In 2004 Goldkist converted from a co-operative to a "for profit stock listed company".

In 2006 it agreed to merge with Pilgrims Pride and by 2007 the company had been swallowed up into Pilgrims Pride.

This co-operative/company is a story of early success by diversification, but as US and world markets changed and pressure came on with global competition, it, like many other businesses at the time, consolidated and concentrated on one segment becoming dominant in that sector. Capital constraints, and no doubt other issues, forced it to become a PLC which was finally taken over by a larger business.

Kerry Group PLC (Ireland)

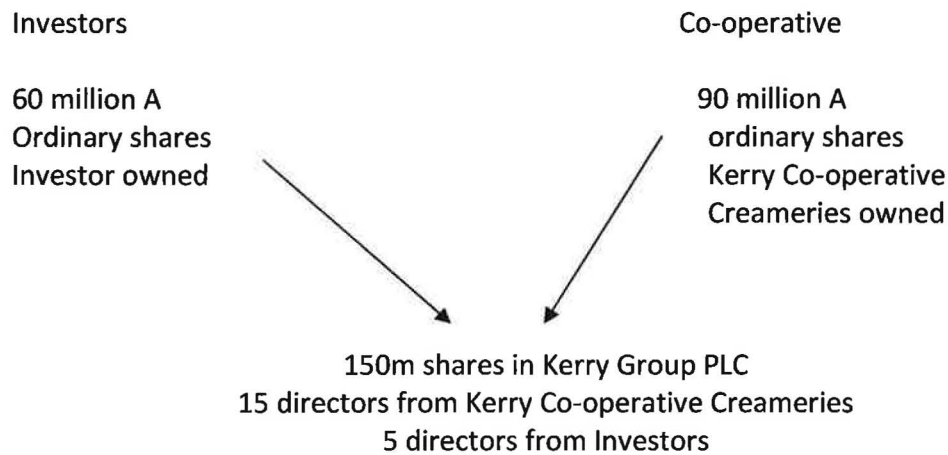
Although this company originated in the dairy sector, through its growth and diversification over the last four decades, it has become a diversified food company involved in ingredients, dairy, pork and beef processing.

Originally started as Kerry Co-operative Creameries in 1974, it came under milk supply pressure in the late 70's due to an Irish brucellosis eradication program which effectively reduced dairy cow numbers at that time.

The Co-operative identified two options; merging or diversification. It took the latter as its preferred pathway and during 1979/80 acquired nineteen Irish firms that sold branded food products.

In 1986 the co-operative exchanged its assets for a majority holding in a Publically Listed Company (PLC). This allowed the company to obtain capital needed for its expansionary goals. The Kerry Co-operative retained a majority shareholding in the new Kerry Group PLC.

The Hybrid co-operative structure took this shape:



Adopting the Hybrid model allowed Kerry to achieve the following:

1. Capital growth
2. Tradability of its shares
3. Share value reflecting the value of the business.

All three had been requested by the co-operative shareholders as their investment grew in the organization.

In 1996 Kerry Co-operative agreed to reduce its shareholding to below 51% but no less than 20% in Kerry Group PLC, to allow the company to float more shares in order to raise further capital.

The formation of the hybrid co-operative model allowed Kerry to accelerate its expansion and overseas acquisitions. Its' focus on overseas expansion was validated in 1984 when the EEC imposed the dairy production quota, effectively limiting expansion in the dairy sector.

Kerry managed the “control tension” by the constitution of the board, having a majority of farmer directors.

The tension around produce prices and investment returns was reduced by procurement competition ensuring a competitive milk price, and also their farmer members benefiting from their investment returns, both share price appreciation and dividends.

Kerry Group PLC is now a global, diversified food business with the original Kerry Co-operative Creameries holding a minority shareholding in the company. The farmer shareholders have benefited from a significant appreciation in the value of their shares. It has been said that the Kerry business is so diversified now that it can afford to pay as high a milk price as it needs to (a form of cross subsidization). However there is a risk to its original farmer suppliers that there is no longer a guaranteed outlet for their milk, although in practice this has not ever been an issue.

