



## COOPERATIVE COMBINATIONS AND FIRM GROWTH

Mergers, consolidations, acquisitions, and federations are not new to agribusiness cooperatives. Over forty years ago agricultural economists such as Frank Robotka, A. W. Colebank, and A. C. Hoffman were urging cooperative creameries in Iowa to consider extensive reorganization and consolidation. Over the years, numerous cooperative leaders, management consultants, bankers, university researchers, and government employees have voiced similar views and contributed much to the long history of such cooperative combinations. In an earlier publication this author reviewed the so-called "urge to merge" and discussed such actions as alternatives to firm growth. Yet to many, cooperative activities along these lines remain feared, misunderstood, and confused. Some view a prospective combination as a last remaining move for cooperative survival, while others are truly fearful of such an action because of the expanded market influence resulting from a successful combination. Regardless of how you view cooperative combination, the agribusiness industry is still characterized by such actual or contemplated actions. Few managers pursue their entire professional careers without becoming exposed, directly or indirectly, to a cooperative combination.

The objective of this discussion is to clarify the various types of cooperative combinations. I shall also review those economic and market-related factors which provide the incentives for the pursuance of such combinations. Finally, I shall attempt to

address those procedures and problems unique to the successful completion of a cooperative combination.

### When Is A Merger A Merger?

It is not uncommon for agribusiness managers to use the word "merger" as a very broad term referencing several alternative forms of cooperative combinations. For purposes of convenience I shall also use the term in its broadest possible sense. Yet for purposes of an in-depth look at alternative combinations, the following definitions shall apply.

*Merger:* Involves the absorption of one firm by another, with only the acquiring firm retaining its identity.

*Consolidation:* Sometimes is also referred to as an amalgamation and is used to describe the situation where two or more previously independent concerns combine in such a fashion that each loses its prior identity and a new organization is formed.

*Acquisition:* Refers to the outright purchase of all or part of one firm by another.

*Federation:* A cooperative combination whereby two or more firms joining as co-owners and members of a (third) single company, while retaining their separate cooperative identity and individual ownership structure.

Despite the differences above, one principle is common to all alternative forms of cooperative combinations; i.e., instead of growing or expanding by adding to its own business volume and/or facilities by building new capacity and/or securing new customers,

a firm increases its size by acquiring, joining, or otherwise gaining some control over the sales of other firms.

### **When Is A Merger Viewed As An Attractive Option?**

One of the fundamental duties of cooperative management (including directors) is to always remain alert to all business situations, which indicates that a combination with one or more other cooperatives may be desirable or necessary. Basically this means a continuous and complete searching analysis of the cooperative's competitive position must be undertaken. And what factors must cooperative management stay particularly alert to? The following list is not meant to be all-inclusive, but will provide some insights to this searching process.

*Market Power:* On the selling side - is the cooperative's share of the relevant market large enough to modestly influence prices and/or establish a more favorable climate for market penetration and product acceptance? On the resource purchases side - can the cooperative buy in sufficient quantity to obtain cost advantages or discounts equal to those secured by major cooperative (and corporate) competitors?

*Operating Efficiency:* Are your processing, storage, marketing, or handling costs competitive? Of special concern here is a consideration of whether or not additional volume would further reduce these costs, thereby producing greater savings or returns for your patrons. This analysis is of particular importance to the cooperative operating at less than full capacity, or that firm contemplating a major capital expansion program.

*Management Capacity:* Is the cooperative organization large enough to be able to afford competent management personnel in all key positions? In addition, it must consider the general depth of top- and middle-management personnel to ascertain whether a cooperative combination would

overtax the existing pool of management skills and abilities.

*Financial Strength:* Is the cooperative adequately capitalized? Does it retain enough reserve financial resources in the form of untapped equity or borrowing capacity to: (1) support its current operational base, (2) expand or improve on its operational base in accordance with the perceived needs of the combination, and (3) withstand a prolonged financial strain resulting from unforeseen market setbacks, aggressive competitive counter-measures taken against the combination, or some other related contingency.

*Environmental Change:* The agribusiness industry is in a constant state of change. Components of this dynamic environment which management must be made aware of include: (1) the evolution of new marketing methods and patterns, (2) the composition of cooperative membership by number, age, and producing preferences, (3) federal farm programs and related institutional/political constraints, and (4) the development of new products or new uses of old or existing products.

### **Reviewing The Pros and Cons**

Those factors described above and other related questions arise time and time again as mergers are considered and/or evaluated. By far the most dramatic and observable impact of a cooperative merger (or combination) is that related to the rather sudden change in the size of the resultant business entity. Mergers or combinations result in fewer, but larger, organizations. It would seem obvious, therefore, that major arguments in support of or against mergers relate directly to the increased size of the cooperative.