Recently Kerry has been less successful with proposed acquisitions, being outbid by competitors. Some commentators suggest that Kerry Group may well become an acquisition target itself.

**Silver Fern Farms** **(New Zealand)**  
(Originally PPCS)

Originally set up as a red meat marketing co-operative in 1948, it relied upon other meat processing companies to 'toll' process its member's animals.

Difficulties arose around product specification demanded by the marketer, PPCS (Primary Producers Co-operative Society), for its customers and the toll processors being willing to supply.

Deregulation of the New Zealand meat industry and industry rationalization in the 1980's and 90's caused further tensions between the marketer and processors.

In 1982, PPCS purchased 'Canterbury Frozen Meat', an IOF which was struggling financially. Other processing facilities were acquired during the 80's and 90's when 'Fortex' and 'Waitaki' collapsed and in 2004, PPCS purchased 'Richmond LTD'.

These acquisitions enabled PPCS to grow to become New Zealand's largest meat processor and marketer with a turnover of just under \$2b NZ in 2007. With the Richmond purchase it inherited a \$75mNZ bond. It raised further capital by way of another \$50mNZ bond in 2004 and bank debt to fund these acquisitions. The expected increase in new shareholders with the Richmond takeover, particularly from the North Island, did not really eventuate. Thus the injection of new capital did not occur and

along with the whole New Zealand meat industry going through two years of poor product prices, the co-operative announced a \$39mNZ loss and only \$37% equity in 2007.

2008 saw the co-operative change its name to Silver Fern Farms, as part of its business transformation, the goal being the adoption of a “plate to pasture” model moving away from the “through put” driven model. It also closed several processing facilities to better match capacity with projected stock supply.

On September 8<sup>th</sup> 2008 shareholders voted in favor of the co-operative forming a partnership with Pyne Gould Guinness Wrightson (PGW), a New Zealand IOF with roots in the New Zealand farm supply and stock agency agribusiness sector, whereby PGW will pay \$220mNZ for the issue of investor shares in the co-operative, giving PGW a 50% ownership stake in the re-capitalized co-operative. This will effectively change the co-operative from a relatively traditional model to a hybrid, and increase the co-operatives equity to around 80%.

Partnership and constitutional agreements between the two companies will maintain farmer shareholders’ relative control.