Adjustments to the size of a business entity introduces a concept that is very dear to the hearts of economists; i.e., "economies of scale." In practical terms, it is economies of scale which, given an increase in size, make

it possible for the business to increase its returns by conducting its business operations at a lower per-unit cost. As applied to cooperatives, such economies of scale may facilitate two actions: (1) it will enable the business to become more efficient at performing those functions or providing those products and services already engaged in, or (2) the growth in business volume may provide the business with function, product, or service opportunities never before available to it.

**Product and Market Advantages.** The combined business volume normally resulting from a merger will enable most cooperatives to reduce per-unit costs. Such product-related advantages are significant if the pre-merger firms were operating at less than full capacity. Similarly, if either firm was anticipating the construction of a new plant or processing facility, the merger would generate the greater volume of business over which to more broadly distribute the major fixed expenses associated with the construction.

The increased volume that results from a merger will also likely provide for the cooperative an increased market influence - be it the market for raw products and productive resources or the final product market. The market power attributes associated with large volume sales or purchases are well-known and understood. Quite obviously, the size of the total market, itself, has some impact on this relationship. As the market becomes more highly specialized, or as the merged cooperatives' share of the total market increases, so does the firm's ability to participate in that market to its greater relative advantage increase.

Improved quality control is another product-related merger advantage often overlooked by cooperative management. The larger cooperative resulting from the merger may now be able to justify an active quality control function where none existed previously. Perhaps as a result of larger scale operations, a firm may have the

opportunity to purchase on a specification basis. Higher quality inputs and enhanced production expectations, together, should contribute to qualitative improvement.

**Service Advantages.** Similar to the product-related advantages, increased firm size may enable some cooperatives to either provide many member services more efficiently or undertake new ones that previously would not have been possible. For example, the expanded volume may justify the construction of additional storage facilities or measurably add to the existing fleet of transportation vehicles. Credit might now be provided and/or secured where before it could not have been justified.

Expanded volume and economies of scale may provide the basis for providing or improving on such services as fertilizer application, petroleum delivery, spraying, custom machinery use, feed grinding, and in-field servicing of equipment needs. Providing a fieldman to accompany the product is often a service which becomes more feasible as the cooperative becomes larger.

**Facilities Advantages.** Numerous manufacturing or processing activities cannot be accomplished unless business volume reaches some specified minimum. The effective operation of complex technological equipment requires some minimum throughput of product. Such minimums associated with such activities as food processing, fertilizer manufacturing, and feed mixing or grinding are well-known and exceed the requirements of many smaller cooperatives. Merger may make it possible to meet these facilities' minimums. A merger may also enable cooperatives to write-off outmoded facilities and replace them with more modern and efficient plants or processes.

**Finance Advantages.** Quite obviously, a stronger financial position for the cooperative can frequently be achieved by a merger. In fact, such finance-related matters may

provide the major incentive behind the merger, particularly where the merging firms recognize that raising large amounts of expansion capital is important to their future.

Improved financial condition, of course, is related to many other aspects of the cooperative's operations. For example, any attempt to broaden the product line, expand services, improve quality control, or add to productive capacity are often achieved only via the cooperative's ability to marshal the necessary financial resources. Finally, it must be noted that it is only the strong and well-financed cooperative that will generally be in a position to attract and train talented personnel and conduct a credible job of member and/or public relations.

**Potential Disadvantages.** Size is not an end in itself. Business growth, alone, is rarely the paramount goal of farmer cooperatives. Furthermore, just as economies of scale reference the advantages of growth, a good economist must also acknowledge the existence of so-called diseconomies of scale. Such diseconomies suggest that under some conditions size may contribute to higher rather than lower costs.

This entire matter of merger disadvantages suggests that the size where a cooperative operates most effectively is closely related to the competency of its management team. It suggests, further, that most factors contributing to diseconomies of scale are related to human behavior. Quite clearly, the competency of management in dealing with the problems of a merger will very likely determine that point at which efficient operations collapse into slow, cumbersome, and inefficient performance. Stated a little differently, as the demands on management increase as a result of a merger and first begin to exceed management's abilities, it is at that point that so-called diseconomies of scale begin to exert a significant influence. If the merger involves the assimilation of broadly scattered facilities or diverse activities, this point of management failure may be reached early as supervision and

control become increasingly more demanding. In other cases, the merger, itself, initiates a sudden confrontation with bureaucratic constraints and an endless stream of red tape. To the extent that such a confrontation was unexpected and ill-prepared for, merger costs are significantly increased.

### **The Human Element in Mergers**

The previous discussion might suggest that if cooperative merger considerations were confined exclusively to the field of economics, the decisions would be relatively simple. At least within this format, most matters can be quantified and subsequently judged as to what is or is not in the best interest of cooperative members. Unfortunately, we too often forget that cooperatives are organizations comprised of people. As so constituted, these organizations are thoroughly and sometimes dramatically impacted by human behavior.