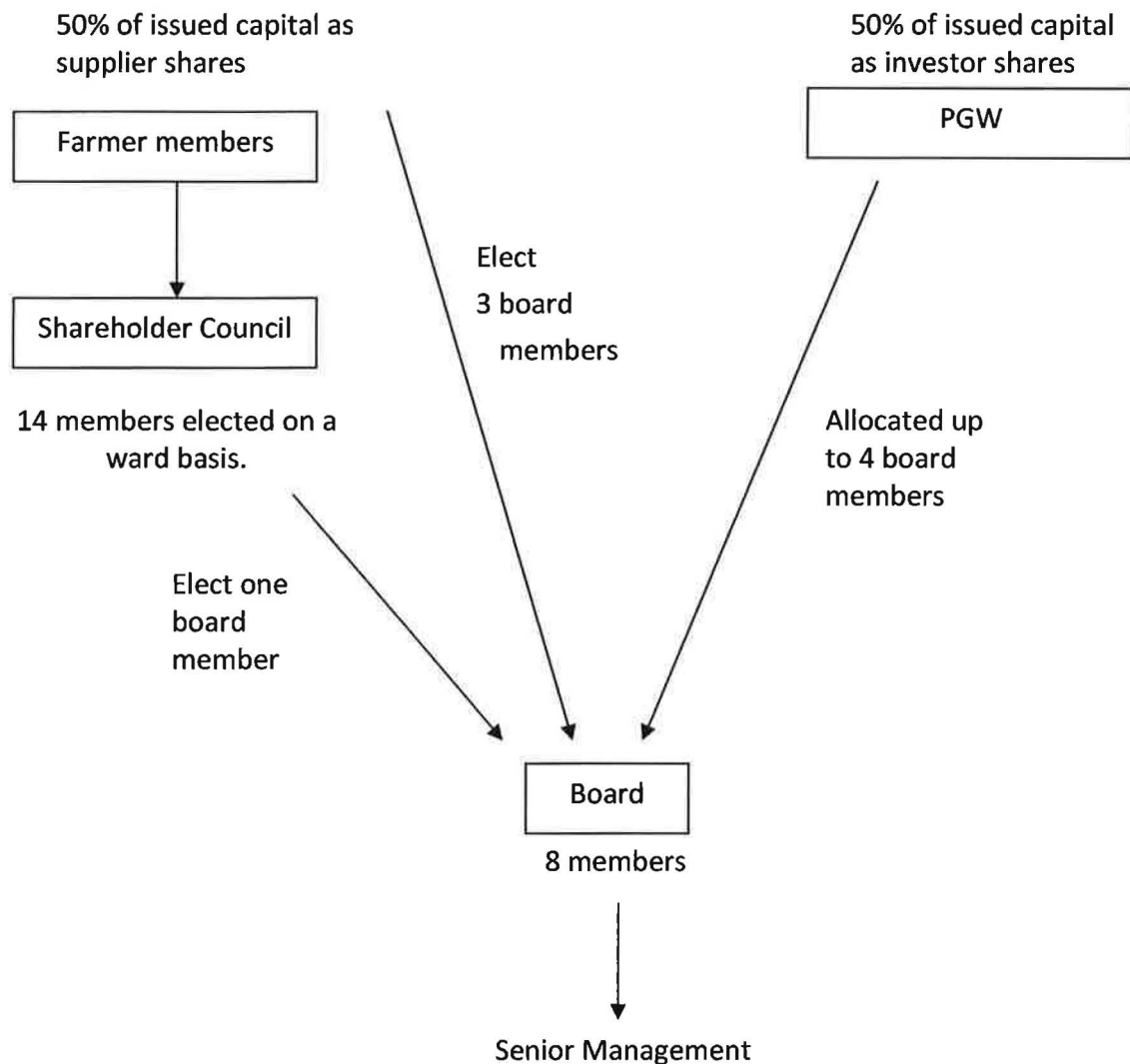
This latest move by Silver Fern Farms, dovetails well with the name change and restructuring that had previously happened in 2008 and is expected to hasten the co-operatives achievement of its goals, being:

- the change to a market focused (plate to pasture) operation
- earlier adoption and installation of new robotic processing technology
- more resources used to develop new markets and new consumer products
- brand development and enhancement
- a move away from a bulk processor who takes in any livestock to process, to a processor which has a much closer relationship with its farmer suppliers, with supply contracts reflecting the demands of its various customers, e.g. specific market/customer supply contracts which may have different specifications
- and finally, but not least, the desire to achieve further meat industry consolidation in New Zealand, so that the New Zealand meat industry can compete, in the globalized markets, with the consolidated supermarkets, i.e. a response to the supply chain power shifts.

Silver Fern Farms will take the opportunity with their major change in ownership structure to institute two other significant changes:

1. Original 'nominal value' shares will be changed to 'market value' shares, as well as the cap on farmer member shares being significantly lifted to 100,000 shares dependant of each member's level of business with the co-operative.
2. Institution of a shareholders council.

### Proposed Structure:



Foot note: The Silver Fern Farms/Pyne Gould Guinness Wrightson partnership proposal was terminated at the end of November 2008 due to PGW's inability to raise the funds needed to pay for the purchase of the shares. The global credit crisis (October 2008) was not foreseen and that alone created insurmountable problems in raising the capital. The two parties are now in discussion to see if there are any other suitable proposals that would have the same desired outcomes of vertical integration and industry consolidation.