How does human behavior relate to the topic of cooperative combinations? It is most common that we describe human behavior in relation to what is or is not rational. If we assume that human behavior is generally "rational" and that people will attempt to protect and promote their own best interests and those of society, then the impact of the human element on mergers is likely to be negligent. Unfortunately, this assumption is a terribly precarious one as it applies to cooperative combinations. Many people do not, in fact, act in their own best interests and in other instances, individual interests may be contrary to the interest of the group of which they may be a member. Quite obviously, man is a complex being despite the many advances of the psychological sciences, we still do not understand too well the many things that motivate him. As suggested by the iceberg theory, not over 10 percent of the things that motivate people are above the surface and can be readily described.

In my own studies of and participation in cooperative mergers, I have viewed all kinds

of behavior on the part of management, directors, and the membership. Problems involving the human characteristic of pride and jealousy are among the most difficult to deal with in a cooperative combination. Representation on the new "merged" board of directors often becomes a matter of paramount importance. While everyone involved will freely admit that combining the two existing boards results in a new board too large to function successfully, no one is anxious to sacrifice his position, the associated prestige, nor the implied political base. Tact and diplomacy are required as some attempt must be made to rapidly assimilate the two teams into one of manageable size. Pride of ownership or association cannot be underestimated and must always be considered. Longstanding local rivalries and jealousies must be uncovered and confronted at an early stage if the merger proceedings are not to be sabotaged at a later date. The more a member has contributed toward the success of his cooperative by his investment of time, energy, enthusiasm, faith, trust or money, the greater will be his pride of membership. This cooperative spirit can be positively employed by involving this individual in the planning or some other phase of the merger procedure.

Reduction in personnel usually is at least a part of the general incentive to merge. Only one general manager can be employed by the merged organization. The same is true of many middle-management positions. In some situations, the problems of personnel displacement can be alleviated by such means as generous termination pay, limited term employment contracts, and early retirement packages. Very often, the desire to preserve the status quo and thereby preserve their positions, is a very strong urge and may cause the management team to assemble solid resistance to a merger proposal. In some industries, this resistance may penetrate right down to the unionized plant employees.

## **Overselling and Misinformation**

My own experiences suggest that there do exist two major "human factor" problems associated with cooperative mergers, but they are rarely discussed.

A real significant problem can result from the practice of overselling the attributes of merger and, therefore, overselling the characteristics of the resultant new cooperative. Members are sometimes led to expect too much from the newly formed organization. As expectations exceed actual performance, membership support drops, making it even harder for the firm to maintain efficient and effective operations. Those who become prophets of doom, therefore, become the major vehicle through which their prophecy is subsequently fulfilled. Cooperative members should be made fully aware of the fact that a cooperative is a legal form of business organization engaged in economic activities. To be sure, cooperatives retain certain ideals of democracy, social consciousness, and respect for human values that are not so overtly upheld by other forms of business organizations. Yet, the member should not be led to believe that cooperatives can solve all problems, right all evils, or adjudicate all grievances. They must view their cooperative as part of a free and competitive capitalistic economic system and not as a reform agency, a welfare institution, or a charitable society. They must assess the merger and the resultant new cooperative within a realistic criteria where efficiency of operations and service to patrons become the important factors. If their expectations exceed the parameters of these two criteria, few members will be satisfied with the end product of the merger and many will become rapidly disillusioned.

Misinformation is the second major pre-merger problem I have encountered. The extent of this misinformation is often limitless -- extending from gossip surrounding the various incentives to merge to libelous statements regarding the surreptitious actions of the manager and/or individual board

members. In a tense situation such as that which normally surrounds a merger consideration, the manager and his board of directors share the responsibility for establishing and maintaining a good membership information program. Honesty, integrity, and an effective communications vehicle are the only tested elements useful in combating those problems associated with misinformation. It requires that management and directors spend an ever-increasing amount of time communicating directly and indirectly with members. Such communication must stress facts and minimize speculation; it must emphasize an accurate portrayal of merger prospects while not becoming deeply embroiled in emotional or less substantive issues, and it must answer member concerns honestly and without bias.

### Summary

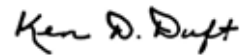
Member patrons of agricultural cooperatives may often benefit from a merger. Yet the prospects for and process of merging are complex and must be accompanied by an in-depth analysis of all the associated attributes and detriments. Our study of an experience with mergers suggests the following:

1. A systematic study of a cooperative merger feasibility requires a careful evaluation of numerous economic considerations.

2. Mergers often offer cooperatives an opportunity to reduce operating costs, expand services, improve quality, and strengthen their financial base through the realization of some economies of scale.
3. Mergers can provide for some cooperatives an increased bargaining power and market influence.
4. Mergers encourage the development of improved and/or expanded services.
5. Under some conditions, increased firm size resultant from merging may initiate diseconomies of scale and added costs when existing management capacity is exceeded by the rapidly expanding needs of the new organization.
6. Misinformation and overselling are two important problems attached to the human element in cooperative mergers.

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Sincerely,



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