## **Conclusion**

To answer the question; “what mechanisms are available for Agricultural Meat Marketing Co-operatives to achieve/fund their strategic goals”, this report initially briefly discusses the fundamentals of co-operatives and their main structural issues/constraints, then moves on to discuss the key goals and strategies found in the global agricultural meat marketing co-operatives.

The main section covers the common mechanisms available, and used to fund these goals and strategies, then finishes with some brief case studies, with particular attention to the meat industry sector.

The common goals and strategies invariably revolve around and include a mix of:

1. The desire to expand to gain economies of scale and increased power in the value chain.
2. Development of new consumer products including “ready made meals”, fast food, etc. i.e. adding value.
3. Development and enhancement of their own brands.
4. Development of new technology.
5. Diversification (in some cases).

All these goals/strategies have a high requirement for capital which has led to an array of solutions to raising this capital. In the co-operative sector some of these

solutions are structural, all are applicable and the model(s) any one co-operative uses reflects their unique circumstances. There is no one best model that fits all.

These solutions/mechanisms include:

1. Simply borrowing capital in various ways.
2. Federalizing and/or merging.
3. Hybridizing.
4. Listing portion of their share capital.
5. Full conversion to a farmer owned limited liability.
6. Conversion to a listed co-operative
7. Conversion to an investor owned firm (IOF).

As co-operatives move away from the more traditional model to the models that include outside investment, they gain a wider access to investment capital, but they also develop tensions between the farmer members and the investors.

Also the risk of losing the co-operative increases, the further they move away from the traditional model.

The tensions that can develop, particularly in the hybrid models, revolve around:

1. The farmer members desire for maximum returns for their products, whilst investors desire for maximum returns on their investment.
2. The tension around effective control of the co-operative between the farmer member and the investors.

The success of these many non-traditional co-operative structures, which involve outside capital will depend on, in part, how well these tensions are managed with clear and well understood heads of agreements between the different groups of owners, and robust constitutions.

It is apparent in the global scene, that there is a lesser presence of the co-operative model in the meat sector than in the dairy sector.

This can be explained by the fact that meat producing farmers are not under the same pressure to own a stake in the value chain, as dairy farmers are.

Animals, once ready for slaughter and processing, are not perishable, giving meat producing farmers a larger window of opportunity to sell their animals. Whereas in the dairy sector, milk is produced daily and once in the dairy shed vat, is perishable. So dairy farmers feel a very real need to have a guaranteed outlet for their milk, hence ownership and control of their processing company.

Historically, meat farmers have had less ownership in their processing sector, and in fact have tended to 'play' the procurement market to gain some short term advantage. Arguably, this has been to the detriment of the medium and long term advantages that can be gained from a more controlled/planned participation in the value chain.

Ironically, once milk is processed into its many consumer and ingredient products, it has, in many cases, a relatively long 'shelf life'.

On the other hand, as consumer preferences have changed away from frozen towards fresh and chilled meat products, meat, once processed, is tending to have a much shorter 'shelf life'. Also, meat is dominantly a consumer product, with little used as an ingredient, limiting its market range. So it is not surprising to see a move in the meat industry sector towards closer relationships in the value chain. The call for each sector in the meat value chain to better understand and align with each other is becoming common.

The meat sector historically has had difficulty in persuading farmers to invest or increase their investment in their processing/marketing companies. Meat companies have had little guarantee of supply of livestock to process and market and they are facing power shifts in the value chain.

The co-operative companies in this sector are reacting by:

- combining to increase economies of scale and rebalance power in the value chain,
- developing closer relationships with partners in the value chain from producers to consumers,
- developing new consumer products
- developing and promoting their own brands
- and moving towards less traditional structures to access capital, which is needed to fund their strategies and goals.

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